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"Potential Impact of BEPS on Tax Systems"

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

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

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

Ha formato oggetto dell'ultima edizione del Wintercourse – tenutosi presso l'Università di Vienna dal 14 al 21 aprile 2016 – il tema "Impatto potenziale del BEPS sui sistemi fiscali", così articolato:

1. Permanent Establishment (PE) and similar concepts in the post BEPS world;
2. specific provisions on hybrid mismatches in the post BEPS world;
3. general anti-abuse rules (GAARs) in a post-BEPS world;
4. specific anti-abuse rules (SAAR) in a post-BEPS world;
5. procedural aspects in a post BEPS world;
6. transfer pricing in a post-BEPS world.

I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti da: Gilda Natoli (Subtopic 1), Simone Pietro di Giacomo (Subtopic 2), Federica Variola (Subtopic 3), Margherita Pittori (Subtopic 4), Fabio Fanigliuolo (Subtopic 5) e Luigi Spinello (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 Vienna.

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

Elenco dei contributi

1. Permanent establishment (PE) and similar concepts in the post BEPS world;
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6. Transfer Pricing in a post-BEPS World.

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Permanent establishment (PE) and similar concepts in the post BEPS world

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INTRODUCTION

The present work deals with the concept of permanent establishment under the national perspective and in the light of the BEPS Project, provided for by OECD. The concept of permanent establishment is 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 impact of the e-commerce on the concept of permanent establishment, with particular reference to the cases in which, according to the Italian legislation, it is possible to identify a permanent establishment referred to the digital enterprises. The ordinary regulation of this concept should be rethink in relation to the so-called "*new economy*", as it is demonstrated by the Action 1 and the Action 7 of the BEPS. 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 concept of 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 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

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

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 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 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 applied in absence of conventional norms about the specific case, but also 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

[2] P. Valente; S. Mattia, *Residenza fiscale e stabile organizzazione: possibili soluzioni dalla legge delega,* in *Il Fisco,* n.22, 2014.

[3] Hereinafter only referred to as "*Article 162*".

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].

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*

[4] M. Leo, *Le imposte sui redditi nel testo unico*, Bologna, 2014.

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

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[5] Paragraph 4 of the Commentary of Article 5 of the OECD Model.

[6] Resolution of Italian Revenue Agency, 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 Article 5 of the OECD Model.

deemed to exist only if the place of business has a certain degree of permanency, *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

[8] Paragraph 6 of the Commentary of Article 5 of the OECD Model.

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 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

[9] Paragraph 6 of the Commentary of Article 5 of the OECD Model.
[10] M. Pennesi, *Stabile organizzazione. Aspetti critici ed evoluzioni sul tema*, Milano, 2014.

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 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

[11] R. A. Papotti, *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 Italian Revenue Agency, number 9/2398 of 10 February 1983

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

[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*".

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 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

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

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;

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

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[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.

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 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

[16] Paragraph 24 of the Commentary of Article 5 of the OECD Model.
[17] Paragraph 21 of the Commentary of Article 5 of the OECD Model.

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

[18] Paragraph 25 of the Commentary of Article 5 of the OECD Model.

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 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 "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

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[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.

[21] Paragraph 22 of the Commentary of Article 5 of the OECD Model.

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 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

[22] M.Piazza, *Guida alla fiscalità internazionale*, 2004, pag. 219.
[23] Paragraph 23 of the Commentary of Article 5 of the OECD Model.
[24] Resolution of Italian Revenue Agency, number 9/2398 of 10 February 1983.

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

[25] Paragraph 26 of the Commentary of Article 5 of the OECD Model.
[26] K.Vogel, *On Double taxation Conventions*, 1996, pag.321.

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 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

[27] Paragraph 24 of the Commentary of Article 5 of the OECD Model.
[28] Paragraph 27.1 of the Commentary of Article 5 of the OECD Model.

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*").

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

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

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 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].

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[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.

[32] Paragraph 17 of the Commentary of Article 5 of the OECD Model.

[33] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.317.

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

[34] Paragraph 17 of the Commentary of Article 5 of the OECD Model.

profits attributable to functions performed in relation to the various construction 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

[35] Paragraph 16 of the Commentary of Article 5 of the OECD Model.
[36] Paragraph 18 of the Commentary of Article 5 of the OECD Model.
[37] Paragraph 19 of the Commentary of Article 5 of the OECD Model.

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

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

[38] K.Vogel, *On double Taxation Conventions*, 1996, pag.307.

[39] Paragraph 19 of the Commentary of Article 5 of the OECD Model.

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

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".*

[40] Paragraph 19 of the Commentary of Article 5 of the OECD Model.

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 Commentary of 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

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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.

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).

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.

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

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 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,*

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

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 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

[51] Paragraph 38.3 of the Commentary of Article 5 of the OECD Model.
[52] Paragraph 38 6 of the Commentary of Article 5 of the OECD Model.

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*".

[53] Paragraph 38.7 of the Commentary of Article 5 of the OECD Model.
[54] Paragraph 38.8 of the Commentary of Article 5 of the OECD Model.

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 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

[55] P.Baker, *Double taxation Conventions and International Tax Law*, Londra, 1994, pag. 150; K.Vogel, *On Double taxation Convention*, 1996, pag.352
[56] Paragraph 40 of the Commentary of 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.

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].

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

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[59] Paragraph 41 of the Commentary of Article 5 of the OECD Model.
[60] Paragraph 41.1 of the Commentary of Article 5 of the OECD Model.

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 relevant rule is Article 2509 of the Civil Code[63], according to which the secondary office of a

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[61] F.Aramini, *Le Proposte OCSE*, in *Dialoghi tributari*, 2008, pag.868 ss.; Paragraph 42 of the Commentary of 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 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*".

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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[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. *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 since the introduction of the tax of movable wealth, for the purpose of identifying 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[66]. 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

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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 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".*

supreme jurisdiction, 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 State (other than that of residence) entailed 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 mechanism 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"*[67]. 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

[67] Judgments of 27 November 1987, n. 8815 and 8820 of Supreme Court of Cassation.

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[68].

1.6.1. 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 accepted standards and the jurisprudence of other OECD member countries. The controversial character of the Italian Supreme Court jurisprudence regarding PE

[68] Judgments of 7 May 2008, n. 11079 of Supreme Court of Cassation.

matters is not new: it is worth recalling, in this respect, the very well-known *Philip Morris* case[69].

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

[69] 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.

Italy, on the basis of the last paragraph of Article 5 of the OECD Convention[70] 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.

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[71]. 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

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[70] 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".*

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

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 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"*[72]. 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

[72] Italian Supreme Court, judgment n.10925 of July 25, 2002.

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*" [73] - 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.

1.6.2. 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[74] 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 [75] - seems in line not only with the notion of permanent establishment developed by OECD in respect of commissionaire agreements, but also with some recent judgments of other relevant OECD countries on the matter[76].

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[73] Italian Supreme Court, judgment n.20597 of October 7, 2011.

[74] Italian Supreme Court, judgment n. 16106 of July 22, 2011.

[75] Italian Supreme Court, judgment n. 3769 of March 9, 2012.

[76] 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

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 non-resident companies are subject to Italian corporate income tax if and insofar as they have a permanent establishment in Italy and the non-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

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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.

the opinion of the Court, such an approach was also confirmed by the VAT 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.[77]. 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, non-resident parent company and the taxable person see paragraph 2 in the chapter 2.

The judgment referred to the *Boston Scientific International BV* case[78] 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

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

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

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 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[79], and attributing relevance to the actual conduct of the agent carrying on his activity[80].

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

CHAPTER 2

2. *Concept of permanent establishment in the post BEPS world*

Taxation is at the core of countries' sovereignty, but in recent years, multinational companies have avoided taxation in their home countries by pushing activities abroad to low or no tax jurisdictions. Political leaders, media outlets, and civil society around the world have expressed growing concern about tax planning by multinational enterprises that makes use of gaps in the interaction of different tax systems to artificially reduce taxable income or shift profits to low-tax jurisdictions in which little or no economic activity is performed[81]. So, the G20 asked OECD to address this growing problem by creating an action plan to address base erosion and profit shifting. In response to this concern and to the request of the G20, the OECD published an Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013. The BEPS Action Plan identifies 15 actions to address BEPS in a comprehensive manner, and sets deadlines to

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[79] 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.

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

[81] Public Discussion Draft "*BEPS Action 1: Address the Tax Challenges of the Digital Economy*", OECD, 2014.

implement those actions.
The goal of the OECD is to adopt a series of internationally shared measures to prevent and eliminate the base erosion carried out by multinational companies, identifying the various critical issues and, at the same time, ensuring a greater certainty and fairness to the taxpayer. The BEPS Action Plan regards several themes such as the treaty abuse, the hybrid mismatch arrangements, the problem of intangibles in transfer pricing, the multilateral instruments, the mandatory disclosure rules for aggressive tax planning schemes and the taxation of the digital economy.

This last theme was very significant during the works about BEPS. In fact, the characteristics of the digital economy are very relevant from the fiscal point of view. The growing relevance of the e-commerce and the particular features of on-line transactions, have pushed the OECD to examine the existing relationship between the rules applicable in the field of international taxation and the "new *world*" of the digital economy[82]. As noted in the BEPS Action Plan: *"the spread of the digital economy also poses challenges for international taxation. The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. This raises fundamental questions as to how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax*

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[82] R. Rizzardi, "*Tassazione dell'economia digitale: le proposte degli esperti europei*", in *Corriere Tributario*, n. 40/ 2014, pag. 3103.

purposes." [83]

In implementation of the Action 1 provided by the BEPS Action Plan, OECD published the document "*Address the Tax Challenges of the Digital Economy*" in September 2014. The document provides some preliminary recommendations for the regulation of digital transactions and dictates the guidelines for the conduct of an international study on digital matter. In the last years, the tax planning schemes of multinational companies have involved the *minimization* of taxation in the so-called *"market country*" (by avoiding a taxable presence, or in case of a taxable presence, either by shifting gross profits via trading structures or by reducing net profit by maximising deductions at the level of the payer), the reduction/elimination of the withholding tax at the source, the reduction/elimination of the taxation at the level of the recipient. It is, therefore, necessary to identify specific measures that do not allow companies to:

- avoid taxation in the various countries in which they even operate "*digitally*" (identifying an appropriate territorial nexus);
- confer a value to the data collected through the use of digital services;
- determine a proper qualification of the income arising from this sector. [84]

Given the increasing importance of the digital economy from a tax prospective, all G20 countries are working to achieve the objectives defined by BEPS Action 1. A particular question concerns the notion of permanent establishment and whether its traditional definition is still suitable to the digital businesses. In fact in many

[83] Public Discussion Draft "*BEPS Action 1: Address the Tax Challenges of the Digital Economy*", OECD, 2014.

[84] P. Valente, *"Erosione della base imponibile e "profit shifting": "focus" sugli aggiornamenti dell'OCSE",* in *Corriere Tributario*, n. 41/2014.

digital economy business models, a non-resident company may interact with costumers in a country remotely through a website or other digital means (e.g., an application on a mobile device) without maintaining a physical presence in the country, so without a permanent establishment (as provided by Article 5 of OECD Model). The treaty definition of permanent establishment may limit the application of domestic law rules applicable to the taxation of the business profits of non-resident companies derived from sources in the market country. The work done with particular respect to Action 7 aims at preventing the artificial avoidance of the treaty threshold below which the market country may not tax. The objective of the work is to develop changes to the definition of permanent establishment to ensure that certain features of the definition are not circumvented through arrangements that unduly restrict the intended scope of the definition and, therefore, domestic taxing rights[85].

In the following paragraphs, we will examine how Italian system is taking on the new challenges posed by e-commerce with reference to the permanent establishment and to the question whether a new nexus approach based on a significant digital presence or a virtual permanent establishment concept needs to be introduced.

2.1. Permanent establishment and digital economy under Italian law

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*

[85] Public Discussion Draft "*BEPS Action 1: Address the Tax Challenges of the Digital Economy*", OECD, 2014.

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. In fact, the enterprises operating in Internet market are able to carry on their businesses in many countries, even without the use of those facilities on site, which allow to identify a permanent establishment under the traditional rules. Nevertheless they achieve high profits in the various countries.

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, 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. This assertion is surely confirmed if the server, on which the web site is located, belongs to a third part[86].

[86] G. Liberatore, *"La stabile organizzazione nell'e-commerce: occorre un approccio attuale",* in *Fiscalità e Commercio Internazionale*, n.11/2015, pag. 25.

Actually the choice, supported by OECD and welcomed by the Italian legislator, to exclude, in any case, the web site from the permanent establishment definition, appears questionable. The aforementioned approach does not seem to take into account the potentiality of some web sites, which can replace the traditional shops. In fact, a web site can not be considered a permanent establishment in the case that it is used exclusively for the exposition of goods for sale, and also when, for the realization of the transaction, it is required a combination of external factors (as when the user proposes its own initiative to buy a given good or when the purchasing contract is concluded outside of Internet). It is different the case in that the web site fulfills every functions required to carry on the enterprise's business. For the purpose to resolve the interpretative problems, it should be opportune to introduce a specific regulation of the cases in which a web site can be considered as a permanent establishment (probably according to *"new"* criterions in the light of the digital economy)[87].

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[88]. 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

[87] A. Tommasini, *"Stabili organizzazioni e commercio elettronico"*, in *Corriere Tributario*, n.19/2013, pag. 1498.
[88] Paragraph 42.2 of the Commentary of Article 5 of the OECD Model.

paragraph 1 of the Commentary of Article 5 of the OECD Model[89]. 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[90].
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[91].
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

[89] Paragraph 42.4 of the Commentary of Article 5 of the OECD Model.
[90] Paragraph 42.5 of the Commentary of Article 5 of the OECD Model.
[91] G.Melis, *Commercio elettronico nel diritto tributario*, in *Digesto*, 2008

performed by the enterprise through that equipment[92]. Such exclusion cannot, however, be related to the situation in which the business of the enterprise, that has the equipment, is just the collection and transmission of data [93].
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 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

[92] Paragraph 42.7 of the Commentary of Article 5 of the OECD Model.
[93] M.Manca, *La stabile organizzazione nell'ordinamento italiano ed il commercio elettronico*, in *Il Fisco*, 2003, pag.7532

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[94]. 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 [95] . The Italian Supreme Court, recently, has been interested on the question[96]. In particular, the judges have dealt with the possible existence in Italy of a permanent establishment of a foreign enterprise in the case in which the same have on the national territory a *"place of management",* through which the strategic and economic decisions are taken. The simple introduction of an advanced computer system is not, in itself, a sufficient element to configure a branch if there isn't a personal staff that belongs to the system. The web site of an enterprise, whether it is only a virtual "*window*" on the world, or it is a virtual platform for intercompany use aimed at an optimal management of the supply and demand (as in the specific case examined by the Court) , is merely a software installed on the hard disk of a server. Therefore, it can not configure a permanent

[94] G.Melis, *Commercio elettronico nel diritto tributario*, in *Digesto*, 2008
[95] Paragraph 42.10 of the Commentary of Article 5 of the OECD Model.
[96] Italian Supreme Court, judgment n. 5429/ 2015.

establishment. Otherwise, the server can constitute the *"fixed place of business",* independently from the presence of personnel whose activity is restricted to its operating, updating or loading of commercial data [97]. Furthermore 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[98]. 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 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,*

[97] G. Liberatore, *"La stabile organizzazione nell'e-commerce: occorre un approccio attuale",* in *Fiscalità e Commercio Internazionale*, n.11/2015, pag.25.
[98] Resolution of Italian Revenue Agency of 28 may 2007, number 119/E.

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".

In addition to the issue dealing with the configurability of a server as a permanent establishment, the resolution in question provides a further element of analysis. The French company, in fact, asked confirmation about the income nature of the payments for the purchase of copyright limited to enable the user to the program's operation. On this point, the Tax Office, maintaining a beforehand orientation[99], confirmed the interpretation contained also in the OECD Commentary, according to which "*if the purchase of the software is aimed at the simple personal ad commercial use, regardless any form of reproduction and commercialization of the same software, therefore the amount paid will be configurable as a business or a self-employment income, depending on the nature of the percipient, and not as a royalty".* In the present case, the personal use is supported by the circumstance that the final costumer could neither reproduce nor commercialize the downloaded software, but only use it for game purposes[100].

2.1.1. Creation of a withholding tax on digital transactions

In general, the TAG (*Technical Advisory Group)* in 2001 published the document "*Discussion draft on the attribution of profits to permanent establishment*", direct to revisit the criteria to determine the income attributable to the permanent

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[99] Expressed in the resolution of Italian Revenue Agency of 30 July 1997, number 169.

[100] M. Marconi, *Il server come stabile organizzazione*, in *Fiscalità Internazionale*, n.6/2007, pag.486.

establishment in accordance with Article 7 of OECD Model[101]. This document reveals that the OECD countries adopt two different approaches to identify the profits attributable to the permanent establishment:
- the relevant business activity approach, according to which the permanent establishment would be unconditionally tied to the company as a whole, resulting in inability to produce the same income other than earned by the enterprise as a whole;
- the functionally separate entity approach, according to which would be attributed to the permanent establishment the profits that the same would follow if it were a separate and distinct company, carrying on the same functions in equal or similar conditions.

In this regard, although most of the Contracting States adhere to the first approach, considering that it has based on Article 7, par.1, of the OECD Model, the TAG

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[101] Article 7 of the OECD Model: *"1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.*
2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.
3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.
4. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."

believes it easier to apply the second methodological approach, the most appropriate, indeed, agreed to the application of the arm's length principle of Article 9 of the aforementioned conventional model.
TAG also drew up the document "*Attribution of Profit to a Permanent Establishment Involved in Electronic Transaction*", in order to revisit the methodology for determining the income attributable to the permanent establishment in e-commerce field. It is examined, in detail, the case in which an ICP has set up a website on a server of his property, located in a State other than that of residence, considering the circumstances in which:
- the server constitutes a permanent establishment;
- the server is included in an existing permanent establishment.
In the first case, in order to apply the principles laid down in Article 7, par.2, of the OECD Model, it observes that the activity carried on by the server is comparable to that of the service provider, distinguishing, however, the situation in which the permanent establishment is acting as an ISP or a CPS (Service Provider Contract).
In the second case, instead, in order to a correct imputation of the income to the permanent establishment, the document in question operates a distinction depending on whether:
- the web site is completely developed within the permanent establishment. The staff is appointed of developing the software required for the operation of the web hosting service;
- the web site doesn't be completely developed within the permanent establishment. The staff simply put in place mere technical support functions.

Also in this case the permanent establishment can be assimilated to a service provider.

However different consequences might arise about the configurability of the permanent establishment from the occurrence of the first or second circumstance and, if a fixed place of business exists, different assessments concerning the allocation of the income produced in the State where it is located might arise too. As noted in the document, the attribution of profits to a permanent establishment constituted by a server that carries on e-commerce transactions, is a difficult operation. In particular, there are interpretative difficulties about the allocation of the performed functions, the assumed risks and utilized goods [102]. In this contest, one of the options that the OECD is studying, within the BEPS project, regards the application of a withholding tax on the digital transactions. Essentially, among the proposals made by the Task Force instituted at the OECD, it is considering to apply a withholding tax to payments made by residents of a State, when they purchase digital products or services from a foreign e-commerce provider. The adoption of this measure finds its main obstacle in the potential difficulties to subject to taxation the supply of digital products, carried on directly to final consumers (who may not operate as substitutes). Therefore, the only solution up until now identified by the OECD for the application of such withholding tax would implicate the direct involvement of the financial institution, appointed to regulate the relative payment of online purchases (such as, for example, the financial operators that manage the electronic payment instruments and credit cards). They should have the task to "tax" the digital transactions,

[102] G. Valente, *E-commerce: l'OCSE fa luce sulla doppia imposizione*, in *A&F*, n.17/2003.

transferring to the Treasury the revenue derived from the retention, with obvious bureaucratic burdens on these subjects. In the light of the new common business models in the web economy, certainly the software sales - which often occur through digital channels and no longer make use of magnetic supports - could be included among the transactions subjected to the withholding tax currently under consideration by the OECD. However on the basis of conventional and national regulations currently in force in the field of cross-border taxation of income from the exploitation of intellectual property rights, the issue is particularly relevant concerning:

- the classification as royalties of the payments made by the domestic operators to the non-resident manufacturers of computer programs (cd. Software House) for the purchase of software licenses, subsequently distributed on the Italian market;
- the consequential applicability in the case of the withholding tax provided for by Article 25, paragraph 4, of Presidential Decree n. 600/1973, in conjunction with Article 23, paragraph 2, subparagraph c) of the Income Tax Code.

Article 25, paragraph 4, of Presidential Decree 600/1973 provides for the application of the ordinary withholding of 30% on the fees paid for the economic use of intellectual property, trademarks, patents, processes, formulas, or information relating to experience acquired in the industrial, commercial or scientific field, even if they are achieved during the enterprise's business (royalties). The adoption of the ordinary tax regime of royalties, paid to non-residents, is subject to the lack of applicability of the more favorable conditions provided:

- by the Directive no. 2003/49 / EEC, which provides for the exemption from

withholding tax;

- by Conventions against double taxation stipulated by Italy, in the case in which they expect the application of a reduced withholding tax or, in some cases, the total exemption.

Beyond the determination of the correct rate of tax on royalties, it is important to determine the correct nature of the income, in particular if the fees paid to the foreign producers for the software's purchase can be considered as royalties. According to Article 12 of OECD Model: *"the term "royalties" 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, in particular, to the software, the OECD Commentary to the Article 12 has clarified this point. In fact, payments made for the acquisition of partial rights in the copyright (without the transferor fully alienating the copyright rights) will represent a royalty where the consideration is for granting of rights to use the program in a manner that would, without such license, constitute an infringement of copyright. Examples of such arrangements include licenses to reproduce and distribute to the public software incorporating the copyrighted program, or to modify and publicly display the program[103]. However, the qualification as royalties of the payments received for the software has raised some critical issues, which have required the OECD interpretation, according to which it depends on the nature of the rights that the beneficiary

[103] Paragraph 13.1 of the OECD Commentary on Article 12.

acquires on the basis of the specific agreement relating to the use and the exploitation of the program.
In this sense, the following paragraph 14.4 of the Commentary specifies that *"in a transaction where a distributor makes payments to acquire and distribute software copies (without the right to reproduce the software), the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business profits in accordance with Article 7"*. Even if this interpretation seems to resolve the problem about the qualification of the payments in question, Italy has expressed a reserve with reference to the mentioned paragraph 14.4. In fact, the paragraph 31.2 of the Commentary includes a reserve expressed by Italy about the criterion used to exclude from the category of royalties the fees derived from the distribution of software products, where it was made clear that our country will not apply tout court this criterion. It will maintain the right to examine each particular case, taking into account all the circumstances, including the rights granted in relation to the acts of distribution[104].

2.2 Italian proposals

The particular characteristics of the digital economy involve the need for a detailed study of the theme of the web companies' taxation with modalities, innovative tools and procedures, possibly as result of international agreements, in order to limit the behavior of those companies that over time have reduced their

[104] F. Antonacchio, *La distribuzione di software esteri nelle nuove prospettive OCSE sull'economia digitale*, in *Il fisco*, n. 26/2014.

tax rate, eroding the tax base and transferring their profits to countries with lower taxation. Waiting for an international coordination thanks to the BEPS project by OECD, some countries have already introduced measures in this regard. In UK, for example, from April 2015, it applies the so-called Diverted Profits Tax, a tax of 25% on profits made in the UK by digital multinationals; in Spain, from 2015 it applies the "*Google tax*" which allows to the publishers to charge a compulsory contribution, by way of compensation, by content aggregators like Google News; in Hungary, where the enterprises of the telecommunications sector are charged at the rate of voice minutes and text messaging numbers, etc. Also the Italian Government has announced the emanation of measures relating to *"digital anti-avoidance",* aimed at regulating and reducing the phenomenon of profit shifting and tax avoidance of companies in the digital economy. In fact, in Italy, some bills have already been introduced.

2.2.1. The case of the "web-tax"

From some years, also the Italian Parliament is interested in the issue relating to the necessities arising from the peculiarities of the digital economy.

The Budget Law 2014 introduced the so-called "*web tax*". It was not a real tax introduced in the field of electronic commerce but it appeared as a set of dispositions (for the purposes of VAT and income tax) afferent to the so-called B2B operations of purchase of online advertising services, with the objective to restore the tax fairness in the e-commerce market. In particular, the goal was the taxation, in the source State, of the income arising from the purchase of advertising by the e-commerce's majors. For the purposes of VAT, with the

introduction of Article 17-bis of the Presidential decree n. 663/1972 was provided that:

- the taxable persons who want to buy advertising services and sponsored links online, including through media centres and other operators, are obliged to purchase them from owners of a VAT registration, issued by the Italian tax authority;

- the online advertising spaces and sponsored links that appear in the search engine results pages (so-called search advertising services), viewable on the Italian territory during the visit of a website or the use of an online service, must be purchased by Italian VAT numbers (i.e. publishers, advertising agencies, search engines or other advertiser).

For the purpose of income tax, the introduction of a new hypothesis of permanent establishment in the field of electronic commerce was rejected[105] and Article 1, paragraph 177, of the Budget Law provided that, for the determination of business income relating to intercompany transactions (transfer pricing) referred to in Article 7 of the Italian Income Tax Code, resident companies that operate in the field of online advertising and auxiliary services had to use profit's indicators other than those applicable to costs incurred for carrying on its activities, without

[105] The deputies Carbone e Fanucci have expressed a proposal, direct to the inclusion of the paragraph 5-bis in Article 162, which provided that "*the habitual use of the fixed, mobile or satellite national network, to transmit data from computers, also located outside of the national territory, to Italian IP, in order to provide online services constitutes a permanent establishment"*. According to this hypothesis of permanent establishment, the mere habitual use - although not exclusive - of the Internet for the supply of online services would have entailed the existence of a permanent establishment in Italy, even in the absence of the requirements of *"materiality*" and "*fixity"* which usually characterize the concept of permanent establishment for the purposes of income tax.

prejudice to recourse to the procedure of the international ruling[106]. Lastly, the purchase of online advertising and auxiliary services would have to be made exclusively through bank or post office transfer, from which the identification

[106] 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 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*" who want to define in advance with the Italian Financial Administration:

- 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.

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.

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"*.

data of the beneficiary could be deduced, or though other payment instruments that allow the full traceability of operations and deliver the VAT number of the beneficiary[107].

However, the Italian Government has turned soon around on the "*web tax*", which was partially repealed in March 2014. Article 2, par.1, subpar. *a),* of the Decree Law n.16 of 6 March 2014 has promptly abrogated Article 17-bis of the VAT Decree. There was an infringement procedure started by the European Commission against Italy, as result of which the abovementioned draft law has been criticized as incompatible with the European system, for the supposed infringement of Article 16, paragraph 2, of Directive 2006/123 / EEC (the so-called Bolkestein Directive). In fact, the web tax – in the part in which it provides for the obligation for VAT taxable persons to purchase advertising services and sponsored links on line only by owners of an Italian VAT number - was incompatible with EU principles regarding freedom of movement of goods and services, since it ended to exclude from the Italian market those operators without an Italian VAT number.

Therefore, today, the individuals who want to buy online advertising space and sponsored links that appear in the pages of search engine results, viewable on the Italian territory during the visit of a website, and use the online services through a fixed network or a network and a mobile devices, no longer have the obligation to make such purchases necessarily from subjects equipped with an Italian VAT registration. But the obligation to make such purchases by paying through bank or post office transfers persists. The permanence of this provision allows to the

[107] A. Tommasini and G. Iaselli, *"Web-tax" in cerca d'autore*, in *Corriere Tributario*, 4/2014.

Italian financial administration to constitute a database to monitor the extent of the commercial transactions carried on in the Italy by the foreign Web Advertisers, that, thanks to the efficient allocation of income in the low tax countries (made possible by the new technology offered by the digital economy and through the adoption of aggressive tax planning) succeed to avoid the taxation in the country where the profits are fulfilled[108].

2.2.2. The case of the "Digital tax"

In June 2014, the Commission VI "Finance" of the House of Deputies has expressed the necessity to conduct a cognitive survey on the issues affecting the taxation of the digital economy, emerging from the awareness of how the digital technologies constitute the essential element of an evolution that involved, virtually, all the sectors of the economic and social life and which has assumed the character of a true global revolution. The survey allows to examine the question concerning the objective obsolescence of the tax system, both at the supranational level and at Italian level, which in many areas has already demonstrated its inability to keep pace with the digital evolution, leaving thus rise to distortions, improper tax competition, or even tax avoidance or evasion. Another issue, addressed by the survey of the Commission, concerns the identification of corrective mechanisms to be made to the tax system and to the Tax Office's operations, in order to properly and effectively subject to taxation the income generated by the new forms of the digital economy.
In the this context, the Italian government has recently announced plans to introduce in our legal system a digital tax, namely a tax on non-resident

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[108] F. Antonacchio, *La distribuzione di software esteri nelle nuove prospettive OCSE sull'economia digitale*, in *Il fisco*, n. 26/2014.

companies operating in the digital economy sector and carrying on an economic activity in the Italian market through communication technologies. Based on the information available, the provisions of the Italian digital tax – to be included in the 2016 Budget Law the government is currently drafting and to be applied as from year 2017 – should be largely shaped after the contents of the bill recently proposed in the House of Deputies by MPs Quintarelli and Sottanelli and named "*Rules on the prevention of online tax avoidance*". This bill is made up of four Articles: one dedicated to the review of the permanent establishment, one dedicated to the online transactions of individuals, one dedicated to the online transactions of legal entities and one dedicated to the elimination of double taxation (with a reference to the conventional norms). The bill, primarily, aims to review the definition of permanent establishment (any organization, characterized by a sufficient level of permanence and a suitable structure to the economic activity, in terms of human or technical means, would be considered as a permanent establishment). The permanent establishment would have the "*place of business*" in the place where the business' central administration functions are carried on; that place is determined i) based on where the essential decisions concerning the general management of the business are taken, ii) based on the location of its registered office and iii) according to the place where the management meets. If it is impossible to determine, with certainty, the place of business, however, it prevails the criterion of the place where essential decisions concerning the general management are taken.

The bill also seeks to regulate the institution of a "*virtual permanent establishment*", according to the following principles:

a) the localization of an online service does not in itself constitute a permanent establishment;

b) the localization of a service provider that deals with the hospitality and the on-line service management is not relevant to the identification of a permanent establishment, unless such services are rendered by a dependent agent, which operates in the name and on behalf of the company;

c) the physical location of the server related to the online service, in the territory of the State, is not in itself sufficient to presume the existence of a permanent establishment (unless the server can be considered as a dependent agent of the company);

d) a server can, in any case, be considered a permanent establishment if the activities carried on through the same are significant and essential for the company[109].

According to the Quintarelli-Sottanelli bill, an Italian permanent establishment should be considered existent in any case (regardless, therefore, of the circumstance that the requirements of the "*traditional*" notion of permanent establishment are not met) "*if a non-resident company has a continuous presence of online activities, for a period not shorter than six months, so as to generate in the same period payment flows directed to it [...] for an amount not lower than five million Euro*".

In addition, and in order to induce the non-resident company to spontaneously declare the existence of an Italian permanent establishment, the bill provides for a 25 per cent withholding tax on payments directed to non-resident companies for

[109] G. Molinaro, *La tassazione della ricchezza derivante dall'economia digitale*, in *Il fisco*, n. 39/2015.

goods and services purchased online, requesting Italian financial intermediaries to act as withholding agents. Such withholding tax – and this clearly sheds light on the intention of inducing the non-resident companies to declare the existence of an Italian permanent establishment – does not apply if and insofar as such non-resident companies have an Italian permanent establishment pursuant to Article 162 of the Italian Income Tax Act. The Quintarelli-Sottanelli proposal raises doubts related, in particular, to the relationship between domestic tax provisions and provisions included in the double tax conventions Italy concluded with the other countries of the international community. In this respect, the provisions included in double tax conventions take precedence over domestic rules conflicting with them on the basis of the lex specialis principle. As the notion of permanent establishment is provided – not only under the aforementioned Article 162 – but also under all double tax conventions concluded by Italy, an amendment of that notion limited to the domestic provision will likely prove to be ineffective, since the more favourable (for the taxpayers) notion provided for by double tax conventions will prevail over the new Article 162 by virtue of the aforementioned lex specialis principle. In other words, the "new" and wider concept of permanent establishment of Article 162 will be relevant in a very limited number of cases[110], id est for the taxation of the Italian-sourced income of foreign companies resident in countries which have not concluded a double tax convention with Italy. By the same token, also the provisions of the final withholding tax of 25 per cent on payments directed to foreign companies for goods and services purchased online

[110] Id est those countries Italy qualifies as "tax havens" and which has not concluded a double tax convention with. None of the larger companies (so called big players) of the digital economy (Google, Facebook, Apple, Amazon) would fall in such cases, since they are tax resident in states that have entered into a double tax convention with Italy (e.g., Ireland, Luxembourg, Netherlands).

raise doubts on their compliance with the provisions of double tax conventions. If – as it seems preferable on the basis of a number of arguments related to the Italian income tax system considered as a whole – the income the non-resident entity derives from its Italian economic activities qualifies as business income, it is taxable in Italy only if and to the extent that an Italian permanent establishment exists. However, and by definition, an Italian permanent establishment is absent in this case. Moreover, even accepting the qualification of such income as "other income", it seems that the referred withholding tax does not comply with the distributive rules provided under double tax conventions, as Article 21 of the OECD Model Convention – which the double tax conventions concluded by Italy are shaped after – attributes taxing rights on "other income" exclusively to the state of residence of the recipient[111]. Other doubts arise with respect to the withholding tax of 25% and the burden on the financial intermediaries as withholding agents. The rationale of this choice lies in the fact that those intermediaries would be able to monitor more closely the payments made by the final consumers. At the same time, the proposal in question fails to consider the reluctance of financial institutions to fulfil this role, given that the same perform already the expensive function as intermediaries for transactions on capital income and other income arising in Italy. Therefore the intermediaries should identify any time the type of transaction giving rise to the turnover required by the bill for the existence of a digital permanent establishment. Thus they would play a key-role in order to identify this type of permanent establishment. However the bill does not specify nor their possible liability for any omissions or errors neither

[111] A. Persiani, *The Italian digital tax: some brief reflexions*, in *Diritto Mercato Tecnologia*, 21/09/2015.

the specific burden on them, including that to trace the reason placed at the base of the on-line transaction. In addition, the proposal in question fails to consider the fact that not all payments are made by credit cards or equivalent electronic payment instrument, subjected to the close examination by the banks. In fact, the majority of the actors operating in the electronic market can not be qualified as professional users, but as simple users. So the involvement, in these terms, of the financial intermediaries would be totally unsuitable.
Even the concept of "*digital presence*", to which the proposal binds the configurability of a virtual permanent establishment, seems to arouse some interpretative uncertainties. In fact, it is evident that the idea of linking the birth of a virtual permanent establishment to the passing of a predetermined volume of transactions seems inadequate, given that the recognition of a branch should depend solely on the way it operates on the national territory or by its link with the same, and certainly not by the quantum turnover (on a monthly basis) or the number of transactions. In other words, the approach chosen by the bill seems to contrast with the principles recognized by the OECD for the identification of a permanent establishment, on the base of which an analysis of the functions performed by the same should be conducted according to a purely qualitative approach, regardless of the threshold concretely turnover reached. Ultimately, despite the proposal indicates its intention to adopt measures to combat evasion, shared by the international community, the same fails to consider the orientation recently formed in the OECD on the revision of the permanent establishment concept in the digital economy. Well, in the Revised discussion draft adopted under the program BEPS ACTION 7 on the subject of "*Preventing the artificial*

avoidance on PE Status" the international community's attention has focused on the revision of the traditional concepts of material and personal permanent establishment - adapting them to the typical features of the web economy -, without assuming the adoption of a third category of "*virtual*" permanent establishment[112].

In the bill of the Budget Law transmitted by the Government to the Parliament in October 2015 there is no trace of the rules on the Italian digital tax, which the Government had announced to introduce in our legal system, albeit deferring the effective date to 2017. The Government's change of mind is probably founded on the aforementioned doubts and on the different conclusions reached by OECD under the BEPS project. In light of this, if Italy actually intends to levy tax on the Italian-sourced income of the enterprises of the digital economy through an enlargement of the territorial scope of its income tax (id est, through a widened notion of permanent establishment) it would be appropriate to pursue this approach in the context of the BEPS project currently underway at OECD level. Only this way can result in the simultaneous change of the provisions dealing with the notion of permanent establishment included in all the double tax conventions concluded by Italy and, therefore, in the adoption of a tax measure really affecting the non-resident companies operating in the digital economy. Therefore, the Government's decision to not introduce, in our legal system, the digital tax referred to Quintarelli-Sottanelli proposal should be positively welcomed, in the hope that such postponement also allows a more thoughtful reflection on the more

[112] G. Sepio e M. D'Orsogna, *Impresa multinazionale digitale e tassazione delle transazioni on line*, in *Il fisco*, n. 29/2015, pag. 2851.

suitable tax instruments to hit the wealth of the big players in the digital economy[113].

2.2.3. The specific measure in the field of gaming

In the end, we can deal with the particular solution introduced by the Budget Law 2016[114] with reference to the field of game. According to Article 1, par. 927, of the Law *"in the case in which one or more resident individuals, operating under the same sale's network, carry on, on behalf of not resident entities or however on the basis of contracts of brokerage or game store with third parties, the manager's typical activities, even in the form of centre data transmission, such as, for example, collection bets, collection of wagered sums, payment of premiums, and make tools to realize the game, such as the technologic equipment or the bet place, available to the end-consumers, and when the financial flows relating to the above activities existed between the managers and the non-resident person, exceed, over the span of six months, 500,000 euro, the Income Revenue Authority, ascertained the aforementioned conditions from the disclosure of the financial intermediary […] within sixty days from the disclosure, convene jointly the managers and the foreign taxpayer, who can provide the contrary evidence about the presence in Italy of a permanent establishment, under Article 162 of the Income Tax Act".* Whereas, at the end of the procedure (which must be completed within ninety days), it is evident that the foreign subject has a permanent establishment in Italy, the Income Revenue Authority promulgates a "motivated audit", liquidating the additional tax and penalties due. After the report about the

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[113] A. Persiani, *Digital tax: melius re perpensa il Governo fa marcia indietro*, in *Diritto Mercato Tecnologia*, 29/10/2015.

[114] Law 208 of 28/12/2015, in Gazzetta Ufficiale n. 302 del 30 dicembre 2015 S.O. n. 70/L.

taxpayers in respect of which it has been verified the permanent establishment, the Financial intermediaries are required to apply a withholding taxes to the extent of 25 per cent on the amounts of transactions towards non-resident beneficiary. The solution in question is inspired to the British Diverted Profits Tax[115].

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[115] Great Britain provided this interesting initiative, 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 (with that assessment a punitive rate of 25%, commensurate with profits subtracted to taxation in the UK, is applied).
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.

CHAPTER 3

3. *European Law*

Under the European system, the concept of permanent establishment is treated in relation to the concept of residence and to the fundamental freedoms (in particular freedom of Movement and freedom of Establishment) and also 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 non-residents' one, for the fact that, on the one hand, residents are taxed in relation to income everywhere products in the world, while non-residents only to income from sources located in the home territory, and secondly, because non-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*"[116].

However – the Court specifies yet[117] - 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.

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

[117] 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.

According to the jurisprudence of the Court started with the *Schumacker* judgment, there is a case where the position of non-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 different way. The case occurs when a non-resident does not receive his significant income in the State of residence and instead takes the essential part of his taxable income from an 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 *"non-residents more often are not citizens of the State where they conduct their activities"*[118].

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

[118] So we read in the judgment of 14 February 1995 in Case C279 / 93, *Schumacker*.

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[119].

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*[120]. 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-

[119] A.M. Gaffuri, *La residenza fiscale nel diritto comunitario*, *Dottrina d'Italia*, 2008.
[120] ECJ 28 January 1986, 270/83, *Commission v France ("Avoir Fiscal").*

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

[121] ECJ 21 September 1999, C-307/97, *Saint-Gobain*.

From these cases the conclusion can be drawn that permanent establishments have to be treated in the same manner as domestic companies[122].

3.1. *Permanent establishment in the Parent-Subsidiary Directive*

The Parent-Subsidiary Directive[123], on the common system of taxation applicable in the case of parent companies and subsidiaries of Member States deals with the elimination of economic and juridical 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[124], which has broadened inter alia the scope of the Directive by extending it to permanent establishments.

[122] V. Englmair, *The relevance of the fundamental freedoms for direct taxation*, in *Introduction to European tax law: direct taxation*, 2003.
[123] Hereinafter "the Directive".
[124] Hereinafter "the amending Directive".

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;

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[125]. It is not compulsory for a company to meet the three requirements in the same Member State[126]. 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.

[125] 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.

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

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.

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[127] of the Directive[128]. In 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

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[127] 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.

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

under Article 1, second dash[129] and Article 5[130] of the Directive and the Member State of the parent company is obliged to eliminate economic double taxation under Article 1, first dash[131] 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[132].

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.

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[129] 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."*

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

[131] 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".*

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

Two more cases not covered by the 2003 amendments, although still involving the 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[133]. According to others, the Directive would only bind the state of the parent company to eliminate economic double taxation according to Article 4[134]. 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[135]. 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

[133] Maisto, *EC Tax Review*, 2004.
[134] Garcia Prats, *ET*, 1995.
[135] Terra/Wattel, *European Tax Law*, 2008.

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[136].

3.2. Permanent establishment in the Merger Directive

The Merger Directive[137] 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

[136] M. Tenore, *The Parent-Subsidiary Directive*, in *Introduction to European Tax Law: Direct Taxation*, 2013.
[137] Hereinafter "the Directive".

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 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[138]; 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.

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

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).

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[139].

3.3. Permanent establishment in the Interest and Royalties Directive

On 1 January 2004 the Interest and Royalty Directive[140] 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 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[141]. 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 1 which provides

[139] M. Hofstatter, D. Hohenwarter-Mayr, *The Merger Directive*, in *Introduction European Tax Law: Direct Taxation*, 2013.
[140] Hereinafter "the Directive".
[141] Eicker/Aramini, *EC Tax Review*, 2004.

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 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[142].

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

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Potential Impact of BEPS on Tax Systems

Specific provisions on hybrid mismatches in the post BEPS world.

Simone Pietro Di Giacomo

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Introduction.

The Base erosion and profit shifting project (BEPS) was developed in the OECD context with the aim of dealing with transnational, aggressive, tax planning practices, which may give rise to international tax evasion and tax avoidance.

In today's world, the increase of Globalization and cross border transactions make it easier, for economic operators, to take advantage of asymmetries of domestic tax legislations, in order to realize a base erosion in the State of origin and to shift profits towards other States, characterized by a lower tax burden or qualifying as tax heavens in a strict sense. Thus, curbing tax arbitrage is one of the main priorities of the OECD, endorsed by the G20 and the G8 as well. With this respect, the BEPS project is intended to identify and counteract the main structures and tools, of a fiscal nature, by means of which economic operators are capable of exploiting national domestic laws and double taxation conventions in order to wrongfully or illegally obtain tax advantages. The objective of the OECD is to promote the adoption of specific legal measures, shared at international level, so as to prevent and eliminate the base erosion phenomenon, however providing taxpayers with more legal certainty.

The aggressive tax planning schemes, dealt with by the OECD, also comprise hybrid mismatch arrangements, which form the object of Action no.2 of the BEPS project ("Neutralizing the effect of hybrid mismatch arrangements"). The attention paid to this issue is quite understandable, since in the past decades, due to globalization of business, increasing tax competition and perhaps also consolidation of advisory firms, tax planning through the use of hybrid mismatches dramatically grew.

CHAPTER 1 - HYBRID MISMATCHES FROM ITALIAN DOMESTIC LAW'S PERSPECTIVE.

1.1 Definition of hybrid mismatch arrangements in terms of international tax law.

In terms of international tax law, hybrid mismatch arrangements include techniques which aim at exploiting a difference in the characterization of a transaction, a financial instrument or an entity under the laws of two or more tax jurisdictions, in order to produce a mismatch in tax outcomes[1]. Therefore, the term comprises the subsequent types of schemes:

- Hybrid entities, treated as tax transparent in one State but lacking of tax transparency in another State;
- Double resident entities, considered as fiscal residents in two States;
- Hybrid financial instruments, benefiting from a different tax treatment in different States: the same financial instrument could be considered as an equity instrument in one State and as a debt instrument in another. In the international context, the most widespread hybrid financial instruments are[2] subordinated bonds[3], convertible preference shares[4], redeemable preference shares[5], convertible bonds[6].
- Hybrid transfers, seen as transfer of property of an asset in one State and as collateralised loan[7] in another[8].

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[1]OECD - BEPS Action 2: *Neutralize the effects of Hybrid Mismatrch Arrangements* (Recommendations for Domestic Laws), 2 May 2014, p. 8; OCSE, *Addressing Base Erosion and Profit Shifting*, 12 February 2013, p. 40; P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, in *Il Fisco*, n. 33/2013, p. 1; R. DE BOER, O. MARRES, *Beps Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements*, in *Intertax*, 1/43, p. 16.

[2] P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, in *Il Fisco*, 33/2013, p. 2.

[3] Bonds whose reimbursement, in the case of a bankruptcy proceeding, is carried out only after the satisfaction of both the preference and the unsecured creditors.

[4] Convertible preference shares confer on the holder, under certain conditions, the right to exchange them with ordinary shares.

[5] Redeemable shares confer on the issuing company the right to repurchase them under certain conditions.

[6] Convertible bonds attribute to the holder the right to receive, as remuneration, bonds belonging to another category.

[7] A collateralised loan is a financing operation secured by a (collateral) asset, which usually consists of a securities portfolio.

In its reports[9], the OECD highlighted that the abusive characteristics of hybrid mismatches derive from the fact that they take advantage of asymmetries existing in different tax jurisdictions, in order to obtain[10] either a "double deduction" of costs in two States involved, or a deduction of costs in one State and non-taxation in another[11], or an undue tax credit for taxes paid abroad.

Therefore, the use of such abusive schemes results in several negative consequences[12].

First of all, a loss or a reduction of tax revenue arise in the States concerned, since, in addition to the tax advantage deriving from the abusive practice, the costs incurred for the creation and implementation of hybrid mismatch arrangements are generally deductible as expenses.

Secondly, these techniques lead to an unfair tax competition, as they allow big companies to benefit from more economic advantages than those received by small companies, which are not capable of making use of such complex arrangements.

Thirdly, hybrid mismatches result in a prejudice to Capital Import and Capital Export Neutrality. In fact, from the one hand such structures make cross border investments more advantageous than purely internal investments; from the other hand, they make outbound investments more profitable than inbound investments.

In fourth instance, these practices cause a lack of transparency[13].

In order to better understand the tax issues connected to hybrid mismatch arrangements, an analysis of the main tax planning practices based on them

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[8] P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, cit., p. 1; CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, in *Riv. Dir. Fin. Sc. Fin.*, 1/2014, p. 25.

[9] OECD, *Building Transparent Tax Compliance by Banks*, July 2009, *Corporate Loss Utilisation Through Aggressive Tax Planning*, August 2011, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, March 2012; *Addressing Base Erosion and Profit Shifting*, February 2013.

[10] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 11.

[11] P. VALENTE, *Aggressive Tax Planning: profili elusivi delle transazioni finanziarie*, in *Il Fisco*, n. 22/2013, p. 3372.

[12] P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, cit., p. 2.

[13] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 11.

may be useful. As mentioned before, the aims of these schemes are to obtain either a double deduction of costs in two States, or a deduction of costs in one State along with non-taxation of profits in another, or an undue tax credit for taxes paid abroad[14].

The first result (double deduction of costs in two States) is usually achieved through the interposition of a hybrid entity between two companies, which are fiscally resident in two States. Assume that company A, resident in State A, controls a hybrid entity and that the latter controls company B, resident in State B. The hybrid entity is treated as transparent for country A tax purposes and as non-transparent for country B tax purposes. The hybrid entity signs a financing contract with a third party, paying interests, and it uses the loan amount to inject it as equity into company B. At this point, under the country B group relief regime, interest expenses can be used to offset other country B group's companies' income, while, in contrast, country A treats the hybrid entity as transparent or disregarded, with the consequence that its interest expenses are allocated to company A, where they can be deducted and offset unrelated income. Thus, the effect of the scheme is two deductions for the same contractual obligation in two different countries. Similar effects can also be achieved through different schemes, for instance through the use of a dual resident company instead of a hybrid entity where such a dual resident company has a loss and it can benefit from group relief / tax consolidation systems in both countries[15].

The second result (deduction of costs in one State, along with non-taxation of profits in another) may be achieved by the use of hybrid instruments. Assume that company B, resident in country B, is funded by company A, resident in country A, with a financial instrument that qualifies as equity in country A but as debt in country B. If current payments are made under the instrument, by company B to company A, the sums of money are treated as

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[14] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 7; F. ANTONACCHIO, *Evasione fiscal internazionale e tax governance*, in *Il Fisco*, 39/2013, p. 7.

[15] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 7.

deductible interest expenses for company B, under its domestic law, and as exempt dividends for country A tax purposes. As a result, a net deduction arises in country B without a corresponding income inclusion in country A[16]. Similar results can also be achieved through the use of hybrid entities, where an entity, treated as non-transparent in the country in which it is organised, makes a deductible payment to its shareholders, whose country of residence treats the foreign entity as transparent, thus disregarding the payment for tax purposes. Finally, the same effect may be obtained through a hybrid transfer. With this respect, the OECD pays attention to a widespread abusive scheme, the so-called *Repo* (repurchase agreement)[17]. This is a contract under which a vendor sells some securities to a purchaser, with the commitment of repurchasing them at a higher price; from an economic and substantial perspective, such a contract has the same effect as a loan guaranteed by securities and the difference between the lower purchase price and the higher repurchase price constitutes the interests expenses paid on the loan itself[18]. The abusive characterization of the transaction arises when it is carried out between two companies of the same group, which are established in different States, whereby one tax jurisdiction treats the operation as a repurchase agreement and the other one treats it as a collateralized loan: from the different characterization, a different tax treatment emerges in the two States involved. In fact, in the State which considers the operation as a repurchase agreement, the parties of the contract may benefit from the exemption of capital gains, while, in the country where the financing contract is treated as a collateralized loan, they may benefit from the deduction of interest expenses[19].

The third result (undue tax credit for taxes paid abroad) may be obtained by the use of hybrid transfers of an equity instrument. The most common way

[16] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 9.
[17] OECD, *Building Transparent Tax Compliance by Banks*, cit., p. 40.
[18] P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, cit., p. 4.
[19] OECD, *Building Transparent Tax Compliance by Banks*, cit., p. 40.

to create a hybrid transfer of an equity instrument is with a sale and repurchase agreement concerning shares, where the transaction is treated as a sale and a repurchase of the shares in one country, while in the other country it is treated as a loan with shares serving as collateral[20].

The basic structure involves a company in country A (A company) typically seeking financing from a company in country B (B company). A company establishes a special purpose vehicle ("SPV"), contributes equity in exchange for preferred shares in SPV and enters into a repo over the preferred shares with B company. According to the repo, A company sells the SPV preferred shares to B company and receives cash in exchange, and at the same time the parties agree that A company will purchase back the shares at a later point in time at an agreed price. Between the sale and the repurchase, SPV is taxed in country A and pays corporate income tax to that country. SPV further pays out dividends to B company, typically at a fixed rate. Under the repo agreement, B company is entitled to keep the dividends, which economically serve as its remuneration for the transaction. For country B tax purposes, the repo is treated as a sale and a repurchase. B company is thus treated as the owner of the SPV shares and the recipient of the dividends during the time of the repo. Country B has an indirect foreign tax credit regime that allows B company to claim a foreign tax credit for the corporate income tax paid by SPV in country A. On the other hand, for country A tax purposes, the transaction is treated as a loan by B company to A company that is secured through the SPV shares. A company is thus regarded as still being the owner of the SPV shares and as the recipient of the dividends during the time of the repo. Country A grants to A company either an exemption for dividends received by B company or an indirect foreign tax credit regime, in any case a method that allows A company to receive the dividends effectively tax-free. A company further claims a

[20] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 9; P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, cit., p. 5.

deduction for the interest expenses on the deemed loan received from B company, equal to the dividend payments.

The effect of this scheme is a net deduction in country A, coupled with taxation in country B which is nonetheless offset by an indirect foreign tax credit for taxes that the SPV paid on the distributed profits[21].

After the analysis of the general background concerning hybrid mismatch arrangements, this paper will explain how the abusive schemes at issue are dealt with by Italian domestic law.

1.2 Legal entities according to Italian domestic law.

As mentioned before, hybrid mismatches arrangements can be carried out through hybrid entities, namely legal entities treated as tax transparent in one State but lacking of tax transparency in another State, or legal entities with double residence, thus considered as fiscal resident in two States. In order to explain how the Italian domestic law deals with these issues, it is firstly necessary shed light on the qualification of legal entities in Italy and then a reference must be made to the key Italian principles of company's taxation, applicable both to internal and cross-border situations.

According to Italian domestic law, legal entities can be grouped into five main categories: associations, foundations, committees, partnerships, corporations (or capital companies).

Associations of persons are collective organizations whose social objective is a non-economic purpose. For this reason, associations are recognized as no-profit entities and they are different from companies in general, which are profit-making bodies[22]. However, even though associations may not have an economic purpose, they can nonetheless exercise business activities

[21] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 9; P. VALENTE, *I profili di elusività degli Hybrid Mismatch Arrangements*, cit., p. 5.
[22] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, Milano, 2011, p. 152.

within the meaning of art. 2082 of the Italian civil code[23], namely professional and organized activities aimed at producing or exchanging goods or services. The unique necessary condition is that the statute of association denies the possibility to distribute profits to the members of the association[24].

Within the category at issue, a difference must be made between associations which have legal personality and associations which are not considered as legal persons. The importance of this differentiation mainly concerns the legal liability. In fact, associations with legal personality have a limited liability in a strict sense: they are liable in respect of all their obligations without involving their members. On the other hand, associations lacking of legal personality have a partial, limited liability: for contractual obligations, persons who act for and on behalf of the association are liable along with the latter[25].

Under Italian domestic law, a second category of legal entities comprises foundations. Like associations, these bodies may only have a non-economic purpose, but they might exercise a business activity. It is essential that foundations have a heritage in order to achieve their purposes. Hence, with the document of establishment the founder has to transfer specific assets to the foundation (this is the so-called "*atto di dotazione*" or "endowment act"). Foundations are liable in respect of their obligations only to the extent of their assets[26]. The main difference between associations and foundations is that the former are organizations of persons, while the latter are organizations of goods and capitals.

The third category of legal entities comprises committees. They are organizations of persons which, through fundraising, create a heritage in

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[23] Hereinafter "c.c."
[24] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, cit., p. 157.
[25] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, cit., p. 162.
[26] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, cit., p. 166.

order to achieve a specific purpose, of a public or altruistic nature[27]. If committees are recognized as legal persons, they are liable in respect of their obligations without involving the liability of their members; on the other hand, if the legal personality lacks, committees are liable along with their members[28].

As regards the last two categories of legal entities, they comprise different types of companies. In fact, under Italian domestic law the term "company" comprises both partnerships (the so-called "*società di persone*" or "company of persons"), belonging to the fourth category, and corporations or capital companies (the so-called "*società di capitali*" or "company of capital"), which form part of the fifth category. Before briefly explaining the main characteristics of such entities, it should be noted that in Italy, until 1993, a company could only be created by a contract, by means of which "two or more persons confer goods or services for the common exercise of an economic activity, with the aim of distributing profits" (art. 2247 c.c.). As from 2003, all companies may be established by a unilateral act[29] (d. lgs. n. 6/2003).

The category of partnerships comprises three types of legal entities: "società semplice", "società in accomandita semplice", società in nome collettivo"[30]. The main characteristics are: *a*) the shareholders' full liability for social obligations (with the exception of the limited liability attributed to a specific category of shareholders belonging to the "società in accomandita semplice"); *b*) the fact that the power of administration is attributed to all the shareholders; *c*) the fact that the status of shareholder cannot be transferred without the consent of all the members.

Instead, the category of corporations (or capital companies) comprises other three types of legal entities, namely the "società per azioni", the "società in

[27] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, cit., p. 168.
[28] A. TORRENTE and P. SCHLESINGER, *Manuale di diritto privato*, cit., p. 170.
[29] G. CAMPOBASSO, *Diritto commerciale 2 – Diritto delle società*, Milano, 2012, p. 3.
[30] G. CAMPOBASSO, *Diritto commerciale 2 – Diritto delle società*, cit., p. 42.

accomandita per azioni" and the "società a responsabilità limitata", whose main characteristics are: *a*) the shareholders' limited liability for social obligations; *b*) the fact that the power of administration is attributed to specific governing organs and not automatically to all the shareholders; *c*) the fact that the status of shareholder may be freely transferred[31]. It should be noted that a specific regime, similar to that which refers to corporations, is applicable to other types of companies ("società cooperative", "società mutualistiche", "società di mutua assicurazione", "società europee", "società cooperative europee").

1.3 The key Italian principles of company's taxation: the principle of transparency and the subjects of taxation.

Having introduced the differences existing among Italian legal entities, this paragraph will explain how they are treated under domestic tax law. A reference must be made to the Italian regime of company taxation, since it is applicable not only to partnerships or corporations, but also to the other legal entities which have not the form of companies.

Italian system of income tax comprises two fundamental taxes, IRPEF (applicable to natural persons) and IRES (applicable to capital companies and to some other legal entities).

Unlike corporations, which are subject to IRES, partnerships are neither subject to IRPEF, nor to IRES. In fact, they are always treated as fiscally transparent[32], while the principle of transparency applies to corporations only on the basis of a specific option[33].

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[31] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, Milano, 2014, p. 21.
[32] P. ROSSI MACCANICO, *Riforma del sistema fiscal statale: prospettive della tassazione per trasparenza delle società di capitali*, in *Il Fisco*, 20/2003, p. 2.
[33] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit. p. 19.

In fact, according to art. 5 of the TUIR[34], incomes and losses of a partnership are directly attributed, for tax purposes, to its shareholders in proportion to their participation shares, regardless of any distribution of profits, which is fiscally irrelevant. If a withholding tax applies to the partnership, income tax imposed on the shareholders is proportionally reduced. Notwithstanding the fact that the partnership is not a subject of taxation, it has several formal obligations concerning, for example, keeping the accounts and filing its tax return. The tax treatment of partnerships also applies to other legal entities, which are considered as fiscally associated to partnerships: these are the so-called "società di fatto" (they are companies which are not created by a formal contract), "società di armamento" and "associazioni professionali" (they are associations formed by freelancers)[35]. As opposed to partnerships (and the other legal entities associated to them), corporations (or capital companies) are subjects of taxation. More precisely, the specific income tax applicable to corporations and associated legal entities is IRES, with a proportional nature and a rate of 27,5%. The subjective scope of IRES is regulated by art. 73 of the TUIR, which establishes that the tax at issue applies, with a different regime, to three categories of legal entities[36]: *a*) corporations and other companies associated to them ("società cooperative", "società di mutua assicurazione", "società europee", "società cooperative europee") and commercial entities which are resident, for tax purposes, within the territory of Italy; *b*) non-commercial entities which are resident in Italy; *c*) companies and legal entities which are not resident in Italy. Resident entities are subject to tax on their worldwide income, while non-residents are taxed on incomes which they produce in Italy.

[34] The TUIR ("Testo Unico delle Imposte sui Redditi) is the Italian fundamental act concerning direct taxes).
[35] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit. p. 22.
[36] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit. p. 86.

As regards the concept of residence, under art. 73, par. 3, of the TUIR, a company or an entity is considered as resident in Italy when, for the most part of a taxable period, they have in Italy the legal seat, the seat of administration or the principal object of their activity[37].

As mentioned above, entities that are subject to IRES may have a commercial or non-commercial nature. The difference is relevant, because commercial entities carry out activities that are taxed with IRES in all cases, while non-commercial entities are taxed with IRES only in respect of their commercial activities[38]. According to art. 73 of the TUIR, a legal entity has commercial nature if its exclusive or principal object consists in the exercise of a commercial activity (namely a business activity); on the other hand, a legal entity qualifies as non-commercial if it has not an exclusive or principal object consisting in the exercise of a commercial activity. According to art. 73, par. 4, of the TUIR, the principal object comprises the activity which is essential in order to realize the primary objectives foreseen by the law, the constituent act or the statute. Whether or not a legal entity exercises a commercial activity as its exclusive or principal object depends on the law, the constituent act or the statute, on condition that the latter two documents exist in the form of an official record or of a similar document, the so-called "scrittura privata autenticata". In the absence of these formal acts, it is necessary to refer to the activity which is actually exercised within the territory of the State[39].

The application of IRES is the ordinary criterion of taxation of corporations and assimilated legal entities. However, they can also opt for the application of the principle of transparency. The difference from partnerships is that the latter are always treated as tax transparent, while corporations shall exercise a specific option for this purpose[40]. In this respect, several conditions must

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[37] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit. p. 86.
[38] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 90.
[39] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 91.
[40] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit. p. 90.

be fulfilled. First of all, it is necessary that the option is exercised both by the participated company and all the shareholders (this is the so-called "all-in, all-out" rule); secondly, both the participated company and all the shareholders must be capital companies within the meaning of art. 73 of the TUIR; thirdly, the shareholders must have a participation between 10% and 50% in the capital of the transparent company[41]. The principle of transparency applies to corporations also in the case in which there are non-resident shareholders, but on condition that there is not an obligation to apply a withholding tax on outbound dividends, namely on dividends which are distributed to non-resident shareholders. Therefore, in these cases the principle of transparency applies either where non-resident shareholders are subject to the parent-subsidiary directive's regime, or where they participate in the capital of a resident company through a permanent establishment located in Italy, or where they reside in a State which has concluded a Double Taxation Convention with Italy and the Treaty provides for the non-application of a withholding tax on outbound dividends[42]. When the principle of transparency applies to corporations, it produces the same effects as the case it applies to partnerships. An important difference is that a corporation treated as tax transparent, unlike a transparent partnership, is jointly and severally liable for social obligations along with the shareholders[43].

Finally, the principle of transparency may apply to trusts and legal structures having similar content. In this respect, a difference must be made between transparent trusts and opaque trusts. The former are trusts whose constituent act clearly identifies the beneficiaries; these trusts are subject to the application of the principle of transparency. Instead, opaque trusts are

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[41] P. ROSSI MACCANICO, *Riforma del sistema fiscal statale: prospettive della tassazione per trasparenza delle società di capitali*, cit., p. 1.

[42] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 154.

[43] P. ROSSI MACCANICO, *Riforma del sistema fiscal statale: prospettive della tassazione per trasparenza delle società di capitali*, cit. p. 14.

those trusts in respect of which the beneficiaries are not identified; under art. 73, par. 2, of the TUIR, they are ordinary taxed with IRES[44].

1.4 The key Italian principles of company's taxation: the issue of economic double taxation of companies and their shareholders.

With regard to companies (partnerships or corporations) which carry out gainful activities and which distribute profits to the shareholders, the problem that arises is the elimination or, at least, the reduction of economic double taxation between the company and its shareholders[45].

Concerning partnerships, the automatic application of the principle of transparency ensures the complete elimination of economic double taxation, since the profits of the company (in an economic sense) are taxed only once, namely in the hands of the shareholders.

On the other hand, as far as corporations are concerned, until 2003, if they did not exercise the option for the application of the principle of transparency, the complete elimination of economic double taxation was granted by the credit method: an indirect credit was attributed to shareholders and it was equal to the tax paid by the company on dividends distributed[46]. In 2003, the credit method was replaced by the exemption method (the so-called participation exemption), which currently applies both to dividends deriving from participations held in the capital of corporations (and assimilated commercial entities). According to this regime, the distributing company is ordinary taxed on its income, but dividends distributed to shareholders are partially exempt from taxation or are subject to a withholding tax at source.

Firstly, a difference must be made between the case in which dividends are received by natural persons or partnerships and the case where dividends

44 F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 94.
45 G. MELIS, *Lezioni di diritto tributario*, Torino, 2015, p. 588.
46 G. MELIS, *Lezioni di diritto tributario*, cit., p. 588.

are received by corporations and, more in general, legal entities which are subject to IRES.

In the former case, if dividends are distributed to natural persons, not in the context of a business activity and if they are related to non-qualified participations (namely participations not exceeding a certain amount), they are subject to a withholding tax at a rate of 26%; if, under the same circumstances, dividends derive from a qualified participation, they are exempt from taxation for 50,28% of their total amount (this means that in this case dividends are taxed for 49,72% of their total amount). The latter tax treatment applies where profits are distributed to partnerships or to natural persons, in the context of a business activity[47]. Furthermore, the same regime applies to taxation of capital gains related to participations held by the subjects in question.

On the other hand, dividends received by corporations and, more in general, by legal entities subject to IRES, are exempt from taxation for 95% of their total amount (therefore being taxed only for 5%)[48]. The taxation of 5% of profits relates to the need of allowing companies to deduct the costs that are inherent to the participation. If profits were totally exempt from tax, costs would be non-deductible as well; instead, the Italian domestic law permits the deduction of costs inherent to the participation, but only to the extent of 5% of dividends, which, in connection to this premise, are taxed for 5%[49].

Art. 89, par. 3, requires the attainment of a specific condition in order to apply the participation exemption regime: dividends must be distributed by a company located in a State not qualifying as a tax heaven. If the distributing company resides in a tax heaven, the participation exemption regime applies only if it is proved that such a company has received profits (which then have been distributed to its shareholders) by another company

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[47] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 46-47.
[48] G. MELIS, *Lezioni di diritto tributario*, cit. p. 591.
[49] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 118.

not established in a tax heaven[50]. The exemption also applies to capital gains related to participations held by capital companies and commercial entities. However, for this purpose more stringent conditions must be fulfilled. The matter is regulated by art. 87 of the TUIR, which provides for four requirements: two of them relate to the shareholder company, while the others concern the participated company[51].

Firstly, a minimum holding period is required: the participation must be held for at least 12 months. Secondly, in the financial statements of the shareholder company the participation must have been recorded, for the first time, as a financial asset and not as a current asset. Thirdly, the participated company must not reside in a tax heaven, unless it is proved that the company in question has received dividends (which then have been distributed to its shareholders) by another company not established in a tax heaven. In fourth instance, it is necessary that the participated company carries out a commercial activity (*resctius* a business activity). The last two conditions must be fulfilled as from the third taxable period before the realization of capital gains and, if the participated company qualifies as a holding, they must also be fulfilled by the companies which are participated by the holding[52].

1.5 The tax treatment of foreign companies in cross-border situations.

As mentioned before, IRES applies not only to resident companies, but also to non-resident (foreign) companies and legal entities. Under art. 73, par. 3, of the TUIR, a company or an entity is considered as resident in Italy when,

[50] G. MELIS, *Lezioni di diritto tributario*, cit., p. 591.
[51] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 114.
[52] M. C. PANZERI, *La riforma del diritto societario e la disciplina fiscal degli srumenti finanziari e dei patrimony destinati: soluzioni a confront*, in *Dir. Prat. Trib.*, 6/2003, p. 23-24.

for the most part of a taxable period, they have in Italy the legal seat, the seat of administration or the principal object of their activity[53].

Furthermore, art. 73 contains specific provisions dealing with an abusive practice (the so-called "esterovestizione") consisting in the fictitious placing of the tax residence in another State (the latter is often a "tax heaven")[54]. The first provision concerns trusts (which may be qualified as commercial or non commercial entities, depending on the circumstances). Under art. 73, par. 3, of the TUIR, unless proven otherwise, trusts established in a tax heaven[55] are considered as resident in Italy if, alternatively, at least one settlor and one beneficiary are resident in Italy or, after the constitution of the trust, a person who is resident in Italy transfers to the trust itself immovable property, constitutes or transfers rights in rem in immovable property or creates an earmarking on them. Other provisions dealing with the so-called "esterovestizione" concern companies and legal entities in general. According to art. 73, par. 5-bis, of the TUIR, unless proven otherwise the seat of administration of a company or entity established abroad, which control Italian companies or commercial entities subject to IRES, is considered to be existent in Italy if, alternatively, the foreign company or entity is controlled by a person (natural or legal) resident in Italy or if they are administered by a management board which is formed, for the most part, by persons resident in Italy. Finally, art. 73, par. 5-quarter of the TUIR establishes that, unless proven otherwise, companies and entities established abroad are considered to be resident in Italy if their heritage is invested for the most part in participation shares of Italian investment funds, on condition that the foreign company or entity are controlled by a person who is resident in Italy.

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[53] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 86.

[54] G. MELIS, *Lezioni di diritto tributario*, cit., p. 599.

[55] According to the Italian domestic law, tax heavens are identified by default: they are those countries which are not mentioned in the so-called white list. However, this list has not been issued yet, therefore currently tax heavens are those countries which are mentioned in a previous black list.

Unlike resident companies, foreign companies are taxed in Italy only in respect of incomes arising within the territory of the State[56]. Whether or not income is considered to arise in Italy depends on its qualification. In fact, real estate income is considered to arise in Italy if the immovable property is located in the territory of the State; capital income arises in Italy if it derives from a resident legal person or from a permanent establishment situated in Italy; business income arises in Italy if the non resident company or legal entity carry out a business activity in Italy through a permanent establishment located therein; self-employed income arises in Italy if it relates to an activity exercised within the national territory; as regards the so-called "diverse incomes" (a residual category which comprises incomes not falling within the other categories), they arise in Italy when they relate to goods situated within the territory of the State or when they result from capital gain of participations held in resident companies; if the non-resident company or legal entity participate in a resident company to which the principle of transparency applies, the income attributed to the non-resident company or legal entity is considered to be produced in Italy[57].

Concerning the regime applicable to cross-border distributions of profits, dividends distributed by non-resident companies are taxed in the same way as the case in which they are distributed by resident companies, unless they derive from a company established in a tax heaven[58]. Furthermore, also capital gains of participations held in non-resident companies are taxed in the same way as capital gains of participations held in resident companies, unless they derive from a company established in a tax heaven. In both of these cases, if the participated company is resident in a tax heaven, dividends and capital gains are ordinary taxed in Italy, unless it is proved that the distributing company has received profits (which are then

[56] P. ROSSI MACCANICO, *Riforma del sistema fiscal statale: prospettive della tassazione per trasparenza delle società di capitali*, cit., p. 4.
[57] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 168.
[58] E. MIGNARRI, *Trattamento fiscale dei dividendi di fonte estera*, in *Il Fisco*, 1/2010, p. 6490.

distributed to its Italian shareholders) by a company not resident in a tax heaven.

On the other hand, dividends distributed by a resident company to a non resident one (the so-called outbound dividends) are subject to a withholding tax at a rate of 27%, regardless of the legal nature of both the participation and the recipient[59]. Furthermore, non-resident subjects are entitled to reimbursment of taxes paid on dividends in their residence State, but only up to a maximum of a quarter of the tax withheld at source. However, this general regime does not apply if the recipient is a company or a legal entity established in a EU member State or in the EEA. In this case, outbound dividends are subject to a withholding tax at a rate of 1,375%[60]. Finally, a different regime is connected to the application of the Parent-Subsidiary Directive.

Apart from the options for the application of the principle of transparency or the tax consolidation regime, Italian domestic law does not provide for options similar to the American check-the-box rules.

Finally, as regards the guidelines for qualifying a foreign company as a partnership or a corporation, according to art. 73, par. 2, of the TUIR, the category of non-resident companies comprises both corporations and partnerships, which are subject to the application of the same regime. Therefore, the qualification of a foreign company as partnership or corporation is irrelevant for domestic tax purposes, because the applicable legal regime is the same. An evidence of this assertion is the fact that, for example, the internal provisions concerning the principle of transparency (when it applies to corporations)[61] and the tax consolidation regime[62] address the case in which one of the relevant companies is established

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[59] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 181.
[60] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 181.
[61] Artt. 115 and ss., TUIR.
[62] Artt. 117 and ss. as regards the so-called "consolidato nazionale"; art. 130 and ss. as regards the so-called "consolidato mondiale".

abroad, but they do not make any difference between non-resident corporations or partnerships.

1.6 Hybrid financial instruments and Italian domestic law.

According to the OECD, hybrid instruments are those financial instruments which benefit from a different tax treatment in different States: the same financial instrument is considered as an equity instrument in one State and as a debt instrument in another[63].

Italian domestic law does not contain any definition of hybrid financial instruments. Art. 44 of the TUIR only defines equity instruments, debt instruments and financial instruments considered as assimilated to equity instruments or to debt instruments.

As regards equity instruments, this category comprises financial instruments which produce profits deriving from the participation in the capital or heritage of companies and other legal entities subject to IRES[64]. Financial instruments assimilated to equity instruments are those instruments whose remuneration totally derives from the participation in the economic results of the issuing company or of another company belonging to the same group or of the deal in relation to which the financial instruments are issued. In this case, if financial instruments are issued by a company not resident in Italy, those instruments are considered as assimilated to equity instruments on condition that the remuneration paid by the foreign issuing company is totally non-deductible under the domestic law of its State of residence[65].

Concerning debt instruments, art. 44 of the TUIR defines them by default: they are those financial instruments which produce interests deriving from

[63] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 7; CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

[64] Art. 44, co. 1, l. *e)*, TUIR.

[65] Art. 44, co. 2, l. *a)*, TUIR.

the use of capital[66]. Furthermore, some financial instruments are considered as assimilated to debt instruments: they are financial instruments carrying an obligation, for the issuing company, to pay a specific sum of money at a certain period of time, with or without the payment of periodic proceeds, not attributing the right to participate in the control or management of the issuing company or of the deal in relation to which the financial instruments are issued[67].

For tax purposes, dividends (deriving from equity instruments and assimilated financial instruments) and interests (deriving from debt instruments and assimilated financial instruments) belong to the same category of income (capital income). However, they are subject to a different treatment.

From the point of view of the paying company, dividends paid to its shareholder are non-deductible, while interests paid to its creditors (who possess debt instruments) are deductible within certain limits. These limits are foreseen in art. 96 of the TUIR, which establishes that interest expenses and assimilated costs are deductible up to the amount of interest income and assimilated profits which are produced in the same taxable period. If the amount of interest expenses and assimilated costs exceeds the amount of interest income and assimilated profits, the difference is deductible in the same taxable period, but only within the limit of 30% of the so-called "reddito operativo lordo" of the same year. This is an economic indicator resulting from the difference between the value and the cost of production, recorded in the accounts. In the case in which, after the deduction, an amount of interest expenses is still existent, it is deductible in the subsequent taxable periods, without any time limit but only within 30% of the "reddito operativo lordo" of every single year. In case the national consolidation regime applies, if a company of the group has an amount of

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[66] Art. 44, co. 1, l. *h)*, TUIR.

[67] Art. 44, co. 2, n. 2, TUIR.

interest expenses which exceeds the “reddito operativo lordo” of a specific taxable year, that company can use its interest expenses in order to reduce the overall income of the group, on condition that other companies have an amount of “reddito operativo lordo” not used for the deduction of their interest expenses. This rule allows the deductibility of interest expenses and assimilated costs for companies that every year have a negative “reddito operativo lordo”[68], by using the available amount of other companies of the same group[69].

From the point of view of the receiving company, dividends and interests are subject to a different tax treatment as well.

As regards dividends deriving from shares and from financial instruments assimilated to equity instruments, they are non-deductible for the paying company, on the one hand, and taxed in the hands of the shareholders, on the other. Therefore, it is necessary to avoid, or at least to reduce, economic double taxation arising from this situation. As before mentioned, until 2003 Italian domestic law provided for credit method in order to eliminate economic double taxation. As from 2004, the method of relief is the exemption (the so-called participation exemption). According to this regime, if dividends are received by a partnership they are taxed for 49,72% of their total amount (50,28% is exempt from tax); On the other hand, dividends received by corporations and, more in general, by legal entities subject to IRES, are exempt from taxation for 95% of their total amount (therefore being taxed only for 5%)[70]. However, Art. 89, par. 3, requires the attainment of a specific condition in order to apply the participation exemption regime: dividends must be distributed by a company located in a State not qualifying as a tax heaven. If the distributing company resides in a

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[68] Companies having always a negative “reddito operativo lordo” are, for example, industrial holdings. In fact, their profits (dividends, capital proceeds and capital gains) are systematically excluded from the calculation of the “reddito operativo lordo”.

[69] T. GASPARRI, *Interessi passive e leveraged buy-out*, in *Il Fisco*, 23/2014, p. 3-4.

[70] M. C. PANZERI, *La riforma del diritto societario e la disciplina fiscal degli srumenti finanziari e dei patrimony destinati: soluzioni a confront*, cit., p. 23-24.

tax heaven, the participation exemption regime applies only if it is proved that such a company has received profits (which then have been distributed to its shareholders) by another company not established in a tax heaven.

1.7 The Italian anti-avoidance measures dealing with hybrid mismatch arrangements.

As from 2015, Italian domestic law provides for a General Anti-Avoidance Rule (GAAR), which is contained in art. 10-bis l. 212/2000. According to it, one or more operations which lack of economic substance and which, despite the formal compliance with the domestic law, essentially produce wrongful tax advantages, are abusive. Such operations are unenforceable against the tax administration, which disregards the tax advantages for tax purposes. "Operations which lack of economic substance" means any fact, act or contract, even connected to each other, not capable of producing significant effects which are different from tax advantages. Furthermore, a tax advantage is considered as wrongful if it is in contrast with the object and purpose of internal tax provisions or with general principles of the internal tax system. An operation cannot be qualified as abusive if it is justified by valid commercial reasons, also concerning the reorganization or the improvement of an enterprise or of the professional activity of the taxpayer. However, the latter is free to adopt legal schemes lowering his tax burden, the unique limit is the denial of the possibility to attain a wrongful tax advantage, namely an advantage which is contrary to the spirit of the system. The Italian GAAR may apply only by default, i.e. only if the economic operation, carried out by the taxpayer, does not qualify as tax evasion. Finally, in Italy tax avoidance does not constitute a crime: it only triggers the application of administrative sanctions[71].

[71] Art. 10-bis, l. 212/2000.

As it is clear, the Italian GAAR has a very wide scope and it can also apply to cross-border situations. However, it is not suitable to counteract hybrid mismatch arrangements, firstly because this aim is achieved by the application of Specific Anti-Avoidance Rules (SAAR), secondly because tackling hybrid mismatches is a challenge of a general character and it requires an action coordinated and comprehensive in the international context[72]. A unilateral solution, adopted by a single State, is not enough, as hybrid mismatch arrangements do not simply take advantage of asymmetries only existing in one country, but they aim at exploiting the differences arising by comparing national laws of at least two States[73]. In other words, the terms of general anti-avoidance rules and the frequent need to show a direct link between the transactions and the avoidance of a particular jurisdiction's tax tend to make the application of general anti-avoidance rules difficult in many cases involving hybrid mismatch arrangements[74]. For these reasons, The 2012 OECD Hybrids Report recommended revising or introducing specific and targeted rules denying benefits of hybrid mismatch arrangements. In keeping with this recommendation, the 2013 OECD Action Plan called for development of targeted and specific domestic rules to neutralize hybrid mismatch arrangements. More specifically, the 2013 OECD Action Plan asked for recommendations for the design of: (i) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer; (ii) domestic law provisions that deny a deduction for a payment which is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); and (iii)

[72] T. GASPARRI, *Interessi passivi e leveraged buy out*, cit., p. 2242; J. MALHERBE, *Double Taxation and National Fiscal Interests*, in *Riv. Dir. Trib.*, 2/2015, p. 27.

[73] R. DE BOER, O. MARRES, *Beps Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements*, cit., p. 14.

[74] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 13; R. DE BOER, O. MARRES, *Beps Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements*, cit., p. 16; CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction.
Concerning the Italian Specific Anti-Avoidance Rules (SAAR), Italian domestic law, like other countries, provides for rules specifically addressing certain forms of hybrid mismatch arrangements. Pursuant to these rules, the domestic tax treatment of an entity, instrument or transfer involving a foreign country is linked to the tax treatment in the foreign country, thus eliminating the possibility for mismatches. Although rules under which the tax treatment in the first country depends on the tax treatment in the second country make the application of the law more complicated, rules taking into account the tax treatment in another country are not a novelty, as in principle foreign tax credit rules, subject to tax clauses, and CFC rules often do exactly that.
Domestic law rules which link the tax treatment of an entity, instrument or transfer in the country concerned to the tax treatment in another country appear to hold significant potential as a tool to address hybrid mismatch arrangements that are viewed as inappropriate.
One of these rules is contained in art. 73, par. 2, of the TUIR, which provides that the category of non-resident companies and legal entities (category which is subject to the tax treatment applicable to corporations) comprises not only non-resident corporations but also non resident partnerships. Therefore, according to this rule non-resident companies, despite their qualification as corporations or partnerships, are subject to the same tax treatment. One may not overlook that a specific hybrid mismatch arrangement is created by the use of hybrid entities, namely entities taxed as a look-through entity in a foreign jurisdiction and as a corporation in their local jurisdiction[75]. This phenomenon is made possible by some rules such as the American check-the-box system, which allows foreign companies to

[75] T. ROSEMBUJ, *Hybrid Entities Why Not Tax Pass-throughs as Corporations?*, in *Intertax*, 5/40, p. 304.

choose, by reflecting it in a simple form, to be a corporation separated from the members and therefore subject to corporate tax, or as a look-through entity to allocate the income to the members[76]. By making this choice, a foreign corporation may be qualified as a partnership in the U.S., with the result that the principle of transparency applies to it. If the foreign corporation, in its State of residence, has opted for the application of the tax consolidation regime, its losses may be deducted twice: first of all, they may reduce the consolidated income of the group in the State of residence, secondly they may be deducted by the shareholders in the U.S., where the principle of transparency applies. This kind of tax arbitrage cannot be obtained in Italy, since art. 73, par. 2, of the TUIR considers non resident companies as corporations, despite their qualification under the domestic law of the State of residence, and the principle of transparency does not apply. As before mentioned, the latter can apply to corporations only exercising a specific option; however, under art. 115 of the TUIR the option cannot be exercised by non-resident legal entities.

Another internal rule which has the effect of hindering mismatches is contained in art. 44 of the TUIR. The essential characteristic of hybrid financial instruments is that they are considered as equity instruments in one State and as debt instruments in another. By exploiting this mismatch, they benefit from a different tax treatment which leads to a tax arbitrage: in the State where such instruments are treated as debt instruments, the remuneration paid by the issuing company is deductible, while, in the State where they are considered as equity instruments, the shareholders receive dividends totally or partly exempt from tax. This from of abuse in encouraged, in some members State, by internal tax rules that simply list the financial instruments qualified as equity or debt, without establishing a general principle applicable by default. However, such a general principle is

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[76] T. ROSEMBUJ, *Hybrid Entities Why Not Tax Pass-throughs as Corporations?*, cit., p. 300; CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

foreseen in Italian domestic law. As before mentioned, art. 44 of the TUIR qualifies equity instruments as those financial instruments which produce profits deriving from the participation in the capital or heritage of companies and other legal entities subject to IRES[77]. Financial instruments assimilated to equity instruments are those instruments whose remuneration totally derives from the participation in the economic results of the issuing company or of another company belonging to the same group or of the deal in relation to which the financial instruments are issued. On the other hand, the provision at issue qualifies debts instruments by default: they are those financial instruments producing interests deriving from the use of capital[78]. Furthermore, financial instruments assimilated to debt instruments are those instruments carrying an obligation, for the issuing company, to pay a specific sum of money at a certain period of time, with or without the payment of periodic proceeds, not attributing the right to participate in the control or management of the issuing company or of the deal in relation to which the financial instruments are issued[79].
Like other countries, Italy has rules addressing the non-inclusion of income which is deductible at the level of the payer[80]. These rules deny the exemption of income which is deductible in the other country. According to Italian domestic law, profits distributed by non-resident entities are 95% exempt for tax purposes only if they are not deductible in the foreign country where the issuer is resident[81]. Otherwise, they are ordinary taxed in the hands of the shareholders[82]. 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.

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[77] Art. 44, co. 1, l. *e)*, TUIR.
[78] Art. 44, co. 1, l. *h)*, TUIR.
[79] Art. 44, co. 2, n. 2, TUIR.
[80] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, cit., p. 18.
[81] Art. 44, par. 2, TUIR.
[82] Art. 89, par. 3, TUIR; M. C. PANZERI, *La riforma del diritto societario e la disciplina fiscal degli srumenti finanziari e dei patrimony destinati: soluzioni a confront*, cit., p. 24.

Furthermore, Italian tax law provides a specific rule which can be used to tackle foreign tax credit generator schemes[83]. Specifically, in the case of Repurchase agreement (Repo) and Securities lending or other transactions that yield similar effects, the Italian taxpayer (borrower) receiving dividends, interests or other proceeds is entitled to a foreign tax credit only if these benefits would have been granted to the beneficial owner (lender) of the said income flows (i.e. if the lender is subject to the same tax regime of the borrower). As a consequence, the borrower can claim a foreign tax credit only if the lender is an Italian entity or a foreign entity with a permanent establishment in Italy.

Finally, a specific provision aimed at tackling hybrid mismatches has been introduced in the internal tax law by the d.lgs. 147/2015, which provided the so-called Branch Exemption. According to this regime, by virtue of a specific option incomes and losses of permanent establishments, located abroad, of Italian companies are respectively exempt from taxation and non-deductible. For tax purposes, the branch which constitutes a permanent establishment is treated as a subject that is autonomous from the respective Italian company. In fact, when the relevant prerequisites arise, the CFC regime apply to the permanent establishment which benefit from the Branch Exemption. The legal regime at hand aims at counteracting hybrid mismatches since it is established that it applies only to the extent that the State, in which the branch is situated, considers the latter as a permanent establishment of the Italian company and taxes it in consequence. If, on the other hand, the State in question does not qualify the branch as a permanent establishment, the option for the application of the Branch Exemption regime ceases to have effects: in this case, incomes and losses of the branch

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

are respectively taxed and deemed as deductible in the hands of the Italian company.

A specific hybrid mismatch arrangement is characterized by the use of dual-resident entities, namely legal entities considered as fiscal resident in two States. However, Italy does not tackle such abusive schemes with an internal provision, but rather with treaty-based provisions. On this ground, art. 4, par. 3, of Double Taxation Conventions signed between Italy and several countries[84] provides that "*Where by reason of the provisions of paragraph 1 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*". However, the meaning of the term "place of effective management", if one considers this particular criterion, is based on factual circumstances, and case law and practice of the tax authorities vary from State to State[85].

Italian domestic law also provides for Specific Anti-Avoidance Rules like CFC rules or Thin Cap rules switching to the credit method, but they are not effective to avoid hybrid mismatches. In fact, the simultaneous application of both specific anti-hybrid rules and, for example, CFC rules may give rise to some issues of circularity[86]. Specifically, in the same circumstances, one state could deny the tax deductibility of payments made under hybrid arrangements and the other could apply its CFC legislation to those payments, as being made under hybrid arrangements. For example, parent P, based in home State H, has two subsidiaries: subsidiary S1, based in a low-tax jurisdiction (State L), and subsidiary S2, based in a normal- tax jurisdiction (State N). A hybrid arrangement could be used such that subsidiary S2 makes a payment to subsidiary S1 that is tax deductible in State N, but not taxable in State L. State L could, however, apply anti-

[84] See, for instance, the Double Tax Treaties signed with France, Switzerland, Spain and so on.

[85] G. MAISTO, *Controlled Foreign Company Legislation, Corporate Residence and Anti-Hybrid Arrangement Rules*, in *Bullettin for International Taxation*, June/July 2014, p. 327.

[86] G. MAISTO, *Controlled Foreign Company Legislation, Corporate Residence and Anti-Hybrid Arrangement Rules*, cit., p. 329.

hybrid legislation to make the payment taxable in State L. Simultaneously, home State H could also apply its CFC legislation with regard to subsidiary S1 that is based in low-tax State L. In this case, the problem is to establish which State should be granted the primary right to apply its anti-BEPS measures.

In the field of the fight against hybrid mismatch arrangements, the BEPS discussion has not had an impact on Italian anti-avoidance legislation yet.

3.2 Exemplary case studies.

- **Example 4a.**

If Italy was State S, in order to reduce withholding taxes on interest and royalties, the tax treaty signed with State P would be applicable, since both of the States do not apply the principle of transparency in the case at issue and the subjects "a" and "b" could not be considered as the beneficial owners.

If Italy was State R, it would not be possible to grant a tax credit for the (reduced) withholding tax levied in State S since Italy does not apply the principle of transparency when the participated company is established abroad[87], save in the case of application of the CFC regime. Therefore, the subjects "a" and "b" would be taxed on dividends received by the company established in State P.

The first of these two cases would lead to a partial double taxation in State P and S (Italy); in fact, Italy would apply a (reduced) withholding tax on the royalty payment, while State P would tax the royalty income as well.

The second case would lead to the elimination or, at least, the reduction of economic double taxation only if the participation exemption regime applies. Otherwise, a situation of economic double taxation would arise, since the same item of income would be taxed twice, firstly in State P,

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[87] Art. 5 and 115, TUIR.

which applies the principle of transparency, and secondly in Italy, which does not apply the principle of transparency to non-resident companies.

- **Example 4b.**

If Italy was State S, the same first solution as the previous example would be apply: in order to reduce withholding taxes on interest and royalties, the tax treaty signed with State P would be relevant, since Italy would not apply the principle of transparency and would not disregard the company in question for tax purposes.
In terms of the effectiveness of such measures, the application of the treaty between State S (Italy) and State P would imply the imposition of a (reduced) withholding tax in Italy, on the one hand, and the taxation of the same item of income in Sate R, but in the hands of the subjects “a” and “b”. In fact, State P would consider the company as tax transparent and it would not levy tax in its territory.

- **Example 4c.**

If Italy was State P, interests expenses would always be deductible, but only within the limits provided for by art. 96 of the TUIR. This tax treatment would be totally independent from the regime applying to dividends in State R. Therefore, if the later State entirely taxed dividends, this would lead to an economic double taxation. On the other hand, if State R exempted dividends from tax, this would result in a partial double non-taxation, relating to the amount of interests that would be deductible in State P (Italy).
If Italy was State R, under art. 44, par. 2, and 89, par. 3, of the TUIR, dividends would be exempted from taxation (for 95% of their total amount and under the specific circumstances described above) on condition that the relative remuneration would be non-deductible for the paying agent or company under the domestic law of State P. In principle, this specific anti-

hybrid rules prevents double taxation or double non-taxation. However, a situation of partial double taxation may nonetheless arise if the prerequisites for the application of the participation exemption regime were not fulfilled (for example, it may be the case in which dividends are received by partnerships: on the one hand they would be taxed for 49,72% in State R, on the other hand they would not be deductible in State P).

- **Example 4d.**

If Italy was State A, "B co" would not be subject to tax on its worldwide income, since the application of the national consolidation regime is precluded to non-resident controlled companies[88]. On the other hand, the worldwide consolidation regime involves that only a part of the income produced by non-resident controlled companies is allocated to the resident parent company[89].

"B co" would be permitted to surrender its losses to "A co", but a difference must be made between the application of the national and the worldwide consolidation regime. Under the national consolidation rules, non-resident companies can be consolidated only as parent companies and not as subsidiaries. Instead, the worldwide consolidation regime applies to non-resident subsidiaries as well. It involves that, exercising a specific option, a part (proportional to the participation shares) of incomes and losses of the foreign subsidiaries is attributed to the resident parent company, but for this purpose some specific conditions must be fulfilled. First of all, it is necessary that the parent is a corporation or a commercial entity resident in Italy. Secondly, it must be quoted on the stock exchange and controlled by the State, by another public body or by natural resident persons not having the control of other companies[90]. The control requirement is integrated when the resident parent company has the majority of the voting rights

[88] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 161.
[89] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 175.
[90] Art. 130, TUIR.

which may be exercised in the general assembly of the foreign subsidiary and, in addition, when it has the right to participate in the distribution of profits for more than 50% of their total amount. Specific prerequisites for subsidiaries are not foreseen, therefore they may be companies of any type. The option for the application of this regime (option which must be exercised only by the parent and not by the subsidiaries, since the worldwide consolidation regime only taxes the part of their income which is proportional to the participation held by the parent) produces effects if:

- the option itself regards all the subsidiaries ("all in-all out" rule);
- each subsidiary has a business year which corresponds to that of the parent company;
- the accounts of all the companies are subject to an audit;
- each subsidiary expresses its agreement concerning the audit of its accounts and it makes a commitment to collaborate with the parent for the determination of the taxable income and for fulfilling all the requests of the Tax Administration within a period of time not exceeding 60 days from the day of the notification;
- there is the positive opinion of the Tax Administration regarding the existence of the requirements for the valid exercise of the option[91].

If Italy was State B, "B co" would be subject to tax on its worldwide income there, since, according to art. 73, par. 3, of the TUIR the relevant criterion of residence (in this case) is that of the incorporation. "B co" would not be allowed to surrender its losses to "B sub 1": provided that the national consolidation regime, as specified, does not apply to non-resident subsidiaries, the worldwide consolidation discipline involves the transfer of losses from the subsidiary to the parent and not vice versa.

In the first hypothesis (where Italy would be State A), the solution provided for by Italian domestic law may lead to a double deduction of the losses of "B co": in fact, its losses may be deducted both by "A co" within the tax

[91] F. TESAURO, *Istituzioni di diritto tributario – Parte speciale*, cit., p. 177.

consolidation regime and then by “B co” itself according to State B domestic law.

CHAPTER 2 – HYBRID MISMATCHES AND ITALIAN TREATY LEGISLATION.

2.1 The influence of the BEPS discussion on Italian treaty legislation.

In Italy a discussion on the suggested Art. 1, paragraph 2, of the OECD Model Convention has not been developed yet. In fact, neither this provision nor similar rules have been implemented into Italian treaty legislation. Art. 1 of almost all the treaties concluded by Italy only provides that "*This Convention shall apply to persons who are residents of one or both of the Contracting States*"[92].

Furthermore, currently there is not any difference in Italian treaty-legislation before the BEPS discussion and afterwards to be noticed: since the BEPS discussion came up, Italy has not agreed on new tax treaties or changed its older treaties. Concerning the latter treaties, there are not new approaches in interpreting and applying them which might be a result of the BEPS discussion.

Italy does not have an autonomous Model Convention intended to avoid double (non) taxation. All the treaties concluded with other States are based on the OECD MC.

2.2 Implementation of the OECD Partnership report.

[92] In this respect, see the Double Taxation Convention signed with Albania, Algeria, Saudi Arabia, Argentina, Armenia, Australia, Austria, Azerbaijan, Bangladesh, Belgium, Bielorussia, Brazil, Canada, Cina, Congo, South Corea, Ivory Coast, Croatia, Denmark, Ecuador, Egypt, United Arab Emirates, Estonia, Russia, Philippines, Finland, France, Georgia, Ghana, Germany, Japan, Greece, Hong Kong, India, Indonesia, Ireland, Iceland, Israel, Ex Yugoslavia, Kazakhistan, Kuwait, Latvia, Lebanon, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Morocco, Mauritius, Mexico, Moldova, Mozambique, Norway, New Zeland, Oman, The Netherlands, Pakistan, Poland, Portugal, Qatar, United Kingdom, Czech Republic, Slovak Republic, Romania, San Marino, Senegal, Syria, Singapore, Slovenia, Spain, Sri Lanka, South Africa, Sweden, Switzerland, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Uganda, Hungary, Uzbekistan, Venezuela, Vietnam, Zambia.

The 1999 report called "*The Application of the OECD Model Tax Convention to Partnerships*" deals with the application of the provisions of the OECD Model Tax Convention, and indirectly of bilateral tax conventions based on that Model, to partnerships. It put forward a number of changes to the Model Tax Convention which have been included in the subsequent updates to the Model**.**

The first decision of the OECD Working Group (which has written the 1999 report) was to make it clear when partnerships can be associated to persons. In this respect, the Working Group proposed to introduce a new sentence the Commentary on the OECD Model Convention, whereby "*Partnerships will also be considered to be "persons" either because they fall within the definition of "company" or, where this is not the case, because they constitute other bodies of persons*"[93]. This statement was included in the subsequent Commentary on art. 3 of the OECD MC and also Italy has adopted it, not making any reservation to this rule. However, the definition of the term "national" in subdivision 1 *f*) (*ii*) of art. 3 could give rise to an implication that partnerships are not "persons" for purposes of the Convention, since it is stated that the term "national" includes "any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State". Therefore, in order to avoid any confusion that may result from that definition, the Working Group has agreed to add a new provision to the Commentary on Article 3 and this clarification was adopted by Italian treaty-legislation as well: "*The separate mention of partnerships in sub-paragraph 1 f) is not inconsistent with the status of a partnership as a person under sub-paragraph 1 a). Under the domestic laws of some countries, it is possible for an entity to be a "person" but not a "legal person" for tax purposes. The explicit statement is necessary to avoid confusion*"[94].

[93] OECD Commentary on art. 3, par. 1.2.
[94] OECD Commentary on art. 3, par. 10.1.

Paragraph 3 of the Commentary on art. 1 deals specifically with the problem of whether a partnership qualifies as a "resident" for treaty purposes. The Working Group discussed this issue and concluded that if the State in which a partnership has been organised treats that partnership as fiscally transparent, then the partnership is not "liable to tax" in that State within the meaning of Article 4, and it cannot be a resident for the purposes of the Convention. To clarify this point, the Committee has agreed to add the following sentences to the Commentary on art. 1: "*Where, however, a partnership is treated as fiscally transparent in a State, the partnership is not "liable to tax" in that State within the meaning of paragraph 1 of Article 4, and so cannot be a resident thereof for purposes of the Convention. In such a case, the application of the Convention to the partnership as such would be refused, unless a special rule covering partnerships were provided for in the Convention. Where the application of the Convention is so refused, the partners are entitled, with respect to their share of the income of the partnership, to the benefits provided by the Conventions entered into by the States of which they are residents to the extent that the partnership's income is allocated to them for the purposes of taxation in their State of residence*"[95]. Some OECD Member States, such as France, has made reservations and observations to this rule, but Italy has entirely adopted it.

Another specific provision was added to the Commentary on art. 4, concerning the issue of residence. Such a provision, adopted in general by Italy as well, establishes that "*Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In such a case, since the income of the partnership "flows through" to the partners under the domestic law of that State, the partners are the persons*

[95] OECD Commentary on art. 1, par. 35.

who are liable to tax on that income and are thus the appropriate persons to claim the benefits of the Conventions concluded by the States of which they are residents. This latter result will obtain even if, under the domestic law of the State of source, the income is attributed to a partnership which is treated as a separate taxable entity. For States which could not agree with this interpretation of the Article, it would be possible to provide for this result in a special provision which would avoid the resulting potential double taxation where the income of the partnership is differently allocated by the two States"[96].

The Committee has found that a number of difficulties relating to the application of tax conventions to partnerships fall in the broader category of so-called "conflicts of qualification", where the residence and source States apply different articles of the Convention on the basis of differences in their domestic law. Conflicts of qualification may lead either to a double taxation or to a double non-taxation. Since the former problem was already dealt with by Art. 23A of the OECD MC, the Working Group therefore decided that the following paragraph 4 had to be added to Article 23A: "*The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income*". This provision was also added by Italy to the Commentaries on its tax treaties and it aims at eliminating situations of double non-taxation. The paragraph would therefore not apply where the State of source considers that it may tax an item of income or capital in accordance with the provisions of the Convention but where no tax is actually payable on such income or capital under the provisions of the domestic laws of the State of source. Similarly, where the source and residence States disagree not only with respect to the qualification of the

[96] OECD Commentary on art. 4, par. 8.8.

income but also with respect to the amount of such income, paragraph 4 applies only to that part of the income that the State of source exempts from tax through the application of the Convention or to which that State applies paragraph 2 of Article 10 or 11 this proposed provision would only apply to the extent that the State of source.

There are not specific aspects of the Partnership Report that have been discussed particularly among Italian scholars, tax administration or jurisdiction and there have not been any changes in implementing and applying the principles set by the report at issue since the BEPS discussion came up.

2.3 Implementation of anti-hybrid rules through multilateral instruments.

Until now, in Italy there have not been a discussion on the implementation of anti-hybrid rules through multilateral instruments. However, if this result was reached, it would lead to a significant advantage in respect of counteracting hybrid mismatches. As discussed before, such abusive schemes take advantage of the asymmetries existing between two or more States[97], therefore the more harmonization of national legislations is achieved, the more effective the fight against hybrid mismatches.

Furthermore, a very useful outcome which may be obtained through multilateral instruments is an adequate level of exchange of information. In fact, the underpinning of any response to aggressive tax planning is the availability of timely, targeted and comprehensive information. The availability of information at an early stage allows the tax administration to improve risk assessment and to make efficient use of the resources available, therefore improving overall compliance. At the same time, it

[97] R. DE BOER, O. MARRES, *Beps Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements*, cit. p. 14; S. CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

allows the tax policy function to make timely and informed decisions on appropriate legislative responses[98].

[98] OECD – *Tackling aggressive tax planning through improved transparency and disclosure*, February 2011, p. 12.

CHAPTER 3 – IMPACTS OF EUROPEAN UNION LAW ON THE ITALIAN DISCUSSION ON HYBRID MISMATCHES.

Concerning the example 4a, as mentioned before, If Italy was State S, in order to reduce withholding taxes on interest and royalties the tax treaty signed with State P would be applicable, since both of the States do not apply the principle of transparency in the case at issue and the subjects "a" and "b" could not be considered as the beneficial owners. This solution would comply with the European Union law, in particular with the freedom of establishment and the free movement of capital[99], since the requirements for the application of the interest and royalty directive are not satisfied. Conversely, if the latter requirements were filfilled, the European directive at issue would impose State S (Italy) to grant the exemption of royalty payments from tax[100].

If Italy was State R, it would not be possible to grant a tax credit for the (reduced) withholding tax levied in State S since Italy does not apply the principle of transparency when the participated company is established abroad[101], save in the case of application of the CFC regime. Therefore, the subjects "a" and "b" would be taxed on dividends received by the company established in State P. However, if the conditions for the application of the parent-subsidiary directive were integrated, State P would be obliged to grant the exemption from withholding tax on outbound dividends[102].

Ad regards the example 4b, as discussed before, the same solution as that of the example 4a would apply. Therefore, reference must be made to the same consideration concerning the compliance with the European Union Law.

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[99] M. LANG, P. PISTONE, J. SCHUCH, C. STARINGER, *Introduction to European Tax Law: Direct Taxation*, Vienna, 2014, p. 49-50.

[100] M. LANG, P. PISTONE, J. SCHUCH, C. STARINGER, *Introduction to European Tax Law: Direct Taxation*, cit., p. 179.

[101] Art. 5 and 115 of the TUIR.

[102] M. LANG, P. PISTONE, J. SCHUCH, C. STARINGER, *Introduction to European Tax Law: Direct Taxation*, cit., p. 142.

With respect to example 4c, if Italy was State P, interests expenses would always be deductible, but only within the limits provided for in art. 96 of the TUIR and this tax treatment would be totally independent from the regime applying to dividends in State R. Therefore, if the latter State entirely taxed dividends, this would lead to an economic double taxation. On the other hand, if State R exempted dividends from tax, this would result in a partial double non-taxation, relating to the amount of interests that would be deductible in State P (Italy). This solution complies with the European Union Law, which does not contain a specific anti-hybrid rule intended to eliminate mismatches at the level of the State of the subsidiary.
On the other hand, If Italy was State R, under art. 44, par. 2, and 89, par. 3, of the TUIR, dividends would be exempted from taxation (for 95% of their total amount and under the specific circumstances described above) but only on condition that the relative remuneration would be non-deductible for the paying agent or company under the domestic law of State P. This regime complies with the European Union Law. In fact, the EU Directive 2014/86/UE, modifying the parent subsidiary directive, has established that the State of the parent company shall exempt inbound dividends from tax only if the corresponding sum is not deductible in the State of the subsidiary; instead, the former State would be obliged to tax inbound distribution of profits if the remuneration paid by the subsidiary was deductible according to the domestic law of its State of residence[103].
Finally, regarding the fourth example, all the solutions that are applicable pursuant to Italian domestic law are in line with the EU fundamental freedoms.
Unlike Italian domestic law, the European Union Law has not other specific provisions dealing with hybrid mismatch arrangements. However, the other Italian anti-avoidance dispositions concerning hybrid mismatches are

[103] L. ROSSI, G. FICAI, *Modifiche antielusive alla direttiva Madre Figlia*, in *Corr. Trib.*, 22/2015, p. 1701.

compatible with the supranational law, since they are clearly intended to counter "*wholly artificial arrangements intended to escape the national tax normally payable*"[104].

As mentioned before, until now the BEPS discussion has led to the amendment of the parent subsidiary directive[105].

Already in 2010, the EU Code of Conduct Group on Business Taxation reported to the Economic and Financial Affairs (ECOFIN) Council on hybrid financial instruments and advised that participation exemptions should not extend to payments treated as deductible in the source state. This recommendation has led to the adoption by the ECOFIN Council in July 2014 of a corresponding amendment to the EU Parent-Subsidiary Directive, providing that EU Member States should not at parent level exempt a profit distribution that was deductible by the subsidiary[106]. More precisely, Art. 1 of the EU Directive 2014/86/UE, modifying the parent subsidiary Directive, has established that the State of the parent company shall exempt inbound dividends from tax only if the corresponding sum is not deductible in the State of the subsidiary; instead, the former State is obliged to tax inbound distribution of profits if the remuneration paid by the subsidiary is deductible according to the domestic law of its State of residence[107]. According to Art. 2, EU member States must grant the entry into force of the new provisions within the 31st December of 2015 and they must communicate the text of the new dispositions to the EU Commission.

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[104] ECJ, C-196/04, Cadbury Schweppes, final paragraph.

[105] R. TAVARES, B. N. BOGENSCHNEIDER, *The New De Minimis Anti-abuse Rule in the Parent- Subsidiary Directive: Validating EU Tax Competition and Corporate Tax Avoidance?*, in *Intertax*, 8/43, p. 490; G. LIBERATORE, *Rivisitazione antielusiva della direttiva parent-subsidiary*, in *Il Fisco*, 13/2014, p. 8.

[106] R. DE BOER, O. MARRES, *Beps Action 2: Neutralizing the Effects of Hybrid Mismatch Arrangements*, in *Intertax*, cit., p. 15.

[107] L. ROSSI, G. FICAI, *Modifiche antielusive alla direttiva Madre Figlia*, cit., p. 1701.

Finally, a proposal concerning the introduction of a similar provision was also made in respect of the interest and royalty Directive and the merger Directive[108].

The BEPS discussion has had also another influence on the EU Law with regard to the soft-law[109].

In 2012, the European Commission has issued a Recommendation[110] intended to counteract the phenomenon of aggressive tax planning, which also comprises the use of hybrid mismatch arrangements[111]. Avoiding situations where no or very little tax is paid is the key mission of this Recommendation. In this respect, the Recommendation suggests to allow a reduction of the tax burden for the avoidance of double taxation under treaty application if this avoids situations where no tax at all is charged over a specific income component. All tax treaties should include a regulation to that effect. Member States must include a general anti-abuse provision in their national legislation too, at least insofar as no specific anti-abuse provision applies. Such anti-abuse provision must specifically target cross-border anti-abuse situations. This concerns both the relation between Member States and between Member States and third countries. The Recommendation includes a number of criteria for assessing when the anti-abuse provision can be applied. This means it must involve a complex of artificial transactions without any real meaning and aimed at tax avoidance[112].

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[108] CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

[109] C. BROKELIND, *Legal Issues in Respect of the Changes to the Parent- Subsidiary Directive as a Follow-Up of the BEPS Project*, in *Intertax* 12/43, p. 816.

[110] Recommendation 2012/772/UE.

[111] CIPOLLINA, *I redditi "nomadi" delle società multinazionali nell'ecomnomia globalizzata*, cit., p. 25.

[112] P. KAVELAARS, EU and OECD: *Fighting against Tax Avoidance*, in *Intertax*, 10/41, p. 511.

CONCLUSIONS.

In conclusion, this paper shows that tackling hybrid mismatch arrangement cannot be exclusively a matter of a specific domestic law. Since the abusive structures at hand are characterized by the facts that they take advantage of asymmetries existing among various legal systems, international coordination and harmonization, which the OECD aims to, are fundamental in this respect. Even though the BEPS discussion has not had a particular impact in the Italian legislation yet, in the immediate future the situation is going to dramatically change.

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General anti-abuse rules (GAARs) in a post-BEPS World

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INTRODUCTION

On the 5th October 2015 the OECD, as part of its final reports on base erosion and profit shifting (BEPS), released Action 6 to prevent Treaty Abuse.

The final report proposes that tax treaties should include a clear statement in their title and preamble to avoid that the contracting parties create opportunities for non-taxation (or reduced taxation) through tax evasion or treaty shopping arrangements.

Furthermore, the OECD recommended to include in tax treaties a "limitation on benefits" rule and to add a more general anti-abuse rule at the national level based on the principal purposes of transactions or arrangements.

Acknowledging that treaty anti-abuse rules are unlikely to be enough to address tax avoidance strategies that seek to circumvent domestic tax laws, the OECD report suggests that these rules must be addressed also through domestic anti-abuse rules.

In fact, treaty abuse could derive from the circumvention of treaty rules as well as from the circumvention of domestic tax law.

As part of this preface, it is important to define what a General Anti-Avoidance Rule (GAAR) is.

It is a principle or an express law which aims at counteracting the avoidance of tax in general, 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. Differently, "Specific Anti-Avoidance Rules" (SAARs) are anti-avoidance rules which aim to deal with particular situations or transactions.

GAAR and SAARs share the same purpose but they work on two distinct levels. SAARs, with the objective of safeguarding the effectiveness of the obligations and prohibitions that compose the set of obligations and prohibitions that regulate the determination of the tax base and of the tax, create new obligations and new prohibitions, expand this set.

The GAAR is placed outside it, empowering the tax authority to disregard the ordinary regime of the transaction carried out in order to remove the tax advantages stemming from it.

These rules do not therefore clash. The application of a SAAR does not leave out the application of the GAAR. It is true that, when the taxpayer fulfills all the conditions of a SAAR to enjoy a tax benefit, the assumption should be that the enjoyment of the benefit is consistent with the purpose of the provisions that establish it, so the GAAR cannot apply.

CHAPTER 1: IMPACT OF THE GAAR IN THE ITALIAN TAXATION SYSTEM

1.1 Before the entry into force of the Legislative Decree 128/2015 Article 1 paragraph 5 introducing the actual GAAR

In the Italian context, the introduction of a General anti-abuse rule has been widely discussed over the years.

Until 1970, there were no General nor Specific anti abuse rules in Italy[1]. The only methods present to contrast tax avoidance were the ones created by doctrine[2] and jurisprudence[3].

From 1970 the tax avoidance phenomenon started to spread around and, with it, the necessity of a law preventing it. Numerous were the gaps in the tax law system and the taxpayer was obviously taking advantage of it trying to avoid the payment of taxes finding always new artificial methods to do it.

During these days, the doctrine[4] was debating weather it was better to introduce a General Anti Avoidance rule (GAAR) like in Germany or France at the time, or a Specific one (SAAR) regulating specific situations being of course more certain and giving a better guarantee on the law applicability for the taxpayer.

Obviously, choosing this second option, it would have been easier for the taxpayer to find new ways, not formally contemplated by the law, to avoid the payment of taxes.

Essentially, a GAAR would have been acting *ex ante* generally prohibiting the abusive behaviour of the taxpayer, while a SAAR would have been acting *ex post*

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[1] For a comparison with other juridical orders see P. MASTELLONE, "Fenomenologia dell'abuso del diritto tributario nella prospettiva comparata", in Riv. Trib. Int., n. 1/2014, p. 295-346.

[2] The civil instrument of fraud, GALLO F., "Brevi spunti in tema di elusione e frode alla legge (nel reddito d'impresa)", in Rass. Trib., 1989, pag. 11; Civil instrument of re-qualification of the contractual relationship see MELIS. G, *L'interpretazione nel diritto tributario,* Cedam 2003. Pg. 263 – 266.

[3] Ruling "Orsi e Mangelli", 1979.

[4] Pro and contra of both solutions are analyzed by MELIS G., "Lezioni di diritto tributario", cit., p. 106.

forcing the National Legislator to prohibit that the new tax avoidance behaviours are put in practice with the circumvention of the words of the law. It acts ex post because once those new abusive ways of abuse are performed by taxpayers, the Legislator is pushed to intervene with new legal tools to stop the law abuse.

After numerous attempts, the national Legislator introduced in 1990 Article 10.1[5] with the Law no. 408[6], which was considered as having a "quasi general" applicability[7].

Article. 10.1 stated: *"The tax authorities may refuse to recognize the tax benefits received through business combinations, transformations, demergers, capital reductions, liquidations, valuations of shareholdings, transfers of credit and transfers or valuations of securities performed without sound economic reasons, for the sole purpose of fraudulently obtaining tax savings"*.

This provision provided a rather ambiguous definition, since the term "fraudulently" could be interpreted either as having a meaning of "contrary to the purpose of the relevant legal provisions", or of "through false statements and documents". While the first meaning was in line with the common understanding of the notion of tax avoidance, the second was not, recalling the notion of tax fraud[8].

Moreover, the scope of the Article was too narrow. It regarded essentially corporate reorganizations and was applied mainly in the field of income taxes.

In the 80s, new methods of tax avoidance were created by the taxpayers which were not part of the ones defined by the newly introduced legislative provision[9].

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[5] Law no. 408 of 29 December 1990.

[6] G. Melis, *Abuso del diritto (rectius, elusione) ed interpretazione del diritto tributario.*

[7] On tax avoidance and abuse of law, in general: P. Tabellini, *L'elusione fiscale*, Giuffrè, 1988; S. Cipollina, *La legge civile e la legge fiscale*, CEDAM, 1992; S. Fiorentino, *L'elusione tributaria. Scelte di metodo e questioni terminologiche*, ESI, 1996; A. Contrino, *Elusione fiscale, evasione e strumenti di contrasto*, Cisalpino, 1996; A. Garcea, *Il legittimo risparmio d'imposta*, Cedam, 2000; S. Cipollina, *Elusione fiscale*, UTET, 2007; G. Zizzo, *Elusione ed evasione tributaria*, in Dizionario di diritto pubblico p. 2173, S. Cassese, Giuffrè 2006; G. Zizzo, *Abuso del diritto, scopi di risparmio d'imposta e collegamento negoziale,* Rass. Trib., p. 869 (2008); G. Zizzo, *L'elusione tra ordinamento nazionale ed ordinamento comunitario: definizioni a confronto e prospettive di coordinamento, in Elusione ed abuso del diritto tributario*, G. Maisto ed., Giuffré 2009.

[8] R. Lupi, *Prime ipotesi in tema di norma anti elusione sulle operazioni societarie*, II Riv. dir. trib., p. 439 (1992).

[9] *dividend washing and dividend stripping,* MELIS G., *Lezioni di diritto tributario*, op. cit., p. 107.

1.1.2 A first attempt of GAAR

In order to contrast the new abusive techniques and to avoid the doubts that the aforementioned Article 10.1 raised, in 1997 the latter was replaced by a new provision. In fact, a new Legislative Decree was applied by the Italian Legislator in 1997 (D. Lgs. 8th October no. 358 of 1997). Such Decree introduced Article 37-*bis* in the President of the Republic Decree (D.P.R 600/1973) which was entitled "*Anti-Avoidance Provisions*". It empowered the tax administration to disregard the tax advantages deriving from *"acts, facts and transactions, whether or not related, lacking of sound economic reasons, aimed at avoiding obligations or prohibitions foreseen by the tax system, and obtaining tax reductions or refunds otherwise not obtainable"*[10].

By the way it was written, this Article could have been considered as a GAAR but instead it also had a "quasi general"[11] nature because its application was limited only to direct taxation and only to those operations specifically listed in Paragraph 3 of the Article concerned.

According to this provision an operation was in tax avoidance when the circumvention or avoidance of tax obligations or prohibitions, was aimed at obtaining a tax reduction or refund which would not otherwise be obtained and could not be justified by showing the existence of sound economic reasons[12].

An advantage was undue whenever the operation resulted *"directed to circumvent obligations and prohibitions provided by the tax order[13]"*. In order to ascertain an

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[10] On this provision: P. Piccone Ferrarotti, *Riflessioni sulla norma antielusiva introdotta dall'art. 7 del D.Lgs. n. 358/1997 (art. 37-bis del D.P.R. n. 600/1973),* Rass. Trib., p. 1147, 1997; M. Nussi, *Elusione tributaria ed equiparazioni al presupposto nelle imposte sui redditi*, I Riv. dir. trib., p. 503, 1998; G. Zizzo, *Prime considerazioni sulla nuova disciplina antielusione*, in Commento agli interventi di riforma tributaria p. 435, M. Miccinesi ed., Cedam, 1999; G. Vanz, *L'elusione fiscale tra forma giuridica e sostanza economica*, Rass. Trib., p. 1606, 2002; R. Lupi, *Le operazioni societarie tra lecita pianificazione fiscale ed elusione: concetti generali e casi applicativi*, in La fiscalità delle operazioni straordinarie d'impresa, R. Lupi - D. Stevanato, Il Sole 24 Ore 2002); D. Stevanato, *La norma antielusiva nei pareri del Comitato per l'interpello*, I Dir. Prat. Trib., p. 219

[11] MELIS G., op. ult. cit., p. 104.

[12] This requirement recalls the USA jurisprudence according to which, *"every operation has to have an economic substance and a business purpose different form the tax saving*" Gregory v. Helvering, 293, U.S. 465 (1935).

[13] Introducing Relation of the Legislative Decree which introduced Article 37-*bis* DPR 600/1973 "*The essential nucleus of the tax avoiding behaviors is given by the use of circumventions formally legitimated aiming to circumvent typical fiscal regimes, obtaining advantages which ordinarily the legal system does not allow and indirectly does not approve"*.

undue fiscal advantage the tax authority needed to compare between two behaviors: the less onerous which has been practiced and the more taxable path which had been avoided[14]. If the two alternatives of the taxpayer were fiscally equivalent there was no tax avoidance.

The effect of the application of this anti abuse law was only to make unenforceable to the economic operations to tax authorities[15]. In this way, tax authorities were legitimated to not recognize the fiscal advantages of illicit operations, applying the taxes determined based on the eluded dispositions. Tax avoidance was not financially sanctioned by the tax law[16]; this lack of the sanction derived from European law.

The tax authority's anti avoidance assessment, was issued after an obligatory previous confrontation with the taxpayer. The tax authority was obliged to ask the taxpayer for clarifications before the assessment's notification. The request needed to have as object, the existence of the valid economic reasons which gave rise to the operation.

The act needed to be motivated also taking into account the motivations previously given by the tax payer.

Although, this law was not strong enough to contrast abuse. Firstly, because it was applied only to <u>specific circumstances</u>[17] but especially because it was <u>not retroactive</u>[18].

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[14] Cass., 21st January 2009 n. 1465.

[15] A. Cisello, G. Odetto, G. Valente "Guide e soluzioni accertamento", Eutekne 2010 p.1330.

[16] ECJ, 21st February 2006, C-255/02 *Halifax*, p.93 and Cass. 25th May 2009 n. 12042, Corr. trib., 2009,1992 the question for the misapplication of sanctions in case of tax avoidance is to be considered valid *"in the presence of valid conditions of uncertainty on the extension of the sanctions of the law where it could be applied to violations of general principles of the law like the abuse of law"*.

[17] Par.3 Article 37-*bis* DPR 600/1973 *"The Article in applied whenever one of the operations expressively indicated by par.3 is fulfilled :*

- *Mergers, transformations, divisions, voluntary liquidations and distributions to shareholders of sums withdrawn from the net asset different form the ones created by profits.*
- *Conferrals to the company and legal transactions having as an object the transfer or the enjoyment of companies;*
- *Loan transfers;*
- *Transfers of exceeding taxes;*
- *Operations of the Legislative Decree 30th December 1992 n. 544 for the implementation of EU Directives regarding the tax regime for mergers, divisions and transfers;*

Although its list (enlarged from time to time) encompassed indeed a significantly higher number of transactions than the one included in the previous Article 10.1, it still left many areas outside its protection.
Regarding the fact that it was not retroactive, this lead to a problem in identifying a solution to the tax avoidance actions concluded before the entry into force of the new Article.

1.1.3 The concept of abuse of law

The matter changed between 2005 and 2008 with the introduction of the principle of abuse of law deriving also from the ECJ jurisprudence.
The jurisprudence considered existing in the national legal system a “non written” GAAR[19]. This orientation partially derived from the European jurisprudence which (and not only in the tax field) had declared the prohibition of abuse of law[20].

- *Operations, form whoever exercised, included the evaluation and the classifications of the fiscal balance, having as an object goods and relations of Article 81 par.1 lett. c) to quinques of the TUIR approved with the DPR 22nd December 1986 n.917*
- *Supply of goods and provision of services effected by subjects admitted to the group taxation of Article 117 TUIR;*
- *Payment of interests of Article 26-quater, when those payments are effected by subjects controlled directly or indirectly of one or more subjects non resident in a State of the EU:*
- *Pacts between controlled or connected companies according to Article 2359 cc.”.*

[18] For further analyses see F. Gallo, *Rilevanza penale dell'elusione fiscale,* in Rass. trib., 2001, pag. 321; P. Corso, *Secondo la Corte di cassazione l'elusione non integra un'evasione penalmente rilevante*, in Corr. Trib. n. 38/2006, p. 3047; A. Spoto, *Revisione della clausola antielusione (art. 10 della legge n. 408/1990). Si devono applicare le sanzioni?,* in il fisco, 1997, p. 1965; G. Porcaro, *Il rapporto tra elusione e sanzioni amministrative*, in Corr. Trib. n. 35/1997, p. 3553; D. Stevanato, *Elusione e sanzioni amministrative: spunti per una discussione*, n. 27/1997, p. 1963.

[19] In different rulings regarding *dividend stripping or dividend washing*, in 2005 the SC jurisprudence considered as void under civil law, a legal act which is avoiding tax laws. Case. 14 November 2005 n.22932, *Giur. it*. 2006, 1077.

[20] C-125/76 11th October 1977 Cremer; 2nd May 1996 C-206/94, Pailetta; 3rd March 1993, C-8/92, General Milk Products; 12th May 1998, C-367/96, Kefalas; 30th September 2003, C-167/01, Diamantis.
Doctrine: M. Gestri, *Abuso del diritto e frode alla legge nell’ordinamento comunitario*, Milano 2003.

A clear progress was reached with the decision Halifax[21] of the European Court of Justice in which the Court neglected the deducibility of VAT in case of abuse of law[22].

This principle aimed at fighting an undeserved fiscal advantage obtained by a taxpayer with an abusive use of the law.

Prohibition of law abuse is a limit to the exercise of an individual right "*facultas agendi"* whenever the use of that right could contrast the social-ethical goals of the legal system.

According to the ECJ, the abusive conduct was integrated with two fundamental characters: one objective and one subjective. The subjective character was the willingness of the taxpayer of obtaining an undue fiscal advantage from the European fundamental freedoms. On the other hand, the objective character was that even if the conditions requested by European law were fulfilled, the scope those rules aimed at, was not reached. In the ruling, the ECJ stated that the taxpayer, who is subject to VAT, has no right to deduct it when the operations are integrating the conduct of law abuse.

The principle of abuse of law was recognized also at the national level. In fact, the Ministerial Circular no. 320/E of 19th December 1997, defined that a certain transaction might be considered as an abuse of law when the taxpayer used *"manipulations, loopholes and stratagems that, even if formally lawful, distort the general principles underlying the tax system"*.

Since Member States are required to respect the principles of the European Union law, being the prohibition of abuse of law one of them, national tax authorities are allowed to enforce it even though no specific national provision exists.

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[21] ECJ, 21st February 2006, C-255/02.

[22] Highlights of the ruling: par.69 "*The application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law* (see, to that effect, Case 125/76 Cremer [1977] ECR 1593, paragraph 21; Case C-8/92 General Milk Products [1993] ECR I-779, paragraph 21; and Emsland-Stärke, paragraph 5"; par.81 "*As regards the second element, whereby the transactions concerned must essentially seek to obtain a tax advantage, it must be borne in mind that it is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden* (see, to that effect, Emsland Stärke, paragraph 58)".

The Supreme Court in most decisions focused mainly on the purpose to obtain a tax saving, setting apart the other element that characterized the ECJ's definition, i.e. the contrast between the accrual of the saving and the purpose of the relevant provisions. Indeed, in these decision the Supreme Court held that transactions were to be deemed abusive when, *"even if actually desired and not subject to invalidity, they are carried out, based on a group of objective elements, essentially for the purpose of obtaining a tax benefit"*[23].

Since reliance on ECJ's case law was clearly weak outside the field of harmonized taxes, as in the case of income taxes, at the the end of 2008 the Supreme Court stated that the national jurisprudence was also grounded on the "ability to pay" Constitutional principle found in Article 53 (par.1).

Thus, the Italian Supreme Court extended the European principle of prohibition of law abuse in the VAT field to the one of direct taxation[24]. This extension was criticized because the European jurisprudence did not regard the non harmonized fiscal sectors[25].

This important breakthrough, which brought to the first internal recognition of the principle in question, was reached with the so called "twins decisions" of the Italian Supreme Court (from now on SC) no. 30055, 30056 and 30057 of 23rd December 2008[26].

In these decisions, the SC provided also a new definition of abuse of law according to which it is defined as *"a distorted use of legal instruments capable of producing tax savings which, without violating specific provisions, lack of sound economic reasons other than the mere expectation of the tax saving"*[27].

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[23] Sup. Ct., sec. V, 9 Mar. 2011, 5583; Sup. Ct., sec. V, 22 Sept. 2010, 20030; Sup. Ct., sec. V, 9 Dec. 2009, 25710.

[24] Cass. 29th September 2006, n.21221, giur.it, 2008,5,1297 ss. in which it considered as non deducible from the income of a company the unrealized losses deriving from operations concluded only to obtain a fiscal advantage.

[25] Tesauro, "Divieto comunitario di abuso del diritto (fiscale) e vincolo da giudicato esterno incompatibile con il diritto comunitario", Giur. it., 2008,4,103.

[26] Sup. Ct., 23rd December 2008, n.30055, Rass.Trib., 2009, 476 *"It could not be considered as part of the legal system, directly deriving from Constitutional laws, the principle according to which the taxpayer could not obtain undue fiscal advantages from the distorted use of tax laws even though not directly contrasting with a specific tax law, not existing valid economic reasons which justify the operation, different from the mere tax savings".*

[27] Sup. Ct., sec. V, 23rd Dec. 2008, 30055, 30056 and 30057 commented by G. Zizzo, *Clausola antielusione e capacità contributiva,* Rass. Trib., p. 486 (2009), and by M. Cantillo, *Profili*

Afterwards this definition was always applied by the Supreme Court which later on stated that the use of legal instruments is distorted when it is misused or used inappropriately, in a way which is contrary to the ordinary market practices.

The Supreme Court stated that EU Laws may be considered as a basis to catch abusive behaviours only to the extent they are related to harmonized taxes (e.g. VAT).

Instead, for what concerns non harmonized tax sectors, the prohibition of law abuse used to be grounded in the internal Constitutional law, more precisely as written above in Article 53 (ability to pay principle).

According to the Supreme Court, the ability to pay principle, excluded the chance for a taxpayer to benefit from a tax advantage deriving from the misuse of legal instruments. On the ground of Article 53, all tax abuses may be challenged even when they felt outside the scope of application of Article 37-*bis*.

This long path created the basis for a national General anti avoidance rule.

In order to reconcile the definition of tax avoidance provided by Art. 37-bis of the Decree no. 600 of 29 September 1973 with the one of abuse of law developed by the SC, Article 1 of the Legislative Decree no. 128 of 5 August 2015 inserted into Law no. 212 of 27 July 2000 (Charter of Taxpayer's Rights) a new Article 10-*bis*, entitled "*Abuse of Law or Tax Avoidance*" (new Italian GAAR), as will be broadly explained above.

1.1.4 The relationship between civil law and tax law

Because of the absence of a General anti avoidance clause in our tax system, starting from the 70s part of the doctrine[28] was considering the possibility of

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processuali del divieto di abuso del diritto: brevi note sulla rilevabilità d'ufficio, Rass. Trib., p. 476 (2009). Similarly, Sup. Ct., sec. V, 21 Jan. 2009, 1465; Sup. Ct., sec. V, 20 Mar. 2009, 6800; Sup. Ct., sec. V, 21 Apr. 2010, 9476; Sup. Ct., sec. V, 12 Nov. 2010, 22994; Sup. Ct., sec. V, 31th March. 2011, 7343; Sup. Ct., sec. V, 12 May 2011, 10383; Sup. Ct., sec. V, 13 May 2011, 10549; IT: Sup. Ct., sec. V, 20 May 2011, 11236; Sup. Ct., sec. V, 16 Feb. 2012, 2193.

[28] GALLO F., op. cit., p. 11; favourable to the applicability of Art. 1344 c.c. in the tax field are also SANTONASTASO F., *I negozi in frode alla legge fiscale*, in Dir. prat. trib., 1970, p. 505,; PACITTO P., *Attività negoziale, evasione ed elusione tributaria*, in riv. dir. fin. sc. fin., 1987, p. 729; TABELLINI M.P., *L'elusione fiscale*, Milano, 1988, p.72; ANDRIOLA M., *Ipotesi applicative di norme anti elusive*, in Rass. Trib, 2006, p. 1900.

extending civil law principles to tax law. The concept of abuse was difficult to identify and sometimes was attributed to the legal institute of circumvention, some others to a behaviour contra *bonos mores*, to simulation, to purely artificial constructions; sometimes to the *substance over form* theory, some others to the *regulatory arbitrage*[29].

The most important comparisons made by the doctrine are deeply explained hereafter.

1.1.4.1 Invalidity of the contract lacking the scope

The attempt of an influential doctrine[30] was to extend the field application of article 1344 of the national Civil Code (c.c.) in order to apply the general principle of "invalidity of the contract lacking the scope" to the tax system. According to this provision, a contract was void (in *fraus legis*) when it is used as a vehicle to avoid the application of an imperative law. Imperative, are those rules that prohibit certain acts or guarantee a specific right. It is used to limit the private autonomy. The doctrine chose this Article to underline that a contract is void whenever it was used to avoid the payment of taxes.

Essentially, article 1344 cc. was read as a general clause against tax fraud to prevent tax avoidance.

The recall to the "contract invalidity" for lack of scope was also used by the jurisprudence of the Italian Supreme Court in 2005 [31] to contrast dividend stripping and dividend washing.

In fact, the Court affirmed that when one or more judicial acts connected are done in absence of valid economic motivations only to obtain an illicit fiscal advantage, are considered as without legal scope; as a consequence Article 1344 c.c. can be applied.

This tendency to adapt the civil instrument of *fraus leg*is to tax law, was strongly criticized by another part of the doctrine[32]. The critic was that tax laws are not

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[29] *"Relazione illustrativa"*, introduction Article 10-*bis.*

[30] GALLO F, *Brevi spunti in tema di elusione e frode alla legge (nel reddito di impresa)*, Rass.Trib,1989 p.11.

[31] Sup. Court, 21.10.2005 n. 20398; 26.10.2005 n. 20816 and 14.11.2005 n. 22932

imperative. They do not impose any obligation or right, they only assume a specific fact which is the “ability to pay” mentioned in article 53 of the Constitution.

The doctrine recalled the two precedent rulings of the Italian Supreme Court (7th March 2002 no.3345 and 3rd April 2000 no. 3979) in which it was said that civil law could have not been used to contrast dividend washing.

According to the SC, also article 53 of the Italian Constitution was an imperative norm. This article was considered to be a restriction to the exercise of free private autonomy so automatically by its avoidance, article 1344 c.c. would have been applied.

On the other side, another part of the doctrine was deeming the invalidity of the wider application of article 1344 c.c. as a too strict consequence. In fact, with its extension to tax law, the Financial Administration would have had too much discretionary power and this could have been a negative consequence for the judges but also for the taxpayer.

Not existing a general anti abuse taxation law yet, it was considered not necessary to take it from other branches of law.

Now that a GAAR has been inserted in our national taxation system, there is no more general opinion of the doctrine that recalls to the applicability of the civil law principles.

By not extending the civil principle of *fraus legis* now formally there is no need of a fraudulent intent of the taxpayer when he avoids the payment of taxes. Although in practice, the jurisprudence has claimed the necessity of it in the infringement of tax laws.

1.1.4.2 Simulation

[32] CIPOLLINA S, *La legge civile e la legge fiscale. Il problema dell'elusione fiscale,* Padova 1992, p. 149; DOLFIN N., *Negozio indiretto e imposta di registro,* Giur.it., 1978, p. 108; GALEOTTI FLORI M.A., *L'elusione tributaria,* in Il Fisco, 1985.

Another part of the doctrine[33] and jurisprudence[34] was trying to contrast the tax avoidance phenomenon by extending the legal institute of simulation.

In simulation there is a difference between what a person declares to will and what he really wants either because the appearance will is totally inexistent (complete simulation) or because the declared interests are not the actual ones (partial simulation)[35]. This doctrine was not followed simply because in tax avoidance there is instead a coincidence between what the parties want and what they are effectively looking for. It is exactly what they are really looking for (an undue fiscal advantage) which is leading to the avoidance of law.

1.1.4.3 Re-qualification of the contractual relationship

Another civil method used by doctrine[36] and jurisprudence of the Supreme Court is the "re-qualification of the contractual relationship". In order to do so, the judges took into consideration the act done by the parties to see if it was possible to re-qualify it[37] ("substance over form").

Re-qualification means to consider the situation as one of the contractual relationships specifically considered by the rule which has been avoided.

The doctrine[38] says that tax authorities in re-qualifying an act, should never forget about the juridical nature of the act in favor of the economic situation. The only exception is if there is a specific law which allows it.

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[33] G. Falsitta, *Spunti critici e ricostruttivi sull'errata commistione di simulazione ed elusione nell'onnivoro contenitore detto "abuso del diritto"*, in Riv. dir. trib., 2010, 350; G. Falsitta, *Il principio della capacità contributiva nel suo svolgimento storico prima e dopo la costituzione repubblicana*, Milano, Giuffrè, 2014, 261. Also A. Gentili, *Abuso del diritto*, cit., 18 and U. Morello, *Frode alla legge,* Milano, Giuffrè, 1969, 218; G. Fransoni, *Abuso di diritto, elusione e simulazione: rapporti e distinzioni*, in Corr. trib., 2011, 13 ss. On the distinction between abuse and simulation, also I. Vacca, *L'abuso e la certezza del diritto,* cit., 1128, and F. Paparella, *Possesso di redditi ed interposizione di persona,* Milano, 2000, 297.

[34] Cass., 12 novembre 2010, 22994, examined by G. Fransoni, *Abuso di diritto, elusione e simulazione*, *cit.*, Cass, 26th February 2010, n. 4737.

[35] Ex multis, referred to the shadows of the different civil law applications, F. Gazzoni*, Manuale di diritto Privato*, XVI, Napoli, 2013, p.978 following.

[36] D. Stevanato, *Cessione frazionata dell'azienda e imposta di registro: simulazione o riqualificazionedel contratto?,* in GT - Riv. giur. trib.,1999, 758.

[37] MELIS. G. *L'interpretazione nel diritto tributario*, Cedam 2003. P. 263.

[38] MELIS. G, *L'interpretazione nel diritto tributario,* Cedam 2003. P. 266.

To justify the activity of re-qualification of the act, many times the doctrine invoked the principle defined in Article 53 of the Constitution. The interpreter facing a different contractual relationship not specifically defined by the law but which represents the same ability to pay could proceed to the re-qualification of the relationship concerned.
Although the re-qualification method is opposed by the application of Article 23 of the Constitution which indicates the statutory reservation on tax matters.
With the re-qualification there would be the imposition of a tax in a matter which is not expressively specified by the law. This can be done only by the legislator and not by an interpreter.

1.2 The new Article 10-bis (GAAR)

With the Law 11th March 2014 no. 23, the national Government was delegated to introduce a GAAR in order to reach a better level of transparency and stability in the national taxation system. As reported in the Illustrative Relation introducing the Article 10-*bis*, the problem with the precedent anti abuse laws (the before mentioned Article 10 and after Article 37-*bis*), was that they were regarding only specific situations considered as more dangerous abusive practices, following the wording of Article 23 of the Constitution[39].
The Supreme Court had developed a general anti abuse jurisprudence, applicable to the entire tax system, although in some recent rulings, assuming a substantial identity between the statutory notion of tax avoidance provided by Art. 37-*bis* and the judicial one of abuse of law, it clarified that in the field of income taxes abusive practices could be disregarded only if the conditions set forth in Art. 37-*bis* were fulfilled[40]. The Supreme Court therefore recognized that Article 37-*bis*, while providing a tool to fight abusive practices, had also the purpose to draw a

[39] Article 23 Constitution, *"No tax imposition could be requested if not specifically stated by the Law"*.
[40] Sup. Ct., sec. V, 14 Jan. 2015, 405 commented by G. Zoppini, *Nuove prospettive giurisprudenziali in tema di abuso*, Rass. Trib., p. 1276, 2015; Sup. Ct., sec. V, 27 Mar. 2015, 6226.

line between more dangerous abusive practices and less dangerous ones in order to foster certainty in this specific area of tax law.

This judicial doctrine has been applied very successfully by the tax authority. The uncertainty of its boundaries has led the Court to apply it even in cases clearly outside its scope, where the tax authority had no need to resort to it in order to justify the assessment, as in cases dealing with sham transactions or in cases merely rising statutory construction issues[41]. This created problems of insufficient certainty regarding the constitutive elements of abuse and regarding the identification of abusive substance also in circumstances which needed to be identified as civil law prohibitions such as simulation, *fraus legis*, or circumvention.

To finally solve all this uncertainties, with the Legislative Decree 128/2015 Article 1 paragraph 5, was introduced Article 10-*bis* in the Italian taxation system. The provision integrated the Law n. 212/2000 with this new Article. That brought to the abrogation of the previous Article 37-bis of the DPR 600/1973.

It was inserted in the Charter of taxpayer's rights to strengthen the central role of the abuse practice and to underline the procedural and substantial guarantee for the taxpayer being also such and not only an obligation[42]. It is inserted between Article 10 which talks about the reliability of the taxpayer and Article 11 which instead deals with the general institute of consultation.

It provides a real statutory GAAR[43], since it applies to all abusive practices[44], regardless the area of tax law and the transactions involved. The legislative intent was clearly to bring under the same regime all cases of abuse of law and to put an end to the excesses brought about by the judicial doctrine. In fact, the GAAR is applicable to all sectors of tax law weather harmonized or not with the exemption only of custom law that is currently regulated by the internal Legislative Decree n. 374/1990 and by European Law.

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[41] G. Falsitta, *Spunti critici e ricostruttivi sull'errata commistione di simulazione ed elusione nell'onnivoro contenitore detto "abuso del diritto",* II Riv. dir. trib., p. 349 (2010); G. Zizzo, *La giurisprudenza in materia di abuso ed elusione nelle imposte sul reddito*, Corr. trib., p. 1019 (2012).

[42] Gallo, *La nuova frontiera dell'abuso*, cit. 1317.

[43] When too General its applicability should be reduced according to par. 12

[44] Part of the doctrine believes these abusive practices are limited only to all abusive operations of company law, CONSOLI, *Approfondimento al d.lgs. n. 128/2015,* in forum notartel.

Article 10-*bis* is entitled *"Discipline on the abuse of law or tax avoidance"*. According to par. 1, *"One or more transactions are deemed to be abusive when they do not have economic substance and, while formally consistent with tax law, achieve essentially undue tax advantages"*. Thus, in the Italian taxation system are considered as abuse of law all those operations when:

1) there is no economic substance[45];
2) an undue fiscal advantage is reached;
3) the undue advantage is the essential aim of the operation.

These operations could not be opposed in front of the tax authority which is in charge to ignore the advantages obtained on the basis of the abused tax law.
According to paragraph 2 of Article 10-*bis* are lacking of economic substance[46] those facts, acts and contracts, also in connection with each other, which aim at producing significant effects different from tax advantages, i.e. the lack of coherence in the qualification of the operations with their juridical grounds. Moreover, are considered as undue those fiscal advantages which, even though not immediate, are realized with the scope of contrasting tax laws or the juridical grounds of the taxation system. As underlined in the Illustrative Relation, these undue fiscal advantages need to be fundamental in comparison with all the other aims reached by the taxpayer.
Par.3 of the same Article instead, is establishing that are not abusive the operations which are justified by valid extra-fiscal reasons, not marginal, also of an organizational or managerial nature, which aim at a structural or functional improvement of the Company or the professional activity of the taxpayer.
This paragraph provides that the extra-fiscal reasons are a guarantee of non exclusivity of the operation's abuse and preclude the configuration of an abusive conduct as it is defined in Article 10-*bis*.

[45] This introduction reflects the Recommendation n. 2012/772/EU of the European Commission, 6th December 2012 *"avoidance of purely artificial constructions"*.
[46] VACCA, *L'abuso,* cit., 1138 critics the centralilty of the valid economic reasons in evaluating a conduct as abusive because this leads to an economic criteria of interpretation different from the literal meaning of the pre-laws. Also FRANSONI, *Spunti in tema di abuso del diritto e intenzionalità dell'azione,* in Rass. Trib., 2014, 403 interprets abuse with objective criteria.

The main aim of the Legislator in the introduction of this Article according to part of the doctrine[47], was to consider tax avoidance as "fraud to the tax law"[48]. Par. 2 lett. b) of the Article 10-*bis* instead, concerns the undue fiscal advantages as benefits that even if not immediately realized, are contrasting with the aims of tax laws. This is a way to indirectly give relevance to the concept of "circumvention"[49] which was present in the old Article 37-bis but which does not well coordinate with the rules on tax avoidance.

1.2.1 Retroactivity of Article 10-bis

Differently from Article 37-*bis* and the previous Article 10.1, the new provision applies retroactively. In fact, Article 10-*bis* of the Law 27th July 2000 n. 212 provides that it will be effective from the first day of the month after the date of entry into force of the Legislative Decree 5th August 2015 n.128 (1st October). Furthermore, it will be applied also to those activities carried on before the date of validity of Article 10-*bis* to which have not been assessed yet[50].

1.2.2 Free choice between different tax regimes

Regarding the mutual relationship between the GAAR and the freedom of choice between different optional tax regimes for the taxpayer, it is important to analyse paragraph 4 of Article 10-*bis*.

The law says that it is possible for the taxpayer to choose between different optional tax regimes offered by the law and operations leading to a different tax imposition but this should not bring to an abuse of law. The possibility was already introduced also by the Illustrative Relation D. Lgs. 358/1997[51]: *"The legitimate tax saving is realized when between two options provided by the law, the tax payer chooses the less onerous one".*

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[47] D. Stevanato, *Elusione fiscale e abuso delle forme giuridiche, anatomia di un equivoco,* in Diritto e pratica tributaria, n. 5/2015, p. 10695.

[48] As provided by the Illustrative Relation introducing Article 10-*bis*.

[49] D. Stevanato, *Elusione fiscale e abuso delle forme giuridiche, anatomia di un equivoco,* in Diritto e Pratica Tributaria, n. 5/2015, p. 10695.

[50] For further information on retroactivity consult par. 1.2.6.1.

[51] Which introduced art.37-*bis* DPR 600/1973.

This provision states the importance of certainty of law but when the law in a specific case does not provide any specific behaviour to follow, then it is legitimate from the taxpayer to choose the most convenient tax road.

It is important to mention that this provision is an innovation in the Italian tax system because it is the first time that this principle is specifically written in an Article (before it was illustrated only in the Relation following the Article's introduction).

It was introduced thanks to the wide jurisprudence of the European Court of Justice[52].

This principle should have already been applied through the extension of Article 41 of the Italian Constitution regarding the freedom of economic initiative. Although, being very clear in the Illustrative Relation introducing the D. Lgs. n. 358/1997[53], according to the critic[54], this principle has been many times forgotten in the past. Thus, it was necessary a specified introduction of it by the Italian Legislator.

1.2.3 Applicability of the GAAR

The difference between Article 10-*bis* and the old Article 37-*bis* of DPR 600/1973 is that the latter was applicable only in:

- the absence of valid economic reasons;
- cases of avoidance of prohibitions or obligations imposed by tax law;
- obtainment of an undue fiscal advantage.

Furthermore, it was applied only in certain circumstances and there was a special procedure to follow; the precautionary consultation was necessary.

With the new Article 10-*bis*, the law is applicable to everybody and to all kind of operations.

[52] 12/09/2006 C-196/04, *Cadbury Schweppes plc,* 21/02/2006 C-255/02, *Halifax*, 21/02/2008 C-425/05, *Part Service.*

[53] Which introduced the previous Article 37-bis of the DPR 600/1973.

[54] L. Miele, *Abuso del diritto distinto dalle fattispecie di evasione*, in Corr. Trib., n. 4/2015, p. 243.

Three are the main requirements necessary to identify the abuse of law under Article 10-*bis*:

- lack of economic substance of the operation;
- obtainment of an undue fiscal advantage[55];
- the undue advantage has to be the essential effect of the operation.

In the initial project, it was present also the sentence *"no matter the intentions of the taxpayer"*, with which the Legislator wanted to underline the difference between the demonstration of the economic substance of the operations and the reasons of the taxpayer's behaviour. The elimination of this clause does not mean the tax authorities need to demonstrate the psychological behaviour of the taxpayer (fraud, negligence ...). It is the elimination of the subjective element which now distinguishes the abuse of law from tax evasion and simulation.

As already written above, the absence of economic substance recurs when *"facts, acts, contracts, also connected with each other do produce significative effects different from fiscal advantages (for example the lack of conformity of the juridical instruments used by the taxpayer compared to the usual market standards)"*.

The second requirement is the obtainment of an undue fiscal advantage which occurs when benefits obtained are realized in contrast with the scope of tax laws or with the fundamental principles of the juridical order; those advantages are in contrast with the tax system[56].

Par. 12 specifies that the conduct does not have to be prohibited by specific anti abuse rules. In fact, these undue fiscal advantages shall not be contrasted by specific laws otherwise the latter would be applied. This requirement was present also in Article 37-*bis* of the DPR 600/1973 but there the tax advantage was considered undue only when compared with the heavier tax road the taxpayer

[55] S.C., 30th November 2012, n. 21390; S.C,14th January 2015, n. 438., G. Fransoni, *Spunti in tema di abuso del diritto e «intenzionalità» dell'azione*, cit., 414.

[56] Illustrative Relation to the introduction of Art.10-*bis.*

could have taken. It was not a comparison with the *ratio* of the laws which were contrasted.

The third element is that the undue fiscal advantage which has to be the essential effect of the operation. It has to prevail as the main scope of the operation. Part of the doctrine observed a different treatment of tax advantages[57] between tax advantages contestable by the tax authority and those undue advantages not contestable because attributable to licit tax savings.

To be essentially undue the tax advantages shall be deprived of an economic substance essential and not marginal. Moreover, there has to be no valid extra-fiscal reason.

This requirement is introduced by the implementation of the EU Commission's Recommendation of 6.12.2012 par. 4.6 *"a given purpose is to be considered essential where any other purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case".*

The anti abuse clause is residual as stated by par. 12 of the Article 10-*bis*[58]. It is applied in the lacks of the taxation system[59].

1.2.4 Procedural aspects of the application of Article 10-bis

The procedural aspects of the application of the GAAR are exhaustively regulated by the national legislation.

The abuse of law protection is characterized by many procedural guarantees both in the precautionary phase (request of clarifications otherwise the act is void) and in the subsequent phase of the assessment.

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[57] BEGHIN, *La clausola generale antiabuso tra certezza e profili sanzionatori,* in Fisco, 2015, 2207.

[58] *"Are not considered as abuse of law those tax advantages which are punishable under specific anti abuse rules".*

[59] FEDELE, *Il valore di principi nella giurisprudenza tributaria*, in Riv. Dir. Trib., 2013, I, 875; LA ROSA, *L'accertamento tributario antielusivo: profili procedimentali e processuali*, in Riv. Dir. Trib., I, 2014, 499.

1.2.4.1 Precautionary consultation

According to paragraph 5 of the new Article 10-*bis*, the taxpayer has the right to apply for a precautionary consultation [60] "interpello" to the income revenue authority, as stated by Article 11 par.1 of the Law no. 212/200 in order to know if the acts he intends to comply or he has done already, constitute abuse of law.

With the D. Lgs. n. 156 of 24th September 2015 was introduced a simplification and reorganization of the discipline of consultations, especially anti abuse ones newly reformed by the D. Lgs n. 128/2015. The dispositions of this new Decree entered into force from the 1st of January 2016[61].

It was in fact stated by the ECJ[62], that it is a fundamental right to be heard of the taxpayer before the adoption of provisions affecting its tax sphere, to guarantee the rights of taxpayers.

The tax authority in fact, is bound by the answer given to the taxpayer in the precautionary consultation even though only regarding the single specific case. Differently, the answer is not binding on the taxpayer who can still decide not to conform with the interpretation given by the tax administration.

Before the modifications introduced by the new law, the consultation was differentiated into:

- ordinary (Art. 11, Law n. 212/2000)
- anti tax abusive (Art. 21, Law n. 413/1991)
- not applicability of tax avoidance laws (Art. 37-bis, par. 8, DPR n. 600/73).

They were distinguished into: obligatory and optional consultation.

The motion was shown before the expiry of the term for presenting the tax return.

The obligatory consultations were introduced to facilitate the control activity of the tax authority which was pre-emptively monitoring potentially abusive situations. The problem was that they were used as forms of precautionary judicial

[60] In Italy there is no GAAR review Panel.
[61] Art. 12 par.1, D.Lgs 156/2015.
[62] Sopropé - Organizações de Calçado Lda contro Fazenda Pública, ruling C-349/07.

decisions instead of using it as means of privileged dialogue with the tax authority[63].

The Law n. 23/2014 Article 6, stated the criteria to be followed in order to eliminate the obligatory consultation.

With the new Law, are now existing four types of the precautionary consultations:

- ordinary (to ask for clarifications);
- probative (to ask the access to specific tax regimes);
- anti abuse (regarding potentially abusive situations);
- dis-applicable (to ask for the non applicability of specific anti abuse rules), provided by Article 11 par. 2 of the Charter of taxpayer's rights .

The new system is based on the responsibility of the taxpayer, to whom is recognized the possibility to verify autonomously the existence of the conditions requested by the law to access specific tax regimes.

From the 1st of January 2016 the new discipline on consultation is in force and there was recently a Provision of the Director of the income tax authority n. 27 of 4th of January 2016[64], explaining the procedural rules to follow for precautionary consultation until the 31st December 2017.

This document was solving the interpretative doubts regarding the abrogation of Article 37-*bis* starting from the 2nd September 2015 and the entry into force of the new discipline on the 1st October 2015.

Moreover, the D. Lgs 24th September 156/2015 changed the date of the entry into force of the new Article into the 1st of January[65] and reorganized the discipline of consultations, reformulating the anti abuse one[66].

The new D. Lgs. n. 128/2015 abrogated Art. 21 of the Law n. 413/1991.

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[63] R. Fanelli, *Nuovo regime dell'interpello basato sulla responsabilizzazione del contribuente,* in Corriere Tributario n. 37 del 2015, p. 3797.

[64] Point 2.3 of the Provision, in fulfillment of the Art. 8 par.1 of the D.Lgs. 156/2015.

[65] If no assessment was notified by the 30th of September 2015, the possible assessment made later on shall follow the new procedure. Art. 12 par.1, D.Lgs n. 156/2015.

Transitory discipline doctrine: FRANSONI, *La multiforme efficacia nel tempo dell'articolo 10-bis dello Statuto*, in Corr. Trib., 2015, 4362.

[66] G.M. Committeri and G. Scifoni, *Revisione degli interpelli: migliorano dialogo e collaborazione tra Fisco e contribuente?,* in Corr. Trib. N. 42/2015, p. 4193 and *Il nuovo interpello tributario tra tempi di risposta accelerati e tutela giurisprudenziale differita,* in Corr. Trib., n. 43/2015, p. 4270.

With the Resolution n.104/E/2015 the income revenue authority tried to give coherence to the system of anti abuse consultations. In fact, the lack of coincidence between the abrogation of the old Article 37-*bis* (from the 2nd of September 2015), the entry into force of the new anti abuse consultation (1st October 2015) and the actual effectiveness of the modifications (1st January 2016), brought to serious uncertainties in the system. The paradox of different terms for the entry into force of the new regimes, brought to a necessary intervention of the income tax authority regarding 1) the disapplication of instances already presented according to Art. 21 par. 9 pf the Law 413/1991 in the light of the modifications of the D. Lgs 128/2015; 2) the instances of anti abuse consultation presented in the light of the new discipline Article 10-*bis*; 3) the new anti abuse consultations presented after the 1st of January according to Article 11 par.1 lett. c of the Charter of taxpayer's rights.

First of all, the instances proposed during the validity of Article 37-*bis* should be treated according to the income tax authority, following the procedural rules of Article 21 par. 9 of the above mentioned Law n. 413/1991 following the principle of *tempus regit actum*[67]. Differently, for the instances presented between the 2nd and the 30th of September, they lack of whatever kind of legislative parameter. Thus, the income tax authority specified in this case that the taxpayers should present a new request of consultation this time based on Article 10-*bis* although with no need to attach again the requested documents.

At last, for the instances presented between the 1st October and the 31st December 2015, the applicability of the procedural rules of the ordinary consultation, implicitly lead to the abrogation of the anti abuse consultation rules provided by the old Article 21 par. 9 of the Law n. 413/1991. Being not possible to rely on this Article anymore, the income tax authority stated the possibility to apply the procedural rules of Article 11 of the Charter of Taxpayer's rights.

The tax authority has to answer within 90 days for the requests of precautionary consultation regarding the application of tax laws while in the term of 120 days for the consultations having as object the conditions and the applicability of the

[67] G. M. Committeri and G. Scifoni, *Le istanze di interpello antiabuso tra modifiche legislative non coordinate e sforzi interpretativi dell'Agenzia,* Corr. Trib. 8/2016, p. 585.

law on abuse. When the answer is not notified to the taxpayer within the obligatory term, the silence has to be interpreted as consensus of the tax authority of the prospected solution of the taxpayer. The acts of the tax authority different from the ones regarding the answer given to the taxpayer have to be considered as void.

1.2.4.2 Request of clarifications and act's motivation

Very peculiar is the provision provided by par.7 which states that: *" The request of clarifications is notified within the term of decadence provided for the notification of the payment order. Between the date of reception of the clarifications or when the time to answer for the taxpayer has expired already and the date of decadence of the tax authority from the power to notify the payment order, have to pass not less than 60 days. Otherwise the term is automatically postponed".*

The request of clarifications is notified by the tax authority according to Art. 60 D.P.R. 600/1973 and possible further modifications within the term provided by the assessment act. The abuse of law is contested through an assessment which needs to be preceded by a notification to the taxpayer in order not to be declared void.

The doctrine[68] believes that the reasons why the act non in conformity with the consultation is void, should be found in the consultation as a responsibility of both the tax authority and the taxpayer and not an obligation of the first and a right of the latter.

According to Article 60 of the DPR 600/1973 there has to be a request of clarifications by the taxpayer within 60 days and it has to contain all the motivations explaining the abusive conduct, the undue fiscal advantages realized always in order not to be declared void. This is the pre-emptive consultation

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[68] Philip Laroma Jezziin, "*Si fa presto a dire "diritto al contraddittorio"*, Corriere Tributario" n. 36 del 2015, p. 3760.

regarding the notified act which is preserving the right to defence of the taxpayer in the precedent phase.

The specific procedural rules for the "interpello" are found in paragraph 6 and 9 of the same Article and they are aimed at guaranteeing an effective confrontation between the Financial Administration and the taxpayer.

As stated in par. 6, the tax administration with the new reform has to answer to the request of the taxpayer within the term of 60 days from the day it receives the request (before the term was 120 days). The request for consultation can be considered inadmissible for example when the request is done before the terms to present the tax return. In the case of inadmissibility, the obligatory "interpello" will be transformed in discretionary and there will be specific hypothesis in which the taxpayer could ask for a "preliminary consultation".

According to Art.10-*bis* par. 7, the request of clarifications is notified within the expiry date provided for the notification of the assessment. If between the expiry date to answer and the expiry date of the assessment pass less than 60 days, the term to notify the assessment id automatically postponed until the 60th day.

In the year 2011 in the ruling n.1372, the Supreme Court specified that it is on the tax authority the obligation to explain why the juridical form used has an irregular character and it is not uniform with the economic operation done. The taxpayer instead has the duty to proof the existence of an economic reason of the act he has committed which goes beyond the mere tax saving.

Today, the law states that the act has to be specifically motivated according to what was the behaviour which lead to the abuse of law, the undue fiscal advantages realized and the tax and the laws avoided or not respected. This has to be done by the tax administration otherwise the act will be void (par.8 Art.10-*bis*).

1.2.4.3 Burden of proof

According to paragraph 9 of the same Article, the financial administration has the obligation to proof the abusive conduct. In the law is not specified the obligation to proof but to provide the demonstrations and motivations.

The financial administration, has to demonstrate the existence of the abusive conduct that is not possible to detect *ex officio*. The abusive conduct is defined as such in relation to the criteria listed in paragraph 1 and 2. Thus, the tax authority needs to: (i) verify the existence of the three constitutional elements (operation with no economic substance, undue fiscal advantage, essentiality of the undue fiscal advantage); (ii) contest to the taxpayer the existence of those three elements and proving which were the arguments that brought to that solution; (iii) permitting the defence of the taxpayer so to express; (iv) expressively motivate why the defence was not approved. The taxpayer can oppose to the tax authority possible procedural or substantial invalidities.

Whenever in the assessment act the abuse is confirmed, the taxpayer has to contest it. If it is supported by proofs, the taxpayer could consider it as doubtful.

The taxpayer can underline invalidities in the motivations of the tax authority which are not considerable *ex officio*.

The doctrine[69] considered as highly harmful for the guarantees of the taxpayer the lack of a specific maximum term for the exercise of the control by the tax authority.

The sequence of acts to be done to prove the abuse is the same provided by the previous Article 37-*bis*.

A reversal of the burden of proof is possible for the taxpayer who can demonstrate the mere essence of his behaviour had an "extra fiscal" nature (par.8 art.10-bis).

The Italian Supreme Court with the ruling no. 6226 of of 27th March 2015 declared that it is up to the Financial Administration to prove the tax avoidance intent. It is therefore unlawful the assessment in which the tax authority does not indicate a different (correct) behaviour which the taxpayer should have had adopted in the situation concerned.

Taxpayers external to the abusive facts who although have suffered from them, once the conduct is ascertained as abusive, have the right to ask the refund of income taxes payed because of those abusive operations.

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[69] LA ROSA, *L'accertamento tributario antielusivo*, cit. 499.

1.2.5 Penalties resulting from the application of Article 10-bis

In paragraph 13 of Article 10-*bis* the Legislator specified that the abusive operations are not punishable under tax criminal law[70]. The Supreme Court ruling[71] has extended this provision also to conducts concluded before the entry into force of the new Article, included those for which the assessment already has been notified. Moreover, important was the contribution of the EU Court of Human Rights[72] for the extension of this par. 13 to acts already committed before the entry into force of the new provision to apply the more favourable law.
A brief interpretation of Article 1 par. 5 of the D. Lgs 128/2015 could lead to the same conclusion for acts concluded before the entry into force of Article 10-bis only if the assessment has not been ratified yet. Although, this conclusion is inappropriate according to the doctrine[73].
The formulation of the new Article 10-*bis* does not well uniform with the last paragraph of Article 1 of the D. Lgs. n. 128/2015[74]. From this legislative choice derives the fact that the more favourable regime (non sanctions and the criminal irrelevance of the abusive conducts), would be applied only to those conducts – also precedent to the entry into force of the Decree – through which the assessment has not been notified yet. It would exclude all those conducts already object of of an assessment already notified ad potentially still object of a criminal procedure. Such a conclusion seems not acceptable not only according to Article 2 par. 2 of the Criminal Code, but also according to the constitutional principle of equality stated by Article 3 of the Constitution[75]. With reference to the case in fact, it does not seem possible to apply derogations to Article 2 par. 2 of the criminal Code, because they are admitted only if the aim is to preserve particular

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[70] This was said by the Supreme Court also before the entry into force of Article 10-*bis* see Cass. 9th September 2013, n. 36894
[71] Supreme Court, ruling n. 40272/2015.
[72] 17th September 2009, *Scoppola vs Italy*.
[73] F. Donelli, *Irrilevanza penale dell'abuso del diritto tributario: entrata in vigore l'Art. 10-bis dello Statuto del Contribuente*, in Rivista di diritto penale contemporaneo, 1st October 2015 and F. Mucciarelli, *Abuso del diritto e dei reati tributari: la Corte di Cassazione fissa limiti e ambiti applicativi*, in Rivista di diritto penale contemporaneo, 9th October 2015.
[74] The dispositions of the Article dows apply also to operations done before the date of entry into force for which, t the same date, it has not been notified the concerned assessment act.
[75] G. Consolo, *I profili sanzionatori amministrativi e penali del nuovo abuso del diritto, in "Corriere Tributario,* n. 39 del 2015, p. 3966.

interests of constitutional relevance, according to the principle of good sense[76]. The presence of the *favour rei* principle[77] permits to interpret the law in conformity with the Constitution and so excluding the applicability of Art. 1, last paragraph, of the D. Lgs. n. 128/2015 regarding the criminal irrelevance of the abuse. Although, in order to avoid uncertainties regarding the relationship between tax authority and taxpayers, it would be better to have a Legislator's intervention to clarify the criminal irrelevance of the abuse, excluded from the partial regime of non retroactivity of Article 10-*bis*.

The ratio of the provision could derive from the fact that criminal sanctions have a typical conduct which is punished. In fact, Article 25 of the Italian Constitution states: *"No one shall be subject to safety measures if not in the cases specified by the law"*.

The abuse of law has an atypical nature and this contrasts with the corollaries of the criminal punishment. In fact, as recalled above, the criminal punishment can be applied only when the conduct is specifically defined as criminally punishable by the law. Also the ECJ underlined in the afore mentioned ruling *Halifax* that an abusive conduct could not lead to a sanction which needs to be based on univocal and clear grounds; it should simply bring to a duty of refund.

The criminal conduct to be punished has to be precisely described by the law. The abuse of law is a principle that can be used to see the compatibility of the norms with the legal system. They could not constitute a criminal case. The conduct punished in the case of abuse of law is not typical and entirely defined by the law. Excluded the applicability of criminal sanctions, the legislator does not preclude the use of administrative penalties whenever the necessary requirements are present[78].

[76] C. Pecorella, *"Art. 2"*, in E. Dolcini, G. Marinucci (a cura di), *Codice penale commentato* I, Milano, 2011, p. 68-69.

[77] ECJ, 3rd May 2005, C-387/02, C-391/02, C-403/02, Berlusconi and others, par. 68-69, in Cass. pen., 2005, p. 2764.

[78] Before the entry into force of Article 10-bis there was a relationship of *species – genus* between the specific abusive situations outlined in Article 37-*bis* and the genereal anti abuse principle defined by the national and European jurisprudence. With the ruling no. 405/2015, the Supreme Court instead stated that in the matter of indirect taxation the sole hypothesis of abuse of law were the ones specifically defined by the previous Article 37-bis.

Although, according to part of the doctrine, the old uncertainties regarding the sanctions regime seem not to be entirely eliminated[79] . Regarding the administrative penalties, the sanction regime delineated by the DD. Lgss. no. 471 e 472 of 1997 does not seem to guarantee the necessity to differentiate punishable conducts between abuse and tax avoidance. On the criminal side, instead, there is a critical issue regarding the possible contrast of the new law and the fundamental principle of "*favor rei*" wherever the D. Lgs. n. 128/2015 states the partial non retroactivity of all the provisions of the new Article 10-bis.

The new system of administrative sanctions leads to a "criminalization" of the discipline[80]; an evident intersection with the criminal law comes into force with the Art. 3 of the D. Lgs n. 472/1997, which is requiring the respect of the principle of legality in applying the administrative sanctions. The terms used by the national Legislator are very vague and generic. This leads to a problem of compatibility with criminal law and the prohibition of analogy and the aforementioned principle of legality. In fact, Article 10-bis lists[81] the operations with no economic substance but the operations justified by valid extra-fiscal reasons not marginal are not listed and this leads to a freedom of interpretation by both the tax authority and the taxpayers.

A possible solution to the problem could be given by the ECJ Jurisprudence[82] which considers the administrative punishing sanctions as subject to the same treatment of the criminal ones.

Differently, part of the doctrine, believes that excluding sanctions of certain abusive conducts on the basis of a strict interpretation of the principle of determinateness would be against the principle of proportionality[83] .

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[79] G. Consolo, *I profili sanzionatori amministrativi e penali del nuovo abuso del diritto,* in Corr. Trib., n. 39 del 2015, p. 3966.

[80] G. Bellagamba, G. Cariti, *Il sistema delle sanzioni tributarie. I reati tributari. Le sanzioni amministrative tributarie,* Milano, 2011, p. 349 ss.

[81] (i) "Non coherence of the qualification of the single operations according to their juridical; (ii) "Non conformity of the use of specific juridical instruments compared to the usual market trends".

[82] ECHR, Nykänen vs. Finland, 20th May 2014., E. Boffelli, *"Principio del ne bis in idem nella recente giurisprudenza europea: considerazioni sul doppio binario sanzionatorio in materia tributaria"*, in Dir. prat. trib., 2014, II, p. 1097.

[83] A. Giovannini, *"La delega unifica elusione e abuso del diritto: nozione e conseguenze*", in Corr. Trib., 2014, p. 1827.

Article 10-*bis* seems to confirm the application of Article 1, par. 2 of the D. Lgs n. 471/1997 stating that "administrative sanctions are maintained". Implicitly recalls the same administrative sanctions which were recalled by Article 37-bis of the DPR 600/1973 which covered both tax avoidance and tax evasion sanctions.

1.2.6 Critical reactions to the new Article 10-bis

Not all the critic is in favour of the newly introduced provision.
Part of the doctrine[84] in fact, considers the modifications scarce and worthless.
Fist of all, the doctrine[85] criticized the abstract nature of the definitions used by the Legislator to define abuse ("undue fiscal advantage", "absence of economic substance").
Part of the critic regards the relationship between abuse of law and tax avoidance.
It should be excluded from the definition of abuse and considered as tax avoidance all those operations which aim to results different from the ones provided by the law. Thus, the abuse of law has to be identified through exclusion: abuse are all those conducts which regard the application of Article 10-bis, which are not a legitimate tax saving and do not concern the application of the specific circumstances of tax avoidance[86].
Another critic is that the conducts which the anti abuse provision aims at contrasting are the same of the old Article 37-*bis,* although excluding all the limitations which were present in that provision. The characteristics of the abusive conducts are the same of the tax avoidance operations listed in the old Article 37-*bis:* 1) circumvention of the law; 2) undue fiscal advantage and 3) absence of valid economic reasons. The new introductions of Article 10-*bis* merely regard a clarification of the terms and concepts. The new Article 10-*bis* contains a negative list of what are the operations which are not considered as abuse of law. This introduction is important but still is considered as a mere clarification: those limits

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[84] A. Carinci and D. Deotto*, Abuso del diritto ed effettiva utilità della novella: Much ado about nothing?*, in il fisco n. 32 del 2015, p. 1-3107
[85] M. Procopio *"La poco convincente riforma dell'abuso del diritto ed i dubbi di legittimità costituzionale"*, in Dir. e Pratica Trib. 2014, p. 746.
[86] Supreme Court, ruling n. 40272/2015.

are not peculiar of the abuse of law; they are the same of the tax avoidance operations. In fact, abuse of law like tax avoidance are difficult to distinguish from tax evasion and the legitimate tax saving.

An element which was introduced by the new Article is the explicit burden of proof on the tax administration and the possibility for the taxpayer to demonstrate the existence of "valid extra-fiscal" reasons. Also this introduction, according to part of the doctrine, seems like a mere clarification because it is obvious that the requirements of a tax rule need to be demonstrated by the tax authority.

The real introduction seems to be that the abuse of law could not be noticeable *ex officio.*

As reported above, a critic of the doctrine[87] is that "valid extra-fiscal economic reasons not marginal" being not specified and determined, gives the tax authority and the taxpayers freedom to evaluate them subjectively.

Another critic underlined by part of the doctrine[88] and the jurisprudence[89] deals with par.5 of Article 1 of the D. Lgs 128/2015 which regards the temporal period of validity of the Article 10-*bis*. It states the validity of the new Article 10-bis will be from the 1st October 2015. The acts to be considered are those concluded before that date to which the assessment has already been notified. Although, the Legislator in the Delegation, did not have the authorization to introduce retroactive laws. Thus, the interpreter should avoid derogations to the ordinary principles of Constitutional law, especially Article 76[90].

Moreover, Article 10-*bis* par.13 avoids the application of criminal sanctions to abusive operations. The ruling n. 40272/2015 of the Supreme Court, extends this disposition also to conducts concluded before the initial term of entry into force of the new discipline. *"Whatever interpretative doubt on the significant of the tax laws regarding the Law n. 212/2000, should be solved in the way better conforming to the Charter of taxpayer's rights principles".* Although, if this

[87] G. Consolo, *I profili sanzionatori amministrativi e penali del nuovo abuso del diritto*, in Corriere Tributario n. 39 del 2015, p. 3966.

[88] G. Fransoni *"La multiforme efficacia nel tempo dell'Art. 10-bis dello Statuto su abuso ed elusion fiscal"*, Corr. Trib., n.44/2015, p. 4362.

[89] Sup. Court, 7th October ruling n. 40272/2015.

[90] G. Fransoni *"La multiforme efficacia nel tempo dell'art. 10-bis dello Statuto su abuso ed elusion fiscal"*, Corr. Trib., n.44/2015.

happened for taxation procedural rules, different is the solution regarding criminal law sanctions because in this case the principle of *lex mitior* applies also to conducts practiced before the entry into force of the new legislation. It would have been impossible to limit the more favourable effects of criminal law in favour of a non criminal event, like the notification of the assessment.
Moreover, another critic made by part of the doctrine[91] is that now between the ideas of the experts[92] of taxation law, tax avoidance consists on the abuse of juridical forms, aimed at excluding a certain economic operation to its natural tax regime.

1.3 Specific anti avoidance rules (SAARs)

A "specific anti-avoidance rule" (SAAR) is an anti-avoidance rule aimed to deal with particular situations or transactions.
In the Italian tax system there is a general anti avoidance rule but there are also Specific anti avoidance rules in force.
It is important to underline that the general attitude of the national tax administration toward invoking GAAR(s) is residual. GAAR(s) are provisions of a last resort (ultimate solution). In the circumstances which are specifically listed in a SAAR, the general rule does not apply. It applies only in cases in which there is no specific rule provided by the law. This recalls the general principle of the Italian law which applies to all fields of law *"lex specialis derogat legi generali"*.
In the following paragraph, some Italian SAARs will be briefly explained.

1.3.1 Thin capitalization

[91] D. Stevanato, *Elusione fiscal e abuso delle forme giuridiche, anatomia di un equivoco*, in "Diritto e Pratica Tributaria" n. 5 del 2015, p. 10695.
[92] S. La Rosa, *Principi di diritto tributario,* Torino, Giappichelli, 2004, 21; Russo, *Manuale di diritto tributario*, Milano, Giuffrè, 1999, 94; G.Falsitta, *Manuale di diritto tributario. Parte generale,* Padova, Cedam, 2012, 224; A.Fantozzi, *Diritto tributario*, Torino, Utet, 2012,358; G. Vanz, *L'elusione fiscaletra forma giuridica e sostanza economica*, in Rass.trib., 2002, 1626; A. Giovannini, *L'abuso del diritto nella legge delega fiscale*, in Riv. dir. trib.,2014, I, 234.

First of all, it is important to underline the presence of the thin capitalization rule[93] which used to be found in Article 98 of the Law 917/1986 (TUIR). The thin capitalization rule aimed to tackle the base erosion deriving from the use of debt capital instead of risk capital.

It is present in different law regimes and it applies to company's capitals that are made up by a greater amount of debt than equity. It is a limitation of tax deduction of interests. Interests are deducible differently, dividends are not. The thin capitalization is helpful to avoid that subsidiary companies pay dividends in the form of interests to the parent company in order for them to be deducible. This is not only illegal but especially brings the effect of a huge indebtedness of the subsidiary company. The thin capitalization aimed at considering non deducible the borrowing interest rate in order to avoid the undercapitalization of companies.

In 2003 thin capitalization rules were inserted in ITC (Income Tax Code). Under them, if the proportion between debt directly or indirectly connected to qualified shareholdings and equity related to the same shareholdings exceeded 4 to 1, interest on the excess debt was assimilated for fiscal purposes to a dividend. It therefore could not be claimed as a deduction by the paying company and enjoyed the dividend's exemption in the hands of the receiving shareholder, unless it could be demonstrated that the excess debt was justifiable on the basis of the arm's length borrowing capacity of the company.

Since these rules applied even when no tax advantages could stem from the excess debt, it could be argued that they did not have (at least, essentially) an anti-avoidance purpose but were meant to characterize correctly the relation between the company and its shareholders.

They were extremely complex and this lead to their abrogation in 2008. It has been abolished in Italy with the Law no. 244 of 24th December 2007 that modified article 98 of TUIR.

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[93] For a first analysis on the Italian thin capitalization rule F. Pau, *La thin cap italiana: profili operativi e criticità*, in "il fisco" n. 10/2004, p. 1409; A. Nuzzolo-P. Consiglio, *Le misure di contrasto alla sottocapitalizzazione delle imprese nel nuovo testo unico delle imposte sui redditi*, in il fisco n. 6/2004, p. 790; P. Pisoni and F. Bava and D. Busso, *Nuova Ires e indicatori di bilancio per determinare la deducibilità degli interessi passive*, in il fisco, n. 6/2004, p. 766; M. Campra, *Thin capitalization e pro rata patrimoniale: nuove norme per l'indeducibilità degli interessi passivi,* in il fisco, n. 11/2004, p. 1588.

1.3.2 Tax losses carry-forward

Article 84, par. 1, of ITC provides that the tax loss of a tax year may be used to offset 80% of the income of each of the subsequent tax years. The 80% threshold does not apply, according to par. 2, to the tax losses incurred in the first three tax years of activity.

According to par. 3, the carry-forward of the losses are prohibited when there is a change of the shareholding structure of the company, even temporarily, and when in the tax year of the transfer of the shares, in the two previous years or in the two following ones, the core business changes.

The prohibition does not apply if during the two years preceding the one of the transfer of the shares the company has had a number of employees never lower than 10 units and if the income statement of the year preceding the one of the transfer of the shares shows an amount of proceeds from the core business and an amount of costs of employment higher than 40% of the average of the amounts of the same items as shown in the income statements of the previous two years.

The provision aims at fighting the trade of tax losses, enacted through the acquisition of the ownership of a company in economic crisis for the purpose of pouring into it a profitable business and then using its tax losses to offset the income stemming from this business.

1.3.3 CFC rule

Another SAAR rule is the CFC[94] (Controlled Foreign Companies) rule which is provided by Article 167 of the DPR 917/1986. It is applied to the income earned by companies located abroad which are controlled by other Italian companies.

[94] Doctrine - Stevanato D., *La delega fiscale e la CFC legislation*, Il Fisco, 2002, p.2731; Tinelli G., *Sulle CFC regole più incisive e più rischiose*, Il Sole 24 ore, 20th August 2003; Franzè R., *I paradisi fiscali nella riforma tributaria* in AA.VV., *La nuova imposta sul reddito delle società*, cured by Marino B., *Quaderni della rivista dei dottori commercialisti,* 2004, p.268; A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale* 3rd Edition, 2008 p.1055 and following.

Usually, the income produced by a subsidiary company is taxed in the State in which the company is located and not in the State of residence of the parent company. The problem with this system arises when the company is situated in a Tax Heaven country or in a country where the tax legislation is far more favourable.

The CFC rule is applied in these cases to tax the income directly imputing it on the Italian parent company regardless of dividend distributions.

Italy has adopted a CFC legislation in 2000[95]. Over the years this legislation has undergone extensive changes, even though it still maintained the same approach, meaning that the resident person must include in his tax base his share of all CFC's income[96]. Originally, it applied both to controlled entities (defined by reference to Art. 2359 of the Civil Code par. 1 – 2[97], as entities in which a person holds, directly or indirectly, the majority of the votes at the shareholders' meeting or sufficient votes to exert a decisive influence in the shareholders' meeting, or which are under the dominant influence[98] of another person due to a special contractual relationship) and affiliated ones (i.e. entities in which the Italian person holds, directly or indirectly, a profit entitlement exceeding 20%, or 10% in the case of a listed company), provided that they were resident of a State or territory included in a black-list country as issued by the Ministry of Finance, taking into account a level of taxation significantly lower in respect of the Italian one (less than 50% of the taxation that would apply in Italy) and the absence of an adequate exchange of information with the Italian tax authority.

In 2009[99], its scope has been extended to controlled entities residing in States or territories not included in the black-list, if (1) they are subject to a taxation that is

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[95] IT: Art. 1, par. 1, lett. a) of the Law no. 342 of 21 November 2000. For a general overview on the Italian CFC rules see G. Maisto, *Il regime di imputazione dei redditi delle imprese estere participate, c.d Controlled Foreign Companies*, IV Riv. dir. trib., p. 39 (2000); D. Stevanato, *Controlled Foreign Companies: concetto di controllo ed imputazione del reddito*, I Riv. dir. trib., p. 777 (2000); R. Cordeiro Guerra, *Le imprese estere controllate e collegate*, in Imposta sul reddito delle società (IRES) p. 961, F. Tesauro ed., Zanichelli 2004.

[96] In this regard, see R. Franzé, *Il regime di imputazione dei redditi dei soggetti partecipati residenti o localizzati in paradisi fiscali*, in Diritto tributario internazionale p. 929, V. Uckmar ed., CEDAM 2007.

[97] Art. 167, par. 3 of ICTA.

[98] P. VALENTE & M. MAGENTA, Italy: new CFC legislation, cit., page 53.

[99] Art. 13 of the Law Decree no. 78 of 1 July 2009.

less than 50% of the one applicable in Italy and (2) more than 50% of their proceeds qualifies as passive income.
In 2015, the involvement of the affiliated entities in the CFC legislation has been abolished together with the black-list system[100].
The application of this rule can be avoided provided that the resident person shows either that (1) the foreign entity predominantly carries on an actual business in the market of the country where it is located or that (2) the participation in the foreign entity does not achieve the effect of positioning income in a country were the nominal level of taxation is less than 50% of the Italian one.

1.3.4 Exit tax

Another SAAR is the so called exit tax, provided by Article 166 TUIR[101].
The exit tax is applied to related companies. When two companies are related to each other in Italy and one of them decides to move its residence to another country where the tax legislation is far more convenient or to a Black List country, the exit tax is applied. The company that moves needs to pay the exit tax in the country it used to be resident in. The tax is calculated on the capital gains of the transfer of legal seat. The transfer is considered, according to article 166 of TIUR, as an earning at the normal market value on the assets of the company unless they are not considered as part of an Italian permanent establishment in Italy.
Obviously, this provision needs to be coordinated with single double taxation treaties between the two States concerned in order to avoid double taxation.

1.3.5 Preference for a general anti-avoidance rule

[100] Art. 1, par. 142, lett. b), n. 2, of the Law no. 208 of 28th December 2015.
[101] For further analysis read G. Ferranti, *I profili fiscali del trasferimento in Italia delle società estere,* in Fiscalità Internazionale, n. 2 del 2010.

In 1988 a new project was realized and presented to the national government in order to introduce an anti avoidance rule having a "quasi general" nature.

From one side it had the structure of a GAAR because it established the conditions which qualified an operation as abusive but provided expressively which were the specific acts and situations that were giving rise to a law abuse (like mergers and transformations).

After the long series of introductions over the years of "quasi general rules", the Italian Legislator identified the problem in the specific list of acts which had to be considered as aiming at law abuse. This is the reason why there has been lately a serious trend in preferring the introduction of a GAAR to SAAR(s).

The previous Special Anti-abuse rules in force in our system did not seem to work because of the tendency of the taxpayer to adopt new methods to avoid the situation specifically prohibited by the law. Nevertheless, there is a logical condition that derives from the application of a GAAR which is a degree of indeterminateness of it. This leads to the necessity from the legislator to avoid it in the best way possible.

1.4 Key national judicial decisions involving GAAR

Since the GAAR is new, there is no case law dealing specifically with it.

Nevertheless, based on their similarity, in relation to its first element it is possible to recall the position taken by the Supreme Court on the circumvention element of Art. 37-*bis*. For the Court, in order to apply this provision, it was necessary to inquire if "*there is a manipulation or alteration of traditional legal instruments, to be considered inconsistent with ordinary market practices, and if there is an actual interchangeability with the solutions indicated by the tax authority*[102]".

[102] Sup. Ct., sec. V, 14 Jan. 2015, 438 and 439, commented by M. Beghin, *Ancora equivoci sul concetto di vantaggio fiscale elusivo e sulla sua inopponibilità al Fisco*, Corr. Trib., p. 895, 2015 and by D. Stevanato, *Il disconoscimento del prezzo pagato per acquistare l'azienda e il paradosso dell'elusione senza "aggiramento"*, GT – Riv. giur. trib., p. 501 (2015); Sup. Ct., sec. V, 15 July 2015, 14760 and 14761; Sup. Ct., sec. V, 27 Mar. 2015, 6226 commented by M. Beghin, *Elusione, tassazione differenziale e impatto sulla motivazione degli avvisi di accertamento,* Corr. Trib., p. 1827, 2015.

In the field of tax law, the Italian Supreme Court underwent a slow path in order to extend the national definition of tax avoidance to the ECJ theory of "abuse of law" and so to conform with the European Union Law.

With the ruling no. 3979/2000, n. 11351/2001 and n. 3345/2002, the Supreme Court concluded that only the specific behaviours indicated by the law needed to be considered as tax avoiding.

In 2005 the Supreme Court started changing direction and opinion on the situations which were giving rise to tax avoidance.

In the before mentioned rulings contrasting dividend washing n. 20398 and n. 22932 of 21st October 2005, the Supreme Court did not recognize any economic advantage rather than the tax ones because of the fact that those contracts were missing their scope according to Art. 1418, co. 2 c.c. The mere scope of the operation was to obtain an undue tax advantage, thus the Court ruled for the lacking of scope. Different was the approach of the Supreme Court in the ruling no. 20816/2005, examining a case of dividend stripping. Here it was declared void the operation ex Article 1344 c.c. because it was done in *fraus legis.* This was an innovation in the Court's jurisprudence since before than, the applicability of Article 1344 c.c. had been always denied in the taxation sector.

During those years, there was a tendency of the ECJ to introduce the prohibition of abuse of law. With the above mentioned rulings in 2005, the Supreme Court did not recognize the direct applicability of the EU principle of abuse of law in the national jurisprudence but it first underlined that it constitutes a principle in general coherent with the tax system.

A progress was made with the ruling no. 21212/2006. *"Acts in abuse of law, according to the European jurisprudence, are not opposable to the national tax administration"*. In order to punish those abusive conducts practiced before the introduction of the new Article 37-bis D.P.R no. 600/1973, the Supreme Court affirmed the direct applicability in the internal jurisdiction of the EU general principle of abuse of law as defined by the ECJ in the ruling *Halifax*[103], pronounced in the same year, regarding VAT to underline the loyalty between

[103] 21st February 2006 ruling n. C-255/02.

taxpayers and tax authority. The Supreme Court reached this conclusion considering Article 37-bis as having a non exhaustive character and thus, par. 1 and 2 would lead to the mere applicability of the EU principle[104].

The jurisprudence expressed in the ruling no. 21212/2006 was then confirmed in the subsequent rulings no. 8772 and 10257 of 2008 related to dividend stripping. The Court stated that are abuse of law all those operations which are done essentially with the scope of obtaining a fiscal advantage. These advantages are not opposable to the tax administration, save the possibility for the taxpayer to proof the existence of alternative economic reasons of a non marginal character, different from the fiscal ones. In these rulings the Court first stated the difference between the general anti abuse rule deriving from the national jurisprudence and the specific anti avoidance provisions.

Thus according to the Supreme Court, the prohibition of abuse of law was not meant to substitute all the special anti avoidance rules in the internal system but it was a residual anti abuse clause present in the national taxation system. This lead to the application of the clause to all sectors of taxes also non harmonized ones (like the income taxes), to the operations listed in par.3 of the Article 37-bis and also to all the acts non contemplated by Article 37-bis.

As written already above this was strongly criticized by the doctrine at the time since this extension went beyond the abuse of law principle defined by the ECJ.

The most important change in the internal jurisprudence was reached with the before mentioned "twin decisions" (n. 30055, 30056 and 30057 of 2008).

These rulings affirmed the existence of the prohibition of abuse of law also in the field of harmonized taxes. In order to do so, the Supreme Court did not make reference to the European general anti abuse principle[105], but it applied Article 53[106] (ability to pay and progressive payment of taxes) of the Constitution as a base for non harmonized sectors to contrast tax avoidance.

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[104] F. Gallo, *La nuova frontiera dell'abuso del diritto in materi fiscale,* Rass. Trib. 6/2015 p. 1323.
[105] Not even to the internal provision of negotiation invalidity as in the ruling n. 20398 of 2005.
[106] N. Lipari, *I civilisti e la certezza del diritto*, Studies in honour of N. Picardi.

The Supreme Court, applied the general principle of abuse underling that Article 37-*bis* is not the only juridical base but it merely represents the expression of the ability to pay constitutional principle.

With the help of the Constitutional Court especially the ruling n. 1/1956, the distinction between the nature of the norms has been abolished and the principle of the ability to pay defined in article 53 has been clarified. It ruled that: *"Every tax withdrawal has to be justified by wealth index"*.

As the doctrine observed[107], the recall to Article 53 is not contrasting with article 23 of the Constitution *("neither any personal nor economic performance should be imposed if not provided by the law*") . It is a Legislator's task to regulate the essential elements of the tax to be imposed.

With a subsequent ruling in 2010, the SC declared the principle of abuse of law a norm having general character while article 37-*bis* was applicable only in those cases listed by paragraph 3.

With the injunction n. 24739/2013 the judges of the Supreme Court have asked the Constitutional Court[108] an assessment of constitutionality of par. 4 of Article 37-*bis* of the DPR n.600/1973, specifically referring to the part of the provision in which it was considered necessary (otherwise the act would have been void) to request a clarification in the period stated by the law before the anti avoidance tax assessment was issued.

The provision was considered by the prosecution as violating Article 3 of the Constitution. Article 37-*bis* was a SAAR and it wasn't rational that the necessity of a preliminary consultation was not guaranteed by a GAAR.

Moreover, Article 37-*bis* was accused to be in contrast with Article 53 of the Constitution because it was too formal and strict leading to the annulment of grounded tax demands.

Before the answer of the Constitutional Court, the judges of the Supreme Court with the ruling n. 406/2015 affirmed that a person who was accused by the tax authority with a detrimental act, needs to be put in the best position possible to

[107] MELIS G., *L'interpretazione nel diritto tributario*, p 270.

[108] The Constitutional Court answered with the ruling no. 132/2015 and defined as not unconstitutional par. 4 because it reflects the general principle of the preliminary consultation which has to be respected in all the anti abuse contexts.

contradict with the tax authority before suffering those detrimental effects and without any difference between harmonized and non harmonized tax sectors.

The necessity of the preliminary consultation no matter whether concerning harmonized taxes or not, was so declared also by the national courts.

The prohibition of abuse of law was not meant to substitute all the special anti abuse rules in the internal tax system.

Although, in the ruling n. 27087 of 19th December 2014 the Supreme Court again went a step back considering as abusive those conducts listed in par. 3 of the Article 37-bis. This brought to the issue that if this precedent would be approved and used as model in other subsequent jurisprudence, the whole jurisprudence of 2008 would have been put into discussion.

This made even more necessary the intervention of the Legislator through the Law n.23/2014.

1.5 Legislative proposals introducing the Beps and conclusions

Until now there have been no concrete legislative proposals[109] in Italy introducing the BEPS Action 6. The European Commission has urged Member States to develop new policies to adapt to the OECD recommendations.

To conclude this first Chapter on GAAR in Italy, the new Article 10-*bis* is sufficiently clear and gives a better level of certainty of the law.

It eliminates all those widespread uncertainties created over the years by the different opinions of the national and European doctrine and jurisprudence. Finally, also the principle of abuse of law is regulated by an internal legislation and it seems to have improved the relationship between tax authorities and the taxpayer.

[109] Until today, in Italy we only had one legislative proposal in the Parliament but it aimed at adapting the national legislation to Action 1 of the BEPS to develop an internal strategy to contrast tax avoidance during digital transactions.

CHAPTER 2: ITALIAN GAAR AND DTCs. OECD'S IMPACT ON TAX TREATY POLICY

2.1 The role of domestic anti avoidance laws in DTCs

In the Action Plan on Base Erosion and Profit Shifting (BEPS), the OECD identifies all those areas where National Governments should take the necessary measures to contrast evasion and abuse. Since the first modifications to the OECD Model Commentary, introduced in 2003, the aim of the DTCs is not only the one of avoiding double taxation but also the one of preventing tax evasion and tax avoidance[110].

Regarding the improper use of tax treaties, the new OECD Commentary deals with other 3 matters.

The first one is "treaty shopping" which involves strategies through which a person who is not a resident of a State attempts to obtain benefits that attacks Treaty concluded by the State granted to residents of that State. Secondly, the relationship between internal anti avoidance rules and DTCs. At last, the application of a specific anti-abuse rule, the limitation of benefits rule (LOB), that limits the availability of treaty benefits to entities that meet certain conditions and the relation between single rules in the Conventions and internal SAARs (thin capitalization, CFC ...).

Some of the provisions included in DTCs concluded by Italy with other States do expressively make reference to national anti avoidance rules[111]. This method recalled the old OECD Commentary from 1977. In fact, paragraph 7 of the old Commentary stated that: *"True, taxpayers have the possibility, double taxation conventions being left aside, to exploit differences in tax levels between States and the tax advantages provided by various countries' taxation laws, but it is for the States concerned to adopt provisions in their domestic laws to counter such*

[110] Commentary art.1 par. 7 The position of the Commentary to the UN Model is more blurred: it recognizes the exchange of information as one of the main objects of the Conventions in order to avoid tax evasion and tax avoidance. This provision was not agreed by only one State, Switzerland, Observations to the OECD Commentary, par 27.9.

[111] Miele L., *Il nuovo abuso del diritto. Analisi normativa e casi pratici*, Eutekne, 2016.

manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of this kind contained in their domestic laws". Thus, according to the old Commentary, States could refer in DTCs to their internal anti avoidance provisions.

The Commentary left to the States wide margins of appreciation using the verb to adopt.

Other DTCs instead, are dealing with the relationship and the possible contrasts between provisions in DTCs and domestic laws aiming at contrast anti avoidance[112]. A typical example of it[113], in the Italian DTCs practice, is the relationship between the general principle of non discrimination provided by article 24 of the OECD model Convention and Article 110 paragraph 10 of the Italian TUIR[114].

Article 24 paragraph 6 of the Model Convention is specifying that Article's 24 precedent paragraphs are not jeopardizing the application of domestic laws to prevent evasion and tax avoidance[115]. Thus, according to this statement, there is no doubt of the prevalence of internal anti avoidance SAARs over DTC rules[116]. The doubt is weather also the internal GAAR (Italian Article 10-bis) could be applied in these cases even though not directly recalled. Although according to the principle "*ubi lex voluit dixit, ubi noluit tacuit*[117]", this could be a clear sign of the fact that only SAARs could be recalled in DTCs otherwise Contracting States would have made reference also to GAARs.

There are instead other groups of Conventions concluded by Italy which recall to domestic GAARs. An example could be the Protocol n.8 of the DTC Italy-Jordan.

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[112] The Italian doctrine distinguished between general anti avoidance laws and laws with anti avoidance aim; the latter are specific rules. "Their anti avoidance scope is not explicit, but is found in the ratio". Tessera F., *Istituzioni di diritto tributario, I - General Part*, Torino, 2009, p.254

[113] L.Miele, *Il nuovo abuso del diritto analisi normativa e casi pratici,* Eutekne, 2016 p.91.

[114] Now abrogated.

[115] We find a similar provision is found in the DTCs concluded by Italy with Ukraine (art. 25 par. 3), Italy - Emirates (art.24, par.6), Italy - Ethiopia (art.24 par.6), Italy - Uzbekistan (art. 25 par. 6), Italy - Macedonia (art. 25 par. 5), Italy - Lituania (art. 30 par. 2), Italy - Georgia (art. 25 par. 6), Italy - Ghana (art.25 par.6), Italy - Jordan (art.24 par.6 and Protocol n.6, Italy - Qatar (art.24 par.6).
Art.1 par. 9 Protocol to the convention Italy - USA relating to associated enterprises.

[116] L.Miele, Il nuovo abuso del diritto analisi normativa e casi pratici, Eutekne, 2016 p.9.

[117] L. Miele, *Il nuovo abuso del diritto. Analisi normativa e casi pratici*, Eutekne, 2016. Meaning of the brocard: *"when the law wanted to regulate the matter in further detail, it did regulate the matter; when it did not want to regulate the matter in further detail, it remained silent"*.

"Nothing in this Convention shall preclude either contracting State in applying its domestic tax laws in order to prevent fiscal evasion and tax avoidance[118]*"*. In this case there is no doubt on the prevalence of Article 10-*bis* over single DTC rules[119].

It is very hard to define if domestic anti avoidance rules could be applied when there is no specific reference to them in DTCs.

According to the OECD Commentary *"as a general rule, there will be no conflict between such rules (of the Commentary) and the provisions of tax conventions"*. Such position is very wide and simplistic. It is justified by the fact that if each Contracting State could apply its own domestic rules, the abuse would result into a domestic abuse of law and not punished according to the DTCs[120].

Although, the fundamental rule is found in par. 9.5 of the Commentary of Article 1 and it should be used as a guide by all DTCs. The benefits of DTCs should not be recognized whenever the operations concluded by the parties have the main aim of reaching a fiscal advantage.

The first difficulty encountered with such a vague OECD provision regarding the express reference is that national tax avoidance rules could exclude their application in DTCs[121].

Regarding the Italian GAAR, it contains the expressions like "tax laws", "tax system", "different optional regimes offered by law". These are all expressions that do not exclude the application of the GAAR to Double Tax Conventions.

The second difficulty regards the "nature" of the domestic GAAR to which the reference is made. The question of the relationship between treaty rules and domestic anti-abuse rules is based on the assumption that these rules do, in fact, overlap with each other, i.e. they are both substantive rules. On the one hand, it is indisputable that treaty provisions are substantive rules, at least those concerning the allocation of taxing powers with regard to income categories. On the other

[118] Other similar provisions are found in DTCs concluded by Italy with Ghana (Protocol n.5) and the Convention with Hong Kong (Article 27).

[119] Rust A. "Art. 1" p.128, in Reimer E. and Rust A. "Klaus Vogel on Double Taxation Conventions", Vol. 1, Alphen aan den Rijn, 2015.

[120] OECD Commentary par.9.2 *"any abuse of the provisions of a tax convention could also be characterized as an abuse of the provisions of domestic law under which tax will be levied"*

[121] "Double Taxation Conventions", Baker P. London, 2014,1B.53.

hand, it should be investigated as to whether or not it is possible to arrive at the same conclusion with regard to domestic anti-abuse rules. As far as Treaty provisions are concerned, their qualification as substantive rules is based, according to both Italian and international doctrine[122], on their main purpose of allocating taxing powers between the contracting states, thereby limiting the respective domestic tax provisions, whilst retaining the application of the domestic substantive rules regarding income calculation and the domestic procedural rules on the enforcement of tax obligations[123]. Such an allocation is made, in tax treaties based on the OECD Model Tax Convention, under the provisions that exclude (Arts. 8, 12, 13, 15, 18, 20 and 21) or limit (Arts. 7, 10, 11, 16, 17 and 19) the taxing powers of the state of source, as well as from the provisions that exclude or limit the taxing powers of the state of residence (Art. 23A or 23B). These provisions neutralize, fully or partially, domestic tax law provisions. It is, therefore, essential to establish whether or not the same conclusion can be drawn with regard to domestic anti abuse rules. If these rules were regarded as procedural rules, it could be concluded that Treaty provisions do not preclude the application of domestic anti abuse rules (and the issue dealt with in this article would be exhausted). With regard to general anti abuse rules, the thesis under which they are regarded as substantive rules should be preferred for the reasons noted by most Italian scholars and to which reference is made.

This view is also true with regard to domestic anti abuse rules that specifically disregard the tax effects that are typical of certain fact patterns on the grounds of circumstances that are indicative of an abusive conduct. Such is the case with the controlled foreign company provisions, under which the characterization for tax

[122] K. Vogel et al., *Klaus Vogel on Double Taxation Conventions* (3rd ed.), London: Kluwer Law International, 1997, pp. 26-27; R. Rohatgi, *Basic Inter- national Taxation* (2nd ed.) (Richmond: Richmond Law & Tax, 2005), Vol. I, Principles, pp. 32-33; K. Van Raad, *Five Fundamental Rules in Applying Tax Treaties*, in J.F. Avery Jones et al. (eds.) *Liber Amicorum Luc Hinnekens* (Brus- sels: Bruylant,2002), p.588;A.FantozziandK.Vogel,*Doppia imposizione internazionale*, *Digesto, sez. comm.* (Turin: UTET, 1990), Vol. V, p. 190; C. Garbarino, *La tassazione del reddito transnazionale* (Padua: CEDAM, 1990), p. 482; and G. Melis, *Vincoli internazionali e norma tributaria interna*, Rivista di diritto tributario, 2004, p. 1083.

[123] It is undisputed that treaty provisions do not prevent the application of domestic provisions on the enforcement of tax obligations, so that, for example, once the source state has been limited in its power to tax dividends (Art. 10 of the OECD Model), that state remains free to apply its domestic pro- visions in the determination of the taxable base and in the way to tax such an income, i.e. by way of withholding tax or self-assessment.

law purposes remains that of income of a non resident company, although such income is imputed, as the substantive regime, to the resident shareholder.

The primacy of treaty law is not a decisive argument to maintain that domestic anti abuse rules are not compatible with treaty rules, as there are opinions, in tax law literature, according to which domestic anti abuse rules still apply, notwithstanding that treaty law prevails over domestic law. It has been pointed out that[124], although without making any distinction based on the substantive or rather procedural nature of domestic anti abuse rules, tax treaties, whilst affecting the allocation of taxing rights, leave room for the application of such rules. This argumentative reconstruction would be based either on the title and preamble of tax treaties or on the purpose of tax treaties according to others instead is based on the law of interpretation of Treaties.

The third issue considered by part of the doctrine[125] is the law of the interpretation of the national provision, in the case of non explicit recall of it in the DTC.

DTCs are international law sources and they need to be interpreted according to the principles of article 31 of the "Vienna Convention of 1969 on the Law of Treaties". These rules are part of an autonomous legal system compared to the one of national rules of interpretation. Thus, to interpret DTC's rules, national rules of interpretation are not recalled.

Taking domestic anti avoidance rules for the interpretation of DTCs, it should be concluded that they are applied to International Double Taxation Conventions. Although, in the Italian Constitution and jurisprudence[126], it is a general principle the prohibition of tax avoidance. Constitutional laws are generally (according also

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[124] This is the position taken by the OECD in the Commentaries on the OECD Model after the 2003 update. In brief, the OECD maintains that no conflicts arise between domestic anti-abuse provisions and international treaties, as (and to the extent that) domestic anti-abuse provisions are aimed at "determining which facts give rise to a tax liability" and, therefore, they are "not affected by them", without making any distinction between substantive and procedural provisions. Amongst scholars who consider such a distinction not to be relevant, see F. Zimmer, "Domestic Anti-Avoidance Rules and Tax Treaties – Comment on Brian Arnold's Article", Bulletin for International Fiscal Documentation 1 (2005), p. 26. (This author, however, does not deal with the issue of whether domestic anti-abuse rules do or do not conflict with international conventions.) Amongst scholars who maintain that domestic anti- abuse rules are applicable notwithstanding international conventions, see K. Vogel et al., supra note 3, p. 125.

[125] Falsitta G, *Natura delle disposizioni contenenti norme per l'interpretazione di norme e l'art. 37-bis sull'interpretazione analogica o antielusiva*, Milano 2014, p.299.

[126] Supreme Court Joint Chamber Decisions 24.12.2008 n. 30055, 30056,30057.

to article 117 of the Cost.) in a precedent position respect to conventional laws and thus, they prevail over DTC rules. In effect, the primacy of treaty provisions over constitutional principles (reference here is made to Art. 53 of the Italian Constitution, which includes the “ability to pay” principle, that has been regarded as the basis for the abuse of tax law principle by the Supreme Court) is doubtful. So, according to this interpretation, national rules can be extended for the interpretation of DTC laws. However, it should be questioned whether or not constitutional principles on tax law matters belong to the category of “super constitutional principles”. These are principles that can never be derogated from and, therefore, prevail over other constitutional principles, such as those affirming the obligation to respect treaty law and even EU law[127]. The debate is ongoing and no conclusive views have been expressed on this issue.
Although the BEPS Action Plan has not exerted any impact on the Italian Treaty policy yet.

2.2.Treaty abuse prevention in DTCs between Italy and developed or developing counties and anti avoidance provisions

There is no GAAR applicable in DTCs concluded by Italy neither with developed nor with developing countries.
The provisions present in DTCs generally, in all of them, aim at preventing tax avoidance and are not general provisions against the abuse of law.
For example one of these provisions preventing tax avoidance is the exchange of information. In order to combat international tax evasion, tax authorities must be able to access and exchange relevant information about individuals’ and companies’ activities, assets or incomes in foreign jurisdictions. Since 2009, the environment for tax transparency has changed dramatically with the OECD and G20 providing leadership on actions to combat tax evasion.

[127] Regarding the inclusion of Art. 53 of the Constitution within the fundamental principles that cannot be restrained, see F. Gallo, *Ordinamento Comunitario e Principi Fondamentali Tributari*, Naploli, Editoriale Scientifica, 2006, p. 34 and following.

Exchange of information can take several forms: information exchange upon request, automatic exchange of information (AEOI) and spontaneous exchange of information.

There is currently a trend to move towards AEOI among OECD countries, and both the G8 and the G20 in 2013 endorsed the OECD's work to set a new single global standard for this form of exchange of information. However, for AEOI to be successful, countries must be in a position to apply the relevant technical standards and safeguards to transmit, receive and protect confidential information. This is not currently the case for many developing countries, and there are unmet technical assistance needs.

Anti avoidance provisions tend to be similar in all DTCs with no difference between the ones concluded between developed and developing countries.

In general, Italy does not have subject-to-tax clauses in its DTCs since, as State of residence, it adopts the credit method to relief juridical double taxation, for example in situations in which the same income is taxable in the hands of the same person by more than one State[128]. A case of double non taxation is unlikely to arise when Italy acts as the State of residence. In such circumstance, if an item of income is not subject to tax in the source State, no foreign tax will be applied and such income will be completely taxed in Italy. In this regard, a case of double non- taxation can originate only where Italy, as State of residence, does not retain the right to tax a certain income on the basis of domestic law. A general subject-to-tax rule may be found in the Protocol to the Convention between Italy and France. Specifically, paragraph 15 of the Protocol stipulates that *"In the cases where, in accordance with the provisions of this Convention, income must be exempted by one of the States, the exemption shall be granted if and to the extent such income is taxable in the other State"*.

A different type of general subject-to-tax clause may be found in the Convention between Italy and Germany[129]. Paragraph 16, lett. d), of the Protocol states: *"For*

[128] S. Mayr & P. Conci, IFA Branch Report: Italy, in Cahiers de Droit Fiscal International. Double Non- Taxation, p. 463 (IFA Cahiers 2004). See also, P. Tarigo, *Doppia non imposizione e trattati italiani*, Dir. Prat. Trib., p. 11127, 2009.

[129] Protocol to the Italy-Germany Double Tax Convention, 18 October 1989, par. 16, lett. d). For a comment see M. Lampe, General Subject-To-Tax Clause in Recent Tax Treaties, 39 European

the purposes of subparagraph (a) of paragraph 3 of Article 24, items of income of a resident of a Contracting State shall be deemed to arise in the other Contracting State if they have been effectively subjected to tax in the other Contracting State in accordance with the Convention".

Specific subject-to-tax rules relate to those allocation rules enshrined in DTCs that attribute the right to tax to a single Contracting State, thus preventing the other State from taxing the same item of income, i.e. the income earned by teachers and professors resident of a Contracting State for a teaching or research activity performed in the other Contracting State[130].

Another subject-to-tax clause inserted in some Italian DTCs deals with the treatment of pensions[131].

Italian DTCs often contain SAARs. The most famous one, present in many DTCs concluded by Italy is the "beneficial ownership" (BO) clause dealing with dividends, interests and royalties[132]. The beneficial ownership clause was first introduced by the OECD Commentary in 1977 in order to contrast treaty shopping. The old Commentary of 2003 stated that the notion of beneficial owner should be interpreted in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. The definition of beneficial owner is a negative one because it applies in all cases in which there are not the premises to apply the tax treaties being the direct beneficiaries of the income not also the real owners of it

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Taxation 4, p. 183, 1999, Journal IBFD; A. Rust, *Avoidance of Double Non-Taxation in Germany, in Avoidance of Double Non-Taxation,* p. 111, M. Lang ed., Linde Verlag, 2003.

[130] DTC Art. 20 of the Italy-Australia DTC reads as follows: *"a professor or teacher who visits one of the Contracting States for a period not exceeding two years for the purpose of teaching or carrying out advanced study or research at a university, college, school or other educational institution in that State and who immediately before that visit was a resident of the other Contracting State shall be exempt from tax in the first-mentioned State on any remuneration for such teaching, advanced study or research in respect of which he is, or upon the application of this Article will be, subject to tax in the other State"*.

[131] DTC with Syria it is stated that "*Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State. 2. The provisions of paragraph 1 shall not apply if the recipient of the income is not subject to tax in respect of such income in the State of which he is a resident and according to the laws of that State. In such a case, such income may be taxed in the State where they arise"*. Analogous provisions are contained in the treaties with Ghana, Lebanon, Georgia and Zambia.

[132] There is also an internal Beneficial Ownership clause in the Italian taxation system, found in Article 26-quater and 27-ter of the DPR 600/73

(difference between substantial and formal beneficiaries). The beneficial owner clause is present in Articles 10, 11 and 12 of the Model Convention in order to avoid tax evasion. According to the Italian Law, the beneficial owner is the effective person who shall be subject to taxation related to the income received. An example of it could be found in the Resolution 7 May 1987, n. 12/43[133]. This specific case regarded dividends distributed by an Italian company to an English bank, nominee of shares of an American Bank Institute which was administering some American pension funds. The Italian Financial Administration provided that the DTC applicable in this case was the Italy - USA one because the English bank concerned was only an intermediate and the dividends were not taxed in UK. The taxation was applied in the USA because there was the residence of the effective beneficial owners. Ten years later the thesis was confirmed by the Italian Financial Administration the 23rd December 1996 n. 306/E/5-2153/14-2185[134]. This clause is present in several DTCs concluded by Italy. For example, Article 10 par.2 of the DTC Italy - Germany in fact states: *"However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed 15% of the gross amount of the dividends".* The same provision is present in Article 11 par.2. *"However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10% of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation".* The beneficial owner is mentioned also in Article 12 par.2 (royalties) of the same DTC. This order recalls the Model OECD Convention so it is found in all DTCs concluded by Italy with other States.

[133] Resolution 7th May 1987, n. 12/431, Banca Dati BIG, IPSOA.
[134] Circular Min. Fin. Dip. Centr. Affari giuridici e contenzioso tributario 23rd December 1996, n. 306/E/5-2153/14-2185, in Banca Dati, IPSOA.

Differently, in the treaty Convention with Hungary there is no beneficial ownership clause. This lack of the BO clause, is present also in other DTCs concluded by Hungary[135].

Interestingly enough, usually the least recent DTCs are concluded by Italy either with developing Counties or with European States. Thus, in order to see the possible changes, they shall be compared with more recent ones. Hungary, from the fiscal reform of 1988, has always attracted foreign investors adopting very high fiscal advantages. Foreign passive income receives a very favourable treatment: it is not subject to taxation in the State of source and is de-taxed in the State of Residence of the person receiving the income, being or not the BO. In 1998, the concept of beneficial owner was introduced in the Hungarian national legislation to be recalled in DTCs. The beneficial owner is denied as a foreign organization not resident which is receiving dividends and declaring to the tax authorities the Hungarian source of those dividends. This is a definition very different from the OECD conception and the international jurisprudence's one.

Interestingly enough, usually the least recent DTCs are concluded by Italy either with developing countries or European States.[136] Thus, in order to see the possible changes, they shall be compared with more recent ones[137].

Briefly comparing them there is no big difference between these DTCs and the older ones. Many of them contain the SAAR regarding the beneficial ownership in Article 10, 11 and 12. In the additional Protocol most all of them contain a general provision against tax avoidance.

It is interesting to underline that the Italian Supreme Court has recently considered in the ruling n. 25281/2015 that the beneficial ownership clause could be considered as a special anti abuse clause in the international tax system, born to impede at taxpayers the abuse of tax Treaties through techniques of treaty shopping. In the light of this clause, the Supreme Court state that the absence of

[135] Present: DTC concluded with: Austria, Belgium, France, Canada, Luxemburg, Netherlands, South Africa, Spain, Switzerland
Absent: Austria, Denmark, Germany, UK, USA.

[136] DTC Italy – Thailand 1980; DTC Italy – Trinidad and Tobago 1974; Italy – Tunisia 1981; Italy – Zambia 1990; Italy – Austria 1985; Italy – Portugal 1983; Italy – Rep. Slovakia 1984; Italy-Romania 1979; Italy-Sweden 1983; Italy Switzerland 1979; Italy-Hungary 1980

[137] DTC Italy – Hong Kong 2015; Italy-Jordan 2010; Italy –Island 2008; Italy – Qatar 2011; Italy-Azerbaijan 2011.

such a clause would not underestimate the importance of this anti abuse clause in the DTCs. Thus, notwithstanding the absence of an express reference to it, it has to be considered always as a general anti avoidance principle of international taxation.

<u>*2.2.1 Relationship between LOB, SAAR and GAAR in DTCs*</u>

2.2.2 Domestic and DTS's anti abuse provisions

As above mentioned, certain tax treaties concluded by Italy expressly rule on the relationship between treaty provisions and domestic anti abuse rules.

Italy sometimes makes reference to specific internal tax avoidance provisions[138].

For example, Art. 24 (6) of the Italy - Oman tax treaty of 6th of May 1998 states that: *"The provisions mentioned in the previous paragraphs of this Article (regarding rules on non discrimination) will not limit the application of the domestic provisions for the prevention of fiscal evasion and tax avoidance. This provision shall in any case include the limitations of the deduction of expenses and other negative elements deriving from transactions between enterprises of a Contracting State and enterprises situated in the other Contracting State[139]"*.

With reference to various domestic anti abuse rules, Art. 1(9) of the Protocol to Italy–United States tax treaty of 25 August 1999 provides that: *"[t]he provisions of Article 9 (Associated enterprises) of the Convention shall not limit any provisions of the law of either Contracting State which permit the distribution, apportionment, or allocation of income, deductions, credits, or allowances between persons owned or controlled directly or indirectly by the same interests*

[138] For instance, some tax treaties include a non-discrimination article, which differs slightly from Art. 24 of the OECD Model, as it expressly permits the application of those domestic rules that deny the right to deduct costs incurred by resident enterprises in respect of companies resident in the other contracting state (Art. 110(10) Income Tax Code).

[139] Amongst Italian tax treaties containing such a provision, see those signed with Kuwait in 1987 (second sentence, letter m) of the Protocol as amended in 1998); Ukraine in 1997 (Para. 9 of the Protocol); the United Arab Emirates in 1995 (letter e) of the Protocol); Ethiopia in 1997 (Art. 24(6)); Macedonia in 1996 (Art. 25(5)); Lithuania in 1996 (Art. 30(2)); Georgia in 2000 (Art. 25(6)); Ghana in 2004 (Art. 25(6)); and Latvia in 1997 (Art. 30(2)).

when necessary in order to prevent evasion of taxes or clearly to reflect the income of any such persons".

Finally, letter (k) of Protocol to the DTC between Italy and Canada signed the 17th November 1977[140] provides that: *"nothing in this Convention shall be construed as preventing the application of the provisions of the domestic law of each Contracting State concerning fiscal evasion, in particular the taxation of income of persons in respect of their participation in non-resident companies".*

Most provisions relate to certain domestic anti-abuse rules. There are, however, some tax treaties in which reference is made generally to all domestic rules that prevent tax avoidance and evasion. This is the case of the DTC Italy – Ghana of 19th February 2004[141], in which the Protocol in Para. 5, states that *"nothing in this Convention shall prevent either Contracting State from applying its domestic tax laws in order to prevent fiscal evasion and tax avoidance".*

A further issue concerns specific domestic anti-abuse rules that overlap with treaty anti abuse rules affecting the same tax purposes. One example can be found in Art. 10 of the DTC concluded by Italy with United Kingdom the 21st October 1988[142], where, with regard to dividends paid by a company resident in a contracting state to a resident of the other contracting state, the entitlement to an indirect tax credit on such dividends is conditional on the fact that the shareholding in respect of which dividends was paid[143]. A similar provision is also found in the DTC concluded between Italy and France the 5th October 1989[144].

[140] Convention between the Government of Canada and the Government of the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion signed in Toronto on 17 November 1977 and ratified in Italy by Law 912 of 21 December 1978, published in the Official Journal No. 23 of 24 January 1979).

[141] Convention between the Government of the Italian Republic and the Government of the Republic of Ghana for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion signed in Accra on 19 February 2004 and ratified in Italy by Law 48 of 6 February 2006, published in Official Journal No. 7 of 25 February 2006).

[142] Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Italian Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed in Pallanza on 21 October 1988 and ratified in Italy by Law 329 of 5 November 1990, published in Official Journal No. 267 of 15 November 1990.

[143] Art. 10 (5) DTC Italy – UK.

[144] Art. 10(5) of the Convention between the Government of the French.

Republic and the Government of the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the Prevention of Fiscal Evasion and Fraud

The explicit recognition of the applicability of domestic SAARs to cases arising in International context is also provided by Art. 24 of the OECD MTC. It is included in the tax treaty with United Arab Emirates, Armenia, Qatar and Jordan. Similar provisions, although differently worded, are contained in the conventions with Macedonia Russia, Vietnam, Ukraine, Azerbaijan, Moldova, Belarus, Ethiopia, Oman, Croatia, Georgia, Uzbekistan, Ghana, Uganda, Saudi Arabia and Iceland. Among the most relevant domestic anti avoidance provisions recalled by this clause, it is notable the rule that limits the possibility to deduct certain items of expenses, the thin- capitalization rule, which qualifies certain passive interests as dividends for tax purposes, or even domestic CFC rules.
The overlap between domestic rules and treaty rules should lead to the conclusion that international rules prevail. Such a primacy should, nevertheless, be consistent with Art. 169 of the CTA, which codifies the principle of "non-aggravation", under which treaty law provisions cannot make the taxation more burdensome than that which the taxpayer would have suffered based on the application of domestic rules. In this context, the correct application of Art. 169 of the CTA requires not only that a comparison of domestic anti-abuse rules and treaty law rules be made, but also that the taxation actually suffered by the taxpayer must be taken into account, as the more favourable tax regime set out in domestic law is that of substantive law. Accordingly, a treaty anti-abuse provision more burden some than that in domestic law could, nonetheless, apply, to the extent that the denial of treaty benefits results in the application of the substantive tax regime provided for under domestic law. Consequently, the treaty anti- abuse provision would not have, in general, the effect of determining a treaty regime that is less favourable than that provided for under domestic law. For instance, in the case of such treaty provisions as those previously considered, the wider scope of treaty anti-abuse rules would result in the denial of the indirect tax credit on dividends, but the overall tax regime would not be more onerous than that provided for under domestic law, which, in any case, does not grant any indirect tax credit to non residents without a PE in Italy.

signed in Venice on 5 October 1989 and ratified in Italy by Law 20 of 7 January 1992, published in Official Journal No. 18 of 23 January 1992.

For the same reasons, a treaty provision would prevail over a domestic provision, even if the treaty provision itself has a limited scope of application and a given fact pattern is not covered in the treaty provision. For instance, the scope of the provision in Art. 10 of the France – Italy tax treaty is restricted to companies resident in France and controlled by non residents of France, so that a company that does not satisfy this condition, i.e. a French company controlled by residents of France, would not fall within the scope of application of the treaty anti-abuse provision and not even the application of domestic anti-abuse rules would be permitted.

2.2.3 LOB Clause

The new OECD Model suggests the application of a specific anti abuse rule, the “Limitation Of Benefits” rule (LOB), that limits the availability of treaty benefits to entities that meet certain conditions.

In the Italian DTC network a LOB clause may be found in the 1999 DTC with the United States[145]. Article 2 of the Protocol to the Convention states that, only upon satisfaction of some tests put together to reveal the presence of a sufficient link between the resident of one Contracting State requesting the treaty benefits and the same Contracting State, the benefits of the treaty may be available, in some cases in full, in others to a certain extent, as determined by the DTC or, on a discretional basis, by the competent tax authority.

Among these tests, the publicly traded test requires that all the shares in the class or classes of shares representing more than 50% of the voting power and value of a company have to be traded on a recognized stock exchange. For persons, other than individuals, that otherwise do not qualify for treaty benefits, two other tests are provided: the ownership test and the base erosion test. Under the ownership test, persons must own directly or indirectly at least 50% of each class of shares or other beneficial interest in the company for at least half the days of the taxable

[145] For a comment see G. Rolle – A. Turina, *Condizioni applicative e profili temporali della Convenzione Italia- USA,* Corr. Trib., p. 888 (2010); R. Dominici, *La ratifica della Convenzione Italia-USA contro le doppie imposizioni: un decennio di innovazioni*, Fisc. Int., p. 209, 2010.

year. To comply with this test, it is also necessary that, in the case of indirect ownership, each intermediate owner meets at least one of the conditions. The base erosion test prescribes that less than 50% of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not resident of either Contracting State in the form of payments that are deductible for income tax purposes in the person's State of residence. In applying the "base erosion test", payments attributable to a permanent establishment of the person located in the other State are not taken into account.

If a resident of a Contracting State does not satisfy any of the afore-mentioned tests, the resident is allowed the access to the treaty benefits with respect to specific items of income derived from the other State if he meets the requirements of the "active trade or business test", namely either he is engaged in the active conduct of a trade or business in his own State of residence, or the income is connected with, or incidental to, the trade or business, or the trade or business is substantial in relation to the activity carried on in the other State generating income.

Finally, if a resident of a Contracting State does not satisfy the requirements of any of the above- mentioned tests, he may nonetheless be granted treaty benefits if the competent authority of the State from which the benefits are claimed so determines in its discretion.

LOB clauses are also included in the DTCs with Azerbaijan, Estonia, Latvia, Lithuania, Qatar, Kazakhstan, Kuwait and Iceland. They are more simple than the one included in the DTC with the USA, as they usually read as follows: *"Notwithstanding any other provision of this Convention, a resident of a contracting State shall not receive the benefit of any reduction in or exemption from taxes provided for in this Convention by the other contracting State if the main purpose or one of the main purposes of the creation or of the existence of such resident or any person connected with such resident was to obtain the benefits under this Convention that would not otherwise be available[146]"*

[146] Protocol to Italy-Iceland Double Tax Convention, 10th September 2002.

2.2.4 GAARs in DTCs concluded by Italy

Until now there has been no trend in the DTCs concluded by Italy to insert general anti abuse clauses[147]. Although in some of the Treaties, it emerges the willingness of States to contrast all those operations which are characterized by the exclusive scope of obtaining a tax advantages from the DTCs. One example could be the Italy and Mexico Double Taxation Convention where at paragraph 8 of Article 11 of the part related to interests it states: *"The provisions of this Article shall not apply where the debt-claim in respect of which the interest is paid was agreed upon or assigned with the sole objective of taking advantage of this Article"*.

Another example of a sort of such a general anti avoidance clause, present in Treaties with non OECD States, is found in the Convention Italy - Qatar. Article 29 of the afore-mentioned Tax Treaty states that: "*A resident of a Contracting State shall not receive the benefit of any reduction in or exemption from taxes provided for in this Convention by the other Contracting State if the main purpose or one of the main purposes of the creation or existence of such resident or any person connected with such resident was to obtain the benefits under this Convention that would not otherwise be available"*.

2.2.5 SAARs in DTCs concluded by Italy

The "beneficial ownership" (BO) SAAR is present in many DTCs with OECD[148] and non OECD[149] members, although its content is not uniform. For instance, in the DTC between Italy and Mexico, for the application of the beneficial owner clause to interests and royalties, it is required that the avoidance purpose is exclusive[150]. Instead, in the DTC with the United States, the BO clause goes beyond its traditional boundaries, covering also other items of income[151]. The

[147] F Montanari, *Abuso del diritto, elusione e pianificazione fiscale aggressiva. Profili sostanziali e mezzi di tutela del contribuente,* of 16th December 2014, University of Bolzano.
[148] France, Germany, Spain, Luxemburg, Mexico, New Zeland, Portugal.
[149] South Africa, Singapore, Ecuador, Kuwait, Bangladesh.
[150] Italy-Mexico Double Tax Convention, 8 July 1991, art. 11, par. 8 and art. 12, par. 8.
[151] Italy-United States Double Tax Convention, 25 August 1999, art. 22, par. 3.

same happens in the treaties with India[152], Uganda, Ghana, where the BO clause applies also to the remuneration for technical services, and the treaty with Romania, where it applies also to commissions. Few DTCs signed by Italy define the beneficial owner.

The DTC with Germany[153], for example, provides that *"the recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if he is entitled to the right upon which the payments are based and the income derived therefrom is attributable to him under the tax laws of both States*".

Among other SAARs, it should be mentioned Article 10, par. 5, of the DTC with the UK[154] which grants tax credit on dividends provided that *"the recipient of a dividend shows (if required to do so by the competent authority of the United Kingdom or Italy respectively on receipt of a claim by the recipient to have the tax credit set against United Kingdom or Italian income tax respectively chargeable on him or to have the excess of the credit over that income tax paid to him) that the shareholding in respect of which the dividend was paid was acquired by the recipient for bona fide commercial reasons or in the ordinary course of making or managing investments and it was not the main object nor one of the main objects of that acquisition to obtain entitlement to the tax credit referred to in sub-paragraph (b) or sub-paragraph (c) of paragraph 3 or in sub-paragraph (a) or sub-paragraph (b) of paragraph 4 of this Article, as the case may be".*

It should also be recalled Article 13, par. 4, of the OECD MTC, which attributes the power to tax to the source State in respect to *"gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State".* A similar provision is included in the DTCs with Canada, Philippines, Pakistan, Estonia, Ukraine, Azerbaijan, Ghana, China, Mexico, India, Israel, Australia, United States and Finland.

[152] Italy-India Double Tax Convention, 19 February 1993, art. 13, par. 2.
[153] Protocol to Italy-Germany Double Tax Convention, 18 October 1989.
[154] Italy-United Kingdom Double Tax Convention, 21 October 1988, art. 10, par. 5.

Another SAAR, which follows the look-through approach and is extensively used in Italian DTCs, may be found in art. 17, par. 2, of the OECD MTC, whose purpose is to fight the diversion of the remuneration for the performances of entertainers or athletes to the so called star companies. According to this provision, notwithstanding art. 7 and 15, the remuneration may be taxed in the Contracting State in which the activities of the entertainers or athletes are exercised.

According to the differences between OECD and non OECD Countries, in all DTCs concluded by those States with Italy, there is a tendency to a general provision preventing tax evasion.

In the Convention Italy and Saudi Arabia, ratified on November 14th 2009, it is specified in Article 29 that: *"nothing in this Convention shall affect the application of domestic provisions to prevent tax evasion and tax avoidance concerning the limitation of expenses and any deductions arising from transactions between enterprises of a contracting State and enterprises situated in the other Contracting State, if the main purpose or one of the main purposes of the creation of such enterprises or of the transactions undertaken between them, was to obtain the benefits under the Convention, that would not be otherwise available"*.

Very similar are the provisions present in other DTCs concluded by Italy with other non OECD Countries[155]. The same happens with DTCs concluded by Italy with OECD countries.

In the DTC Italy - Norwegian, for example, the Additional Protocol starts with: *"at the signing of the Convention concluded today between the Government of the Kingdom of Norway and the Government of the Italian Republic for the avoidance of double taxation with respect to taxes on income and on capital and the*

[155] China - Italy DTC 13/12/1990 Additional *Protocol "At the signing of the Agreement concluded today between the Government of the People's Republic of China and the Government of the Republic of Italy for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income the under-signed have agreed upon the following provisions which shall form an integral part of the said Agreement"*; Italy - South Korea DTC 07/14/1992 *"At the signing of the Convention concluded today between the Government of the Republic of Korea and the Government of the Republic of Italy for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income the undersigned have agreed upon the following additional provisions which shall form an integral part of the said Convention"* among others.

prevention of fiscal evasion the undersigned have agreed upon the following additional provisions which shall form an integral part of the said Convention".

The DTCs with developing countries (for example Congo and Ecuador) the Additional Protocol starts always with the general provision of abuse tax evasion. To conclude, although the States stress the need to control and prevent tax evasion, there is no GAAR preventing the general abuse of law. This is the proposal of the latest BEPS Action 6 which wants to introduce a so called "PPT clause" (Principle Purpose Test), which should help considering abusive all the operations which as a principal scope aim at obtaining a benefit of the Convention.

2.3 Summary of the Italian key judicial decisions involving anti-avoidance/anti-abuse measures

As explained already in the first Chapter, the Italian Supreme Court, introduced the prohibition of abuse of law implementing a European principle which was already theorized by the ECJ in non fiscal matters and than extended to tax law with the ruling *Halifax*[156].

With the rulings no. 30055,30056 and 30057 of 23rd December 2008 the Court, recognized the principle of prohibition of law abuse as a general principle based not only on the European jurisprudence but also on Constitutional principles like the "ability to pay" (Article 53, 1 paragraph of the Constitution) and progressive taxation (Article 53, par.2 Constitution). This brought as a consequence the fact that the principle according to which the taxpayer shall not receive fiscal advantages from an inappropriate use of the law in order to obtain a tax saving with no appreciable economic reasons, is part of the grounds of the Italian juridical order. Initially, the abuse of law principle was applied only to harmonized taxes and not non harmonized ones.

[156] ECJ, 21st February 2006, case C-255/02, Gt. Riv. Trib. No. 5/2006 p- 385, commented by A. Santi and in Banca Dati BIG Suite, IPSOA.

The Supreme Court submitted a preliminary ruling to the ECJ asking whether the prohibition of law abuse as stated in the ruling C-255/02, *Halifax* and C-425/06, *Part Service*, is a fundamental principle of EU law only in matters of harmonized taxation and in secondary law or if it is extended also to the abuse of the fundamental freedoms, to non harmonized taxes (like direct taxes) when the operation has as object transnational economic facts[157]. In the answer, the ECJ stated that the prohibition of abuse of law could not be extended to non harmonized taxes and it could not be invoked in cases where a taxpayer did not use in a fraudulent and abusive way the EU law[158].

With the ruling *Halifax*, the ECJ underlined that even though the taxpayer has the right to choose different paths to limit its subjection to taxation[159], the application of EU law is not extended to those abusive behaviors of economic operators and to those operations realized at the mere scope of abusively beneficing of the advantages provided by EU law.

According to the Italian Supreme Court, there is in the national constitutional law a principle by which it is illicit to use abusively, and thus for a scope which is different from the one for which laws were created, tax laws[160]. This thesis was confirmed in later rulings.

Later, the Supreme Court, stated that it is sufficient the improper or unjustified use of a legal instrument to be considered in evasion of the fiscal regime. This because the legal order shall not sustain choices which are not determined by substantial economic reasons being evident that an operation which aims only at obtaining an undue fiscal advantage, is in contrast with the social welfare[161]. The prohibition of abuse of law is strongly linked with a general anti avoidance principle which precludes to taxpayers to obtain fiscal advantages through the distortion of laws regulating the matter, even though not specifically contrasting a provision. With this orientation, for the Supreme Court became then not more

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[157] Sup. Court 3rd November 2010, n. 22309, in Banca Dati BIG Suite, IPSOA.

[158] ECJ, 29 march 2012, ruling C-417/10, 3M Italia, 30-31, in Banca Dati BIG Suite, IPSOA.

[159] See ECJ, C-425/06 del 2008, par. 42; Id., 22 December 2010, ruling C-277/09, RBS, par. 54 e Id., 22 December 2010, ruling C-103/09, Weald leasing Ltd, par. 27, both in GT - Riv. giur. trib. n. 4/2011, p. 285, with comments of M. Basilavecchia, and in Banca Dati BIG Suite, IPSOA.

[160] Cass., SS.UU., n. 30055, 30056, e 30057 del 2008.

[161] Cass., 8 April 2009, n. 8487, in GT - Riv. giur. trib. n. 7/2009, p. 593, con comment of M. Basilavecchia, e in Banca Dati BIG Suite, IPSOA.

important the sole requisite of an undue fiscal advantage in order to qualify a conduct as abusive. The other element that mattered was the lack of economic substance, lack of an economic reason. This brought to a tendency in considering as abusive or tax avoiding certain acts, using only two parameters: the fiscal advantage and the absence of valid economic reasons. This brought to a long jurisprudence of the SC in which it is absent the element of the undue fiscal advantage[162].

Later on the Supreme Court characterized also the operations of *dividend stripping and dividend washing* as abusive, because they provoke an allegation of the fiscal data of the national taxpayer so to an "ability to pay" different (*in peius*) from the one considered by Article 53 of the Constitution. The operations only aim at obtaining a fiscal advantage[163]. Moreover, the Supreme Court also in other rulings[164] where it gave an extensive interpretation of extra - fiscal reasons, still did not consider the undue fiscal advantage nature. In fact, according to the Court, the extra-fiscal reasons could be also of a mere organizational nature and consist in an improvement of the Company.

The element of undue fiscal advantage was used again by the Supreme Court[165] when the operation concerned was done exclusively to obtain an undue fiscal advantage.

Regarding harmonized taxes, like VAT or custom duties, the Supreme Court followed the idea that abusive are those conducts which aim at an undue fiscal advantage[166].

This was the way which brought to the introduction of an Italian conception of abuse of law which started from the ECJ jurisprudence.

In the more recent jurisprudence[167] the abuse of law principle was best explained. The facts regarded an operation of real estate *"sale and lease back"* which was

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[162] Manzitti A., Fanni M., *Abuso ed elusione nell'attuazione della delega fiscale: un appello perché prevalgano la ragione e il diritto*, Corriere Tributario, 15, 2014, p.1141.

[163] Cass., 22 October 2010, n. 21692, in Banca Dati BIG Suite, IPSOA.

[164] Cass., 21 January 2011, n. 1372, in GT - Riv. giur. trib. n. 4/2011, p. 287, with comment of M. Basilavecchia, and in Banca Dati BIG Suite, IPSOA.

[165] Cass., 12th May 2011, n. 10383, in Banca Dati BIG Suite, IPSOA.

[166] Cass., 15th September 2009, n. 19827, in Banca Dati BIG Suite, IPSOA, Cass., 21 April 2010, n. 9477, in Banca Dati BIG Suite, I.

[167] Cass. 5.12.2014 n. 25758.

considered as in tax avoidance, firstly by the Income Revenue Authority and secondly by the "Second degree Tax Court commission of Bolzano" merely because the operation concerned had no valid extra - fiscal reason. According to the Supreme Court, it is not an abuse of law the changing of fiscal status by a taxpayer if this is the lowest taxable path. There is no abuse of law in selling one branch of the Company and re - buying it through a leasing in order to deduce the cost of the good. In the point 7.2 of the ruling, the judges are considering the absence of unreasonable and abnormal clauses in the leas back contract deciding that the Company acted according to the ordinary logic of the Company.

The ruling was in perfect harmony with the Illustrative Relation following through the Delegate Law 23/2014, according to which in order to have abuse of law, there is the need of a violation of the ratio of laws or of the general principles of a legal order, especially of the tax laws.

In this judgment the SC brought back in the jurisprudence the need of an undue fiscal advantage to characterize the abuse.

As above mentioned, in the recent ruling 25281/2015 the national Supreme Court has considered as a general principle in the international tax system, the beneficial ownership clause to prevent treaty shopping.

2.4 Effects of the changes to the OECD Model Convention and Commentary in the Italian Treaty practice

Article 3 (2) of the OECD Commentary states as follows: *"As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State".*

A debated issue which derives from such an extension of the national interpretation, is whether the meaning of a term should be the one given by the doctrine or jurisprudence at the time the Treaty was concluded (*static interpretation*) or the updated one (*ambulatory interpretation*). With the *static*

interpretation, the parties are bound by the original meaning given to terms at the moment the DTC was signed. Differently, with the *ambulatory interpretation* States could adapt the interpretation of Treaties to the current trends, without the need to refer to institutional procedures.

The static interpretation follows the fundamental principle of *"pacta sunt servanda".* It is important to notice that the OECD Commentary, as modified in 1995, seems to adopt the ambulatory interpretation[168] when it is written that the meaning to be given to non defined terms is the one it has <u>at the time</u> under the law of that State. Although, in order to avoid contrasts of an interpretational nature, the law leaves open the possibility to apply the *static interpretation*, where the contest requires the application of an interpretation different from the ambulatory one.

As Article 29 of the MCT states, the Commentary is not an annex to the Convention thus, it is not binding upon Contracting States. Although in the international praxis, it is used as interpretative instrument and sometimes the DTCs make express reference to it[169].

Assuming that the OECD Commentary is an interpretative instrument,[170] the problem which arises is whether its interpretation should be static or dynamic. Article 31 (1) of the Vienna Convention on the Law of Treaties reads as follows: *"A treaty shall be interpreted in good faith in accordance with the <u>ordinary meaning</u> to be given to the terms of the treaty in their context and in the light of its object and purpose".*

Thus, it is in favor to give a statutory interpretation to the terms. Although, par. 4 refers to the "special meaning" of terms, it seems to consider the time DTCs were concluded.

Having analyzed the issue, the best solution seems to be the one which differentiates the modifications to the OECD Commentary between mere

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[168] C. Giordano, *Manuale di tassazione internazionale*, II Edition, 2008, IPSOA.

[169] DTC Italy – Mexico Par. 5 Annex Protocol.

[170] Philip Morris, Cass., Sez. trib., sent. n. 3368 of 20 December 2001-7th March 2002, in il fisco n. 19/2002, n. 1, p. 3008; Cass., Sez. trib., ord. n. 7851 of 18 febbraio-23 April 2004, in il fisco n. 27/2004, n. 1, p. 4246; Cass., Sez. trib., sent. n. 10925 of 20th December 2001-25 July 2002, in il fisco n. 32/2002, p. 5200; Cass., Sez. trib., sent. n. 3368 of 20th December 2001-7 March 2002; Cass., Sez. trib., sent. n. 9942 del 1° June 2000-28 July 2000, in il fisco, n. 33/2000, p. 10321.

clarifications and real modifications. Part of the doctrine[171] believes that changes of small influence or of a mere explanatory nature do not amend Treaties already in force. Differently, if the modifications are consistent, the changes in the Commentary are directly reflected in DTCs.

In fact, when the Commentary was first amended in 1977, the Committee for the Fiscal Affairs took a position affirming that Conventions already existing and concluded shall be interpreted according to the interpretation of the newly modified Commentary. [172] The same approach was followed with the modifications incurred in 1992 and 2003 regarding the Treaties already concluded[173].

The OECD last changes of the Model Convention regard first of all the exchange of information.

Article 26 of the OECD Model Convention defines the standard requested in the exchange of information. The new rule provides for the exchange of information with the Financial Administration of the requesting State, through request only where the information was "foreseeably relevant" no matter the bank secret. The new introduction in Article 26, allow the group requests. The Financial Administrations can ask information about a group of taxpayers with no need of nominating each of them. Although the request does not have to be a fishing expedition.

Effective exchange of information between tax authorities is critical for combating all forms of international tax evasion and avoidance. OECD countries are generally compliant on standards for the effective exchange of tax information as set down by the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum). Cross-border agreements to assist developing

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[171] M. Lang, *"How significant are the amendments of the OECD commentary adopted after the conclusion of a tax treaty?"*, in Dir. Prat. Trib., 2002, I, p. 3 and following; Idem, Later Commentaries of the OECD Committee on Fiscal Affairs not to Affect the Interpretation of Previously Concluded Tax Treaties, in "Inter tax", 1997, p. 7 and following, P.J. Wattel-O. Marres, The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties, in "European Taxation", 2003, p. 222 and following.

[172] OECD, *"Model Tax Convention on Income and Capital"*, op. cit., point 33 (Introduction), 2003.

[173] OECD, *"Model Tax Convention on Income and Capital"*, op. cit., point 35 (Introduction), 2003.

countries in collecting taxes could provide critical support in recovering the taxes legally due. Developing countries need to continue to expand their network of agreements with relevant jurisdictions and they will need the technical capacity and political will to actively pursue international tax evasion through exchanging information. While the existing standard is based on exchange on request, the G20 is committed to automatic exchange of information and significant capacity building support for developing countries is needed in this area.

The exchange of information provision as already written above, is one of those clauses most of the time present in DTCs concluded by Italy so this new introduction will lead to a change in them.

Another change in the Model Convention which could affect the Italian Treaty practice is the notion of "beneficial ownership". It was approved the final version of a common notion in the Commentary of the beneficial owner related to articles 10,11 and 12. Having different interpretation of the concept, lead to double taxation or sometimes double non taxation.

Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to ... a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries1), rather, it should be understood in its context, in particular in relation to the words "paid ... to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance".

To conclude this Chapter, both domestic anti abuse rules and treaty rules are substantive rules and, therefore, can theoretically overlap. In order to establish which rules prevail, the hierarchy of law sources should be investigated. In this regard, as both domestic anti-abuse rules and treaty rules have constitutional grounds, the constitutional ground of the abuse of (tax) law principle and

domestic anti- abuse rules does not lead, in itself, to a situation in which these rules prevail over treaty law.

It should then be investigated whether or not the primacy of treaty law over domestic law leads to the conclusion that domestic anti-abuse provisions do not apply when they conflict with treaty rules. In this respect, it can be concluded that this is not a decisive argument to maintain that domestic anti-abuse rules are not compatible with treaty rules. Such an analysis is, of course, easier when the applicable tax treaty includes provisions that explicitly allow the application of domestic anti-abuse rules, examples of which can be found in several Italian tax treaties.

To conclude this Chapter regarding the Italian international treaty practice, it has to be underlined the importance Italy gives to international tax treaties.

In fact, in the Illustrative Relation introducing the new Art. 10-*bis* of the Charter of taxpayer's rights, it is specified that Italy recalls to both internal and supranational laws having effects in the internal law system. Thus, this underlines the importance DTCs have in the national law practice.

CHAPTER 3: THE RELATIONSHIP BETWEEN THE ITALIAN GAAR AND THE EU PERSPECTIVE

3.1 The relationship between the Italian GAAR and TFEU Fundamental Freedoms

It is known that the main goal of the European Union is to guarantee the unity of an internal market in which it is possible for the Fundamental Freedoms listed in the TFEU to be exercised with no obstacles.

The Fundamental Freedoms have a strong link with taxation because Member States might adopt some protectionist actions which may restrict such freedoms.

Member States have often referred and invoked the abuse of law principle in front of the ECJ in all those cases in which the choice of different tax systems by the taxpayer lead to a final tax evasion. *"The abuse of law represents a distinction between the correct use of EU law, which guarantees to citizens a series of advantages from the competition of different legal systems, and the total distortion of its scope"*[174]. The prohibition of abuse of law is an internal limit to the exercise of the Fundamental Freedoms.

Two are the aspects of the new Italian GAAR which might have to deal with the Fundamental Freedoms of the TFEU.

Firstly, Article 10-*bis* of the Italian Charter of taxpayer's rights, deals in paragraph 4 with the possibility for the taxpayer to choose freely between different regimes offered by the law which might have a more convenient tax burden. The cross border activities could be justified also according to paragraph 3 of Article 10-*bis*, by which the taxpayer can give evidence of the "extra-fiscal" nature of the operation concerned.

Also according to the ECJ, it is not abuse of law when the taxpayer matches different cross border activities, exercising the freedom of establishment to choose

[174] N. GULLO, *L'abuso del diritto nell'ordinamento comunitario: un (timido) limite alla scelta del diritto*, cit. 201.

the tax system more favorable for the activity exercised or the State with more convenient governance laws. It is not abuse of the freedom of establishment[175].

Within the European Union, direct taxes are not harmonized and, consequently, Member States are free to decide the national tax base and tax rate they want to apply to taxpayers who are subject to taxes in their country.

Some Member States offer especially low rates to attract foreign investors. Obviously, this brings to the possibility of choosing cross border activities since there might be cases in which opening a company in another Member State lawfully could be more convenient for the taxpayer. Once again, there is no abuse of law, also according to the ECJ case law, in choosing a country with a governance or a tax legislation more convenient respect to the one of another Member State.

In any case, cross border activities of a company in the European Union need to have valid commercial reasons[176] in order to be considered not in abuse of law.

Secondly, it is said in the Italian GAAR, that tax laws in order to contrast the abusive scope, permit deductions, withholding taxes not usually admitted by the national taxation system it these are an exception once the taxpayer demonstrates that abusive effects could not be reached.

So, as a general rule, the national GAAR is encouraging the exercise of the fundamental freedoms, wherever the aim of cross border activities is not the one of the abuse of tax laws.

3.1.1 The different meaning of abuse of law under national and European Law

"*No legal order can be composed solely of written rules. In all legal orders rules are filled out by general principles of law by the competent judiciary. On account of its lack of maturity and as yet great detail, the Community legal order has need of even greater recourse to general principles for its completion than most of the*

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[175] *Segers*, case 79/85; *Centros,* C-212/97; *InspireArt,* C-167/10.

[176] *Foggia* ECJ 10th November 2011, C-126/10.

national legal orders"[177]. The ECJ developed the idea of a general principle anti abuse starting from some common constitutional principles in the Member States. In different rulings[178], the Court stated that "*EU law cannot be relied on for abusive or fraudulent ends".*

Precisely, the application of EU legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages under EU law[179].

The first difference is that in the ECJ jurisprudence[180], it emerges a tendency to consider the abuse of law as an exception to the application of specific laws like the fundamental freedoms and not as a general concept like in the Italian taxation system (Article 10-*bis* abovementioned in Chapter 1).

Moreover, in the European Law, the testing of an eventually abusive conduct is done only occurring very strict and specific circumstances and the practice is based on a test which is now common in the jurisprudence of the Court. The finding of an abusive practice, in fact, requires a combination of two elements, one subjective and the other objective.

The more recent jurisprudence of the ECJ has used this test to verify the abusive conduct.

The first example is in the ruling SICES[181] where the question referred to the Court must be regarded as concerning whether Article 6(4) of Regulation No 341/2007, although not regulating such transactions by which an importer, holding reduced rate import licenses, purchases goods before they are imported into the European Union from an operator, itself a traditional importer within the meaning of Article 4(2) of that regulation, but having exhausted its own reduced rate import licenses, then resells them to that operator after having imported them

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[177] H.G. Schemers, *Judicial protection in the European communities*, Deventer, 1922, 27.

[178] Case C‑367/*96 Kefalas and Others* [1998] ECR I‑2843, paragraph 20; Case C‑373/97 *Diamantis* [2000] ECR I‑1705, paragraph 33; and Case C‑255/02 *Halifax and Others* [2006] ECR I‑1609, paragraph 68.

[179] *Halifax* and o., p. 69; ruling 5 July 2007, *Kofoe*d,C-321/05, I-5795, § 38.

[180] And European Commission's proposals like CCCTB.

[181] *Sices v. Agenzia delle Dogane di Venezia*, C – 115/13.

into the European Union, must nevertheless be interpreted as precluding such transactions on the ground that they constitute an abuse of rights.

With regard to the objective element, it must be apparent from a combination of objective circumstances that, despite formal observance of the conditions laid down by EU rules, the purpose of those rules has not been achieved. Differently, with the use of the subjective element, it appears from a number of objective factors that the transactions concluded by the taxpayer are done with the essential scope of obtaining an undue fiscal advantage. The prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of an advantage[182]. The existence of such an element relating to the intention of operators may be established, in particular, by proof of the purely artificial nature of the transactions[183]. So, there is no abuse of law all the times in which the operation can be explained in a way which is different from the mere obtainment of a fiscal advantage. Moreover, it is an issue of the subject concerned to proof the existence of the subjective element through the demonstration of the purely artificial character of the operations concerned.

For the ECJ, are abuse of law all those purely artificial mismatches with no economic substance which aim at law avoidance[184]. In fact, in the ruling *Cadbury Schweppes plc* the ECJ states that: "*Articles 43 EC and 48 EC do not preclude national tax legislation which provides for inclusion in the tax base of a resident parent company profits of a controlled foreign company established in another Member State where those profits are subject in that State to a much lower level of taxation than in effect in the State of residence of the parent company, if that legislation applies only to wholly artificial arrangements intended to circumvent national law. Such legislation must therefore enable the taxpayer to be exempted by providing proof that the controlled subsidiary is genuinely established in the State of establishment and that the transactions which have resulted in a reduction in the taxation of the parent company reflect services which were*

[182] *Halifax and Others*, par. 75.
[183] see, to that effect, *Emsland-Staerke*, par.53, and Case C-425/06 *Part Service.*
[184] *Cadbury Schweppes*, C-196/04.

actually carried out in that State and were not devoid of economic purpose with regard to that company's activities[185]*"*.
According to the Italian GAAR, as described in the first Chapter, are considered as in abuse of law *"all those operations with no economic substance, that even if concluded in the formal respect of tax rules, are essentially creating an unfair fiscal advantage"*.
Regarding the content of the abuse of law, the definition seems to be similar to the GAAR of the Italian law and this is also a logical consequence. In fact, it would have been complicated to apply a national GAAR which is contrasting the more general principle of abuse of law deriving from ECJ case law. The main goal of the European Union is to create certainty of law, adopting a national legislation contrasting with the ECJ jurisprudence would lead to confusion for the taxpayer. Moreover, there is a general obligation of Member States to conform the interpretation of national laws with the European case law.
The concept of abuse of law has a very wide application in the European Union law. It applies to different branches of law like criminal, commercial, customs and it is more articulated than the Italian GAAR because it is seen as a general principle in Treaties with reference to rights and freedoms; differently the Italian GAAR is applied in a more restricted series of cases like the taxation field or the procedural one[186].
Although, the main difference underlined by the doctrine, is the fact that the abuse of law under the European Union is not a GAAR because it is not seen as a parameter of legality for acts of derived law. There is no case law in which Directives and Regulations are compared with the violation of the examined principle. It is rather more common to analyze specific conducts in the light of the above mentioned principle of abuse of law. The test should be used as a parameter for the interpretation of laws to verify if there incurred any abuse of law. It is a criteria to verify the legitimacy of of the different national laws of Member States

[185] Conclusions *Cadburry Schweppes plc.*
[186] Ruling 21.1.2011 of Tribunale di Varese, also with reference to the Law no. 69/2009.

which need to apply the concept at national level. So the European abuse of law is not a principle directly applicable in Member States.

The European concept of abuse of law derives, before the developing of the ECJ case law, from the European Convention of Human Rights Article 17 on the "*prohibition of abuse of rights*": "*Nothing in this Convention may be interpreted as implying for any State, group or person any right to engage in any activity or perform any act aimed at the destruction of any of the rights and freedoms set forth herein or at their limitation to a greater extent than is provided for in the Convention*".

In Italy the concept of abuse of law derives from the ECJ jurisprudence which was seen as a model by the Italian Supreme Court and this lead the national legislator to adopt a GAAR.

3.1.2 GAAR as a justification for the Fundamental Freedom's restrictions

The first level of the analysis, regarding the existence of a discrimination or restriction, constitutes only the first of a two-step analysis in order to ascertain the compatibility of a given national provision with EU law.

The prohibition of discrimination[187] is referred directly to Member States[188] in order for the Fundamental Freedoms to be applied with no restriction. The discrimination occurs when two comparable situations are treated in a different way and according to the results of such comparison, the taxpayer who was discriminated has been subject to a less favorable treatment[189]. Thus, even though

[187] Case Shumaker C-279/93, conclusions: *"Article 48 of the EEC Treaty must be interpreted as being capable of limiting the right of a Member State to lay down conditions concerning the liability to taxation of a national of another Member State and the manner in which tax is to be levied on the income received by him within its territory, since that article does not allow a Member State, as regards the collection of direct taxes, to treat a national of another Member State employed in the territory of the first State in the exercise of his right of freedom of movement less favourably than one of its own nationals in the same situation.*

[188] Ruling C-1/93 *Halliburton Services BV* and *Staatssecretaris van Financiën* [1994] in Racc. I-1137, par 16.

[189] Conclusions of the ruling Shumaker: *Article 48 of the Treaty must be interpreted as precluding a provision in the legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is*

imposed by Member States, taxes need to comply with the EU fundamental freedoms.

The prohibition of discrimination derivers form Article 18 TFEU[190].

Regarding restrictions, it is considered as such, also the adoption of a less favorable taxation regime by a Member States, which is not attracting the foreign exercise of activities in that State, i.e. are considered as restrictions the tax conditions which are applicable to all taxpayers, nationals and non nationals, but *de facto* are more difficult to comply with for the foreign taxpayer.

Discrimination or restrictions of the Fundamental Freedoms may be justified.

Some justifications are expressly mentioned in the TFEU but some others are affirmed by the ECJ case law (rule of reason doctrine). By the latter, are considered as legitimate discrimination:

- the necessity to contrast tax avoidance and tax fraud;
- the need to preserve efficiency in tax controls;
- the principle of coherence with the national tax system.

To justify discriminatory national provisions under European law with the anti-abuse argument, the first precondition is that through the international structure the person may benefit from a tax advantage which he would not have benefited from in a pure domestic situation.

The second precondition is that the aim of the national provision has to be to counteract abusive or fraudulent conduct. Moreover, a national discriminatory provision has to be designed in such a way as to discriminate against exclusively abusive behavior.

It is prohibited as a justification the grant of financial aids by Member States[191].

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available only to residents, thereby excluding natural persons who have no permanent residence or usual abode on its territory but receive income there from employment.

[190] "*Within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited".*

[191] Article 107 TFEU par. 1"*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".*

Obviously those restrictions need to be proportionate[192], thus could not exceed what is necessary to pursue a specific goal.
Under this European conditions, the Italian GAAR might be seen as a restriction when it is used to counteract the fraudulent conducts, exclusively on the abusive behavior.

3.1.3 Impacts of the European Commission Recommendations in the GAAR area

The definition of abuse of law outlined in this new Italian GAAR is explicitly drawn from the one used in the Recommendation on aggressive tax planning issued by the European Commission on 6th December 2012.
According to it *"One or more transactions are deemed to be abusive when they do not have economic substance and, while formally consistent with tax law, achieve essentially undue tax advantages"*. As pointed out, the definition of abusive practice provided by Art. 10-*bis* relies therefore on two elements: 1) the transaction shall lack of economic substance, i.e. shall be unable to produce meaningful effects apart from the tax advantages, and 2) the tax advantages shall be undue, i.e. shall be conflicting with the purpose of the tax provisions or of the principles of the tax system. Both tests have an objective nature. No room is thus left to the subjective intention of the taxpayer.
The European Commission has issued a series of recommendations to Member States to introduce national anti abuse laws in order to combat the tax avoidance phenomenon.
The Commission recommendation which had the most impact on the Italian GAAR was the number 2012/772/EU on aggressive tax planning.
In general, the recommendation suggested to avoid the adoption of very specific and particular rules on anti abuse in order to be more competitive in an international landscape.
According to the point 4.2 of the mentioned Recommendation, the abuse of law phenomenon is as such described by the European Commission: *"An artificial*

[192] EU Commission, Comunication no. 785, 10th December 2007.

arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance".

The principle was introduced at the national level with Article 10-*bis* which underlines instead, the main character of abuse of law which is the absence of economic substance of the facts or acts put in practice by the taxpayer. The Italian legislator has taken into consideration the Commission definition of abuse of law because all those artificial arrangements or series of arrangements as defined by the Commission are nothing more than operations without an economic and commercial substance[193]. Also in the point 4.4 of the Recommendation in which the Commission explains deeply the terms of the principle, it is stressing the concept of absence of economic substance. In fact, it is written that *"an arrangement or a series of arrangements is artificial where it lacks commercial substance".* The point 4.4 is recalled by Article 10-*bis* paragraph 2, letter a) in which the Italian legislator explains that indicators of the absence of economic substance are 1) the non coherence of the operation's juridical qualification with its juridical grounds and 2) the non conformity of the use of specific juridical instruments compared with the logical trends of the market.

According to the point 4.5 of the Commission Recommendation, *"the purpose of an arrangement or series of arrangements consists in avoiding taxation where, regardless of any subjective intentions of the taxpayer, it defeats the object, spirit and purpose of the tax provisions that would otherwise apply".* The Italian legislator adopted a wider formula on the abusive tax saving. In paragraph 2 of Article 10-*bis* letter b), it is written that an undue benefit is realized when contrasting the aim of the tax laws.

In the recommendation, the Commission requires also that, for a conduct to be abusive, it should have the undue tax saving as its essential scope. According to the Commission, a given purpose is to be considered essential where any other

[193] G. Zizzo, *"La nuova nozione di abuso di diritto e le raccomandazioni della Commissione Europea"*, Corr. Trib.

purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case.
This view is reproduced by the Article 10-*bis* in paragraph 3 when the legislator wrote that are not considered as abusive all those acts which are justified by valid "extra fiscal" reasons, not marginal also of an organizational or managerial character which are done in order to improve the structural or functional activity of the enterprise. So, in the Italian GAAR the fundamental characters are two and not three like in the Commission's proposal. The first one is the absence of economic substance of the operation and the second is the undue fiscal advantage. For the European Commission constitutive of the abusive conduct is also the essentiality of the aim to an undue tax saving.
Although, ultimately, it is clear that the Italian legislator has been accurate in following the Commission's recommendations regarding the new GAAR.

3.1.4 The ECJ jurisprudence influence on the Italian GAAR

Until now there has been no case law of the ECJ regarding Italy and the restrictions to the exercise of the Fundamental Freedoms, although the ECJ has exercised a huge influence on the introduction of the abuse of law principle in the national system.
In fact, before the ECJ dealt with the theme of abuse of law the Italian (but not only) tax authorities, qualified the abuse of law as whatever choice taken by the taxpayer to obtain a tax saving but who, according to the law, should have taken another and heavier taxation road.
As discussed in the first Chapter, the discussion on the theme of abuse of law was opened in Italy with the two ruling on *dividend washing and dividend stripping*[194].
The Italian Supreme Court, defined it it for the first time also in the civil law ambit with the ruling 20106/2009 defining as such the characteristics of the abuse:

[194] S.C. 21st October 2005, n. 20398, in Riv. Giur. Trib. N. 1/2006, p. 19, with comments by L. Mafiotti and Banca Dati BIG, IPSOA; Id., 14th November 2005, n.22932, in Riv. Trib. N. 3/2006 p. 211, with comment by M. Beghin and Banca Dati BIG, IPSOA.

- possession of a subjective right;
- exercise of a right;
- not proportionate the beneficial of the part exercising the right and the privation of the counterpart.

It is important to underline that in the preparatory work of the Italian Constitution there was a provision mentioning the prohibition of abuse of law*: "Nobody shall behave in a way which is in contrast with the scope of the norm guaranteeing a right".*

The ECJ started dealing with the abuse of law in the ruling *Halifax* first in 2006 and another significant ruling was *Cadbury Schweppes plc* in which the Court saw tax avoidance as an artificial construction aiming only at avoiding the payment of taxes. This view was reported by the Italian legislator in the national provision Article 167 par. 8-*ter* of the Italian Income Tax Act for Controlled Foreign Corporations having legal seat in a black list country.

In the already mentioned ruling *Halifax* and in the national one of the Supreme Court n.1372/2011 (21st January 2011), it is stated that when to exercise an activity is chosen a foreign controlled company and not a local one because this leads to a fiscal advantage, this is not sufficient to determine that the main goal of the activity is the obtainment of a mere fiscal advantage.

In the mentioned ruling, the Italian Supreme Court states that it is necessary to assess that the action is done in accordance with the usual market logic, excluding law abuse in the presence of valid "extra fiscal" reasons. The considerations in the ruling n. 1372/2011 of the Supreme Court are another important step in the national definition of abuse of law. The Court underlined here the principle that wherever the specific anti avoidance rules are not applicable it is applied the general principle of abuse of law.

The Court stated that the abuse of law principle needs to be applied with prudence especially when the operations concern *dividend washing or stripping*, are happening between big groups of companies.

3.1.5 Significant differences between the GAAR and the anti-abuse clauses present in the EU Directives

According to the legislative point of view, there have been numerous attempts of the European legislator to codify the concept of abuse of law.

In order to eliminate economic and juridical double taxation, to facilitate cross border transactions between companies, the European legislator adopted many Directives and proposals[195].

In many of these there are specific provisions on the prohibition of abuse of law. The abuse of law argument is used as a justification by Member States whenever a national provision could be considered as restricting the EU fundamental freedoms. In this way, it is used as a restriction that Member States use to impede the applicability of a European Law.

To be mentioned first is the new provision introduced in the Parent-Subsidiary Directive by the Article 1 of the Council Directive 2015/121 of 27 January 2015:

"Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. (par.2)

[195] Directive proposal CCCTB issued by the European Commission the 16th of March 2011, contemplates not only a general clause but also specific provisions on the theme of Controlled Foreign Companies (CFC) and the non deducibility of interests (art. 80 - 83). This might be a structural difference between the proposal and the Italian legislation. Already in the Working Paper 65/2008 there was a reference to the CFC dispositions which principal objective was to impede to resident companies to transfer income to the controlled company.

The Common Consolidated Corporate Tax Base (CCCTB) is a single set of rules that companies operating within the EU could use to calculate their taxable profits. In other words, a company would have to comply with just one EU system for computing its taxable income, rather than different rules in each Member State in which they operate. In addition, groups using the CCCTB would be able to file a single consolidated tax return for the whole of their activity in the EU. The consolidated taxable profits of the group would be shared out
to the individual companies by a simple formula. That way, each Member State can then tax the profits of the companies in its State at their own national tax rate (just like today).

For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse".
Although, the Directive did not specify which type of behavior is considered as an act with no valid economic reason or what is an undue fiscal advantage.
This Directive was modified after the Commission Recommendation of 2012/772 (see par. 4.1.7) in which it was stressed the need to combat the tax avoidance phenomenon in Member States. In particular, Member States should not guarantee benefits of the Directive to acts which are contrary to the principal scope of the Directive and which are not genuine.
The new Italian GAAR is recalling the recommendations of the European Commission. So having changed the Parent-Subsidiary Directive in the lights of those recommendations, it is evident the strict link between the concept of abuse of law given by the mentioned directive and the concept expressed by the national legislator in the GAAR.
Another Directive to be mentioned which contains provisions preventing the abuse of law is the Directive 77/799/EEC of 19 December 1977 which was the first Eu law concerning the exchange of information between Member States (there is no provision in the TFEU on exchange of information between tax authorities). The Directive was substituted by the updated version of the new Directive 2011/16/EU. On the 12th of June 2013 the Commission proposed to extend the automatic exchange of information between EU tax administrations, as part of the intensified fight against tax evasion.
The Directive provides three types of information exchange:

- spontaneous (information about people likely to be tax evaders);
- automatic;
- on request.

These three forms conform with the standards agreed by tax administrations at international level, notably at the OECD.
The speedy development of the mobility of taxpayers, the internationalization of financial instruments, the increasing number of cross border transactions, makes it always more difficult for Member States to control the effective functioning of the taxation system. In order to avoid tax evasion and tax fraud, Member States needed to develop a new effective system of mutual assistance and administrative cooperation between them in the tax field.
The provision on the exchange of information introduced also at the national level a better coordination between tax authorities which is better exercised at community level rather than at the national one.
Not to forget is also Article 15 of the Directive n. 2009/133 related to the common fiscal regime to be applied to mergers, divisions, partial divisions, transfer of assets and exchange of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.
Art. 15 provides that a Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1 (a): *"has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives"*.
Here, as analyzed before, are listed the same structural needs to identify a conduct as abusive as the ones required by the Italian legislator. The stressing on the absence of valid economic reasons is present also in Article 10-*bis*.
As logical, there are no significant differences between the concept of abuse of law present in the Italian system respect to the European one. Once again, Member States need to conform to the principles stated by the European Institutions.

In the Working Paper n. 65 of 26th March 2008, the European Commission declared that a general anti-abuse disposition would help the Tax Authorities to re-qualify the artificial transactions leaving the chance to the taxpayer to demonstrate the existence of an effective economic reason or the commercial nature of the act. This is also similar to the possibility given to the in Article 10-*bis* to taxpayer to demonstrate the existence of "extra-fiscal" reasons which can justify the presence of a conduct which might have been considered as abusive without them.

Article 80 of the CCTB Proposal is entitled *"anti abuse rule": "Artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored for the purposes of calculating the tax base.*

The first paragraph shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts".

Here also it is recalled the genuineness of the commercial activities. The Article is not clear on what is to be intended for genuine commercial activities and this is also a structural difference with the Italian GAAR. The national legislator was very precise in explaining the terms of the provision. Here, instead, the Institutions did not provide a clear picture of what they intended for genuine.

For what regards structural differences, it has to be underlined that Directives refer to all Member States and not directly (as the national Article 10-*bis*) to the taxpayer; so they tend to give more general directions and give interpretation standards to Member States.

Moreover another difference is that Article 10-*bis* concerns not only the abuse but especially what are the remedies the taxpayer may use like paragraph 5 ("interpello"), paragraph 7 (request of clarification), paragraph 9 (burden of proof). In fact, the avoidance of abuse of law under European law, is more an interpretational concept. There is no specific concern on the consequences deriving from the breach of the principle while instead in the national GAAR there is more attention to the taxpayer.

3.1.6 Differences between tax consequences deriving from the application of GAAR and the ones deriving from the European anti-abuse clause

Paragraph 11 of Article 10-*bis* states that people different from the ones to whom are referred the facts of the anti-abuse clause, could ask for the refund of the taxes paid as a result of the abusive acts which have not been recognized by the Financial Administration. The above mentioned refund can be asked to the competent tax authority by the payer within a year from the day in which the inspection became definitive. This is the consequence the Italian legislator provided in Article 10-*bis*. It is a practical consequence which aims directly at beneficing the national taxpayer who has suffered a damage from the abuse of law. Differently, in European law, as noticed already above, the anti abuse clause refers generally to Member States as a principle for the interpretation of national laws.

According to Article 10-*bis* par. 13, the abuse of law conduct could lead to administrative sanctions; although it is excluded the application of criminal penalties.

3.1.7 Impact of the Parent-Subsidiary Directive in the national tax legislation

As analyzed in the previous Chapter, the Directive 121/2015 which introduced a new general anti abuse clause, changing paragraph 2 and 4 of Article 1 of the previous Parent Subsidiary Directive[196]. It aims to regulate the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. This Directive aims to achieve the Elimination of economic double taxation (forcing the adoption of the exemption or credit method) and the elimination of the juridical double taxation (forcing the granting of an exemption from withholding tax on outbound dividends).

In Italy, according to Article 27, par. 3-ter, of the ITAA, dividends and similar income paid by an Italian entity to a foreign person are subject to a withholding

[196] EU: Council Directive, 30 November 2011, 2011/96/EU, EU Law IBFD, as amended by Council Directive, 8 July 2014, 2014/86/EU, EU Law IBFD.

tax of 1,375% provided that the recipient EU or EESA is a company or an entity (1) subject to corporate income tax and (2) resident in a country that allows an adequate exchange of information with the Italian tax authorities.
Similarly, under the domestic law implementing the EU Interest and Royalties Directive[197], outbound interest and royalties are exempt from Italian withholding taxes provided that the recipient is an associated company of the paying company and is resident in another EU country or a permanent establishment of such associated company situated in another EU country.
The Parent Subsidiary Directive does not preclude the application of national dispositions or conventions necessary to avoid tax avoidance and fiscal fraud or abuse. This general anti abuse clause is a *de minims* measure because it leaves freedom to Member States to adopt their own measures sometimes stricter than the general anti abuse clause present in the Directive concerned[198].
The ECJ, as reported above, has declared that Member States may adopt restrictions to the freedom of establishment between Member States in order to contrast tax evasion or fraud as long as those restrictions are justified. Those restrictions lead to the non application also of the benefits of the Parent-Subsidiary Directive. According to the doctrine[199], with reference to paragraph 5 of Article 27-*bis* of the D.P.R. n. 600/1973, the Italian legislator should introduce a minimum level of contrast to tax evasion, according to the provisions of the Directive 2015/121. In fact, the general anti-abuse clause of the Directive, refers also to those operations which have to deal with cross border situations between non Member States.
The tax administration, according to the new general anti abuse clause, could neglect the application of Article 27-*bis* D.P.R. n. 600/1973 to a Parent company controlled by shareholders of other States non EU Members, only when the artificial nature of the operations is attested[200].

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[197] EU: Council Directive, 3 June 2003, 2003/49/EC, EU Law IBFD.
[198] 5th Considerandum Directive 2015/121, and "Relazione Ecofin", 27th October 2014 14532/14, LIMITE, FISC 166, ECOFIN 954, p.3.
[199] L. Rossi and G. Ficai, *Modifiche antielusive alla Direttiva Madre e figlia*, Corr. Trib. N. 22/2015, p. 1699
[200] G. Maisto, *Temi attuali sull'interpretazione della Direttiva Madre e Figlia*, in "La tassazione dei dividendi inter societari", Milano, 2011, p.586

In order to exercise the freedom of establishment, there should not be any kind of precondition if the shareholders controlling the Parent company are from a State not Member of the EU. Article 54 TFEU in fact, states that the company's status is grounded on the location of the legal seat and on the juridical order of the company and not on the nationality of the shareholders.

ANALYZED DOUBLE TAXATION CONVENTIONS

- Italy – China, 13.12.1990
- Italy – Thailand, 31.05.1980
- Italy – Trinidad and Tobago, 19.04.1974
- Italy – Tunisia, 17.09.1981
- Italy – Zambia, 30.03.1990
- Italy – Austria, 06.04.1985
- Italy – Portugal, 15.01.1983
- Italy – Rep. Slovakia, 26.06.1984
- Italy – Romania, 06.02.1979
- Italy – Sweden, 05.07.1983
- Italy – Switzerland, 27.03.1979
- Italy – Hungary, 01.12.1980
- Italy – Hong Kong, 11.08.2015
- Italy –Island, 14.10.2008
- Italy – Azerbaijan, 13.08.2011
- Italy – Ukraine, 25.02.2003
- Italy – Emirates, 25.11.1997
- Italy – Ethiopia, 9.08.2005
- Italy – Uzbekistan, 25.05.2004
- Italy – Macedonia, 08.06.2000
- Italy – Lituania, 03.06.1999
- Italy – Georgia, 19.02.2004
- Italy – Ghana, 5.07.2006
- Italy – Quatar, 07.02.2011
- Italy – Jordan, 10.05.2010

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Potential impact of BEPS on tax systems

Specific anti-abuse rules (SAAR) in a post-BEPS world

Margherita Pittori

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1 INTRODUCTION

1.1 The "abuse of law"

"Abuse of law" is a blurry and ambiguous notion. However, we should try to define this notion because it is the key to understand the issue we are about to introduce.

An act is abusive when it is "placed outside the law", not because of its form, but because of its effects and pursued aims[1]. "Abuse of law" implies the exercise of a right, formally correct, but aimed to pursuit an advantage that the legal system does not consider worthy of protection[2]. It is important to focus on the fact that if there is not an advantage of any kind, the abuse cannot be identified[3]. The complexity of the definition itself increases when the notion is observed by different points of view and additioning because of the fact that each country developed its own approach over the years.

Jurists and tax advisors do have different points of view about the notion mentioned above: "*abuse of law by jurists is not the same thing as abuse of law by tax advisors*"[4]. Specifically, for jurists[5], abuse of law is a despicable conduct: the ability of using one individual's right with no other purpose than damage another subject. On the other hand, law abuse for tax advisors is something different: it is a profit-seeking process.

Moreover, such concept is far from being uniformed among countries: "*the "abuse of tax law" concept is far from being univocal*"[6].

In order to better understand the concept of tax abuse, it is enlightening to compare it with others tax matters[7]. By this *modus operandi*, the differences that we find will contribute to the characterization of the phenomenon concerned.

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[1] P. Piantavigna, *Prohibition of Abuse of Law: A New General Principle of EU Law?*, in Intertax, 2009, Issue 3, pp. 166-175.
[2] M. Burgio, *The Abuse of Law in the framework of the European Tax Law*, Intertax, 2009, Issue 2, pp. 82-88.
[3] A. Dragonetti, *Fiscalità internazionale,* IPSOA, 2008.
[4] M. Cozian, *What is abuse of law?*, in Intertax, 1991, II, p. 103.
[5] Y. Kergall, *The concept of abuse of law*, Intertax, 1991, Issue 1, pp. 2–2.
[6] S. de Monès, P. Durand, J. Mandelbaum, M. Klein, Alice Niemann, A. Manzitti, G. C. Lasarte, G. M. Benítez, G. J. Airs, *Abuse of Tax Law across Europe*, in Ec Tax Review, 2010, II, p. 85.
[7] The relationship or correlation between tax avoidance, aggressive tax planning, tax fraud and tax evasion has not even been outlined in the 2012 Action Plan presented on 6 December by the European Commission. See R. Mirugia, *Fighting Tax Fraud and Tax Evasion in the EU: The 2012 Action Plan*, EC Tax Review, Issue 4, pp. 220-231.

First of all, we can look at the comparison between the abuse of law and the tax fraud[8]. In the event of tax fraud, the taxpayer is aware of been breaking tax rules and he does so in order to pay less taxes. While, with abuse of law, no tax regulation is being violated, therefore the person who endures in law abuse is an expert in tax matter. He knows tax rules well enough to penetrate into the gaps and makes sure none of the articles are violated[9]. At this step of the examination, it is fundamental to differentiate the abuse of law also from the tax skillfulness, since the former is repudiate in the legal systems, the latter is valued instead[10]. Tax skillfulness is the art of making smart choices. It is only the well founded concern of good management of one's finances or taxes[11]. In tax matters, as well as in others, one can make good or bad choices. That is why tax skillfulness can be regarded as a virtue, a quality[12]. To sum up, abuse of law is not tax fraud since no legal prescription is violated and it is also different from tax skillfulness which is not forbidden at all[13]. It is simply an excess of fiscal ability; but it has to be kept in account there is a point beyond which one shall never go.

"Abuse of law" is a device able to make taxable income disappear by legal manipulations. The "abuse of law" can be defined as an act carried out essentially to obtain undue tax advantages. Undue tax advantages are defined as benefits, even though not immediately obtained, conflicting with the purpose of tax rules or with the principles of the tax system. Abuse only exists when, despite formal compliance with the conditions fixed by the applicable measures, the objective of

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[8] P.M. Tabellini, *L'elusione della norma tributaria,* Giuffrè, Torino, 2007, pg. 27.

[9] The OECD describes tax avoidance as the arrangement of a taxpayer's affairs intended to reduce tax liability. Although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow. So they can be define as unacceptable. See OECD Centre for Tax Policy and administration "Glossary of Tax Terms", footnote 4.

[10] G. Esposito, *Lecito risparmio di imposta e profili di evasione fiscale*, Progen, 2002.

[11] It is referred to the notion that many civil codes contain: "the prudent administrator managing the family wealth". For example, in the French Civil Code there is a provision dealing with "le bon patre de famille – paterfamilias"; again, in the Italian there is a provision dealing with "la diligenza del buon padre di famiglia".

[12] P. Merks, *Tax Evasion, Tax Avoidance and Tax Planning*, Intertax, 2006, Issue 5, pp. 272–281.

[13] M. Aujean, *Fighting Tax Fraud and Evasion : In Search of a Tax Strategy?*, EC Tax Review, 2013, Issue 2, pp. 64-65.

these measures is not attained and there is an intention to gain an advantage resulting in artificial conditions[14].

1.2 Anti-abuse rules

As one could expect, the abuse of law has harmful effects for national Governments and, for this reason, its avoidance or, at least, restriction is one of the main issue[15]. The Member States must be able to manage effective tax systems and avoid any undue erosion of their tax base attributable to abuse or unintended non-taxation[16]. There are several reasons why governments need to fight tax avoidance. The main one is that it distorts the allocation of the tax burden among citizens and other States. It is then regarded as one of the threats affecting the soundness and coherence of the tax system, because of its negative incidence on the main equality principles (i.e. ability to pay, general taxation, etc.).

1.2.1 General anti-abuse rules

1.2.1.1 The current general anti-abuse rule in the Italian Legal System

The Italian Government in September 2015 approved Legislative Decree n. 128 which clearly and explicitly introduced general anti-abuse rules (GAARs) in our legal system. The decree was published in the *Official Gazette* on 18 August 2015 and it became effective on 2 September 2015[17].

The decree has been enacted to give accomplishment to Art. 5 of delegating law no. 23 of 11th march 2014[18]. Art. 5 of delegating law 23/2014 provides for the review of the existing anti-avoidance provisions in order to unify the general principle of anti-abuse law and coordinate them with the European Commission

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[14] See more at: http://eur-lex.europa.eu/legal-content/IT/TXT/?uri=URISERV:l31062¸see more at: http://www.thor.ca/blog/2012/05/italy-seeks-to-define-abuse-in-tax-anti-avoidance-rules/#sthash.ekkWvY0u.dpuf.

[15] B. Kiekebeld, *Anti-abuse in the Field of Taxation: Is There One Overall Concept?, EC Tax Review*, 2009, Issue 4, pp. 144–145.

[16] M. Aujean, *Tax Competition and Tax Planning: What a solution for the EU?*, EC Tax Review, 2014, Issue 2, pp. 62-63.

[17] View the entire Decree at http://www.normattiva.it/atto/caricaDettaglioAtto?atto.dataPubblicazioneGazzetta=2015-08-18&atto.codiceRedazionale=15G00146¤tPage=1.

[18] View the entire law at http://www.normattiva.it/atto/caricaDettaglioAtto?atto.dataPubblicazioneGazzetta=2014-03-12&atto.codiceRedazionale=14G00030¤tPage=1.

recommendation on aggressive tax planning (December 6th 2012, n . 2012/772 / EU)[19]. The principles and guidelines of the delegating law are:

- defining the abusive conduct as a misuse of an existing legal instruments necessary to achieve a tax saving (even if such conduct is consistent with any specific provision),
- ensuring freedom of choice for the taxpayer across several transactions (also involving a different tax burden),
- regulating the regime of proof by requiring the burden of proving the improper design concerned to the tax authorities,
- establishing a formal and precise identification of abusive conduct in the grounds of the investigation tax, under penalty of nullity of this finding provide for specific procedural rules to ensure effective contradictory between the taxpayer and the tax authorities,
- protecting the defense right at any stage of the proceedings of the tax assessment.

Based on these guidelines, the Government enacted the Decree no. 128 of the 5 August 2015 (published in the Official Gazette the 18 August 2015).

Generally speaking, this Decree generalizes a system of clarification and consultation (so called "*interpello")*[20]. In particular, the Decree 158/2015 has introduced a kind of request based of the proof coming from the taxpayer (so called "*interpello probatorio"*)[21] and a kind of request specifically having an anti-abusive aim (so called "*interpello antielusivo"*)[22].

Art. 1 of Legislative Decree no. 128/2015 provides the introduction of art. 10 *bis* of the Statute of the taxpayer (Law 27 July 2000, no. 212) and the union of the discipline of "tax avoidance" and "abuse of rights" by a repeal of the anti-avoidance rule contained in Art. 37 *bis* of Presidential Decree no. 600/1973. According to Art. 10 *bis* abuse of law arises when one or more transactions - without economic substance - are made to achieve undue tax advantages, despite

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[19] P. Parisi, *I decreti attuativi della delega per la riforma fiscale*, in Pratica fiscale e professionale, no. 37, 2015, pg. 3.

[20] See pg. 17 of this work.

[21] See the Explanatory Report for Decree 158/2015 at page 5.

[22] G.M. Committeri, G. Scifoni, *Le istanze di interpelloantiabuso tra modifiche legislative non coordinate e sforzi interpretativi dell'Agenzia*, in Corriere Tributario, no. 8, 2016, pg. 585.

the formal observance of the tax rules[23]. Compared with Art. 37 *bis*, the new discipline of anti abuse covers a wider typology of cases: it requires that the tax saving has to be not the sole purpose of the operation but the main purpose and increases the relevance beyond fiscal matters interests. However, the taxpayer still has the choice between several optional regimes which are offered by the law and which involve a different tax burden.

In conclusion, what is extremely important for the topic of this paperwork is the introduction of GAARs. The GAAR, as part of the decree[24], is applicable to all taxes, both direct and indirect, with the exclusion of custom duties.

1.2.1.2 The previous general anti-abuse rule in the Italian Legal System

Before this Decree, Italy did not have any general anti-avoidance rules.

Until then, Italian jurisprudence had developed only unwritten principles and undefined goals as a result of a pretty ambiguous provision.

The only existing provision with a possible anti-abusive aim was the Article 37 *bis* of the Decree of the President of the Republic no. 600 of 1973 which was enacted by law no. 358/1997[25]. For its ambiguity, this provision was deeply discussed.

Especially, Art. 37 *bis* might be seen as a "provision ruling the interpretation of other tax rules" and also as a criteria of "abuse of legal forms"[26]. Regarding the potential role of the criterion of "abuse of legal forms" it was concluded that it appeared to be at the core of art. 37 *bis*[27]. Due to the structure of our tax system, tax avoidance is possible mainly because the taxpayer can duly realize that taxable fact - which reduces his tax burden - by adopting certain legal forms. Moreover, it

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[23] G. Fransoni, *La "multiforme" efficacia nel tempo dell'art. 10-bis dello Statuto su abuso ed elusione fiscale*, in Corriere Tributario, no. 44, 2015, pg. 4362.

[24] L. Lovecchio, *D.Lgs. 5 agosto 2015, n. 128 - Divieto di abuso del diritto: l'incognita applicazione futura della giurisprudenza "invasiva",* in il fisco, no. 35, 2015, pg. 1-3319; A.Carinci, D. Deotto, *D.Lgs. 5 agosto 2015, n. 128 - Abuso del diritto ed effettiva utilità della novella: Much ado about nothing?*,in il fisco, no. 32, 2015, pg. 1-3107.

[25] Before of the introduction of this article, the Italian Parliament was traditionally reluctant to introduce such a rule as it was considered to impair the certainty and stability of the tax system. The art. 10 of Law n. 408/1990 it has enacted only a "targeted" general anti-avoidance rule which allows tax authorities to get rid of those tax benefits obtained in specific transactions arguing that they were carried out without sound business reasons and for the sole purpose of fraudulently obtaining a tax saving.

[26] M. Nussi, *Elusione fiscale "codificata" e sanzioni amministrative*, in Giurisprudenza Italiana, n. 8-9, 2012, pg. 1936.

[27] F. Tundo, *Abuso del diritto ed elusione: un'anomala sovrapposizione*, Corriere tributario, no. 4 del 2011, pg. 279.

is also required that those legal forms are implemented without a sound business reason. When both of the above situations occur it can be said that these legal forms have been abused as they were used for no *bona fide* reasons.

There have also been delicate discussions concerning the role of Art. 37 *bis* within the domestic legal system. Some authors[28] thought that Art. 37 *bis* had a complementary and subsidiary role. Other authors[29]thought that Art. 37 *bis* had a task of GAAR. But a general rule is a provision which does not have objective limits. On the contrary, Article 37 *bis* has a structure that does not fit for an anti abusive rule. In particular, Article 37 *bis*, paragraph 3, stated a list which is exhaustive of cases where the provision itself can be applied. It means that Article 37 *bis* is not a general rule or a “final rule”.

However, what is clear is that Art. 37 *bis* had been used as a specific anti abuse rule.

Coming back to the Italian jurisprudence’s efforts, Supreme Court[30] first attempt to combat tax avoidance on a general basis was suggested by ruling of ECJ in the case known as Halifax[31]. However, the Supreme Court soon realized that the ECJ’s principle of abuse could be hardly applied to purely domestic cases other than VAT cases[32]. Therefore, at the end of 2008 the Supreme Court relied on Art. 53 Cost. to introduce a domestic principle of abuse of law. This principle is considered by the Court as a general principle of the tax law, thus applicable retrospectively and to all kind of transactions, which precludes the taxpayer to obtain tax savings through the misuse of legal agreements and statutes aimed to obtain tax benefits or tax savings when significant business reason are missing. One of the main issues raised by the introduction of the principle of abuse of law by the Italian Supreme Court concerns its relationship with Art. 37 *bis*[33].

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[28] S. Capolupo, *Art. 37 bis del D.P.R. n. 600/1973: l’elusione quale conseguenza di atti coordinati*, in ilfisco, no.8, 2001, pg. 3036; R. Franzè, *I giudici di merito riconoscono efficacia generale alle fattispecie elusive,* in Corriere Tributario, no. 17, 2008, pg. 1387.

[29] G. Castellani, *Norma antielusiva generale e disposzioni ordinarie con funzione antielusiva,* in Dialoghi Tributari, no. 3, 2008, pg.41.

[30] The most relevant case law in this matter are sentences no. 30055, no. 30056 n. 30057 of 23 December 2008.

[31] Case C-255/02.

[32] F. Vanistendael, *Halifax and Cadbury Schweppes: one single European theory of abuse in tax law?*, EC Tax Review, 2006, Issue 4, pp. 192–195.

[33] M. Nussi, *Elusione fiscale "codificata" e sanzioni amministrative*, in Giurisprudenza Italiana, no. 8-9, 2012, pg. 1936.

According to the Court, the principle represents an unwritten anti-avoidance rule which applies generally, while Art. 37 *bis* was limited only to certain transactions; moreover, the general principles can be invoked *ex officio* by the judge, while Art. 37 *bis* could be applied only if the aforementioned safeguard procedure was respected. This shows that the principle at hand clearly crosses the Parliament's attempt, which is at the core of Art. 37 *bis*, of balancing tax authorities' assessment powers and taxpayers' rights[34].

Furthermore, this situation leads to serious inequalities because tax authorities can easily "abuse of the abuse of law principle", that is possible according to a transaction covered by Art. 37 *bis* they could ground the tax assessment directly on the abuse of law principle in order to get rid of the special safeguard procedure provided by Art. 37 *bis*[35]. It was also argued that *via* the abuse of law principle the Supreme Court was forcing the introduction of a different "model" of GAAR as opposed to the targeted rule adopted by the Parliament with Art. 37 *bis*. However, it was concluded that Supreme Court's approach is untenable because, especially in civil law countries, judges are required to apply constitutional principles consistent with statutory provisions otherwise they have to raise a constitutional challenge with reference to those provisions. Furthermore, the constitutional principles that the Supreme Court took as a ground for the abuse of law principle could not be applied in isolation, but they should have been coordinated with other constitutional principles such as that of equality. In this respect, some Tax Courts claimed that it would be in breach of the principle of equality stated by Art. 3 Cost. to admit that the same avoidance transaction is to be assessed under a special safeguard procedure depending on tax authorities choice to rely on the Art. 37 *bis* or abuse of law principle. This should cast serious doubt over the possibility to apply *ex officio* the abuse of law principle as claimed by the Supreme Court as long as Art. 37 *bis* – or a similar provision – are in place. Nevertheless, nowadays, all the situations presented above are not relevant

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[34] G. Gavelli, *Brevi note sulla disciplina antielusiva (art. 37-bis del D.P.R. n. 600/1973) con particolare riguardo al conferimento in società*, in il fisco, no. 20, 1999, pg. 6739; M, Presilla, *La limitata efficacia dell'art. 37-bis del D.P.R. n. 600/1973 in relazione alle nuove strategie elusive: progetti di modifica*, in il fisco, no. 10, 2001, pg. 1-3875.

[35] G. Ripa, *Art. 37-bis e libertà d'impresa*, in Corriere tributario, no. 48, 2000, pg. 3495; S. Capolupo, *Art. 37-bis del D.P.R. n. 600/1973: l'elusione quale conseguenza di atti coordinati*, in il fisco, no. 8, 2001, pg. 3036.

anymore since the adoption of the Decree 128/2015 which repeals the preexistent anti-avoidance provision and finally introduces an anti abuse written rule[36].

1.2.2 Specific anti-abuse rules.

In the Italian legal system, in addition to the general anti-abuse rules (stated by the decree n. 128/2015) we can also find specific anti-abuse rules (SAAR)[37].

At this stage, it is sufficient to briefly list these rules, leaving their explanation to the following chapters. Italian tax law provides different kinds of SAAR; namely the most important are: CFC rules, exit taxes, thin cap rules and black list rules. While, it is necessary right now to show the relationship between these domestic SAAR and the GAAR.

First of all, it has to be said that both types of anti abuse rules govern the same factual situation[38]. The difference between a specific and a general anti abuse rules is the field of application. As an example, GAARs prohibit any abusive acts, conducts, and behaves. On the other hand, the SAARs prohibit specific and detailed acts, conducts, and behave.

Thus it might happen that a same abusive practice could require the application of both SAAR and GAAR. In other words, an abusive practice may simultaneously be covered by both SAAR and GAAR. In this particular situation, it is important to establish which rule has the priority. Unfortunately, a specific provision laying down the relationship between SAAR and GAAR does not exist in our legal system. That is why we should figure out a way to establish a hierarchy. The only priority rule could be identified in a general principle as perfectly summarized in the Latin aphorism: "*lax specialist derogate lax generalist*". The mentioned principle - embodied by the Vienna Convention and considered as general principles of international law as well as of domestic Italian law - is to be taken into account in order to choose which provisions must be applied. Hence, we will look at the SAAR as a *lax specialist* and at the GAAR as a *lax generalist*. The result is that SAAR derogates GAAR, since the latter has a general character.

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[36] M. Nussi, *Elusione fiscale "codificata" e sanzioni amministrative*, Giurisprudenza Italiana, no. 8-9, 2012, pg. 1936.

[37] F. Gallo, La *nuova frontiera dell'abuso del diritto in materia fiscale*, in Rassegna Tributaria, no. 6, 2015, pg. 1315.

[38] G. Sapio, *Norma anti-elusiva generale e disposizioni ordinarie con funzione antielusiva,* in Dialoghi Tributari, no. 3, 2008, pg. 41.

GAAR and SAAR are indeed in a *genus – species* relationship: the specific rule contains all the typical elements of the general provisions, with the addition of others more specific elements. So, the SAAR's priority does not lead to any misapplication of an abuse rule.

1.2.3 Anti-abuse rules in the light of BEPS.

Both GAARs and SAARs are parts of Base Erosion Profit Shifting recommendations (BEPS)[39]. BEPS is a global problem which requires global solutions[40]. For the first time ever in tax matters history, OECD and G20 countries worked together on an equal footing[41]. More than a dozen of countries have participated directly in the process and more than 80 non-OECD and non-G20 jurisdictions have provided input[42]. Work has been carried out to support all interested countries in implementing the rules and applying them in a consistent and coherent way[43]. By adopting the BEPS package, OECD and G20 countries, as well as developing countries that participated in its development, laid the foundations of a modern international tax framework[44]. The BEPS package was extremely necessary in an increasingly interconnected world where national tax laws have not always kept up with global corporations, and where many gaps and mismatches exists that could undermine the fairness and integrity of tax systems. BEPS' main goal is to weaken those strategies that exploit these gaps and mismatches in tax rules and shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. The final BEPS package enables countries to ensure that profits are taxed right where economic activities generating the profits are performed and where value is created, and at the same time makes business safer by reducing disputes

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[39] OECD (2015), *Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD.* Look at www.oecd.org/tax/beps.explanatory-statement-2015.pdf.

[40] P. Valente, *BEPS e transazioni finanziarie: erosione ed elusione internazionale delle basi imponibili*, in il fisco, no. 6, 2014, pg. 560.

[41] P. Sella, *Le attività preparatorie ed ausiliarie nel progetto BEPS dell'OCSE, in Fiscalità e Commercio Internazionale*, no. 8, 2015, pg. 10.

[42] P. Valente, *Erosione della base imponibile e "profit shifting": "focus" sugli aggiornamenti dell'OCSE*, in Corriere Tributario, no. 41, 2014, pg. 3179.

[43] R. Lupi, G. Marino, *Ripartizione dei flussi reddituali tra stati e gruppi nazionali: simmetrie fiscali, ipocrisie, e beps*, in Dialoghi Tributari, no. 4, 2015, pg. 474.

[44] P. Valente, *Raccomandazioni OCSE su economia digitale, abuso dei trattati e transfer pricing*, in il fisco, no. 39, 2014, pg. 1-3859.

over the application of international tax rules, and standardizing compliance requirements.

In September 2013, G20 Leaders endorsed the ambitious and comprehensive Action Plan on BEPS. This package of 15 reports, delivered only 2 years later, includes new or reinforced international standards as well as concrete measures to help countries tackle BEPS. This is mainly because there is an urgent need to restore common people's trust in their tax systems, to level the playing field among businesses, and to provide governments with more efficient tools to ensure the effectiveness of their sovereign tax policies. It was also imperative to move quickly to try and to limit the risks of countries taking uncoordinated unilateral measures which might weaken key international tax principles which form a stable framework for cross-border investments.

As mentioned before, one of the issues addressed by BEPS package is GAAR and SAAR. This topic is specifically addressed in Action 3, 4 and 6.The Action 3[45] refers to SAAR, as it provides recommendation on CFC rule. Action 4[46] outlines a common approach based on the best practices to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income. Action 6[47] develops model treaty provisions and recommendations regarding the design of domestic rules to prevent treaty abuse.

The Organization for Economic Co-operation and Development (OECD) is aimed to promote policies that will improve the economic and social well-being of people around the world. Over the last years, OECD worked hard to fill gaps in international taxation caused by companies that allegedly avoid taxation or reduce tax burden in their home country by engaging in tax inversions or by migrating intangibles to lower tax jurisdictions.

The goal of OECD is to adopt a series of measures to prevent and eliminate the erosion of the tax base and guarantee more safety and equity to taxpayers. Action

[45] Action 3's writing process started on April 2014 with a discussion draft, which was followed by comments published on May 2014. The Action 3's final draft was released on October 2015.

[46] This action's debate started on December 2014 and the final draft was published on October 2015.

[47] Action 6's final draft was finally published on October 2015 but its wording process has taken quite long time. Three discussion drafts, each followed by their comments draft, released on March 2014, November 2014 and May 2015 respectively.

6, Action 3 and Action 4 are of the highest importance, since they all concern treaty abuse, CFC rules and excessive interests deductions. Some of the revisions may be applied right away[48], while others require changes that can be implemented via tax treaties, including multilateral instrument. However, countries should implement these new regulations in different manners, as long as they do not conflict with their international legal commitments. This is also ensured by BEPS that always coordinates responses, particularly in the area of domestic law measures; it is therefore asked that they will implement their commitments, and that they will seek consistency and convergence when deciding upon the implementation of the measures. Of course, challenges have arisen in the implementation process: some countries have enacted unilateral measures, some tax administrations have been more aggressive, and increasing uncertainty has been denounced by some practitioners as a result of both the changes in the world economy and the heightened awareness of BEPS.

Regarding the Italian domestic situation, we already have said that Italian legal system is equipped with both GAAR and SAAR. So, BEPS introduction did not imply any new provision[49]. Moreover, in Italy there are not any proposal to change and/or amendment existing provisions.

Trying to find a reason why there are not any discussions in Italy regarding amendments to domestic and/or tax treaty, we should look at the relevant rules, especially their background *ratio* and development. We have already said that GAAR are established by the Decree147/2015. This Decree is enacted on the base of art. 12 of the delegating Law 23/2014 and it introduced many new provisions in the Italian legal system. At this point, we can understand that all these news entered into directly through Decree 147/2015 but indirectly through Law 23/2014. In other words the Decree 147/2015 can be considered as a vehicle into the Italian domestic law of European principles[50]. We come closer to the nucleus of this reasoning considering that principles on the base of the Law 23/2015 are

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48 Such as the revisions to the Transfer Pricing Guidelines.

49 L. Allevi, C. Celesti, *10th GREIT Annual Conference on EU BEPS; Fiscal Transparency, Protection of Taxpayer Rights and State Aid and 7th GREIT Summer Course on Tax Evasion, Tax Avoidance & Aggressive Tax Planning*, Intertax, 2016, Issue 1, pp. 70–96.

50 P. Valente, *Erosione della base imponibile e profit shifting nei principi nazionali e internazionali*, il fisco, no. 6 del 2015, pg. 1-563.

influenced by BEPS' discussion[51]. This similarity of the delegating law to the BEPS' recommendation is because the forms were worded during OECS' works and discussions. In the Italian situation, soft law represented by BEPS has been incorporated by "hard law" through the delegating law[52]. In conclusion, the fact that the delegating law contains in itself BEPS' principles and guidelines and then they are transferred to the domestic law could represent a reason why there is not urgency to change Italian provisions.

[51] P. Valente, *Ruling internazionale: le novità introdotte dallo schema di decreto internazionalizzazione,* Bilancio e Reddito d'Impresa, no. 9, 2015, pg. 26.
[52] G. Rolle, *BEPS: Legge delega per la revisione del sistema fiscale e influenza dei lavori OCSE/G20*, Fiscalità e Commercio Internazionale, no. 12, 2014, pg. 1.

2 SPECIFIC ANTI-ABUSE RULES UNDER ITALIAN LAW

As we already mentioned, Italian legal system provides several specific anti abuse rules. In the following, we are going to analyze them individually.

2.1 The "Thin Capitalization" rule

2.1.1 Background and rationale of thin cap rule

In corporate financing, shareholders have the choice to finance a company either by means of equity or by means of loan capital[53].

Financing a company with equity is remunerated by dividends. Dividends are distributed to the shareholders after tax profits. So, dividends are not meaning as a cost, but as an income for the shareholders. What has just been said implies that no deduction is allowed; rather a withholding tax is levied upon distribution.

On the other hand, debt financing is remunerated by interest payments and they are deductible as an expense at the level of the company.

This difference (synthesizing as deductible interests and non deductible dividends) in tax treatment between both financing structures is on the base of the concept of thin capitalization.

To understand the concerned concept we should do a step more. Since interest - differently from dividends - are deductible, companies, during their financing chooses will prefer interest[54]. But the problem is that companies acting in this way have a high proportion of loan capital in relation to the equity capital. This just said could be used as the definition of thin capitalization. It is an excessively high ratio of debt to equity in a corporation's capital structure. This entails an erosion of the tax base. And, for this reason, tax authorities have been concerned about prevent excessive debt financing[55].

In almost every country[56], tax engineering had been concerned in the creation of an effective and efficient thin capitalization rules[57]. In Italy, tax lawmakers have

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[53] D. Soria, A. Sozio, *I finanziamenti dei soci tra capitale di rischio e di credito*, in A&F, no. 3, 2015, pg. 40.

[54] E. Covino, R. Lupi, V. Perrone, *Determinazione della ricchezza, interessi passivi e "capitale mascherato da credito",* in Dialoghi Tributari, no. 1, 2014, pg. 21.

[55] G. Pizzitola, *La capitalizzazione sottile tra salvaguardia della tax jurisdiction domestica e discriminazione rispetto ai non residenti: profili comparatistica e domestici*, in Rassegna Tributaria, no. 6, 2003, pg. 2166,

[56] L. Brosens, *Thin capitalization rules and EU law, EC Tax Review*, 2004, Issue 4, pp. 188–213.

been very committed, especially in the last decade. The treatment of financing instruments was a controversial regime[58]. In particular, there were three reforms within a short timeframe and, in general, there were frequent switching in the taxation policy[59]. But, the most relevant changed started around the end of 2007 when Italy, opened to a German inspired regime of tax deduction, set the barrier to annual deduction of financing costs at 30 per cent of (adjusted) EBITDA. So, we can already say that the system deeply changed in 2008. The reform was radical enough to make some commentators think that thin capitalization rule, after the reform, cannot be defined as a specific anti abuse rules anymore. However, before dealing with the current rules and their consequences it would definitely be appropriate to describe the past rules and then try to draw the evolution of the thin cap rules in the Italian legal system[60].

2.1.2 Italian "thin capitalization" rule

2.1.2.1 Italian "thin capitalization rule" before 2008: art. 98 ITA

The thin capitalization rules, before the mentioned reform of 2008, was included in the former Article 98 of the Income Tax Act (ITA) [61]. This article provided a system denying relief to financing costs accrued on an amount of debt granted by a qualified shareholder exceeding a 4 to 1 ratio between the averaged outstanding debt granted to a company by a qualified shareholder and the adjusted net equity of the borrowing company attributable to the same qualified shareholder[62].

In the interpretation and application of this provision, a "qualified shareholder" was meant as an individual or a company controlling the borrowing company through either a major (direct or indirect) holding of voting rights or a minimum

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[57] P. Essers, *Some Fiscal Aspects of Financing Structures within a Group of Companies and Thin Capitalization Approaches in Europe*, EC Tax Review, 1994, Issue 4, pp. 167–176.

[58] O. Thömmes, B. Stricof, K. Nakhai, *Thin Capitalization Rules and Non-Discrimination Principles*, Intertax, 2004, Issue 3, pp. 126–137.

[59] The first reform occurred in 1997 with the introduction of the so called dual income tax: a system providing a reduced tax rate for the amount of national income generated by capital contributed to the company. The dual income tax was definitively repealed in 2003, when Italy, following the stream of a wellestablished trend in Europe, welcomed the thin capitalization rules. Meanwhile, a rule limiting deduction in order to avoid the possible enjoyment of a double tax advantage through the acquisition of participations generating no taxable income with acquisition debt bearing deductible interest (the `pro rata patrimoniale' rule) was also introduced.

[60] G. A. Galeano, A. M. Rhode, Italy Sets the Barrier to Deduction of Financing Costs at 30 Per Cent of EBITDA, *Intertax*, Issue 6/7, 2008, pp. 292–301.

[61] R. Lupi, Prime osservazioni in tema di Thin Capitalization, Rassegna Tributaria,o n. 5, 2003, pg. 1493; F. Pau, *La thin cap italiana: profili operativi e criticità*, in il fisco, no. 10, 2004, pg. 1-1409.

[62] Par. 1, art. 98 ITA.

25 per cent holding in the company's capital[63]. And a "related party" had to be a subsidiary or, in the case of an individual shareholder, also a relative up to the second degree[64].

It is fundamental to notice that the thin capitalization rules applied only if the overall debt granted/guaranteed by qualified shareholders went beyond a 4 to 1 ratio with respect to the overall equity attributable to qualified shareholders[65].

After that the fulfillment of this condition had been verified, the thin capitalization rules applied on a *per* head basis and the debt/equity ratio had to be computed separately for each qualified shareholder[66]. The thin capitalization rules concerned leverage represented by any form of financing, regardless of the legal outline conceived by the parties. In particular, Art. 98 of ITA referred to "loans, cash deposits and any other financial relationship". Moreover, interest-free debt had also to be accounted. On the contrary, loans undertaken by banks or other financial institution were excluded from the application of the rule.

In Italy, the unrelieved financing costs generated by the application of the thin capitalization rules were treated like dividends in the hand of the shareholder in order to avoid double taxation, as (corporate) shareholders are entitled to a 95 per cent exemption on dividends, reduced to a 60 per cent exemption for individual qualified shareholders[67]. Yet if the shareholder was not residing in Italy[68], double taxation was not always avoided, as interest income was not necessarily re-characterized as dividend income in other countries according to tax treaties, and a withholding tax might also apply[69]. The breaking of the debt to equity barrier did not necessarily trigger the restriction: an escape clause allowed relief when evidence was delivered that the same loan (or guarantee) provided by the

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[63] Par. 3, let. C), art. 98 ITA.

[64] Par. 3, let. B) art. 98 ITA.

[65] L. Ghiazza, *La disciplina fiscale dei finanziamenti dei soci di Luisa, in Pratica fiscale e professionale*, no. 36, 2004, pg. 11.

[66] R. Porfido e G. G. Visentin, *Thin capitalization rule: aspetti qualificanti dell'istituto alla luce dei chiarimenti ministeriali forniti con la circolare n. 11/E del 17 marzo 2005 e aspetti ancora non definiti*, in il fisco, no. 19, 2005, pg. 1-2918.

[67] G. Odetto, *Regime fiscale delle obbligazioni: effetti sulla "thin capitalization rule", in Pratica fiscale e professionale*, no. 11, 2005, pg. 37.

[68] G. Pizzitola, *La capitalizzazione sottile tra salvaguardia della tax jurisdiction domestica e discriminazione rispetto ai non residenti: profili comparatistici e domestici*, in Rassegna Tributaria, no. 6, 2003, pg. 2166.

[69] M. Sodini, *La deduzione degli interessi passivi: analisi di alcuni "casi aperti"*, in A&F, no. 6, 2013, pg. 29.

shareholder would also have been granted by a third party, owing only to the credit standing of the borrowing company[70].

2.1.2.2 "Thin capitalization" rule after 2008: art. 96 ITA

Nowadays, this provision does not exist because it has been repealed by Art. 1, par. 33, let. l) of the Law 244/2007. This change was introduced to rationalizing and simplifying the system. The deduction of financing cost is now ruled by Art. 96 ITA[71].

First of all, pursuant this provision, financing costs are deductible up to the amount of interest income. Moreover, Italy sets the barrier to deduction of financing costs at 30 per cent of EBITDA produced by the company in the same fiscal year, clearly resembling the system introduced in Germany[72] just a few months earlier[73]. The new rule, included in Art. 96 of ITA, refers to "gross operating result" (ROL)[74], specifying that the latter has to be determined pursuant to Art. 2425(1a) (value of production) and Art. 2425(1b) (costs of production) of the Italian Civil Code, regulating the profit and loss account of companies not adopting the IFRS/IAS Standards. Indeed, the adjusted EBITDA is represented by the difference between the value of production and the costs of production[75].

However, the provision concerned provides for the possibility of restore interest expenses that had not coverage to the tax periods following the one where the excess occurred.

In the meaning of financing costs we have to include - pursuant par. 3 of Art. 96 ITA - interest expense, interest income, charges and similar income arising from mortgage, finance leases, the issue of bonds, any other similar securities and any other financial instruments. So, the amount resulting from the difference explained above has to be increased not only by the annual amount of

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[70] P. Parisi, *La disciplina degli interessi passivi secondo Assonime, in Pratica fiscale e professionale*, no. 47, 2009, pg. 36.

[71] G. Salvi, *Nuovi limiti alla deducibilità degli oneri finanziari a decorrere dall'esercizio*, A&F, no. 3, 2008, pg. 19; R. Baboro, F. Mandanici, *Deducibilità degli interessi passivi: un'analisi aziendale a supporto del giudizio di inerenza*, A&F, no. 12, 2015, pg. 25.

[72] D. Bergami, *Transfer pricing: un'indagine globale*, in A&F, no. 6, 2006, pg. 22.

[73] G. Ferranti, *Il nuovo regime forfetario "incorpora" quello "dei minimi"*, in Corriere Tributario, no. 42, 2015, pg. 4175.

[74] M. Antonini, C. Setti, *Esclusione del "ROL virtuale": dubbi di legittimità comunitaria*, in Corriere Tributario, no. 31, 2015, pg. 2397.

[75] A. Bernardini, *Regime forfetario tra semplificazioni e valutazioni di convenienza*, in Corriere Tributario, no. 6, 2015, pg. 412.

depreciation/amortization , but also by the annual amount of capital/financial lease expense without accounting for financing costs, passive income, capital gains and losses, taxes. The EBITDA shall be derived by the results of the profit and loss account and, thus, shall include earnings generated by foreign permanent establishments. Article 96, par. 1 ITA excludes from its objective scope of application the interest expense and similar charges included in par. 1, letter b), Article 110 ITA.

The new system will contribute to offset the tax rate reduction in terms of tax revenues, as it involves a broader range of companies: indeed, small sized companies, excluded from the thin capitalization rules, are concerned by the new regime[76].

Regarding the personal scope, the system applies to all the categories of corporate income taxpayer's, save few excepted business categories, but not to partnerships, for which a different system has been crafted[77]. The alleged unevenness of the thin capitalization rules appears to have been removed, as the new system applies also to financing relationships between independent parties, not only to inter-company loans or guarantees and low-income companies, as there is no minimum threshold of income required to qualify for the application of the system.

Regarding the interest deductions' topic, Italian courts felt the need to establish, in several case law[78], that the deduction of the tax credit on dividends taxed abroad has to be made pursuant the combined provisions of Artt. 15 and 96 of ITA. Moreover, the courts stated that it has to occur only with reference to the percentage of foreign dividends which forms part of the tax base in Italy, accounting for 40 percent in the event of profits received by companies based in non-EU countries and 5 percent in the event of profits received by companies based in EU countries.

2.1.3 BEPS' recommendation on "thin capitalization" rules: Action 4

The Organization for Economic Co-operation and Development (OECD) released a discussion draft regarding this topic. The Discussion Draft reiterates the OECD's

[76] G. M. Committeri, *"Restyling" per la deducibilità degli interessi passivi*, in Corriere Tributario, no. 21, 2015, pg. 1621.

[77] R. Rizzardi, *La scelta fiscale della forma di impresa: norme attuali e della riforma*, in Corriere Tributario, no. 30, 2015, pg. 2317.

[78] Supreme Court: 28/10/2015, no. 21968; 30/11/ 2012 n. 21351; 31/01/2011 n. 2255.

intention to develop recommendations for a best practice approach or approaches for countries to use to address concerns about BEPS through interest expense. This topic is covered by Action 4 which is focused on the use of third party, related party and intergroup debt to achieve excessive interest deductions or to finance the production of exempt or deferred income[79].

The document, titled *BEPS Action 4: Interest Deductions and Other Financial Payments*, sets forth several alternative approaches to limiting deductions for interest expense[80]. The principal approaches discussed are: a group-wide rule which would limit a company's net interest deductions to a proportion of the group's actual net third party interest expense; a fixed ratio rule, which would limit a company's interest deductions to an amount determined by applying a fixed benchmark ratio to an entity's earnings, assets or equity; and certain combinations of these two approaches[81]. In detail OECD recognizes[82] that rules currently applied by countries fall into six broad groups, with some countries using a combined approach that includes more than one type of rule: arm's length tests, which compare the level of interest or debt in an entity with the position that would have existed had the entity been dealing entirely with third parties; withholding tax on interest payments, which are used to allocate taxing rights to a source jurisdiction; rules which disallow a specified percentage of the interest expense of an entity, irrespective of the nature of the payment or to whom it is made; rules which limit the level of interest expense or debt in an entity with reference to a fixed ratio, such as debt/equity, interest/earnings or interest/total assets; rules which limit the level of interest expense or debt in an entity with

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[79] E. C. Millan, M. T. S. Roch, *Limit Base Erosion via Interest Deduction and Others*, Intertax, 2015, Issue 1, pp. 58-71.

[80] B. Gouthiere, *Thin capitalization and the OECD Model Convention*, Intertax, 1990, Issue 6/7, pp. 296–297.

[81] L. Allevi, C. Celesti, *10th GREIT Annual Conference on EU BEPS; Fiscal Transparency, Protection of Taxpayer Rights ans State Aid on 7th GREIT Summer Course on Tax Evasion, Tax Avoidance & Aggressive Tax Planning*, Intertax, Issue 1, 2016, pp. 70-96.

[82] OECD (2015), Limiting *Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pg. 20.

reference to the group's overall position; targeted anti-avoidance rules which disallow interest expense on specific transactions[83].

Regarding Italy, Art. 96 ITA - which has the aim of counteracting thin capitalization and of creating a balanced used of equity a loan – seems to be included in the list laid down in Action 4. So, Art. 96 ITA seems to be compatible with BEPS' recommendation, since the former is contemplated in the latter. In particular, Italy chooses rules which limit interest expense by reference to a fixed ratio. These rules are relatively easy to apply and link the level of interest expense to a measure of an entity's economic activity.

However, OECD recognized also that the way in which existing rules are designed is not always the most effective way to tackle base erosion and profit shifting[84]. In detail, according to OECD a rule which limits the amount of debt in an entity still allows significant flexibility in terms of the rate of interest that an entity may pay on that debt. Also, an equity test allows entities with higher levels of equity capital to deduct more interest expense, which makes it relatively easy for a group to manipulate the outcome of a test by increasing the level of equity in a particular entity.

However, in support of our system we can argue that OECD appreciates the introduction of the EBITDA limit. As we can read in Action 4, OECD thinks that EBITDA is a better tool to combat base erosion and profit shifting. In these tests, the measure of earnings used is typically earnings before interest, taxes, depreciation and amortization.

In conclusion, the recommendations in this report are the result of a significant work which explored the advantages and disadvantages of different types of rules[85]. This included a review of countries' experiences as to how rules operate in practice and impacts on taxpayer behavior. It also included an analysis of empirical data on the leverage of groups and entities in countries which do and do not currently apply rules to limit interest deductions, and the results of academic

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[83] OECD (2015), Limiting *Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pg. 19.

[84] A. Denaro, *L'attribuzione dei profitti alla stabile organizzazione: la posizione OCSE su agente dipendente e interessi passivi*, in il fisco, no. 45, 2012, pg. 1-7216.

[85] I. Caraccioli, S. Mattia, C. Alagna, *Lotta alla frode e all'evasione fiscale: il punto in ambito comunitario*, in il fisco, no. 44, 2013, pg. 1-6845.

studies. The OECD decided to intervene and act in this topic because limitations on interest expense deductions in place today have not been entirely effective, perhaps because countries do not want to adversely impact their attractiveness to foreign capital investment or to impair the ability of domestic groups to compete internationally[86].

After Action 4's publication, there has not been any proposal of change and/or amendment. It must be held *a fortiori* that courts have not changed their point of view regarding Italian thin capitalization rules after BEPS recommendation.

However, as we noticed for GAAR, in the Italian system a recent change occurred pursuant Decree 147/2015 which, as we already mentioned, could be considered as BEPS' principles carrier[87]. Decree 147/2015, recently, modified also art. 96 ITA. In particular, Art. 4, par. 1 let. a) modified par. 2 of Art. 96 ITA. Secondly, Art. 4, par. 1 let. b) of Decree 147/2015 modified par. 6 of Art. 96 ITA and, lastly, Art. 4, par. 1 let. c) of Decree 147/2015 repeal par. 8 of Art. 96 ITA. Pursuant let. a), par. 1, Art. 4 of Decree147/2015, for the calculation of the gross operating result (ROL) the dividends received by non-residents companies that are controlled pursuant to Article 2359, paragraph 1, no. 1) of the Civil Code is taken into account.

2.2 "Controlled Foreign Companies" rules

2.2.1 Background and rationale of "Controlled Foreign Companies" rules

States can levy taxes by virtue of their sovereignty. States usually justify their claims to tax income either by reference to the personal attachment that the recipient has with the state or by reference to the economic attachment that the income has with the state. In others words, there must be a personal of an objective nexus between the taxpayer and the state[88].

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[86] P. Valente, *Base erosion and profit shifting e leverage: profili applicativi nelle stabili organizzazioni*, in il fisco, no. 23, 2014, pag. 1-2277.

[87] R. Rizzardi, *Il Decreto "internazionalizzazione" corregge le distorsioni della disciplina dei dividendi esteri*, in Corriere Tributario, no. 39, 2015, pg. 3939; G. Ferranti *La disciplina degli interessi passivi e l'attuazione della delega fiscale*, in il fisco, no. 24, 2014, pag. 1-2333.

[88] M. Persoff, *HMRC revised draft guidance on controlled foreign companies,* EC Tax Review, 2, 2008, pp. 96–96.

Focusing the attention on the personal connecting factors, the majority of domestic tax law systems (Italy included) chose the criteria of residence[89] to justify and subject a person – in the meaning of both natural both legal person - to tax liability in a country. The form of personal attachment most often chosen for this purpose, for both companies and individuals, is residence[90]. Most of the states levy tax on the worldwide income of persons who have a personal attachment to the state and, if they levy a tax on capital, on the worldwide capital of persons who have a personal attachment to the state. So, since residents are taxed on their worldwide income, all the incomes received by residents are subjected to domestic taxation, regardless of the country of their origin. As a result, taxpayers pay the same amount of taxes in their residence state whether they earn their income at home or abroad. This is called full tax liability. Also distributions of profits are considered income for the shareholders. But the tax law of many countries does not tax a shareholder of a corporation on the corporation's income until the income is distributed as a dividend.

At this point, we can understand which the risk is. In practice[91], it happens that a person resident in a state creates a legal person resident in another state characterized by lower tax jurisdiction. The resident person, leveraging the distinct legal personality of the created company, tries to attribute to the company mentioned all of its income from foreign sources, instead of repatriating them in fiscal year in which they were produced. The consequence is, therefore, that, on the one hand, this foreign company is subject to a very low tax rate on its income, as it is resident in a country with low tax, on the other, the person resident in country's high taxes get a tax deferral on profits earned abroad and transferred to the foreign company, as such profits will be taxed in the residence state, only if repatriated. In other words, the taxpayer can easily reduce his tax burden by setting up a company in a low-tax country and transferring his mobile assets to this company. As long as he does not repatriate the income earned by the foreign company the income remains untaxed in the residence country of the shareholder

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[89] This factor reflects the state's function as a regulator and provider of social services. The tax levied on persons with a personal attachment to the state could be described as the fee for membership of its society.

[90] Others criteria are nationality (which is used by USA) or domicile.

[91] G. Salvi, *CFC rule: alcuni casi specifici*, in A&F, no. 11, 2011, pg. 35.

and the income is only taxed at a low level in the country of residence of the interposed company.

The avoidance of this abusive practice is the aim and the purpose of controlled foreign rules (CFC) legislation. Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence by shifting income into a CFC. Indeed, without CFC legislation, high-tax country will lose tax revenue. As a result of the tax flight to low-tax countries, high-tax countries are obliged to either raise its tax rates on non-mobile income or reduce its government spending. So, CFC legislations are necessary to prevent the erosion of the tax base in high-tax countries and ensure an equal taxation of all taxpayers in high-tax countries[92]. CFC regimes are used in many countries as a means to prevent erosion of the domestic tax base and to discourage residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates. Actually, CFC rules are designed to act as deterrents, since they are not primarily designed to raise tax on the income of the controlled foreign company. They are designed to protect revenue by ensuring profits remain within the tax base of the parent, by preventing taxpayers from shifting income into controlled foreign companies. Then, of course, these rules will indirectly raise some revenue by taxing the income of CFCs, but there is likely to be a reduction in the income shifted to CFCs after the implementation of CFC rules. In conclusion, all provisions relating to CFC rules perform a function, at the same time, essential and delicate, elusive in countering conducted internationally. Essential as the aforementioned discipline pursues the aim of preventing useful products in the territory of the Italian State are fictitiously delocalized at foreign entities located in low tax states or territories. Delicate, since the purpose of countering the phenomena of tax deferral must necessarily be reconciled with the need not to hinder the actual relocation processes and to avoid charges "disproportionate" for the companies to the objective to be achieved.

Now that the aim and the goal of these rules is clear we can image it can be achieved in many different ways. Indeed each state can designate CFC legislations

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[92] B. Kuźniacki, *The Need to Avoid Double Economic Taxation Triggered by CFC Rules under Tax Treaties, and the Way to Achieve It,* Intertax, Issue 12, 2015, pp. 758–772.

in many different ways. As a result CFC rules differ from country to country. In theory, four different types of CFC legislations can be distinguished. In reality, these types never occur in their pure form. The respective national CFC legislation generally contains several elements of different types of CFC legislations[93].

2.2.2 Italian "Controlled Foreign Companies" rule: Article 167 of Italian Income Tax Act

In the Italian legal systems, the rules on controlled foreign companies (CFC) are provided by Article 167[94] of the Italian Income Tax Act enacted by the Law 917 of 22 December 1986 (ITA).

The original wording of Article 167 ITA has been modified often[95].

However, in the following, we try to explain this specific anti abuse rule provided by Art. 167 ITA regardless all the changes occurred: on the light of the current wording[96].

Italian tax rules on CFC apply to profits earned by foreign companies which are resident or located in certain states or territories and controlled, directly or indirectly, by an Italian resident taxpayer[97]. So, the subject of the provision is a person resident in Italy which has the control, "*also through trustee or intermediaries*"[98] of a company, undertaking or other entities, which, however, are

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[93] M. Persoff, C. Calcagnile, J. Juusela, *United Kingdom, Italy, Finland*, *EC Tax Review*, Issue 5,2009, pp. 252–257; G. Tinelli, *Commentario al Testo Unico delle* Imposte sui Redditi, CEDAM, Padova, 2015, pg. 1428.

[94] This article was introduced by Law no. 342 of 21 November 2000 to replace the art. 127-bis of the previous Tax Code and to to counteract the outsourcing of national companies and the deferral of taxation of dividends related to controlled foreign companies.

[95] Firstly, art. 1, par. 83, law no. 244 of the 24th December 2007 deeply modified the first, the 5th paragraph and dropped out the 4th paragraph of article 167 ITA. Subsequently, article 13 of the Decree no. 78 of 1 July 2009 dropped out let. a), par. 5 of article 167 ITA and added par. 5 *bis* and 8 *bis* to the same article[95]. However, more recent changes have been introduced by art. 7, par. 4 of Decree n. 156 of 24 September 2015 which it is been operating since 1th January 2016.
Moreover, others changes, as deep as the previous, occurred though the article 8 of Decree no. 147 of 14 September 2015. In particular, article 8, par. 1, let. a) of the Decree no. 147 of 14 September 2015 totally substitute par. 1 of art. 167 ITA; which, however, had already been modified by article 1, par. 33, lett. l) of the law no. 244 of 24 December 2007. The article 8 concerned modified also let. b) of par. 5 - which was also modified by art. 7, par. 4 of decree n. 156 of the 24th September - and par. 6 of art. 167 ITA. Art. 8 of Decree 147/2015 also added completely new paragraphs, namely par. 8 *ter* 8 *quarter* 8 *quinquies*.

[96] S. Serbini, *The New Italian Legislation on controlled foreign companies*, Intertax, Issue 3, 2001, pg. 86-91.

[97] F. Galletti, *La disciplina Cfc ex art. 167 del Tuir*, in il fisco, no. 35, 2013, pg. 1-5431.

[98] Art. 167, par. 1, ITA.

resident in a particular territory[99]. This particular territory where "the company, the society or the other entity" has to be resident or located was - before of Decree 147/2015 - individuated on the base of a list made by the Finance Minister provided also by Art. 168 *bis* ITA. The reference to this list was introduced in the 2008 through the Italian Budget Law which has replaced the reference to companies resident or located in States or territories having privileged tax regimes with the reference to companies resident or located in States or territories different from those listed in a decree issued by the Ministry of Finance (so called "black list"). Such decree shall have contained a list including all the countries and territories which allow an adequate exchange of information and do not have a considerably lower level of taxation. So, subsequently, due to the modify occurred by Decree 147/2015, the new par. 4 of Art. 167 ITA provided that States and territories where privileged tax regimes are located were identified by decree of the Minister Finance published in the Official Gazette. Minister of Finance had to individuate these states and territories looking at the level of taxation and checking if it was substantially lower than the one applied in Italy and if there was a lack of adequate exchange of information or other criteria equivalent. Considering the level of taxation, it can be defined as significantly lower if it is lower than the 50 percent of the level of taxation existing in Italy[100].
However, what I just stated in the previous lines is not in force any more. The Law no. 208 of 28 December 2015 (so called Stability Law) modified par. 4 of Art. 167 ITA. Now, it lays down that tax systems, also special, are considered privileged when the nominal level of taxation is lower than the 50 percent of the amount applicable in Italy[101]. So, the Italian CFC rule will be applicable if the nominal level of taxation in the state or territory concerned is lower than the 50 percent of the Italian one[102]. The Stability Law introduced a general criteria which

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[99] M. Vergani, *Italy: Recent Measures to fight Tax Evasion through the Use of "Tax Havens"*, EC Tax Review, Issue 6, 2010, pp. 272-275.
[100] G. Barbatagliata, L. Rossi, *L'identificazione degli Stati a fiscalità privilegiata: indicazioni OCSE e "Tax Package" anti-abuso della UE*, In Corriere Tributario, no. 9, 2016, pg. 647.
[101] G. Albano, *Il nuovo regime delle "branch exemption" tra obiettivi di competitività e difficoltà operative*, in Corriere Tributario, no. 2, 2016, pg. 91.
[102] G. Rolle, *Disciplina delle società controllate estere e imposte pagate in Stati diversi da quello di residenza*, in il fisco, no. 5, 2016, pg. 1-446.

departs from lists[103]. Such modify has been made with the aim to conform to the BEPS' recommendations, in particular to the recommendations contained in Action 4 which directly deals with CFC rules[104].

Par. 4 of Art. 167 ITA, it is also relevant for the interpretation and application of let. B) of par. 5 which refers to states or territories with a privileged tax regime as well. Moreover, it is fundamental to point out that pursuant article 167 of the ITA; the income of a CFC must be allocated to the Italian resident taxpayer proportionally to the participation held, irrespective of the distribution of the CFC's income in the form of dividends.

Income from a CFC is qualified in the hands of the Italian resident as business income, computed according to the provisions of the ITA and subject to a tax rate not lower than the rate applicable to the corporate income tax[105]. So, we can notice that, in practice, Article 167 ITA counteract the risks explained above through the provision of a specific discipline derogating the normal criteria of subjective imputation of income. Indeed, business income produced by the non-resident subsidiary in a low-tax country is directly related to the resident shareholder of the parent company, regardless to the actual distribution.

We should also point out that there is a clear difference from the traditional method of taxation of dividends of the subsidiary that usually occurs after the distribution to the parent. In addition, by express provision of par. 6, the calculation of the income attributable to the foreign entity subject to transparency resident must be based on the rules of the Income Tax Code, except for certain provisions (including, in particular, paragraph 4, Art. 86 of the Income Tax Code, regarding deferral of taxation of capital gains on assets related to the company).

In addition, we can notice that Art. 167 ITA is based on the concept of control and the same provision, precisely at par. 3, lays down how control has to be meant. In particular, checking if the control relation exists it is necessary look at Art. 2359 of the Civil Code. According to this provision, the foreign entity is considered to

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[103] F. Molinari, *L'evoluzione della normativa sulle CFC alla luce delle modifiche della Legge di stabilità 2016*, in Corriere Tributario, no. 6, 2016, pg. 417.

[104] G. Scifoni, *Cancellate le limitazioni "ad hoc" alla deducibilità dei costi "black list"*, in Corriere Tributario, no. 5, 2016, pg. 333.

[105] Art. 167, par. 6, ITA. This provision results from the amendments made by the Stability Law 208/2015. In the previous wording the tax rate was not related to the corporate income tax. But it was fixed at 27%.

be controlled if the Italian company holds directly or indirectly the majority of voting rights possesses enough votes to exercise a dominant influence and has a dominant influence on the other company which is supposed to be controlled by virtue of special contractual restrictions.

However, Article 167 ITA states that the Italian taxpayer can claim the non-application of the CFC rules if certain conditions are met[106]. To this end, the Italian resident must give certain evidences to the Italian Tax Authorities. The procedure consists of a written application for a ruling to the competent Italian Tax Authority containing a description of the foreign structure and an explanation of the specific circumstances that would lead to the non-application of the CFC rules.

Under the version of Article 167, par. 5 of the ITA in force before the enactment of the Decree, the CFC rules did not apply if the Italian resident alternatively: gave evidence that the company or the other entity which were not resident carry on an effective activity, industrial or commercial, as his main activity in the market of the state or territory where it was located so where there was the low tax regime and gave evidence that equity investments did not imply the effect of locate incomes in countries or territories where there was a privileged tax system according the mentioned[107].

As we said, the Decree no. 78/2009 has introduced paragraph 5 *bis* to article 167 whereby the exception set forth in Article 167, paragraph 5, let. a) of the ITA is in any case not available if more than 50% of the CFC's income derives: from the managing, the holding, or the investment in securities, shares, receivables or other financial assets; from the transfer or licensing of intellectual properties of industrial, literary and artistic nature; from the supply of intra-group services, including financial services. Therefore, if most of the CFC income consists of passive income or derives from supply of intergroup services, the only available exception to the application of Article 167 of the ITA is to prove that the

[106] Art. 167, par 5, ITA.

[107] C. Sallustio, *La disapplicazione della disciplina CFC in presenza dell'esimente di cui all'art. 167, comma 5, lettera b), del Tuir. Nuovi sviluppi alla luce della risoluzione dell'Agenzia delle Entrate n. 63/E del 2007*, in il fisco, no. 29, 2007, pg. 1-4265.

participation in the CFC is not aimed at allocating income in States or territories with a privileged tax regime.

The most remarkable amendment provided for by the Decree no. 78 of the 1th July 2009 is, however, represented by the introduction of new paragraph 8bis to Article 167 of the ITA. Under this new provision, the application of the CFC rules is extended to companies located in States or territories other than those included in the 'black list', and, therefore, including also companies located in the European Union, provided that the following conditions are jointly met: the actual corporate tax paid in the foreign State or territory is lower than 50% of the Italian corporate tax that would be applicable to the entity, if it were resident in Italy; and more than 50% of the revenues of the controlled company derives from the managing, holding, or investment in securities, shares, receivables, or other financial assets; the transfer or licensing of intellectual properties of industrial, literary, and artistic nature; or the supply of intergroup services, including financial services. However, the above extension of the CFC rules to companies not located in States or territories having a privileged tax regime does not apply if the Italian resident obtains a positive advance ruling from the Italian Tax Authorities. To this end, the Italian taxpayer must give evidence that the foreign company does not constitute an "artificial arrangement" aimed at obtaining an undue tax benefit[108].

Continuing to analyze Art. 167 ITA, the Decree 147/2015 added others 2 paragraphs - namely par. 8 *quarter*[109] and 8 *quinquies*[110] - which lay down procedural rules.

In order to understand and know in a complete way the Italian CFC rules, it is necessary to observe how Art. 167 ITA has been interpreted. Italian judges have been involved in some cases where the debated issue was connected with the questioning procedure. Indeed, Art. 167 ITA states that the taxpayer, in order to

[108] Art. 167, par. 8 *ter,* ITA, introduced by art. 13, par.1, Decree 78/2009.

[109] According to this provision, the Administration, before issuing the notice of assessment of tax or higher taxes, owes to notify a special notice, with whom is granted the same opportunity to provide, within ninety days, the evidence for the non-application of the provisions for transparency imputation of income.

[110] According to this provision, the exemption should not be shown when verifying if the taxpayer has obtained positive response to its ruling , without prejudice to the tax authorities the power to control the accuracy and completeness of the information and evidence in such a place .

achieve the effect stated in par. 5, let. b) and par. 8 *bis,* has to refer the matter to the Italian Tax Authority. Regarding this kind of questioning, the Italian judges stated that the omission of the instance of interpellation required disapplying national rules provided by Art. 167 of Presidential Decree 917/1986 can only justify an investigation which is not incontestable, since the taxpayer could prove before a court the existence of the legal requirements in order to benefit the deduction of costs[111]. Also regarding the interpellation, a judge[112] stated that the act containing the answer given by the Italian Tax Authority after an interpellation made by a tax payer is not challengeable, since such an act does not fall among those exhaustively listed in Article 19 Legislative Decree no. 546/92[113]. Italian judges were also involved, always in the questioning matter, regarding the deadline for the answer that has to be given by the Italian Tax Authority after the interpellation. However, regarding this issue, judges are fragmented and divided. Indeed, in a case law[114] the judge stated that in case of submission of the interpellation pursuant Art. 167 ITA, it is necessary to refer to the term of one hundred and twenty days - pursuant to Art. 11 of the Statute of the taxpayer - within which the response of the Tax authority must be notified to the taxpayer. The judge justified the application of that rule as the one hundred eighty days - pursuant Decree no. 429 and 209 of 2001- cannot be implemented because it is laid down by a source of law of second degree that, in the Italian legal system, cannot dictate provisions contrary to the laws (Art. 1 of the Statute of the taxpayer). On the contrary, in another case law[115], the judge stated that regarding interpellation on questions concerning the application of Article 167 ITA, to the of the PA, the special term of 180 days – provided by Art. 5, paragraph 2, D.M. November 21, 2001, n. 429 – has to be considered applicable for the formation of the silent assent[116]. Moreover, the court stated that this term elapse, from the date of presentation interpellation, or from the date of submission of additional

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[111] Comm. trib. reg. Brescia, (Lombardia), sez. LXIII, 01/02/2012, n. 21.
[112] Sentenza n. 4235 del 25 giugno 2014.
Sentenza n. 289 del 29 luglio 2013.
[113] The mentioned provision lays down an exhaustively list of acts against which the action can be brought. These acts are the tax assessment notice, the tax payment notice, the measure which establish the sanction and the notice for delayed payment.
[114] Comm. trib. prov.le Milano, sez. XLI, 09/11/2012, n. 304.
[115] Comm. trib. prov.le Milano, sez. III, 20/09/2012, n. 229.
[116] And not the ordinary period of 120 days provided for by art. 11, paragraph 2, l. n. 212 of 2000.

documentation. As we can clearly observe these two case law state the opposite sentence. Leaving the interpellation matter, in a sentence a judge stated regarding the general CFC rules. In particular, the judge stated that the transparent imputation is not applicable for incomes earned by a company already controlled and this company in the period before the close of the current has implemented the sale of investments and it has not subsequently showed the subsequent repurchase of shares that can imply the presumption of the interposition fictitious in the detention of the former parent company's income.

2.2.3 BEPS' recommendation on "Controlled Foreign Companies" rule: Action 3.

In general CFC rules have been one of the objects of the BEPS' discussion. In response to the challenges faced by existing CFC rules, the *Action Plan on Base Erosion and Profit Shifting* (BEPS Action Plan, OECD, 2013) called for the development of recommendations regarding the design of CFC rules[117]. In particular, there is a whole action dealing with CFC rules: namely Action n. 3.

Action 3 of this plan stresses the need to address base erosion and profit shifting using controlled foreign company (CFC) rules. This report sets out recommendations in the form of building blocks, which are not minimum standards, but are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries. The report sets out the following six building blocks for the design of effective CFC rules: definition of CFC, CFC exemptions and threshold requirements, definition of income, computation of income, attribution of income, prevention and elimination of double taxation. Moreover, this Action was enacted because some countries do not currently have CFC rules and others have rules that do not always counter BEPS situations in a comprehensive manner.

Italy, as we said before, already has a provision dealing with CFC matter. Moreover, as we cited, this provision was recently modified on the light of the Decree no. 156/2015 and of Decree 147/2015 (Decree "growth and internationalization"). It is fundamental to know that this Decree was enacted on the base of the enabling law no. 23 of 11th March 2014. The law 23/2014 came

[117] H. M. Bjerkestuen, H. G. Wille, *Tax Holidays in a BEPS-Perspective*, Intertax, Issue 1, 2015, pp. 106–120.

into force at the same time of the BEPS' discussion and preliminary works. So the enabling law, due to the period when it was worded and since was worded in compliance with the recommendations of international organism, contains, in broad terms, the principles of BEPS[118]. Strictly regarding CFC rules, Art. 12, letter. b) of Law 23/2014 stated the necessity of a chance in the "system of charging on the base of transparence rule of foreign subsidiaries and of connected companies" or the institute currently governed by Articles 167 and 168 ITA. In this context, specific criteria have been established and there are no indications in the accompanying reports. In addition, as we said above, Art. 167 ITA was recently modified thought Decree 147/2015. So, we can conclude that thanks to these recent legislative changes, Italian CFC rules, in broad outlines, comply with BEPS.

However, the Law 23/2014 is prior than the BEPS' final draft, which was finally adopted in the autumn of 2015. So, the CFC rules of our legal system should be tested in light of the conclusion of the work of the BEPS project. In general, Art. 167 ITA, so our CFC rules, seems to be consistent and in line with BEPS. In the following we try to prove this presumable conformity of Art. 167 ITA to BEPS.

First of all, in chapter 2 of Action 3[119] BEPS lays down some rules for defining CFC. In the context of whether an entity is of the type that would be considered a CFC, the recommendation broadly defines entities that are within scope so that. In addition, CFC rules could also apply to certain transparent entities and permanent establishments (PEs) if those entities earn income that raises BEPS. So, regarding the personal scope, Art. 167 ITA fully addresses BEPS' recommendations. Indeed, Art. 167, par. 1 ITA broadly deals with companies, undertakings and others entities.

Another comparison between BEPS and Art. 167 ITA can be made on the base of the notion of control. In accordance with Action 3 BEPS the definition of control requires two different determinations: "the type of control that is required and the

[118] *G. Rolle, BEPS: Legge delega per la revisione del sistema fiscale e influenza dei lavori OCSE/G20,* in *Fiscalità e Commercio Internazionale,* no. 12, 2014, pg. 11.

[119] OECD (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pg. 21.

level of that control"[120]. Always on the base of BEPS' recommendation, regarding the type of control, it can be established in various ways: legal control, economic control, *de facto control* and control based on consolidation. Checking the conformity of Italian CFC rules to this recommendation, we have to look at Art. 2359 of the Italian Civil Code, which is referred by par. 3 of Art. 167 ITA. Art. 2359 c.c. fully realizes the BEPS' wording, since it states three kinds of control, all complying with BEPS. In particular, Art. 2359 c.c. covers legal control, de facto control and contractual control. The next comparison which has to be made is how much control is enough for the CFC rules to apply. If the aim is to catch all situations where the controlling party has the ability to shift profits to a foreign company, then, as a minimum, CFC rules would need to capture situations where resident taxpayers have a legal or economic interest in the foreign entity of more than 50%. Also in this case Art. 167 ITA seems to respect BEPS. Indeed, in the case of the legal control there is not any doubt since a threshold exactly equal of the percentage provided by BEPS is provided. In the other two cases – namely *de facto* and contractual control – the threshold is not provided but the final effect is the same that is achievable though the percentage.
Chapter 3 of Action 3 BEPS deals with CFC exemption and threshold requirements. This topic corresponds to par. 5 and 5 *bis* of Article 167 ITA. Generally speaking, CFC exemptions and threshold requirements can be used to limit the scope of CFC rules by excluding entities that are likely to pose little risk of base erosion and profit shifting and instead focusing attention on cases that are higher-risk because they exhibit some characteristic or behavior that means there is a greater chance of profit shifting. These provisions can therefore both help to make CFC rules more targeted and effective and also reduce the overall level of administrative burden by ensuring that certain companies are not affected by the rules, although these companies may still need to satisfy certain reporting requirements to show that they meet any requirements for these provisions.
The final draft of Action 3 BEPS provides three different types of CFC exemptions and threshold requirements. The first is a set *de minimis* amount below which the CFC rules would not apply. A *de minimis* threshold could

[120] OECD (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pg. 23.

reduce administrative burdens and make CFC rules more targeted and effective by ensuring that certain companies are not subject to the rules. The second is an anti-avoidance requirement which would focus CFC rules on situations where there was a tax avoidance motive or purpose. An anti-avoidance threshold requirement would only subject transactions and structures that were the result of tax avoidance to CFC rules. This could narrow the effectiveness of CFC rules as preventative measures. Additionally, an anti-avoidance rule should not be necessary if the rules defining the income within the scope of a CFC regime are properly targeted. An anti-avoidance requirement is therefore not considered further in this report, but this is not intended to imply that an anti-avoidance requirement can never play a role in CFC rules that tackle base erosion and profit shifting. Lastly, a tax rate exemption where CFC rules would only apply to CFCs resident in countries with a lower tax rate than the parent company. Such an exemption is included for two reasons. First, this approach means that the rules only apply to companies that benefit from low foreign taxes and therefore pose the greatest risk of profit shifting. Second, a focus on low-tax CFCs can provide greater certainty for taxpayers and reduce the overall administrative burden[121]. A tax rate exemption can, however, mean that CFC rules do not prevent all base erosion and profit shifting since they still allow erosion of the parent jurisdiction's base to high or medium-tax jurisdictions, so a few jurisdictions do not include such an exemption. At this stage, trying to compare BEPS' recommendation with Italian CFC provision, we noticed that the first kind of exemption based on the *de minimis* threshold is similar to par. 5 *bis* of Art. 167 ITA. But we can also notice that in par. 5 let. a) the threshold works indirectly. Indeed, the exemption is directly provided by par. 5 let. a) and par. 5 *bis* lays down an objection to the exemption previously explained by par. 5, namely let. a).

So, par. 5 *bis* revitalizes the working of the CFC rules, previously excepted in certain circumstances by par. 5 let. a). Moreover, let. b), par. 5 of art. 167 ITA seems to work as the second exception explained above which, as we said, focuses CFC rules on anti-avoidance risk situations. Indeed, pursuant to let. b), par. 5, Art. 167 ITA, CFC rule does not apply if the typical effect of locate income

[121] OECD (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pg. 37.

in countries or territories characterized by a privileged tax system does not realized. In conclusion, also in this case art. 167 ITA seems to contain BEPS' recommendations.

Continuing with the comparison, chapter 4 of BEPS discusses the third CFC building block, which focuses on the definition of CFC income. Indeed, once a foreign company has been determined to be a CFC, the next question is whether the income earned by the CFC is of the type that raises concerns and should be attributed to shareholders or controlling parties. CFC rules therefore need to define attributable income. BEPS recommends that CFC rules should include a definition of income that ensures that it will be is attributed to controlling shareholders in the parent jurisdiction. At the same time, it recognizes the need for flexibility to ensure that jurisdictions can design CFC rules that are consistent with their domestic policy frameworks. In particular, BEPS takes into account dividends, interests, insurance incomes, royalties, IP incomes, sales and services incomes. The BEPS' wording is really broad so, we can image that there will not be any particular inconsistency. Moreover, Art. 167 ITA does not specifically appoint the kind of income. Indeed, it simply deals with distribution of profits[122] or generally with incomes.

Chapter 5 of BEPS sets out recommendations for the fourth CFC building block on computing income. Once CFC rules have determined that income is attributable, they must then consider how much income to attribute. Computing the income of a CFC requires two different determinations: which jurisdiction's rules should apply; and whether any specific rules for computing CFC income are necessary. The first recommendation focuses on rules that are used to calculate taxable income. In details, four options are kept into account by BEPS. The first option suggests applying the law of the parent jurisdiction. A second option would be to use the CFC jurisdiction's rules for computing income, but this would be inconsistent with the goals of Action Item 3 as using the CFC jurisdiction's rules may allow for less income to be attributed. This could also create complexity and increase the administration costs for the tax administration that would have to apply unfamiliar rules. A third option would be to allow taxpayers to choose

[122] Art. 167, par. 7 ITA.

either jurisdiction's computational rules, but this is likely to create opportunities for tax planning. A final option would be to compute income using a common standard[123]. The advantage of this option is that it could in theory lead to international consistency as all CFCs and parent jurisdictions would be using the same rules for calculating CFC income, regardless of the residence of either the CFC or the parent. Since most countries do not currently use such standards when calculating taxable income, however, this option may increase both administrative and compliance costs if taxpayers have to recalculate the income of the CFC according to standards that are applied by neither the parent jurisdiction nor the CFC jurisdiction.

Article 167 ITA, on par. 6, states that incomes are determined according to the Italian provisions applicable to persons resident which holds business income, except Art. 86, par. 4 ITA[124]. So, the Italian lawmaker choose the first option, since the relevant provisions belong to the parent company's jurisdiction[125]. This choice can be evaluated as positive. Indeed, it is logically consistent with BEPS and also has the effect to reduce costs for the tax administration[126]. Lastly, par. 6, Art. 167 ITA is also consistent with chapter 6 of BEPS - which will be explained in the following - since it states that "*CFC rules should apply the tax rate of the parent jurisdiction*".

Chapter 6 sets out recommendations for the fifth CFC building block on attributing income. Once the amount of CFC income has been calculated, the next step is determining how to attribute that income to the appropriate shareholders in the CFC. First of all, it is important to make clear that income attribution can be broken into five steps: determining which taxpayers should have income attributed to them, determining how much income should be attributed, determining when the income should be included in the returns of the taxpayers, determining how the income should be treated and determining what tax rate should apply to the income. BEPS, in chapter 6 of Action 3 explains

[123] For example, some jurisdictions instruct taxpayers to use the International Financial Reporting Standards (IFRS).
[124] V. Ukmar, *Corso di diritto tributario internazionale*, Padova, CEDAM, 2002.
[125] T. Lamedica, *Codice della riforma tributaria*, Wolters Kluwer, 2015.
[126] Some jurisdictions achieve a broadly similar outcome by starting with the income calculated according to the rules of the CFC jurisdiction and then adjusting the income in line with the rules of the parent jurisdiction.

recommendations dealing with the attribution of income, which are explained in the following. The attribution threshold should be tied to the minimum control threshold when possible. The amount of income to be attributed to each shareholder or controlling person should be calculated by reference to both their proportion of ownership and their actual period of ownership or influence. In addition, jurisdictions can determine when income should be included in taxpayers' returns and how it should be treated so that CFC rules operate in a way that is coherent with existing domestic law. Lastly, as we mentioned above, BEPS states that CFC rules should apply the tax rate of the parent jurisdiction to the income.

Also these recommendation seems to be fulfilled by Art. 167 ITA. In particular, par. 1 of Art. 167 lays down that income is imputed to residents shareholders in proportion to stakes held by those. Moreover, par. 6 of Art. 167 ITA lays down that the incomes of the not resident person are subject to separate taxation with the average rate applied on the total income of the resident entity and in any case not less than the rate applicable to corporate income tax[127]. In addition, as we mentioned above, incomes are determined according to Italian law laid down in ITA.

The last BEPS' chapter sets out recommendations for the sixth and final CFC building block on rules to prevent or eliminate double taxation. Indeed, one of the fundamental policy considerations raised by CFC rules is how to ensure that these rules do not lead to double taxation, which could pose an obstacle to international competitiveness, growth and economic development. So, according to BEPS, CFC rules should include provisions to ensure that the application of these rules does not lead to double taxation. BEPS final draft identifies at least three situations where double taxation may arise. Namely, they are situations where the attributed CFC income is also subject to foreign corporate taxes, situations where CFC rules in more than one jurisdiction apply to the same CFC income, and situations where a CFC actually distributes dividends out of income that has already been attributed to its resident shareholders under the CFC rules or a

[127] G. Minnucci, *TUIR 2009, Testo unico delle imposte sui redditi: analisi e commento articolo per articolo del D.P.R. 22 dicembre 1986, n. 917 e successive modifiche e integrazioni, completo di: annotazioni, prassi, normativa collegata*, Rimini, Maggioli, 2009.

resident shareholder disposes of the shares in the CFC. BEPS recommends that CFC rules should be designed to ensure that these and other situations do not lead to double taxation. To this end, BEPS also suggests some options. In particular, the recommendation for addressing the first two situations is to allow a credit for foreign taxes actually paid, including CFC tax assessed on intermediate companies. The recommendation for addressing the third situation is to exempt dividends and gains on disposition of CFC shares from taxation if the income of the CFC has previously been subject to CFC taxation, but the precise treatment of such dividends and gains can be left to individual jurisdictions so that provisions are coherent with domestic law. However, BEPS left to individual jurisdictions to address other situations giving rise to double taxation, but the overall recommendation for this building block is to design CFC rules to ensure that they do not lead to double taxation.

Italian CFC rule disposes a whole paragraph dealing with this matter: par. 7 Art. 167 ITA. This paragraph exactly corresponds to BEPS' chapter 7 and identically actualizes it. So, it is possible to affirm that Italian CFC rule is consistent with the BEPS' recommendations.

Regardless this last observation, we can show some aspects where an adjustment could be necessary or appropriate. In particular the changes most probable are represented by the Italian CFC rules' issues which are mostly criticized[128]. These controversial issues are summarized in the following. Firstly, a critic can be support regarding par. 8 *bis* let. a), Art. 167 ITA. In particular, the comparison - contained in letter. a) of paragraph 8 *bis* - between effective taxation faced by the CFC in the State or territory of settlement and the one which would be submitted in Italy (so-called tax comparable approach), is far from easy[129]. In fact, since the tax position to be relevant to the tax rate test, the reference is not only to nominal rates, but also the rules for determining the tax base. Continuing with the analysis of critical issues, the extension of the CFC rules to foreign entities not "blacklist" is restricted in the provisions contained in paragraph 8 *ter*, holding that the presumption of the preceding paragraph shall not apply if the resident enterprise

[128] G. Rolle*, Legge di stabilità: quali prospettive per CFC e costi "black list"?* in *Corriere Tributario,* no. 5, 2015, pg. 341.
[129] P. Boria, *Diritto Tributario Europeo*, Milano, Giuffrè, 2015.

shows that the settlement abroad "is not an artificial time to achieve an undue tax advantage." The provision imposes on the taxpayer liabilities that may be incurred by the tax authorities, in view of the fact that foreign entities, to which the 8 *bis*, are located in countries or territories other than those that lead to inefficient exchange of information[130]. On the light of these critical issues, it cannot therefore be excluded that - also in relation to the developments of the work conducted by the OECD on CFC regulations within the project BEPS - further changes likely to occur soon. However, also on the light of the comparison made above our CFC rules tend to appear compatible with the guidelines of the OECD. Consistently, there are not any amendment proposals of Art. 167 ITA as result of BEPS[131]. A fortiori, the interpretation and consequently the application of these rules by courts and the tax authority has not been affected by BEPS.

2.3 Exit taxes

2.3.1 Background and rationale of exit taxes

The increasing global mobility of taxpayers, as well as individual assets, has caused comprehensive discussions over taxation of taxpayer's migration from one jurisdiction to another. Tax aspects can highly influence a person's decision to migrate, especially when a State decides to tax unrealized capital gains. Typically, capital gains are taxed on realization, so when the asset is effectively alienated. While this holds true to any change of residence in a domestic situation: where the taxpayer remains under the tax jurisdiction of the State; the same cannot be said on a cross-border migration[132]. Indeed, in the second hypothesis, States try to reduce the risk of losing tax revenue they would be entitled to if the taxpayer had not moved. States try to achieve this aim by applying a so-called exit tax.

States usually make recourse to this form of taxation for two main reasons: to prevent transfers of residence that have tax avoidance as its underlying reason and to capture, without giving its tax sovereignty extraterritorial force, income and

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[130] L. Arbitta, R. Lupi, Codice TUIR Commentato, Assago, IPSOA Gruppo Wolters Kluwer, 2011, pg. 567.

[131] L. Miele e V. Ramaglioni, *CFC rules più aderenti alle "best practices" internazionali*, in *Corriere Tributari*, no. 38, 2015, pg. 3873.

[132] D. Zernova, *Exit Taxes on Companies in the Context of the EU Internal Market* Intertax, 2011, 10, pp. 471–493

capital gains which they feel entitled to tax because they were accrued during the time the taxpayer was resident in this State.

An exit tax, as mentioned afore, is usually a tax on unrealized capital gains and is triggered when a person moves to another country. The tax liability arises because a person had decided to leave the tax jurisdiction of a State; if the person had remained in the State, it would only have been taxed on the effective capital gains derived from the alienation of the asset. The main reason for introducing emigration taxes is to protect the tax base of the emigration State in cases when individuals transfer their residence. In conclusion, exit tax implies the taxation of the capital gain accrued on individual's personal and real property at the moment of the change of residence[133].

Each state is free to design its own rule dealing with exit tax. In particular, four categories of emigration taxes are created. These are: exit taxes on latent (unrealized) income; exit taxes on realized income; trailing taxes on latent (unrealized) income; and trailing taxes on realized income.

The first category is the exit tax on latent income (EL rules). Latent income is income which is unrealized, that is, the "normal" time of the taxable event has not yet occurred. The emigration, however, triggers the taxable event which means that an exit tax is levied at the time of the departure. The collection of the tax on unrealized gains takes place immediately before emigration. At this time, the taxpayer is still a resident of the State imposing the tax. The objective of these rules is to tax income that has arisen in the emigration State, but that has not yet been realized.

The second category concerns exit taxes on realized income. In these cases, the income has been realized before the date of emigration, but collection of the tax has been postponed until a specific time in the future. This later time can for instance be the time of emigration. The objective of these rules is to tax the income that has arisen in the emigration State (i.e., the already realized income) and to make sure that the taxpayer pays the tax on the tax deferral.

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[133] H. P. A. M. van Arendonk, *Exit taxes:Separation of Pwers?*, EC Tax Review, Issue 2, 2010, pp.60-61.

2.3.2 Italian exit taxes

Italian legal system provides an exit taxes in ITA, namely in Art. 166. Art. 166 ITA was introduced by the Decree no. 344 of 12 December 2003 to substitute the previous existing Art. 20 *bis* of the previous version of ITA which came into force by Art. 30, par. 1 of Decree no. 41 of 23 February 1995. Pursuant to Art. 166 ITA the transfer of residence is ruled when it happens in a foreign country and it could imply a loss of tax revenue for the country where the company was originally resident. The anti avoidance purpose is clear. The rule is aimed to prevent a resident to transfer its residence to another state only to dispose of property belonging to the enterprise. In relation to the personal scope, Art. 166 ITA is addressed to subjects who carry on commercial businesses[134]. So, as it emerges from the wording of the provision, it applies in respect of natural persons, of limited liability companies, public and private entities and companies, exercising business. In an effort to enhance the effectiveness of the anti-avoidance rule, the legislature of the tax reform has extended the number of subjects covered by the provision in question.

The essential condition for the applicability of article 166 is the transfer of residence for the purposes of direct taxation. And it is also necessary that the lost of the Italian residence as to happen as a result of the transfer. In others words, the lost of Italian residence has to arise from the transfer.

To make this rule understandable in practice it is necessary to know the notion of residence. To this aim we have to look at Article 73 ITA which states that a company has to be considered resident in Italy, for the purposes of direct taxes, if for most of the tax period it has the registered office or the seat of the administration or the main business purpose in Italy. Moreover, it is necessary that the assets related to the company or the company does not flow into an Italian permanent establishment[135]. Indeed, the same Art. 166 ITA specifies that exit tax applies if the components subsequently incorporated in the permanent establishment in the State will be turned away. The rule is justified by the fact that, in the case of a permanent establishment, a conditions required for the application of the rules in question, namely the release of the company's assets

[134] Par 1, Art. 166 ITA.
[135] Par. 1, Art. 166 ITA.

from the country, is not fulfilled. The components of the company, in fact, flowing into a permanent establishment situated in the original State, remain in Italy and continue to be relevant to the determination of income pursuant Italian tax regulation. Indeed, if the exclusion of the exit tax's application was not granted by Italian rules, a double taxation arises.

Now that we know all the prerequisites, we can look at the nucleus of Art. 166 ITA, always keeping into account the aim of this rule which is to attract to domestic taxation all the assets that, in case of transfer abroad of residence, could escape.

The displacement of a company beyond the border, with a consequent transfer of tax residence of the same company, involves the realization at the normal value of the assets belonging to the complex transferred, with a consequent taxation of the positive difference that emerges from a comparison of the predicted normal value of corporate assets and the last fiscally recognized cost of those assets. Regarding this last topic, debates between authors existing regarding the individuation of these assets. However, today, the majority of doctrine thinks that that the provision applies to all assets related to the company and not just those that are part in the technical sense of a business complex. This opinion received the majority of consent because it is consistent with the aim of the exit tax. The sole company's good that, according to the prevailing doctrine, escapes from Art. 166 ITA is the goodwill.

Paragraph 2 of Article 166 of ITA provides that in case of transfer of fiscal residence, funds in tax suspension entered in the last financial budget before the transfer are subject to taxation, including those taxable in case of distribution. Even in this case, the rule does not apply if such funds are reconstituted in a permanent establishment in Italy[136].

The Art. 1, par. 1, let. b) of the Decree no. 199 of 6 November 2007 added par. 2 *bis* to Art. 166. This paragraph states that the losses generated until the tax period prior to the one when the transfer of fiscal residence occurred, which are not compensated by the income earned up to that period, are computable to decrease of income of the said permanent establishment. This has to be happen pursuant

[136] G. Falsitta, *Manuale di diritto tributario; Parte speciale; Il sistema delle imposte in Italia*, Padova, CEDAM, 2014.

Article 84 ITA[137] and keeping into account the conditions and limits set out in Article 181 ITA[138]. The same Decree introduced also par. 2 *ter* which states that the transfer of fiscal residence do not imply the imposition of a tax charge to the shareholders of the transferred company. This provision was introduced to adapt the Italian legislation to the European Union Directive 19/2005/CE.

Lastly, Art. 91, par. 1 of the Decree no. 1 of 24 January 2014 introduced par. 2 *quarter* and par. 2 *quinquies.* These paragraph were introduces by the Italian legislator as a response to the infringement procedure in course and further to the principles expressed in *National Grid Indus*[139]. Par. 2 *quarter* states a procedure of tax collection suspension. According to the new rule, effective for any transfer carried out from 24 January 2012, corporate entities (as well as other taxpayers carrying out a business activity), transferring their tax residence in a Member State or in States that adhered to the EEA included in the White List and with which Italy has an agreement on mutual assistance on tax debts collection comparable to the assistance under the EU Directive No. 2010/24/EU, are entitled, as an alternative to the immediate taxation at the time of the transfer, to opt for the suspension of the unrealized capital gains up to the actual realization in compliance with the principles set forth in *National Grid Indus*[140]. Subsequently, the reference to *National Grid Indus* case was dropped out[141]. So, to obtain the suspension concerned, the tax has to be levied on assets of a company which has been transferred to countries belonging to the European Union or to States party to the European Economic Area included in the list of the Decree issued under Article 168 *bis*, paragraph 1, with which Italy has concluded an agreement on mutual assistance in the collection of tax receivables comparable to that provided by Directive 2010/24 / EU of 16 March 2010.

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[137] This provision deals with the loss carry-forward. According the mentioned provision substantially lays down that the loss of a tax period can be carry forward to the successive tax periods incomes for an amount which is not exceeding than eighty percent of the taxable income of each of them and for the entire sum which capacity in this amount.

[138] This mentioned provision deals generically with the fiscal losses.

[139] Case C- 371/10 of 29 November 2011.

[140] R. Kok, *Exit taxes for companies in the European Union after National Grid Indus*, EC Tax Review, 2012, Issue 4, pp. 200-206.

[141] H. van Arendonk, *National Grid Indus and Its Aftermath*, EC Tax Review, Issue 4, 2013, pp. 170-171.

2.3.3 BEPS' recommendation on exit taxes: Action 6.

Also this matter has been one of the objects of BEPS' discussion. In particular Action 6 f BEPS deals with this matter.

Actually, Action 6 deals with the broader aim of develop model treaty provisions and recommendations regarding the design of domestic rules to prevent treaty abuse[142]. It also includes specific treaty rules to address other forms of treaty abuse and ensures that tax treaties do not inadvertently prevent the application of domestic anti-abuse rules.

The report finally includes changes to the OECD Model Tax Convention that clarify that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping) and that identify the tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country. The report also addresses two specific issues related to the interaction between treaties and domestic anti-abuse rules. One of these two issue deals with so-called "departure" or "exit" taxes, under which liability to tax on some types of income that has accrued for the benefit of a resident (whether an individual or a legal person) is triggered in the event that the resident ceases to be a resident of that State. The tax liability is triggered by the fact that the taxpayer ceases to be a resident of that State. In a globalized word where boards between states are more and more blurred, individuals and legal persons are used to transfer their residence for tax purposes. And in these circumstances, a State may wish to protect its tax base or the consistency of its tax system and impose tax on the income that has accrued to the taxpayer when he was a resident of that State.

Changes to the Commentary of the OECD Model Tax Convention clarifies that treaties do not prevent the application of these taxes. Thus, tax treaties do not prevent the application of domestic tax rules according to which a person is considered to have alienated property for capital gain tax purposes, immediately before ceasing to be a resident. The application of such taxes, however, creates risks of double taxation where the relevant person becomes a resident of another

[142] A. P. Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Action 2 and 6*, Intertax, Issue 1, 2015, pp. 42-57.

State which seeks to tax the same income at a different time. The OECD proposes to resolve that double taxation – which occurs in different assessment years – like it has done for double taxation arising from employee stock option-plans, i.e., through the MAP according to which the new Residence State should give relief for the departure tax assessed by the other State. As an alternative, the OECD suggests that States could include a specific provision to that effect in their treaties[143].

However, after the adoption of the Action 6's final report – which happened on October 2015 – Italian Government and Parliament did not take into account any amendment proposal, or in general any changes. However, we can image that in the future some changes could occur, especially regarding the controversial issues. Almost a year ago, an aspect that deserved to be analyzed was whether a PE in Italy of a foreign entity may claim the deferment of taxes under the new rule, that is, whether an Italian PE of a non-resident company falls within the scope of application of Article 166, paragraph 2-*quater*, of ITA. This interpretative problem was recently solved in an affirmative way by the art. 11, par. 3 of Decree no. 147 of 22 September 2015. So, now, par 2 *quarter* is applicable also to PE.

Currently, an issue worthy to be analyzed is the lack in the Italian exit tax rule of a provision aimed to avoid a double taxation. Indeed, as it was showed above, the double taxation in the exit tax matter is a serious and actual risk, that needs to be prevented and voided.

2.4 Other specific anti-abuse rules

In addition to the rules that have just been analyzed above, Italian domestic law provides other specific anti abuse rules[144].

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[143] L. De Broe, J. Luts, *BEPS Action 6: Tax Treaty Abuse* Intertax, Issue 2, 2015 pp. 122–146; A. Mastroberti, *Decreto Internazionalizzazione: tassazione piena dei dividendi "black list", in "Pratica fiscale e professionale"*, no. 39, 2015, pg. 14.

[144] Other SAARs can be found in the Decree 131/1986 (so called Law of Register). Doctrine and especially judges (Lombardia Tax Commission no.36 of 13.1.2011; Ravenna Provincial Tax Commission n.4 of 17.5.2010; Piemonte Tax Commission no.10 of 12.2.2010; Milan Tax Commission no.230 of 30.9.2009; Florence Provincial Tax commission no.90 of 29.9.2009) to justify the applicability of the abuse of law's principle also in the framework of the Decree 131/1986 is the reference to the anti avoidance function of Art. 20 of the concerned Decree. In particular, art. 20 Decree 131/86 laid down that tax is applied according to the intrinsic nature and the legal effects of the acts filed for registration, even though there is not correspondence of the title or the apparent form. So, the tax regime applicable to an individual act has to be found having regard, primarily, to the content of the clauses and the legal effects produced by the act, regardless of the *nomen juris* given by the parties. This rule, therefore, refer to the regulation of interest

2.4.1 "Black list" costs

Before of January 2016, another SAAR could be found in Art. 110, par. 10 ITA. Article 110(10) of the Italian tax act (ITA) limited the deductibility of expenses and other costs related to transactions with certain nonresident entities and professionals by imposing an increased burden of proof. According to that provision, to achieve the full deductibility of these costs – so beyond the limit laid down in par. 10 Art. 110 ITA - the taxpayer was able to demonstrate that the foreign dealing companies were prevalently running an effective business, or that the transactions which have been carried out match a real economic interest and have actually been performed.

This wording was the result of a recent change occurred by the Decree 147/2015. In particular, before the entering into force of this Decree, par 10 of art 110 laid down that all costs occurred with companies resident or located in states or territories with preferential tax regimes were not deductible. On the contrary, today the same provision states a limitation for the non deducibility. In particular,

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actually pursued by the parties. In addition, also the Supreme Court (C., 23.11.2001 no.14900; C., 25.2.2002 no.2713; C., 7.7.2003 no.10660; C. 30.5.2005 no.11457; C. 11.6.2007 no.13580; C., 12.5.2008 no.11769; C., 16.4.2010 no. 9162 and no. 9163; C., 21.4.2010 no. 9492; C., 30.6.2011 no.14367) interprets this provision in the meaning of an anti avoidance rule. This opinion is also consistent with the legislator's ratio. Indeed, the legislator has felt the need to take actions to suppress phenomenon of avoidance, characterized by a divergence between the scheme of negotiations adopted by the Contracting Parties and their practical purposes which are different and beyond those inherent to the type of negotiation. The Supreme Court[144] once even stated that art. 20 of the Decree 131/1986 represent an useful symptomatic reference of an anti-avoidance principle which is available in the Italian legal system. However, this opinion is deeply criticized by a large number of authors (Supreme Court. no.12042 of 1.04.2009). They give to art. 20 just an exclusive interpretation relevance, denying a possible nature of anti-avoidance rule. The provision concerned just indicates to the interpreter what he can and should do (G. Corasaniti, *L'art. 20 del T.U. dell'imposta di registro e gli strumenti di contrasto all'elusione: brevi spunti ricostruttivi a margine di due contrastanti pronunce della giurisprudenza di merito,* Dir. e prat. trib., no. 3, 2010, pg. 578).

Continuing to look at Decree 131/1986, some judges an authors (G. Marongiu, *L'elusione nell'imposta di registro tra l'abuso del diritto e l'abuso del potere, Diritto e Pratica Tributaria, no. 6, 2008, pg. 11067;* G Escalar, Indebita trasformazione del diviete di abuso del diritto in divieto di scelta del regime fiscale meno oneroso, Corriere tributario, no. 35, 2012, pg. 2707) trace the anti avoidance purpose also in articles 24, 32 and 33. Regarding the former, it states that in real estate transfers accessions, hanging fruit and appliances are presumed to be transferred to the purchaser of the property, unless they are expressly excluded from the sale, or is proved that they belong to a third party or they have been transferred to the buyer by a third party. The second provision deals with the declaration of appointment for the person to be appointed made over the three days after the conclusion of the contract. The last mentioned provision deals with the irrevocable mandate is subject to the act for which he was awarded.

However, in conclusion, regarding all these other SAAR, as we said at the beginning, any proposal for amendments has been made. And the Courts – both lower both supreme – still have not changed their positions.

the deductibility of these costs is allowed up to the normal value. This change, since was introduced by Decree 147/2015 which was enacted on the base of art. 12 of the enabling law 23/2014.

However, what has been said until now regarding par. 10 of Art. 110 ITA is not into force any more. The Stability Law[145] repealed par. 10 of Art. 110 ITA[146].

So, pursuant to the Stability Law, the rules regarding "black list" costs do not differ from the rule governing the "normal" costs. The deductibility of "black list" costs depends just from the same criteria which are applicable to all the kind of costs and expenses. In other words, from the 1st January 2016, they are ordinarily deductible. So, for an Italian enterprise there are no more differences between the costs made to buy product from another subject which is resident in a "black list" territory and which is resident in a "non black list" territory[147].

The doctrine suppose that this recent modify has been made to follow BEPS' recommendations[148].

However, before the entry into force of Law 208/2015, that rule had been subject to many changes and interpretation acts both by judges, both by tax authority. On 6 October 2010, the tax authorities issued Ministerial Circular No. 51/E which clarified that the term "resident entity" must be interpreted as including Italian permanent establishments of foreign entities and the term "resident in a state or territory" mentioned in the black list must be interpreted as including permanent establishments of Italian entities and entities resident in a "white list" country; and the term "expenses" must be interpreted as including all kind of costs and expenses such as depreciation/amortization and capital losses.

2.4.2 Transfer pricing rules

Another specific anti abuse rule could be found in the rules dealing with the transfer pricing phenomenon[149].

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[145] Law no. 208 of 28 December 2015.

[146] In particular the concerned paragraph has been abrogated by Art. 1, par. 142 of Law 208/2015. The same provision abrogated also par. 11, 12 *bis* and 12 of the same Article.

[147] M. Bargagli, *Cambia la disciplina CFC e la tassazione dei dividendi black list*, in A&F, no. 9, 2015, pg. 13.

[148] E. Della Valle, *I costi black list: cronaca di una morte improvvisa*, in il fisco, no. 7, 2016, pg. 1-616.

[149] Read more at P. Valente, *Manuale del transfer pricing*, Milano, IPSOA, 2012.

First of all, it is important understand what this phenomenon is and the reason way it arises. Consequently to the increase of multinational corporations, the amount of intercompany transactions grew up[150]. Such transactions often involve affiliates located in two or more different jurisdictions. It is not difficult to imagine that this situation offers the possibility to shift profits within the multinational company and across borders[151]. As profit shifting directly impacts tax revenue, it is not surprising that national tax authorities try to counter such behavior[152]. So, transfer pricing is one the rule through which States try to prevent taxpayers from adjusting – as the word itself tells - transfer prices for tax purposes.

Strictly regarding the Italian legal system, a rule having the aim explained just above is contained in the already mentioned Article 110 ITA, namely in par. 7.

Paragraph 7 of Art. 110 ITA provides that the income's components arising from transactions with non-resident companies, that directly or indirectly control the resident company , are controlled by the resident company or are controlled by the same company that controls the resident company , are valued based on the normal value of the goods sold , of the services provided and of the goods or services received.

In the aforementioned standard there is an implicit reference to art . 9 , paragraph 3 of ITA which establishes how the normal value has to be meant. In particular, the normal value means the price or the average amount charged for the goods and services of the same or similar kind , in conditions of free competition and at the same marketing stage , in time and in the place where the goods or services were acquired or provided , and , failing that, the time and place nearest .

[150] While intercompany trade amounted to about 25% of world trade in the 1980s, in 2006, it was estimated to be as high as 60%, see M. Kobetsky, Transfer Pricing Measures and Emerging Developing Economies, 14 Asia-Pacific Tax Bulletin 5 (2008), pp. 363–77.

[151] Generally, profits are shifted from high-tax jurisdictions to low-tax jurisdictions in order to benefit from tax rate differentials.

[152] T. Zinn, N. Riedel, C. Spengel, *The Increasing Importance of Transfer Pricing Regulations: A Worldwide Overview*, Intertax, 2014, Issue 6/7, pp. 352–404; H. C. Verlage, Transfer Pricing by Multinational Enterprises; Issues and Developments, 1982, Intertax, Issue 8, pp. 285–293.

For the majority of the doctrine the anti abuse aim of this rule is clear[153]. Nevertheless some authors think that par. 7 of Article 110 ITA has not an anti abuse aim[154].

On the base of the these different points of view we should conclude that the transfer price discipline has a broader rationale[155]. It aims also to relocate the taxing rights among the States. Indeed, besides the cases of abusive contraction of the taxable base, there are also other types of cases that meet the scope of the provision itself: the tax avoidance cases are part of several cases currently faced by transfer pricing; if the abusive tax shelters cause a tax base erosion issue, nevertheless these cases do not include all of those covered by the scope of this rule[156].

2.4.3 SAAR concerning the merger's carrying forward of losses

Article 172 ITA deals with the merger between companies.

In few words, a merger can be defined as the combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock[157].

However, what is important for the topic of this paperwork is the paragraph 7 of Article 172 ITA. Indeed, this paragraph represents a specific anti abuse rule[158].

Par. 7 of Art. 172 ITA lays down a limit to the losses' carryover. In particular, the losses of the companies involved in the merger, including the acquiring company, can be deducted from income of the company resulting from the merger or the acquiring company for a part not exceeding the amount of the respective shareholders' equity as shown by the latest financial statement, or by the financial situation pursuant to Article 2501 *quater* of the civil code if it is lower. So, a first

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[153] D. Stevanato, *Il «transfer pricing» tra evasione ed elusione*, in GT - Rivista di giurisprudenza tributaria, no. 4, 2013, pg. 303; P. Valente, *La revisione della disciplina OCSE in materia di documentazione per il transfer pricing*, in il fisco, no. 12, 2014, pag. 1-1162.

[154] F. Menti, *Il transfer pricing e l'onere di provare la conformità dei prezzi praticati a quelli di libera concorrenza*, in Diritto e Pratica Tributaria, no. 1, 2014, pg. 2-35.

[155] A. Muselli, *Il transfer pricing: i prezzi di trasferimento internazionali: fiscalità italiana e dei paesi OCSE e documentazione di supporto: aggiornato con esempi di documentazione italiana e dell'interim draft OCSE*, Milano, il Sole 24 Ore Libri, 2012.

[156] A. Ballancin, *Natura e ratio della disciplina italiana sui prezzi di trasferimento internazionali*, in Rassegna Tributaria, n. 1, 2014, pg. 73.

[157] A. MacCulloch, *Book Review: The EU Merger Regulation and the Anatomy of the Merger Task Force*, European Public Law, Issue 3, 2002, pp. 431–432.

[158] E. Zanetti, *I limiti al riporto delle perdite fiscali in caso di fusione*, in A&F, no. 3, 2007, pg. 17.

test that merging companies have to pass concerns shareholders' equity's limit[159]. Moreover, in this calculation contributions and payments made in the last twenty-four months do not count.

In addition, to check if the losses can be carry over, a test has to be made[160]. This test is known as "vitality test" since it is necessary that the income statement of the company whose losses may be carried forward of the year preceding the year in which the merger was approved has to show an amount of revenues, revenues from core business, an amount of expenses for subordinate employees and related contributions , referred to in Article 2425 of the Civil Code, higher than 40 percent of the amount emerging from the average of the last two years[161].

The ratio of the "vitality test" of the merging companies would lie in the desire to "prevent the realization of mergers to companies without production capacity, and to prevent mergers aimed by the sole purpose of using the companies' losses"[162].

In conclusion, the anti abuse aim of this provision is clear[163]. Par. 7 of Article 172 ITA aims to avoid a double deduction of the same negative component.

2.4.4 Presumption of existence in a State's territory

The Decree no. 223 of 4 July 2006[164] has as one of its aim the fight to tax evasion. Article 35, par. 13 of this Decree has the more specific aim to contrast "dummy" foreign companies[165]. For this purpose, this provision introduced the Article 73, par. 5 bis within ITA.

Article 73, par. 5 *bis*, ITA states a presumption, based on which, in the presence of specific conditions, the seat of companies and organizations - (formally) non-resident – is considered existing in the State, in absence of proof to the contrary.

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[159] R. Michelutti, A. Prampolini, *Limite del patrimonio netto al riporto di perdite e interessi passivi nella fusione*, in Corriere tributario, no. 27, 2011, pg. 2220.

[160] E. Romita, F. Pedrotti, *Per il riporto delle perdite vitalità economica necessaria finno alla deliberazione di fusione*, in Corriere tributario, no. 46, 2006, pg. 3688.

[161] G, Committeri, P. Alonzo, *La vitalità economica delle società partecipanti ad una fusione*, in Corriere tributario, no. 5, 2010, pg. 374.

[162] Revenue Agency, resolution 29 October 2002, no. 337.

[163] G. Odetto, *Limitazioni al riporto delle perdite fiscali nella fusione*, in Pratica fiscale e professionale, no. 46, 2006, pg. 15.

[164] S. Capolupo, D.*L. n. 223/2006: la presunzione di residenza in Italia*, in il fisco, no. 33, 2006, pg. 5069.

[165] Revenue Agency, circular 4 August 2006, no. 28/E.

In particular, a society or an entity is considered resident in the territory of a State (even if is not formally resident there) if it holds controlling interests, within the meaning of ' Article 2359, first paragraph, of the Italian Civil Code in certain kind of legal persons resident in Italy[166], if it is controlled, directly or indirectly, within the meaning of Article 2359, first paragraph, of the Italian Civil Code, by residents in Italy or if it is administered by a board of directors or equivalent management body, composed mainly of advisers resident in Italy.

Also in this case, the anti abusive aim of this provision is clear[167]. This provision is aimed to counteract the creation of the so called "box company"[168]. The concerned provision is aimed to counteract tax evasion through setting up dummy companies.

In practice, Art. 73, par 5 *bis* prevent the risk associated with the fictitious localization of tax residence in countries - different from Italy, where, however, the person actually resides - in order to escape tax obligations existing in the legislation of real membership and, on the contrary, to benefit the more favorable tax regime in force elsewhere.

Italian resident, to escape taxation in their country, where a heavy tax burden is supposed to exist, elaborate a fictitious residence[169] in State where there tax burden is lower of where more benefits exist[170]. In this way, Italy loses the possibility to charge all the worldwide income of that person. But, Art. 73, par 5 *bis*, avoids this dangerous risk[171].

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[166] Par. 1, Lett. a) and b), Art. 73 ITA.

[167] P. Bertolaso, E. Bressan, *Le "esterovestizioni" alla prova della presunzione di residenzaa: alcune considerazioni con particolare riguardo alle holding statiche*, in il fisco, n. 36, 2006, pg. 5617.

[168] L. Del Federico, *Società estere e presunzione di residenza ai sensi del D.L. n. 223/2006: artt. 43 e 48 del Trattato CE, Convenzioni contro le doppie imposizioni e disapplicazione della norma interna di cui al comma 5-bis dell'art. 73 del Tuir*, in il fisco, no. 41, 2006, pg. 1-6367; S. Allegna, Place of effective management e presunzione di residenza per le holding collocate all'estero, in Comm. Inter., no. 18, 2006, pg. 36.

[169] C. Garbarino, *Manuale di Tassazione Internazionale*, Ipsoa, 2005, p. 260.

[170] OECD, TAG on Monitoring the application of existing treaty norms for the taxation of business profit, Place of effective management concept: suggestions for changes to OECD Model Tax Convention, 2003.

[171] L. Belluzzo, *Giro di vite sulle "holding esterovestite": la presunzione di residenza quale mezzo di contrasto all'elusione e all'evasione*, in Fiscalità Internazionale, no. 5, 2006, pg. 399.

In conclusion, since this provision lays down a presumption and admits to proof the contrary, the effect of this provision is the reversing of the burden of proof[172]. In particular, the taxpayer has to prove both by documents[173] and by real and concrete elements[174].

2.4.5 The concept of "beneficial owner" in the Italian Tax Act

In order to avoid cases of abuse of law, the Decree no. 600/1973 provides the definition of beneficial owner.

More specifically, the definition of beneficial owner can be found both in Article 26 *quarter* and 27 *ter* of the mentioned decree.

Article 26 *quarter* ITA provides a definition of beneficial owner that is very similar to the definition contained in the Directive 2003/49/EC[175]. In particular, Art. 1 of the Directive 2003/49/EC[176] lays down that the beneficiary owner of interest or royalty is the person who receives payments as a final beneficiary and not as an intermediary, as agent, trustee or nominee for another person[177].

Article 26 *quarter* grants totaling exemption on withholding tax to be applied on interest and outbound payments, provided that the companies and organizations that receive interest or payments posses certain requirements[178]. Among the many conditions, it is necessary that these entities can be considered beneficial owners of the concerned payments[179].

Moreover, the Ministerial Circular of 2 November 2005, n. 47 clarified the definition of "beneficial owner" stating that "*the companies - to be regarded as beneficial - have to receive payment as a final beneficiary and not as an intermediary, as agent, trustee or nominee for another person*".

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172 Commentary to Article 4, OCSE Mode Convention.

173 For example shareholders' meeting held in the foreign office.

174 For example bringing strategic business decisions or staffing and related duties performed.

175 A. Picciariello, *Interessi e canoni comunitari infragruppo: la tassazione si sposta nello Stato di destinazione. Recepita dall'Italia la Direttiva n. 2003/49/CE del 3 giugno 2003*, in il fisco, no. 39, 2005, pg. 1-6148.

176 M. Casalini, A. Serafini, *Interessi e royalties: recepimento nazionale delle disposizioni comunitarie contenute nella Direttiva n. 2003/49/CE ad opera del D.Lgs. n. 143/2005*, in il fisco, no. 28, 2006, pg. 1-4324.

177 P. Bonarelli, *Recepimento della Direttiva UE in materia di interessi e royalties, in Fiscalità Internazionale*, n. 4, 2005, pag. 300.

178 M. Bargagli, M. Thione, *La nuova "withholding tax" sugli interessi passivi "outbound" corrisposti a soggetti non residenti*, in il fisco, n. 20, 2012, pg. 1-3121.

179 M. Bargagli, *La tassazione degli interessi corrisposti a società comunitarie e la clausola del beneficiario effettivo*, in Bilancio e Reddito d'Impresa, no. 3, 2012, pg. 26.

So, it is necessary that the company receiving the interest or royalties derive an economic benefit from the transaction just put in place to be considered actual recipient of the payments[180].

In conclusion, these provisions seem to be fully in line with OECD recommendations.

[180] M. Piazza, G. Barbagelata, *Interessi corrisposti a società consociate UE tra chiarimenti e questioni aperte*, in il Corriere tributario, n. 31, 2011, pg. 2987.

3 SAARs IN THE TAX TREATY LAW

3.1 Relation between SAARs in the national Italian law and SAARs in the tax treaties law signed by Italy

Since we are dealing about anti abuse rules and so the "abuse of law" up to now, it is appropriate at this stage of the work to explore the topic of the abuse of tax treaties[181].

Treaty abuse is a widespread phenomenon. In particular, two forms of treaty abuse can be found[182]. The former is represented by the case where a taxpayer circumvents limitations of the treaty itself. The latter is represented by the case where a taxpayer circumvents domestic law provisions by relying on tax treaty benefits[183].

However, first of all, it is fundamental to analyze the relationship between the SAARs included in the national law and the SAARs included in the tax treaties.

In particular, a delicate debate involved the relationship between the SAAR contained in Art. 167 ITC (the CFC rule) and the anti abuse rules included in tax treaties signed by Italy. Very briefly, the issue regarding this relationship is explained in the following.

First of all, it is fundamental to look at the provisions that are at the heart of the debate. We already said that Article 167 ITA leads to the tax transparency of the income produced in Italy by a foreign subsidiary company located in a State or territory qualified as having a privileged tax regime. But, Article 7 of OECD Model Convention, so almost all the Article 7 of the tax treaties signed by Italy, provides that the income of an enterprise shall be taxable only in the State of residence, save for the situation in which that undertaking carries on business in the other Contracting State through a permanent establishment.

At this stage, we can understand that the debate arises because taxation for transparency enshrined in Art. 167 ITA seems to constitute a derogation to the

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[181] For additional information: S. van Weeghel, *The improper use of tax treaties,* Kluwer Law, London, 1989.

[182] L. De Broe, *International tax planning and prevention of Abuse, IBFD, 2007.*

[183] C. HJI Panayi, *Is Aggressive Tax Planning Socially Irresponsible?*, *Intertax*, 2015, Issue 10, pp. 544–558.

more favorable conventional provision that, instead, should prevail over conflicting domestic provisions[184].

The Italian jurisprudence, stated that Article 167 ITA is incompatible with Article 7 of OECD Model Convention[185].

On the contrary, the Italian doctrine does not think that the mentioned incompatibility exists. Some authors[186] justify their opinion stating that the essential purpose of tax agreements does not consist solely of avoiding or limiting double taxation, but also of preventing the tax evasion or avoidance. Consequently, the conventional provisions cannot be interpreted up to compress the taxing rights of a State which, obviously, exercises its powers also through the anti abuse provision such as the CFC rules. Other authors[187] believe that the CFC rules and the Art. 7 of the OECD Model Convention are not in opposition to each other because they are related to different situations. The CFC rules, in fact, provided for the Italian residents taxation as participants in a foreign company (under certain conditions). On the contrary, Art. 7 OECD governs the allocation of taxing rights regarding the business income from the point of view of a non-resident entity that operates through a permanent establishment in the territory of the source.

At last, this issue had been also at the heart of a Supreme Court's decision[188]. The Supreme Court considered legitimate the application of the legislation on CFC in the presence of a treaty against double taxation on the basis of certain innovative considerations. The Supreme Court stated that the conventions against double taxation - the interpretation of which has to be made in accordance with the Vienna Convention of 23 May 1969 forecasts on the Law of Treaties - should be

[184] C. Sacchetto, S. Plebani, *Compatibilità della legislazione CFC italiana con le norme convenzionali e con l'ordinamento comunitario*, in Dir. prat. trib. int., 2002, pg. 13; P. Pistone, *Normativa CFC, convenzioni internazionali e diritto comunitario*, in Tributimpresa, 2005, pg. 47.

[185] Comm. trib. prov. Bergamo 12 November 2009, no. 170. In this case, in particular the National Court referred to Article 7 of the Tax Treaty signed between Italy and Cyprus.

[186] A. M. Gaffuri, *La tassazione dei redditi di impresa prodotti all'estero; principi generali*, Giuffré, Milano, 2008, pg. 282.

[187] A. Ballancin, *Osservazioni a margine di una sentenza di merito in tema di incompatibilità della disciplina CFC con le convenzioni internazionali contro le doppie imposizioni. Ulteriori riflessioni sul rapporto tra la novellata normativa CFC ed il diritto comunitario*, in Riv. dir. trib., no. 3, 2010, pg.161.

[188] Judgment no. 25281, 16 December 2015.

based on the criterion of good faith and in the light of the spirit and purpose of those provisions.

However, the Supreme Court's judgment triggers some concerns. In particular, The Court, in fact, recognizes a general anti-abuse principle in the conventional field based on the concept of "beneficial owner". According to the judges, the enjoyment of the international treaty benefits would be more closely linked to the fact that the party who invokes the application is also the one who will have the economic and legal availability of the element in the profitability analysis. Otherwise this could mean an "*improper translation of the conventional benefit*"[189].

3.2 General features and OECD's recommendations.

Due to the mentioned relevance of treaty abuse, the whole Action 6 deals with the tax treaties abuse[190].

The OECD largely fails to clearly define these two types of cases and to draw unequivocal conclusions as to the proper legal instrument to counter the abuse concerned[191].

However, in general, the principal purpose of Action 6 is the prevention of treaty abuse or "the granting of treaty benefits in inappropriate circumstances".

More specifically, Action 6 BEPS is aimed to

- develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances,
- clarify that tax treaties are not intended to be used to generate double non-taxation and
- identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

Focusing the attention on the Italian legal system, BEPS' Action 6 has had the effect to increase the attention to tax policy.[192] This is happening also because

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[189] G. Zorzi, *Compatibilità della normativa CFC con le convenzioni contro le doppie imposizioni*, in il fisco, no. 6, 2016, pg. 1-561.

[190] OECD (2015), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. *http://dx.doi.org/10.1787/9789264241695-en.*

[191] D. A. Ward, *Abuse of Tax Treaties*, *Intertax*, 1995, Issue 4, pp. 176–186; D. Hund, *Towards a revised OECD-model tax treaty?*, *Intertax*, 1989, Issue 6, pp. 212–224.

OECD explicitly stated in BEPS' working that a revision of existing tax treaties is "desirable and feasible". In our country, the awareness that also the tax treaty's drafting may lead to the profit shifting and taxable base erosion has increased[193].
Moreover, the use of multilateral or bilateral instruments (like treaties are) to prevent and avoid the base erosion and profit shifting seems a good choice. In fact, the treaty's characteristic to involve a plurality of parties at once is a useful to solve international tax matter[194]. In other words, a tax treaty allows the achievement of synchronized results. Consequently, it allows saving time and resources[195].
However, in our country there are not any plans aimed to amend existing treaties[196]. The treaty policy has not been affected by BEPS so far[197].
In conclusion, the doctrine[198] recognizes the necessity to change some rules[199]. But neither the Government, nor the Parliament have begun procedures designed to the mentioned goal.
Nowadays, many clauses aimed to prevent and avoid base erosion and profit shifting already exist[200]. They are going to be explained in the following.

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[192] F. Trutalli, *Trattati contro le doppie imposizioni e fiscalità d'impresa*, in Azienda & Fisco, no. 3, 2000, pg. 116.
[193] R. Dominici, *La ratifica della convenzione Italia-USA contro le doppie imposizioni: un decennio di innovazioni*, in Fiscalità Internazionale, no. 3, 2010.
[194] P. Valente, *Rilevanza dello strumento multilaterale ai fini dell'implementazione delle misure BEPS*, in il fisco, no. 47, 2015, pg. 1-4542.
[195] "*These benefits are in addition to the simple reality that only a multilateral instrument can overcome the practical difficulties associated with trying to rapidly modify the 3000+ bilateral treaty network*": OCSE, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, 16 September 2014, p. 16 ss..
[196] P. Valente, *Erosione della base imponibile e profit shifting nei principi nazionali e internazionali*, in il fisco, no. 6, 2015, pg. 1-563.
[197] P. Valente, *Raccomandazioni OCSE su economia digitale, abuso dei trattati e transfer pricing*, in il fisco, no. 3, 2014, pg. 1-3859.
[198] P. Valente, *Erosione della base imponibile e "profit shifting": focus sugli aggiornamenti dell'OCSE*, in Corriere tributario, n. 41, 2014, pg. 3179; P. Sella, *Le attività preparatorie ed ausiliarie nel progetto BEPS dell'OCSE, in Fiscalità e Commercio Internazionale*, no. 8, 2015, pg. 10.
[199] I. Lepri, G. Sagliaschi, *News di fiscalità e commercio internazionale*, in Fiscalità e Commercio Internazionale, no. 5, 2015, pg. 75.
[200] H. Loukota, *International tax planning and treaty shoppig; An Austrian view*, Intertax, no. 8-9, 1990, pg. 348.

3.3 Limitation-on-benefits clauses

3.3.1 General features: definition and rationale

With the growing rise of bilateral, and also multilateral, income tax conventions the need to limit the benefits (granted under the conventions) to the intended parties rose.

For the purpose of restricting benefits arising from the tax treaties just to the intended parties, a limitation on benefits clause (LOB in the following) has been included in tax conventions and treaties.

Limitation on benefits clauses are drafted with the intention to avoid treaty shopping. So, limitation-on-benefits clauses are Specific Anti-Abuse Rules (SAAR) which are currently predominantly present in tax treaties concluded by a limited number of countries.

However, several types of LOB clauses exist. They have different wording and scopes, depending on the needs of the treaty partners.

Even if limitation on benefits clauses vary from treaty to treaty, they all have some common elements. Indeed, all these types of LOB clauses have a common purpose, which is to deny access to the benefits of a tax treaty to persons who do not meet the requirements (included in other provisions) in order to counteract abusive structures[201]. These kind of subject (which do not fulfill the necessary conditions) are defined "non-qualifying persons".

LOB clauses contain several tests to determine whether a person is qualified to access the tax treaty's benefits[202]. These tests can be divided into three different categories: *structural tests* that establish qualification for all treaty benefits; a *business activity test* to establish qualification for certain income relating to that business; and a *general good faith clause* which is in essence a 'safety valve' to establish eligibility to treaty benefits when no other test is met.

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[201] O. Marian, Y. Brauner, *Chapter 17: United States*,in*Departures from the OECD Model and Commentaries*, IBFD Books.

[202] J. Bates, *Limitation on Benefits Articles in Income Tax Treaties: the Current State of Play*, Intertax 6, 2013, 395.

3.3.2 LOB clauses in tax treaties signed by Italy

Italy is part of several tax treaties with both European countries and not European countries. Parties of tax treaties which are concluded also by Italy, increasingly feel the need to insert a LOB clause into their treaties.

A LOB clause can be found in the convention between Italy and Estonia[203].

First of all, it is necessary to notice that this kind of LOB clause represent an anti abuse instrument and it does not correspond to the OECD's acceptation of LOB clause.

However, the Government of the Republic of Estonia and the Government of the Italian Republic, concluded a Convention to avoid double taxation with respect to taxes on income and to prevent fiscal evasion. Ex art. 1 of the mentioned Convention, it shall apply to persons who are residents of one or both of the Contracting States. So, this mentioned Article represent the personal scope of the convention.

Contracting parties (Italy and Estonia) felt the necessity to clarify that all the benefits arising from the Convention have to be limited to the mentioned subjects. For this reason, contracting parties included a LOB clause in their convention. Namely, it is included in Art. 28.

Art. 28 of the Convention between Italy and Estonia is entitled "limitation on benefits" and lays down: "*Notwithstanding any other provision of this Convention, a resident of a Contracting State shall not receive the benefit of any reduction in or exemption from taxes provided for in this Convention by the other Contracting State if the main purpose or one of the main purposes of the creation or existence of such resident or any person connected with such resident was to obtain the benefits under this Convention that would not otherwise be available*".

The paragraph number two of art. 28 lays down that: "*nothing in this Convention shall affect the application of the domestic provisions to prevent fiscal evasion and tax avoidance concerning the limitation of expenses and any deductions arising from transactions between enterprises of a Contracting State and enterprises situated in the other Contracting State, if the main purpose or one of*

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[203] See http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diest-uk.pdf.

the main purposes of the creation of such enterprises or of the transactions undertaken between them, was to obtain the benefits under this Convention, that would not otherwise be available".

The mentioned provision is aimed to prevent and avoid that a resident of a contracting state can receive an undue benefit.

More precisely, benefits which arise from the Convention have to be denied to all the subjects which place their resident in one of the two contracting States (in the case concerned Italy or Estonia) just with the goal to take advantages from the Convention itself. These subjects try to locate their residence in the mentioned States because according to the personal scope of the Convention it apply to persons who are resident of one or both of the Contracting States.

Regarding the benefit concerned, it has to be meant as a tax reduction or a tax exemption by the other contracting state. And this benefit has to be meant undue because normally it should not been available to that person.

By analyzing such rule, we can notice that it is shaped on the base of the OECD model (which it will be observed in the following paragraphs).

For this reason, the clause existing in the convention signed between Italy and Estonia, differently from other type of LOB clause, does not include a requirement concerning an active trade or business, a definition of qualified person and does not even include a specific rules for investment funds and not even a provision on derivative benefits.

Regarding the interpretation and the application of this clause, it is fundamental to keep into consideration that domestic provisions aimed to prevent fiscal evasion and tax avoidance concerning the limitation of expenses and any deductions arising from transactions between enterprises of a Contracting State and enterprises situated in the other Contracting State may not be jeopardized.

Another LOB clauses can be found in the tax treaty signed by Italy with Lithuania[204].

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[204] See http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/dilit-uk.pdf.

The LOB clauses is laid down in Art. 30 of the tax treaty. It is exactly worded like the LOB clauses contained in the tax treaty between Italy and Estonia. Then, for this reason, all the considerations explained above are valid also in this case.

At last, a different kind of LOB clause can be found on the Convention Italy-USA[205]. Namely, the LOB clause concerned can be found on paragraph 3, of Art. 2 of the Protocol. Conversely from the LOB clause existing in the Italy-Estonia Convention, this LOB clause corresponds to the OECD's idea of LOB clause.

Moreover, this clause is different because it implies a test connected with the existence of a commercial or industrial activity[206].

In fact, an American company that requires the application of the benefits of the Convention Italy-US for an Italian, in addition to the fulfillment of the ordinary conditions required, it has to pass the test of the commercial or industrial use which is explained in paragraph 3.

Broadly speaking, the mentioned test implies the verification of the following three conditions:

- the US company has to be actually engaged in the management of a trade or business in the United States (paragraph 3 (a) (i));
- the income from Italy must be connected to the activity pursued in the United States (paragraph 3 (a) (ii));
- the activity carried out in the USA must be substantial compared to the activity carried on in Italy (paragraph 3 (a) (iii) (3)).

At this point we can notice that the test concerned, unlike other test included in limitation on benefits clause requiring investment relationships (e.g. the tests referred to in paragraph 2), refers only to activities of the resident and to the specific elements that the same perceives from the other Contracting State.

[205] With Law 3 March 2009, n. 20 Italy has ratified and executed the agreement with the United States of America (the "Convention"), which is directed to eliminate double taxation on income and to prevent fraud or evasion tax.
The new Convention came into force replacing the previous one signed in Rome April 17, 1984. However, art. 28, lays down that the previous Convention, signed in Rome on 17 April 1984, will be still applicable for the first 12 months when it confers on the subject interested more favorable treatment.
See https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/italy.pdf.

[206] F. Miotto, *Il test dell'attività commerciale o industriale nella clausola LOB della Convenzione Italia-USA*, Fiscalità e Commercio Internazionale, no. 2, 2015, pg. 58.

In general, the conditions established in the LOB clause be verified in addition to the fulfillment of the conditions ordinarily required[207].

3.3.3 LOB clause in Italian Tax treaties as a result of BEPS

In the light of the much-discussed BEPS report, we know that the OECD proposes to implement more effective anti-avoidance measures to be included in international instruments.

The preceding sentence is very relevant in this topic because LOB rules are mentioned as one of the possible anti-treaty abuse rules. In fact, on 16 September 2014, the OECD released its deliverable on BEPS Action 6, reinforcing its recommendation for the insertion of LOB clauses and other anti-abuse rules in tax treaties. In particular, BEPS Action 6 Discussion Draft ("Preventing the Granting of Treaty Benefits in Inappropriate Circumstances"), which suggests to include an LOB provision, similar to Article 22 of the US Model Convention (2006), in tax treaties. The Report proposes to include a limitation on benefits clause in the OECD.

However, this concept is also not unfamiliar to the OECD, as a comprehensive LOB clause is already suggested in of the current Commentary on Article 1 OECD MC.

In the context of action 6, the OECD thus *de facto* proposes to migrate the suggested LOB clause from the Commentary to the Model Convention itself.

A LOB clause is intended to affect the subjective scope of a tax treaty. By including a LOB clause, Contracting States indeed externalize a wish to only grant treaty protection to taxpayers that, in addition to being "residents", either carry out real business activities, have a sufficient *nexus* to their residence State or have *bona fide*.

According to OECD, a person that qualifies under this paragraph is entitled to all the benefits of the treaty. If a resident fails the test in the second paragraph, benefits can still be granted under paragraphs 3, 4, or 5.

Summarizing, the following categories of residents are considered qualifying persons under paragraph 2: individuals; Contracting States or subdivisions; publicly traded companies and entities ("stock exchange test"); charitable

[207] P. Valente , *Convenzione Italia-Usa. Rassegna delle principali novità*, il fisco, no. 35, 2010, pg. 1-5678.

organizations, pension funds or investment funds; companies of which the majority of the shareholders are residents of the same state ("ownership test") and which do not pay more than 50% of their gross income to third-state residents ("base erosion test"); and certain collective investment vehicles.

Another resident can still be entitled to the benefits of the treaty with respect to a specific item of income under paragraph 3, if that resident is engaged in the active conduct of a business in its residence state ("activity test").

Paragraph 4 allows certain entities owned by residents of other states to obtain the treaty's benefits which those residents would have obtained if they had invested directly ("derivative benefits clause").

Lastly, paragraph 5 contains a safety valve provision which allows the competent authorities (upon request) to grant the treaty's benefits to establish eligibility to treaty benefits when no other test is met.

In conclusion, even if the OCSE issues recommendations and suggestion through Action 6, any amendment scheme has been planned. At this stage, in our domestic tax law, there are not plans regarding the hypothesis to insert the LOB clause in treaties signed by Italy.

3.4 Subject to tax clauses

3.4.1 General features: definition and rationale

At the beginning of this work we said that States can levy taxes by virtue of their sovereignty. This statement is on the base of the subject to tax clause.

To understand the issue, we can image that each single State is a puzzle piece and that the whole puzzle represent the global taxation.

Again, to better understand the matter, we have to image that the taxing jurisdictions claimed by States do not form a neat puzzle in which all the pieces interlock precisely.

On the contrary, this is a puzzle with many overlapping pieces and occasional gaps. On one hand, the overlaps represent items of income which are liable to tax in two or more States and this phenomenon is known as international double taxation[208] and is the subject of the majority of the issues in the European and

[208] In particular, that phenomenon represents the juridical double taxation which occurs when an income is taxed two or more time in the hand of the same taxpayer. Juridical double taxation

international tax scenario. On the other hand, the gaps represent items of income over which no State claims jurisdiction to tax.

The last mentioned phenomenon occurs rarely but is on the base of the clause that we are going to deal with in this paragraph. Namely, the mentioned phenomenon is known as “double non taxation”.

Regarding the tax treaty matter, we have a situation in which certain income remains untaxed in both contracting States.

There are manifold reasons for this kind of double non-taxation. In many cases, double non-taxation stems from the fact that the contracting States simply bind themselves not to raise any taxes with respect to taxing rights that are given to the other contracting State under the double taxation convention[209].

However, in the field on double non taxation arising from a tax treaty, a distinction should be made. A distinction can be made between double non taxation resulting from the proper use of a treaty and double non-taxation resulting from its improper use[210].

The risk of the double non-taxation triggers the necessity to introduce a subject to tax clauses in tax treaties[211]. In fact, subject to tax clause provides that the taxing right of a contracting State may be restricted by the double taxation convention only if the other contracting State domestically exercises the taxing right assigned to it[212].

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differs from economic double taxation which occurs when a same income is taxed two or more times in the hand f two or more taxpayers.

[209] See M. Lang, *General Report*, inDouble Non-Taxation, CDFI 89a, p. 21, at pp. 30–31 IFA ed., IBFD 2004.

[210] J. Dado, *Avoidance of Double Non-Taxation in the Czech Republic*, in: Michael Lang (ed.), *Avoidance of Double Non Taxation* (Linde Verlag, Vienna, 2003), p. 54; S. van Weeghel, *Improper Use of Tax Treaties* (with particular reference to the Netherlands and the United States) (Kluwer Law International, The Hague, 1998), p. 258.

[211] The European Commission is attracting attention by encouraging the Member States of the EU to include a subject-to-tax clause in their bilateral double taxation conventions (see C(2012) 8806 final, p. 4).

[212] The intention is, obviously, to close all the gaps giving rise to double non-taxation (see C(2012) 8806 final, p. 4.): ‘Where Member States, in double taxation conventions which they have concluded among themselves or with third countries, have committed not to tax a given item of income, Member States should ensure that such commitment only applies where the item is subject to tax in the other party to that convention’.

Subject-to-tax clauses can be divided into general and specific clauses. General subject-to-tax provisions apply to all kinds of income[213] while specific subject-to tax clauses only apply to specific items of income[214].

3.4.2 Subject-to-tax clause in OECD's recommendations

The commentary on the OECD[215] several times mentioned the possibility of bilaterally agreeing on a rule according to which the relief to be granted by one contracting State is contingent upon the income being subject to tax in the other contracting State[216].

However, the 2004 IFA Congress in Vienna has shown that there are still some double non-taxation situations that are not prevented by the OECD Model. [217]

Also recently, OCSE recommends the adoption of a subject-to-tax clause aimed to deal with double non taxation and where both intended and unintended double non-taxation are covered[218].

Member States are encouraged to include an appropriate clause in their double taxation conventions. The subject-to-tax clause in the EC Recommendation does not distinguish between intended and unintended benefits and it is a general subject-to-tax clause that seems to introduce the duty to be taxed once in the EU.[219] The subject-to-tax clause in the European Commission Recommendation is

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[213] For example, a general subject-to-tax provision has been included in Art. 26.2 of the Convention between the Nordic countries for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital concluded on 23 September 1996.

[214] Klaus Vogel, *`Which Method Should the European Community Adopt for the Avoidance of Double Taxation?'*, Bulletin for international fiscal documentation
2002, vol. 56, no. 1, pp. 4 - 10, at 10.

[215] In particular, according to the OECD, the fact that domestic (general) anti-abuse rules might apply to deny treaty benefits does not imply that (specific) treaty-based anti-abuse rules ('SAARs') aimed at preventing particular forms of tax avoidance are unnecessary. In that respect, the Commentary (2003) suggested a number of provisions that treaty negotiators might consider, such as subject to tax Clauses.

[216] L. De Broe, *International Tax Planning and Prevention of Abuse*, Amsterdam, IBFD, 2008, 386–404

217 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*, Intertax, Issue 1, 2015, pp. 42–57.

[218] C. Kahlenberg, *Prevention of Double Non-taxation: An Analysis of Cross-Border Financing from a German Perspective*, Intertax, Issue 3, 2015, pp. 218–244.

219 A. Van de Vijver, *International Double (Non-)taxation: Comparative Guidance from European Legal Principles,* EC Tax Review, Issue 5, 2015, pp. 240–257.

much broader than the actions suggested by Action 2, where linking rules are recommended in the case of hybrids[220].

3.4.3 Subject to tax clause in Italian tax treaties

In no one of tax treaties concluded by Italy there is a whole article entirely devoted to the "subject to tax" clause[221].

However, in a lot of tax treaties concluded by Italy there is one provision which takes into account the effects and the reasonable of the "subject to tax clause".

More specifically these provisions which I mentioned just above are:

- Art. 20, "*Professors, teachers and researchers*", of the convention between the government of the republic of Albania and the Government of the republic of Italy for the avoidance of double taxation with respect to taxes on income and on capital and the prevention of fiscal evasion[222];
- Art. 20, "*Professors*, *teachers*", of the convention between the government of the Italian republic and the Government of the Australian republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital[223];
- Art. 19, "*Professors, teachers*", of the convention between the government of Malaysia and the Government of the republic of Italy for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income[224];
- Art. 20, "*Professors, teachers*", of the convention between the government of Mauritius and the Government of the republic of Italy for the avoidance

220See a critical analysis of the subject-to-tax clause recommended by the European Commission in Marchgarber, Christoph, ‚*The Avoidance of Double non-taxation in Double Tax Treaty Law: A Critical Analysis of the Subject-To-Tax-Clause Recommended by the European Commission*, 5 EC Tax Review, 2014 , p. 293.

[221] Conversely, for example, from the LOB clause which is stated wholly in Article 30 of convention between Estonia and Italy.

[222] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/dialb-uk.pdf.

[223] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/aus-en.pdf.

[224] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/malay-en.pdf.

of double taxation and the prevention of fiscal evasion with respect to taxes on income[225].

- Art. 20, "*Professors, teachers*", of the convention between the New Zeeland and the Government of the republic of Italy for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income[226];
- Art. 20, "*Teachers*", of the convention between the government of the Italian republic and the Government of the republic of South Africa for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[227].

As one could expect, since all these provisions are entitled in a similar way, also the wording and the content is very similar. For this reason we are going to analyze them from a general point of view.

These provisions provide that remunerations which a professor, a teacher or a researcher who is, or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State for a short period (usually not exceeding two years) for the purpose of carrying out advanced study or research or for teaching at another educational institution (such as university, college, school) receives for such work shall not be taxed in that State, provided that such remuneration is subject to tax in the other Contracting State.

So, as we can notice, these provisions do not represent an explicit "subject to tax" clause but they are broadly aimed to reach the same result.

Specifically, the mentioned provisions establish an exemption for certain remuneration but, at the same time, they ensure that these remunerations do not escape from the tax sovereignty of one of the State involved by the convention. The mentioned provisions achieve this goal by ensuring that such remuneration

[225] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/mauri-en.pdf.

[226] See the Convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/newz-en.pdf.

[227] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/disaf-uk.pdf.

(which are not taxed in a State due to the provision itself) are taxed in the other State.

In conclusion, with the future in mind, it is expected the introduction in the tax treaties of specific articles entirely dealing with the subject to tax clause. This expectation is based on the fact that the importance of the "subject to tax" clause is heavily affirmed by the EU institution and because this clause is on the core of OECD discussions.

However, in our country there are not still any plans or discussions for the introduction of the "subject to tax" clause.

3.5 Beneficial Ownership

3.5.1 Beneficial Ownership in OECD Model Convention

Also regarding the concept of "beneficial ownership" the reference to the OECD MC is fundamental.

"Beneficial Ownership" is a term which originally stems from English trust law. Then, the concept of "beneficial ownership" was introduced in the OECD model treaty in 1977, to try to eliminate the avoidance of (withholding) taxes in especially structured transactions.

It was introduced in the OECD-model tax treaty to codify that the sole owner of 100% legal ownership (and no economic ownership) would not benefit of certain treaty benefits.

Beneficial Ownership has been introduced in the OECD model treaty after recognizing that allocating treaty benefits to mere legal owners ("agent" or "nominee") who do not have any economic interest in an asset (which economic interest has been allocated to a non-treaty eligible person) would surpass the purpose of the treaty. Therefore, Beneficial Ownership requires 100% legal ownership and a certain degree of economic risk. Especially the term Beneficial Ownership has been introduced in the OECD-model treaty to try to eliminate the avoidance of (withholding) taxes through structured transactions.

In 2003, as a result of the report *Restricting the Entitlement to Treaty Benefits* (which was prepared as a follow-up to the 1998 Report *Harmful Tax Competition: an Emerging Global Issue*), new paragraphs were added to the Commentary on

Art. 10, 11 and 12, in order to clarify the meaning of “beneficial owner” in some conduit situations.

Finally, the on-going work on the clarification of the “beneficial owner” concept has allowed the OECD to examine the limits of using that concept as a tool to address various treaty shopping situations.

As indicated in proposed paragraph 12.5 of the Commentary on Art. 10, which was included in the latest discussion draft on the meaning of “beneficial owner”: “[w]*hilst the concept of ‘beneficial owner’ deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases*”.

Lastly, also recently, OECD gave some recommendation within Action 6 of BEPS. However, these OECD’s recommendation have no consequences for our domestic law. Indeed, no tax treaty provision has been amended and the interpretation of these provisions has not already changed.

However, trying to summarize, the concept of beneficial owner can be found in Articles 10, 11 and 12 which are respectively entitled “dividends”, “interests” and “royalties”.

Dealing with a connected and single analysis for Article 10, 11 and 12, these provisions state at the first paragraph that dividends, interests and royalties arising in a contracting State and paid by a company which is a resident of the same Contracting State to a resident of the other Contracting State may be taxed in that other State.

Always dealing with a single analysis for all the three provisions, the second paragraph provides that dividends and interest paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed a determined amount.

This mentioned amount of tax depends on whether dividends or interests are involved.

Namely, if the charge regards dividends, according Article 10 OECD it cannot exceed: *a)* 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends; *b)* 15 per cent of the gross amount of the dividends in all other cases.

Conversely, if the charge involves interests, Article 11 OECD provides that the tax so charged shall not exceed 10 per cent of the gross amount of the interests.

Moreover, Article 10 ("dividends") and Article 12 ("royalties") end stating that the provisions of paragraph 1 and, limited to dividends, paragraph 2 "*shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply*".

Lastly, Article 12 ("royalties") and Article 11 ("interests") provide that "*where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention*".

3.5.2 Beneficial Ownership in Italian tax treaties

3.5.2.1 Beneficial ownership clause in Italian tax treaties and in non treaty situations

As we said before OECD MC represent an important model for the tax treaties' redaction for many States.

Italy, as many other states, always keeps into account the OECD MC during the drafting of its tax treaties[228]. As a result, almost all the tax treaties concluded by Italy include clauses similar to Articles 10, 11 , 12 OECD MC[229].

However, all the tax treaties concluded by Italy do not refer to the concept of beneficial ownership in the same manner. For this reason, some distinctions should be made to ensure a valid analysis.

In the majority of tax treaties, we can observe that the treaty's wording is very similar to the OECD model. In particular, these treaties equalize the recipient of the income to the beneficial owner.

Only few tax treaties established that the benefits which arise from the treaty have to be recognized to the resident beneficial owner and not to the recipient of the income. Tax treaties which established this reference to the resident beneficial owner are concluded between Italy and: Australia, Belgium and United States of America.

Other tax treaties lay down the mentioned distinction between the resident and the recipient beneficial owner limiting to certain kind of income. These tax treaties are those concluded between Italy and: Austria, Kenya, Czechoslovakia, Macedonia, Russia, Senegal; and in these cases the distinction is limited to fees (*canoni*); Malta (limited to fees and dividends), Sri Lanka (limited to dividends), Bulgaria (limited to interests), Arab Emirates United States (limited to interests).

In other tax treaties the references to the beneficial owner are very restricted. These tax treaties are those concluded with: Cyprus, Japan, Ireland, Kuwait, Morocco, Tanzania, Thailand, Trinidad & Tobago, Hungary, Zambia.

In these mentioned Conventions the reference to the beneficial owner is just related to the presence of a permanent establishment in the source State.

Lastly, in the tax treaty concluded between Italy and India there is not any kind of reference to the concept of beneficial owner. In other word, the mentioned

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[228] 2014 - corriere tributario
P. Valente, *Scambio di informazioni e beneficiario effettivo nel modello OCSE, in Corriere tributario*, 2014, no. 36, pg. 2819.

[229] P. Valente 2011, *Beneficiario effettivo: le proposte di modifica al Commentario agli artt. 10, 11 e 12 del Modello OCSE*, in il fisco, 2011, n. 35, pg. 1-5720; M. Bargagli, M. Thione, *Ritenuta agevolata sulle royalties in uscita solo se il percepiente è il beneficiario effettivo del reddito*, in Azienda & Fisco, 2012, no. 2, pg. 22. 2012; M. Bargagli, *La tassazione degli interessi corrisposti a società comunitarie e la clausola del beneficiario effettivo*, in Bilancio e Reddito d'Impresa, 2012, n. 3, pg. 26.

conclusion is the sole tax treaty concluded by Italy which d not provide a provision linked to the beneficial owner.

Always dealing with a pure national scenario, in our domestic legislation there are rules that lay down a similar concept. In particular, there are rules that have – as the B.O. clause – an anti abuse aim. Moreover, there are rules which can work in treaty situations and other rules which, conversely from the B.O. clause, can work in national transactions.

Limiting the analysis to the second mentioned kind of rules, they are characterized by a "look thought approach", since they allow tax authorities and judges to look beyond the legal construction created by the taxpayer. So, these rules allow tax authorities and judges to unmask artificial constructions characterized by an abusive aim.

An example of this kind of rule is Art. 37, par. 3 of ITA[230]. This provision states that when during a correction or an assessment the income of which appear holders other subjects is charged to the taxpayer when it is shown, on the basis of serious, precise and consistent presumptions that he is the effective owner.

3.5.2.2 Definition of beneficial owner

What is important is to notice that within tax treaties signed by Italy there is not a definition of the expression of beneficial ownership.

Trying to make a more general observation, only in the domestic tax laws of just a few countries, the term Beneficial Ownership (or a similar local definition achieving the same) has been defined.

In most countries the term beneficial ownership did not even exist in domestic legislation.

Moreover, in the countries which had a definition of beneficial ownership this definition stems from its local trust laws. That is the reason way we can notice that countries which provides a definition on beneficial owner are mostly common law countries. It is also true that in later years the definition of beneficial ownership was in some countries extensively interpreted in case law whereby the international meaning as intended in the OECD model treaty was not always followed.

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[230] The mentioned rule works for national transaction. However, other national rules with the same aim exist but they works in treaty situations. They are Articles 87, 55, 27 bis of ITA.

Focusing the attention on our country, since there is not a definition of beneficial owner, we should look at the Commentaries of Article 10, 11 and 12 of OECD. According the Commentary of Article 10 OECD, the term “beneficial owner” is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

Moreover, the Commentary[231] states that where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State. It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned.

For these reasons, the report from the Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies” concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

Regardless the interpretation’s support that can be found within OECD’s Commentaries, in our country, both tax authorities, both the doctrine gave their contribution to reach a beneficial ownership’s definition[232].

For the Italian tax authorities a beneficial owner of an income[233] is the person with regard to whom such income is subject to taxation[234].

The Italian tax authority confirmed this statement in the Minister of Finance Circular of 23 December 1996, no. 306/E/5-2153/14-218[235].

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[231] See the commentary at http://www.oecd.org/berlin/publikationen/43324465.pdf.

[233] Now we generally speak about “income” to mean dividends, interests and royalties that can be charged.

[234] Resolution 7 May 1987, n. 12/431, IPSOA.

The concept of beneficial owner has been addressed in more details with the circular of the Revenue Agency (*Agenzia delle Entrate*), Central Directorate legislation and litigation, of 2 November 2005, no. 47[236]. That circular Nov. 2, 2005, n. 47 states that the company to be considered beneficial owner must receive payments for its own benefit and not as an intermediary, as agent, trustee or nominee for another person.

The term "beneficial owner", provides that if between the recipient and the sender of a payment is to be a broker, the exemption applies only if the beneficial owner of the interest payments or royalty meets the requirements of the "Interest Royalty Directive"[237].

In essence, that the subject can be considered beneficial to them, as provided for by the Directive, it is necessary that the company that receives the interest or royalties draws its own economic benefit from the transaction into being.

This conclusion is strengthened if one examines the purpose of the provision in question which, undoubtedly, is to avoid using the interposition of a subject only to enjoy the exemption. Therefore, in view of the purpose of the anti-avoidance rule, it is believed that the company holds the title of the beneficial owner if he has the ownership and the availability of the resources. From the mentioned circular we can observe that the Italian tax authority interprets the concept of beneficial ownership in accordance of OECD's commentary[238].

With the subsequent circular December 30, 2005, n. 55 / E (to be issued with reference to the transposition of Directive 2003/48 / EEC of 3 June 2003 on taxation of savings income in the form of interest payments)[239], the Revenue Agency has stated that the beneficial owner is any individual, residing in another Member State, who receives an interest payment or for whom an interest payment is assigned. For simplification purposes, the recipient of the interest payment is considered the beneficial owner of that payment unless proves not to have

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[235] Such circular was enacted on the base of the Decree of 1 April 1996, no. 239.

[236] Dealing with the implementation in Italy of Directive n. 2003/49 / EC.

[237] A. Vicari, *Dal beneficiario del trust al suo titolare effettivo: percorsi nella disciplina antiriciclaggio del trust* , in *Trusts e attività fiduciarie*, 2009, n. 6.

[238] A. Tomassini, *Alcuni recenti sviluppi interpretativi sulla nozione di beneficiario effettivo e di residenza ai fini convenzionali*, in *Rassegna Tributaria*, 2008, no. 5, pg. 1383.

[239] P. Bonarelli, *Approvate le norme che recepiscono la direttiva* 2003/48/CE, in *Fiscalità Internazionale*, 2005, no. 3, pg. 229.

received it to its advantage. Even the resolution July 12, 2006, n. 86 confirmed this statement[240].

As we mentioned above also the national courts gave their contribution for the interpretation of the concept of beneficial ownership[241]. However, to be honest, the courts' contribution is less than the national tax authority's one[242].

The Supreme Court[243] stated that, in case of application of the Convention into force with the United States of America in relation to the distribution of dividends by an Italian company, the element fundamental for the reduction of the power of taxation of the Italian State is not already the payment of tax in the US, but the fact that the beneficial owner of the dividends is a company which has its headquarters in the US. In that decision, the judges emphasized that, according the Convention Italy / USA, the beneficial owner of the dividends was a resident in the US and, therefore, regardless of the payment of tax in the US (and being sufficient potential subjugation taxes in the US of the payee) was due to the application of a reduced rate of withholding under Article 10 of the Convention.

So, according to the position of the Supreme Court, the application of the conventional benefits has to be recognized to the beneficial owner resident in the other contracting State.

So the concept of the beneficial owner was linked to the residence. In general, we can recognize the existence of a first moment when the Italian judges individuated the beneficial owner through a residence criteria.

Subsequently a different opinion was privileged. In particular, the precondition for the application of the conventional benefit would not be the residence, but rather the proof of receipt of dividends (in general, incomes) and the reporting requirements in fiscal signatory country of residence of the recipient[244].

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[240] E. Fiorito, *I chiarimenti dell'agenzia delle entrate sulla "Direttiva Risparmio*, in Pratica fiscale e professionale, 2006, n. 6, pg. 18.

[241] A. Righini, *Il beneficiario effettivo nelle convenzioni internazionali: alcuni recenti casi affrontati dalla giurisprudenza straniera*, in Fiscalità Internazionale, 2009, no. 1, pg. 17; D. Avolio, *Il beneficiario effettivo nella giurisprudenza nazionale e internazionale*, in Corriere tributario, 2010, no. 6, pag. 429; M. Grazioli, M. Thione, *Il "treaty shopping" e la clausola del beneficiario effettivo: casi operativi e recente giurisprudenza*, in il fisco, 2010, n. 17, pg. 1-2649.

[242] C. Perrone, *Brevi note sul significato convenzionale del concetto di beneficiario effettivo, in Rassegna Tributaria*, 2003, no. 1, pg. 151.

[243] Civil Court of Cassation, 10 November 1999, no. 12458.

[244] A. Furlan, M. Toccaceli, *Il concetto di "beneficial owner" nei trattati internazionali contro le doppie imposizioni nelle direttive comunitarie*, in Fiscalità Internazionale, 2009, no. 5.

In conclusion, between the two approaches above the Supreme Court[245] has been shown to prefer the first one that was deemed more consistent with the spirit and purpose of the Convention.

3.6 Real estate investment entities

3.6.1 Article 13, paragraphs 1 and 4, OECD Model Convention: Capital Gain

First of all, a capital gain can be defined as the amount by which an asset's[246] selling price exceeds its initial purchase price[247].

The problem of the individuation of the proper tax regime applicable to the capital gain derives from the fact that also the nature of the capital gain is not clear[248].

The taxation of capital gains is one of the most difficult issues. The complexity is increased by the fact that capital gains taxation is one of the types of taxation that vary most among the various states.

More precisely, in some countries capital gains are not deemed to be taxable income; in other countries capital gains accrued to an enterprise are taxed, but capital gains made by an individual outside the course of his trade or business are not taxed; in some countries capital gains are taxed as ordinary income and therefore added to the income from other sources; in others countries capital gains are subjected to special taxes; even where capital gains made by an individual outside the course of his trade or business are taxed, such taxation often applies only in specified cases.

The mentioned happens because countries compete with their tax regimes for international investors, especially with lower tax rates or attractive capital gains tax regimes.

So, international tax planning becomes a decisive task for international investors.

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[245] Civil court of Cassation, Fiscal Section: 29 March 2000, no. 3861 and 11 April 2000, no. 4560.

[246] The word "asset" has to be meant both as investments, both as real estate.

[247] Conversely, if the initial purchase price exceeds the selling price of the asset we will have a capital loss.

[248] S. Simontacchi, *Capital Gains (Article 13 OECD Model Convention.), in Source Versus Residence: Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives*; F. Brugger, T. Ecker et al., Vienna University Conference 2007: *Source versus Residence: The Allocation of Taxing Rights in Tax Treaty Law*, Intertax 35 (2007): 233.

The only possible solution for analyzing the issue from point of view which is not limited to the national context is to refer to the OECD model convention. In particular, we should look at Article 12 OECD MC, which reads as following:

1. gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State;

2. gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State;

3. gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated;

4. gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State;

5. gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.

From the word of this Article, we can see that its aim is to avoid double taxation. In the following we are going to analyze the Article concerned, taking into account the Commentary on Article 13 OECD[249] and focusing in the way in which the mentioned aim is achieved.

Paragraph 1 states that gains from the alienation of immovable property may be taxed in the State in which it is situated[250].

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[249] See the commentary at http://www.oecd-ilibrary.org/docserver/download/2310111ec047.pdf?expires=1453384387&id=id&accname=oid025361&checksum=6D1F25E2620AA15C09D9608ED5BC6EB4.

[250] This rule applies also to immovable property forming part of the assets of an enterprise.

For the definition of immovable property we have to look at Article 6 of OECD MC.

It is important to notice that the Article is applied in situations where there is an effective gain from the alienation of the property[251].

The material criterion on this case is the alienation of the property as such. Thus, this material criterion is different from the one that constitutes an exit tax, that is, the act of leaving the tax jurisdiction of a State.

It is also important to keep in mind that paragraph 1 of Article 13 deals only with gains which a resident of a Contracting State derives from the alienation of immovable property situated in the other Contracting State[252].

For the interpretation and the application of paragraph 1 of Article 4, we have simply to look at the place where the immovable good is located. Once we know the State where the property is located, the subject - which receives gain from the alienation of the property itself - is taxed (for the gain resulting from the alienation concerned) by the government of that State. Consequently, the capital gain concerned is not taxed in the State where its recipient is resident. In this way the avoidance of double taxation is reached.

The rules of paragraph 1 are strictly related to rules of paragraph 4. In particular the formers are supplemented by those of paragraph 4, which apply to gains from the alienation of all or part of the shares in a company holding immovable property.

By providing that gains from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State, paragraph 4 provides that gains from the alienation of such shares and gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in that State.

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[251] T. Albin, F. de Man, *Contradicting Views of Exit Taxation under OECD MC and TFEU: Are Exit Taxes Still Allowed in Europe?*, Intertax, 2011, Issue 12, pp. 613–625.

[252] It does not, therefore, apply to gains derived from the alienation of immovable property situated in the Contracting State of which the alienator is a resident in the meaning of Article 4 or situated in a third State; the provisions of paragraph 5 shall apply to such gains..

Moreover, the OECD Commentary clarifies that it is normal to give the right to tax capital gains on a property of a given kind to the State that, under the Convention, is entitled to tax both the property and the income derived there from. Paragraph 4 allows the taxation of the entire gain attributable to the shares to which it applies even where part of the value of the share is derived from property other than immovable property located in the source State.

The determination of whether shares of a company derive more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company.

In conclusion, also paragraph 4 is aimed to the avoidance of double taxation. In fact, capital gains are taxed only in one State.

However, contrary to the previous paragraph, in this case capital gains are not directly linked to an immovable property. Consequently, the determination of the State where the taxation of the capital gains concerned occurs is not direct and automatic as in the previous case.

However, Article 13 para. 4 OECD-MC covers all other gains resulting from the sale of movable property and states that the right of taxation lies with the country of residence[253].

3.6.2 Italian tax treaties

Since 1963, the OECD Model Convention has had wide repercussions on the negotiation, application, and interpretation of tax conventions.

OECD member[254] countries have largely conformed to the Model Convention when concluding or revising bilateral conventions. A large number of States concluded or revised their convention in accordance with the Recommendations of the Council of the OECD. Moreover, in accordance with the Recommendations

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[253] O. H. Jacobs, *Financial Derivatives in International Tax Law - A Treatment of Certain Key Considerations*, Intertax, Issue 8/9, 1995, pp. 405–420.

254The impact of the Model Convention has extended far beyond the OECD area. It has been used as a basic document of reference in negotiations between member and non-member countries and even between non-member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems.

of the Council of the OECD, these conventions follow the pattern and, in most cases, the main provisions of the Model Convention.

This preamble allows us to image that also Italy, in the redaction of its tax treaty, has been inspired and guided by the OECD model.

In fact, limiting our analysis to the topic of this paragraph, in several tax treaties concluded by Italy it is possible to found a provision analogous to Article 13(4).

Namely, we can found a provision similar to Article 13 (4) OECD MC in the following treaties' provision:

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the republic of Albania for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion;
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the Argentine republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[255];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the people's republic of Bangladesh for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[256];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the kingdom of Belgium for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[257];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the Republic of Brazil for the

[255] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/arg-en.pdf.

[256] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diban-uk.pdf.

[257] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/bel-en.pdf.

avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[258];

- Art. 11, "*capital gains*", of the convention between the government of the Italian republic and the Government of the people's republic of Bulgaria for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[259];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the people's republic of China for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[260];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of Korea for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[261];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the republic of Ivory Cost for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[262];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the government of the kingdom of Denmark for the

[258] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/bra-en.pdf.

[259] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/bulg-en.pdf.

[260] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/cina-en.pdf.

[261] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/corea-en.pdf.

[262] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/hivo-en.pdf.

avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[263];

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the republic of Ecuador for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[264];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the republic of Egypt for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[265];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the United Arab Emirates republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[266];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the republic of Estonia for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[267];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Government of the Russian republic for the

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[263] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/danimarca-en.pdf.

[264] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/ecua-en.pdf.

[265] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/egyp-en.pdf.

[266] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diuae-uk.pdf.

[267] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diest-uk.pdf.

avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[268];

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the republic of Philippines for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[269];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the government of French republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[270];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the federal republic of Germany for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[271];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Hellenic republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[272];
- Art. 14, "*capital gains*", of the convention between the government of the Italian republic and the government of the republic of India for the

[268] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/difru-uk.pdf.

[269] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/phil-en.pdf.

[270] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/franc-en.pdf.

[271] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/germ-en.pdf.

[272] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/grec-en.pdf.

avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[273];

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of the republic of Indonesia for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[274];
- Art. 12, "*capital gains*", of the convention between the government of the Italian republic and Ireland for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[275];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of the State of Israel for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[276];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of the republic of Kazakhstan for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[277];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of State of Kuwait for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[278];

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273 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diind-uk.pdf.

274 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/indo-en.pdf.

275 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/irlan-en.pdf.

276 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/diisra-uk.pdf.

277 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/dikaz-uk.pdf.

278 See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/kuw-en.pdf.

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of the republic of Lithuania for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[279];
- Art. 13, "*capital gains*", of the convention between Luxemburg and the government of the Italian republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[280];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government Malaysia for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[281];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and kingdom of Morocco for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[282];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of Mauritius for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion;[283]
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and government of the Unites States of America for the

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[279] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/dilit-uk.pdf.

[280] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/lux-en.pdf.

[281] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/malay-en.pdf.

[282] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/maroc-en.pdf.

[283] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/mauri-en.pdf.

avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[284];

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and kingdom of Norway for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[285];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and kingdom of Netherlands for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[286];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Islamic republic of Pakistan for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[287];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the polish's people republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[288];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and Portuguese republic for the avoidance of double

[284] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/mexi-en.pdf.

[285] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/norw-en.pdf.

[286] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/nethe-en.pdf.

[287] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/paky-en.pdf.

[288] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/polo-en.pdf.

taxation with respect to taxes on income and on and the prevention of fiscal evasion[289];

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the United Kingdom and the Northern Ireland for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[290];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Czechoslovak socialist republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[291];
- Art. 14, "*capital gains*", of the convention between the government of the Italian republic and the socialist republic of Romania for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[292];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Syrian Arab republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[293];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the republic of Singapore for the avoidance of double

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[289] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/porto-en.pdf.

[290] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/porto-en.pdf.

[291] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/chec-en.pdf.

[292] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/roman-en.pdf.

[293] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/siria_eng.pdf.

taxation with respect to taxes on income and on and the prevention of fiscal evasion[294];

- Art. 13, "*capital gains*", of the convention between the Italy and Spain for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[295];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the democratic socialist republic of Sri Lanka for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[296];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the government of the republic of South Africa for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[297];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the kingdom of Sweden for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[298];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the government of the united republic of Tanzania for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[299];

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[294] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/singa-en.pdf.

[295] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/spagn-en.pdf.

[296] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/sri-en.pdf.

[297] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/disaf-uk.pdf.

[298] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/svez-en.pdf.

[299] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/tanza-en.pdf.

- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the republic of Turkey for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[300];
- Art. 13, "*capital gains*", of the convention between the government of the Italian republic and the Hungarian's peoples republic for the avoidance of double taxation with respect to taxes on income and on and the prevention of fiscal evasion[301].

However, as I said above, all these provisions are worded on the base of OECD Model Convention. So, the analysis and the description of these provisions can be made in a uniform manner and it coincides with the one made above for Article 13 OECD.

Moreover, the fact that Article 13 works like a model has to be kept into account. This fact implies that the role of domestic law in defining capital gains is very important[302].

The importance of the domestic law's role is stressed when we notice that Article 13 has strong relationship with other provisions having a similar objective

For example, it is difficult to clearly differentiate between capital gains and business profits on the one hand and interest payments on the other. The mentioned difficulty is increased by the fact that the distinction between the definition of business profits and capital gains is not seen as a particularly significant problem in the commentary to the OECD MC because both rules lead to the same results in taxation.

The domestic law also plays an important role in clearly differentiating between the range of application of Article 7 OECD MC and that of domestic law of that country.

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[300] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/tanza-en.pdf.

[301] See the convention at http://www.finanze.gov.it/export/sites/finanze/it/.content/Documenti/dipartimento_pol_fisc/unghe-en.pdf.

[302] There are different opinions as to the question why recourse to domestic law is justified. While Vogel and Wassermeyer base their arguments on Art. 3 para. 2 OECD-MC, Lang bases his argument on a definition of what factual conditions need to be fulfilled in order to apply the rule.

In addition, the distinction between Article 13 and Article 11 OECD MC is not so clear and immediate. It is, however, possible to argue that the difference between these rules is that in the case of Article 13 OECD MC there has to be a change in the ownership. In other words, in the case of Article 11 OECD MC income results from the extinguishment of a right. This difference can be made clear with the example of the extinguishment or sale of a right.

3.6.3 Article 13 (4) OECD MC as a result of BEPS

OECD also recently discussed regarding Article 13 OECD MC. In particular, in Action 6[303] of BEPS it is recognized that Paragraph 28.5 of the Commentary on Article 13 already provides that States may want to consider extending the provision to cover not only gains from shares but also gains from the alienation of interests in other entities, such as partnerships or trusts, which would address one form of abuse. However, in Action 6 it is stated that Art. 13 (4) should be amended to include such wording.

Moreover, in Action 6 it is noted that there might also be cases where assets are contributed to an entity shortly before the sale of the shares or other interests in that entity in order to dilute the proportion of the value of these shares or interests that is derived from immovable property situated in one Contracting State.

So, in order to address such cases, it was also agreed that Art. 13(4) should be amended to refer to situations where shares or similar interests derive their value primarily from immovable property at any time during a certain period as opposed to at the time of the alienation only.

However, in accordance of these OECD recommendation, in our country, no tax treaties' provisions have been amended. In our country there are not already any plans to change existing treaties' provisions or to include a broader wording of these existing provisions.

3.7 The problem of the dual residence

3.7.1 Tie breaker rules

We already said that States usually justify their claims to tax income either by reference to the personal attachment that the recipient has with the state or by reference to the economic attachment that the income has with the state.

[303] See Action 6 BEPS at http://www.oecd.org/tax/treaties/treaty-abuse-discussion-draft-march-2014.pdf.

The first justification reflects the state's function as a regulator and provider of social services[304].

The tax levied on persons with a personal attachment to the State could be described as the fee for membership of its society. The criterion most commonly[305] used to determine whether a person has a sufficient personal attachment to justify the imposition of tax is whether or not he is resident[306] in the State[307].

One could expect that it is clearly possible for a company to be regarded by two or more states as resident under their national law[308]. Evenly, it is not uncommon for an individual to be resident in two or more states under their national law.

Again, one could expect that the risk of a dual residence is a menace for the international tax balance.

For this reason, OECD contemplates this risk in the model convention. In particular OECD tries to solve the risk of the dual residence in a separate manner for natural persons and legal persons.

Regarding individuals, Art. 4, par. 2 of OECD MC provides, after the definition of "residence", that where an individual is a resident of both Contracting States, then his status shall be determined as follows:

"a) he shall be deemed to be a resident only of the State in which he has a permanent home[309] *available to him; if he has a permanent home available to him*

[304] The second justification, that the income has an economic attachment with the state, reflects the state's function of creating the conditions in which income can be generated.

[305] In respect of companies some states use nationality instead of residence. In respect of individuals, some states choose Nationality.

[306] Companies have a number of attributes that could be, and are, used as an indication of their residence: they are incorporated under the law of a particular state; they usually have a registered office; they have shareholders; they have directors who make policy decisions; they have managers who run the company on a daily basis; and they have one or more places of administration and/or business. For individuals the form of personal attachment most commonly used as a basis of tax liability is again residence.

[307] A few states also look at whether a person is a national of the state.

[308] The classic case of corporate dual residence is a company which is incorporated in one state and managed and controlled in another. Dual residence may also occur in other cases, for example if a company has a complex management structure spread over two states.

[309] According to the Commentary, this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration. As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room).

in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode[310]*;*

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement".

So, States during the drafting of their tax treaties should solve this conflict using special rules establishing how the attachment to one State has to occur. 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.

Regarding companies, Art. 4, par 3 OECD MC states that where "*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*".

This paragraph concerns companies and other bodies of persons, irrespective of whether they are or not legal persons.

The "place of effective management" has been adopted as the preference criterion for persons other than individuals. The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made[311].

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[310] It is important to notice that subparagraph *b*) does not specify over what length of time the comparison must be made.

[311] The Commentary on Article 4 OECD states that the place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. However, in this work it is extremely important to know that Italy does not adhere to the interpretation mentioned just above concerning the "most senior person or group of persons (for example, a board of directors)" as the sole criterion to identify the place of effective management of an entity. In our country 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.

It is fundamental to keep into account that an entity may have more than one place of management, but it can have only one place of effective management at any one time.
Also recently, OECD through BEPS' recommendation stated that countries that consider that the competent authorities "should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose"[312] may want to supplement the provision to refer to these or other factors that they consider relevant. In addition, OECD in Action 6 BEPS recognized that many tax avoidance risks that threaten the tax base are not caused by tax treaties but may be facilitated by treaties. Regarding these cases, the Action 6 OECD established that it is not sufficient to address the treaty issues; but change the domestic law is also required.
So, we can notice that the Action 6's wording is very clear and accurate. Nevertheless, in our country there is not any proposal to include a different version of these rules. In other words no Article of existing treaties has been amended.

3.7.2 Tie breaker rules in Italian tax treaties.

As we said many times, Italy as many other OECD countries keeps into account the OECD model convention during the drafting of the tax treaty.
As a result many Italian tax treaties provides clauses similar to Article 4 OECD.
Namely tax treaties which include a tie-breaker rule for determining the treaty residence of a dual resident person are those concluded between Italy and: Albania, Argentine, Australia, Austria, Bangladesh, Belgium, Brazil, China, Korea, Ivory Coast, Croatia, Denmark, Ecuador, Egypt, United Arab Emirates, Estonia, Russian Federation, Philippines, Finland, France, Germany, Greek, India, Indonesia, Israel, Socialist Federal Republic of Yugoslavia, Kazakhstan, Leetonia, Lithuania, Luxemburg, Macedonia, Malaysia, Malta, Morocco, Mauritius, Mexico, Mozambique, Norway, New Zeeland, Oman, Netherlands, Pakistan, Poland, Portugal, United Kingdom, Czechoslovak Republic, Romania, Senegal, Syria, Spain, Sri Lanka, United States of America, South Africa, Sweden,

[312] Action 6 BEPS, OECD.

Switzerland, Tanzania, Thailand, Trinidad & Tobago, Turkey, Ukraine, Uganda, Hungary, Uzbekistan, Venezuela, Vietnam, Zambia.

In all these cases mentioned just above, the Article 4 of all the mentioned Conventions is worded exactly in the same manner of Article 4 OECD.

Generally, in these treaties the above tie-breaker rules provide a hierarchical order of criteria that has to be used to solve conflicts about "dual residence" between states in which a bilateral treaty is in force.

"This implies that if one criterion is not effective in determining the individual's residence, it is required to shift to the next one"[313]; so that if an individual has the availability of a permanent home in both states, his residence has to be assessed on the basis of his centre of vital interest, and if it is not possible to clearly determine the State in which his personal and economic relations are closer, his habitual abode has to be considered, and so on.

For this reason, a single analysis of all the tie-breaker rules included in the mentioned Convention seems to be unnecessary, since it does not add any new.

Moreover, in the Convention signed by Italy and Kuwait and in the Convention signed between Italy and Singapore the worded of the tie-breaker rule is not completely the same of Art. 4 OECD.

In particular, there is equally a hierarchy but is not composed by the same 4 steps existing in Article 4 OECD. More precisely, the lect. c) of article 4 OECD is missing in the mentioned Conventions.

The hierarchy is shorter in the mentioned convention and lays down that where a subject results to be resident of both Contracting States, then his status shall be determined as follows: he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closest (centre of vital interests).

If the Contracting State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either

[313] P. Scarioni, *Change of Individual's Residence within EU: The Tax Residence Issue as a Possible Obstacle from an Italian Perspective,* Intertax, 2011, Issue 5, pp. 266–270.

Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode.
If he has an habitual abode in both Contracting States or in neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
On the contrary, in some other tax treaties concluded by Italy there is a tie-breaker rule but it is worded in a different manner.
For example in the tax treaty signed by Italy and Japan, there is a tie-breaker rule which establish a ploy to avoid tax avoidance but it does not establish a cascading hierarchy. Indeed, the tie-breaker rule included in the Convention conclude by Italy and Japan states that where "a person is a resident of both Contracting States, then the competent authorities shall determine by mutual agreement the Contracting State of which that person shall be deemed to be a resident for the purposes of this Convention"[314]. So, we can observe that aim and the consequence of this provision are the same of Article 4 OECD. But the conditions of Art. 4 of the Convention between Italy and Japan are different from Art. 4 OECD. More precisely, Art. 4 of the mentioned convention gives the task of solve the dual residence, directly to the competent authority.
It is also important to underline that, the Italian tax courts are inclined to stop the analysis at the "centre of vital interest" of the taxpayer, which is entirely similar to the "domicile" concept. Moreover, the Supreme Court stated that Article 4 OECD MC has to be interpreted as establishing that a legal person has its residence in the State where the effective management is located[315].

[314] Art. 4, par. 2 Convention between Japan and Republic of Italy for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed 1969.
[315] Supreme Court, Section III, no. 2080/2013; Supreme Court, Section II, no. 7739/2012; Supreme Court, Section V, no. 2869/2013.

4 SAAR AND EU LAW

4.1 Compatibility of SAARs with EU law

4.1.1 General compatibility of domestic SAARs with EU law

Strictly regarding Italian legal system, the current period is marked by profound changes which imply decisive modification of the national fiscal legal system.

At the base of these deep changes there is the enabling law no. 23 of the 11th March 2014. The law 23/2014's aim is to make the fiscal system more equitable, transparent and oriented towards the growth. All the provisions included in the mentioned enabling law are worded in accordance with EU law[316], especially with EU provisions relevant in the fields of international taxation and of anti- abuse law[317].

So, since the base of the Italian provisions (which were modified also in the light of BEPS) is in accordance with EU law, in our country specific anti abuse rules (and in general all the other rules) are compatible with EU law[318].

In addition, we have to keep into consideration that on the base of the law 23/2014 the Italian Government issued many Decrees.

Limiting our attention only to the topic of this work, the Decree no. 147 of the 14th September 2015 (so called "decree on internationalization") and the Decree no. 128 of the 5th August 2015 are very important.

The Decree 147/2015 is aimed to achieve a good level of internationalization useful for enterprises and companies. The provisions contained in this mentioned decree are worded and drafted in accordance with EU law and ECJ jurisprudence[319]. Moreover, the Decree's report expressly affirms that during the

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[316] B. Santacroce, *Il concetto comunitario di Abuso del diritto in una recente circolare delle entrate sull'elusione nell'IVA*, in Dialoghi Tributari, no. 1, 2008, pg. 115; M. Giaconia, L. Greco, *La comunicazione della Commissione Europea sull'applicazione delle misure anti-abuso nell'aerea delle imposte dirette*, in Fiscalità Internazionale, no. 3, 2008, pg. 243.

[317] F. Munari, *Il divieto di abuso del diritto nell'ordinamento dell'Unione Europea*, in Diritto e Pratica Tributaria, no. 4, 2015, pg. 10519.

[318] R. De La Feria, *Prohibition of abuse of (Community) law: The creation of a new general principle of EC law through tax*, Common Market Law Review, 2008, Issue 2, pp. 395–441.

[319] See the Decree's report at http://www.slideshare.net/acardinoagevofacile/internazionalizzazione-relazione-illustrativa-del-dlgs-attuativo-della-delega-fiscale.

drafting of the concerned Decree, the Government kept into account also OECD's recommendations[320].

The Decree 128/2015 is aimed to give taxpayers greater legal certainly. This main goal is achieved through three manners: the creation of anti-abuse rules[321], the review of the rule for the doubling of investigation terms and the reviewing of the rule of the collaborative fulfillment tax burden. However, with our topic in mind we should look just at the part dealing with anti abuse rules. What is important is that in the same way of the Decree 147/2015, the Decree 128/2015 was drafted in accordance of EU law. And with the principles included in the EU Commission's recommendation no. 2012/772/EU of 6th December 2012 which deals with the aggressive tax planning.

In conclusion, in our country anti abuse rules should be compatible with EU law because, as we noticed in the previous paragraphs, they were reviewed by the recent decreed which were enacted fully in accordance of EU law.

4.1.2 Compatibility of Exit Tax with EU law

In case of switch of residence of a taxpayer or transfer of an individual asset from one Member State to another, the ECJ makes it clear that both, the Member State of origin, as well as the host Member State, must ensure that foreign nationals are treated equally to the nationals of the Member State concerned[322].

In many cases[323], the ECJ stated how exit taxation has be dealt within the EU.

In particular, in the aftermath of *Lasteyrie* and *N*, the European Commission proceeded to question the exit tax regimes of numerous Member States on the grounds that they constituted a restriction to the exercise of the freedom of establishment. The first action taken by the Commission was the elaboration of a Communication to the Council, the European Parliament and the European Economic and Social Committee concerning the need to coordinate Member States' tax policies on the field of exit taxation[324]. In the Communication, the

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[320] And Decree's report affirms that Government kept in consideration also the CCCTB's discussion.

[321] P. Valente, *Base imponibile comune consolidata: disciplina antiabuso e prevalenza delle norme CE*, in Corriere Tributario, no. 24, 201, pg. 991.

[322] B. J. M. Terra, P. J. Wattel, *European Tax Law*, Kluwer Law International, 2008, pg. 32.

[323] Case C-9/02 *Lasteyrie du Saillant*; Case C-470/04 *N v. Inspecteur*.

[324] See Communication of 19 Dec. 2006 entitled 'Exit taxation and the need for co-ordination of Member States' tax policies', COM(2006) 825 final.

Commission stated that while Member States may wish to exercise their taxing rights on the capital gains derived from an individual who changed residence before realizing the income, they must do so in a manner which does not lead to double taxation.

Moreover, the Commission has been considerably active by initiating infringement procedures against the exit tax provisions of certain Member States. However, all these infringement procedures do not concern our country[325].

4.1.3 Compatibility of "Limitation On Benefits" clause with EU law

It is settled case-law that although direct taxation still falls within the exclusive competence of the Member States, it is required that Member States exercise their competences consistently with EU law[326].

Moreover, it is fundamental to keep into account that the fact that LOB provisions are included in tax treaties does not allow them to escape the ECJ's scrutiny[327].

In the ECJ's view[328], double tax treaties form part of the legal background, and their compatibility with EU law has been assessed in several cases[329].

However, despite the simplicity of the previous statement, several critical questions can arise regarding the proposed LOB clause.

First of all, problematic from a Fundamental Freedoms perspective is the fact that LOB clauses create a difference in treatment between two types of residents (which are, as we stated above qualifying and non-qualifying residents)[330].

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[325] The first infringement procedure was directed at Sweden and requested the amendment of the Swedish law which levied exit taxes on unrealized capital gains and deductions made for the untaxed reserves when a company transferred its seat or place of effective management to another Member State or a permanent establishment ceased activities or transferred assets to another Member State. This infringement procedure was followed by the reasoned opinion IP/08/1531, sent to Spain on 16 October 2008, requesting the amendment of a Spanish law, which obliged individual taxpayers who transferred their residence abroad to include unallocated income in the tax declaration of the last year in which they were residents in Spain and to pay taxes on this income immediately before leaving. Furthermore, in October 2009, the Commission referred Spain and Portugal to the CJEU due to their restrictive exit tax provisions on the transfer of companies and permanent establishments abroad. In 2010, through the aforementioned IP/10/299 of 18 March 2010, the Commission sent a reasoned opinion to Belgium, Denmark and the Netherlands with respect to their exit tax provisions.

[326] See ECJ, 28 Jan. 1986, *Commission v. France ('Avoir Fiscal')*, 270/83.

[327] See *Gottardo* case (ECJ, 15 Jan. 2002, *Gottardo*, C-55/00).

[328] R. Karimeri, *A Critical Review of the Definition of Tax Avoidance in the Case Law of the European Court of Justice*, Intertax, 2011 Issue 6/7, pp. 296–316.

[329] See ECJ, 19 Jan. 2006, *Bouanich*, C-265/04.

[330] M. Burgio, *The abuse of law in the framework of the European tax law*, Intertax, 1991, Issue 2, pp. 82–88

It is clear that the non-qualifying residents are in a disadvantageous position, as they cannot claim the treaty's benefits under the same conditions as qualifying residents[331].

In Class IV ACT[332], the ECJ was asked for the first time to rule on the compatibility of an LOB clause with EU law in an intra-European context. However, subsequently, there were many other legal cases[333].

In the following we try to summarize the topic and to draw final conclusions.

We said just above that LOB clauses create a difference in treatment between two residents of the same Member State. In particular, a qualifying resident is entitled to the tax treaty's benefits while a non-qualifying resident is not[334].

Moreover, according to ECJ's case law, it appears that, based on relevant case-law, qualifying and non qualifying residents are comparable and the latter is clearly in a disadvantageous position. So, there is a discrimination.

However, according to the ECJ, a discrimination is not contrary to EU law when it can be justified by an overriding reason of public interest.

Focusing the attention in our topic, as LOB clauses are in essence anti-abuse rules, the most relevant justification ground that needs to be discussed is the prevention of tax avoidance and evasion[335].

Such clauses have to be both suitable to achieve the aim of preventing tax avoidance or evasion and should not go further than required to achieve that aim (proportionality) [336].

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[331] It is however settled ECJ case-law that a difference in treatment can be justified in case these persons are not comparable or in case there is a valid justification ground and the discrimination complies with the principle of proportionality.

[332] ECJ, 12 Dec. 2012, *Class IV ACT*, C-374/04.

[333] ECJ 8 Mar. 2001, *Metallgesellschaft*, C-397/98 and C-410/98, s. 46; ECJ, 20 May 2008, *Orange European Smallcap Fund NV*, C-194/78; ECJ, 25 Jul. 1991, C-221/89, *Factortame Ltd,* s. 32; ECJ 5 Nov. 2002, Joint cases: C-466/98 *Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland*; C-467/98, *Commission of the European Communities v. Kingdom of Denmark*; C-468/98 *Commission of the European Communities v. Kingdom of Sweden*; C-469/98 *Commission of the European Communities v. République de Finlande*; C-471/98 *Commission of the European Communities v. Kingdom of Belgium*;C472/98 *Commission of the European Communities v. Grand Duchy of Luxemburg*; C-475/98 *Commission of the European Communities v. Republic of Austria*; C-476/98 *Commission of the European Communities v. Federal Republic of Germany.*

[334] P. H. J. Essers, G.J.M.E De Bont & E.C.C.M. Kemmeren, *The Compatibility of Anti-abuse Provisions in Tax Treaties with EC Law* 141 (Kluwer L. Intl. 1998).

[335] See ECJ 16 Jul. 1998, *ICI*, C-264/96, s. 26; ECJ 18 Nov. 1999, *X&Y*, C-200/98, s. 60–61; ECJ 12 Dec. 2002, *Lankhorst-Hohorst*, C-324/00, s. 37; ECJ 11 Mar. 2004, *Lasteyrie du Saillant*, C-9/02, s. 50.

Regarding the proportionality test for the LOB clause we should keep into consideration the opinion of some authors.

Some authors are of the opinion that LOB clauses are appropriate to achieve the above-mentioned aim, but go beyond what is necessary and thus are not proportionate[337].

Some authors think that LOB clauses are also not necessarily pertinent for achieving the aim that they pursue[338]. Looking at a company's ownership structure is not pertinent to know whether that company is in *bona fide*.

Moreover, in order for the LOB clause to be compatible with EU law, it should thus in the end only target "wholly artificial arrangements". The authors are of the opinion that the ownership test does not only target "wholly artificial arrangements", as it is of a general nature and can easily target companies that conduct genuine economic activities[339].

The stock-exchange test is also a test which does not only target 'wholly artificial arrangements' since it is of a general nature and can capture genuine economic activities.

4.1.4 Compatibility of tax treaty SAARs with EU law

An analysis of the anti-abuse rules in Italian tax treaties and their relationship with EC law cannot be made if we do not analyze and remind ourselves of some fundamental principles[340].

Article 220 TEU provides that "*Member States shall, so far as necessary, enter into negotiations with each other with a view to securing (. . .) the abolition of double taxation within the Community*". It seems clear that between Member States an effort has to be made to achieve the elimination of double taxation[341].

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[336] ECJ 21 Feb. 2006, *Halifax plc et ali* C-255/02, s. 68; ECJ 3 Mar. 2005, *Fini*, C-32/03, s. 32; ECJ 23 Mar. 2000, *Diamantis*, C-373/ 73, s. 33; ECJ 12 May 1998, *Kefalas*, C-367/96, s. 28.

[337] See for example D.A Hofland & F.P.G. Pötgens, *The LOB Provision in the New JapanNetherlands Tax Treaty*, European Taxn. 218 (2011).

[338] J. Malherbe, *La non discriminazione e le clausole anti-abuso delle convenzioni sulla prevenzione della doppia imposizione; diritto svizzero e comunitario*, in Rassegna Tributaria, n. 6, 2006, pag. 2049.

[339] L. De Broe, *International Tax Planning and Prevention of Abuse, doctoral series* 725–726 (IBFD 2008).

[340] F. Gallo, G. Casertano, *The Clause Anti-Abuse in the Italian Double Tax Treaties and their compatibility with the EC Law, Intertax, no. 12, 1995, pg. 649.*

[341] M. Del Giudice, *Brevi note in materia di evasione fiscale internazionale*, in il fisco, no. 46, 2001, pg. 14658.

However, the scope of the double tax treaties is not only to eliminate double taxation, but also to prevent tax evasion and abuse. But it is clear, that tax evasion, or tax avoidance could represent an obstacle to the free flow of capital in the common market[342].

Member States, in applying the anti-abuse clause contained in the double tax treaties with other Member States, have to respect the principles set out above in order to avoid violating Article 67 of the TEU.

In our country, there has been discussion on the compatibility of tax treaty SAARs with EU law.

Regarding the compatibility between the anti abuse treaties and the EU law, the Italian doctrine (and also the majority of the foreign doctrine) tries to solve the possible conflict referring to the ECJ's jurisprudence.

First of all, it seems useful to remember that EU treaties (TEU and TFEU) constitute more than an international agreement. Indeed, Member States have limited their sovereign rights in certain fields by transferring powers to the EU institutions. It implies that the law stemming from these treaties could not be overridden by domestic legal provisions[343]. So, in case of a conflict between a treaty's provision and a national provision, the former takes the precedence over the latter[344].

However, in this work we have to observe the relationship between the EU treaties and, not the pure national law, but the law stemming from a treaty concluded by our country. In other words we have to observe what happens if a provision included in a tax treaty signed by Italy is in conflict with the EU treaty.

First of all, to solve this possible conflict we have to distinguish between two cases. The first case occurs when the tax treaty concerned is concluded between Italy and another EU country. The second case occurs when the tax treaty concerned is concluded between Italy and a non- EU country.

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[342] F. Antonaccio, *Treaty shopping: abuso del diritto convenzionale mediante pratiche di aggressive tax planning*, in il fisco, no. 31, 2013, pg. 1-4779.

[343] ECJ 15 July 1964, 6/64, *Costa v. ENEL.*

[344] The ECJ stated that any national provision which may conflict with it, whether prior or subsequent, have to be set aside. See ECJ 9 March 1978, 106/77, *Simmenthal*, par. 21. In addition, the Court (ECJ 11 July 1968, 4/68, *Internationale Handelsgesellschaft*) stated that the EU law provision even takes precedence over national constitutional provision. Moreover, the Court (ECJ 29 April 1999, c-224/97, *Erich Ciola and Land Vorarlberg*) stated that also the national administration is required to ensure the supremacy of EU law over national law.

In the first case, there are not many issues since the tax treaty follows the EU law and then the EU hierarchy. In the second case, some problems arise since the non-EU country may not be bounded by the EU law and EU hierarchical rules.
Regarding the way to solve this second kind of conflict, the doctrine[345] simply refers to Art. 307 of TEU which states the following: "*the rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty*".
So, the mentioned provision has the purpose of making sure that the entry into force of the EU Treaty does not bring injury to the international legal order, the rights of a third State and the obligations of a Member State in respect of a third State. This aim has been enforced by the ECJ's sentences[346].
Moreover the second paragraph of Art. 307 states that: "to the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude".
Particularly relevant is the discussion which involves the treaty concluded by Italy (and by all the other EU countries) and by Switzerland, since this latter country does not belong to the European Union.

4.2 The relationship between SAARs and fundamental freedoms

Dealing with the relation between SAAR and EU law, it is fundamental to mention that even tough Member States are exclusively competent for direct taxation, they must nonetheless exercise that competence consistently with EU law[347]. This statement means that Member State have to avoid any discrimination[348] and have to respect the fundamental freedoms[349].

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[345] J. Malherbe, *La non discriminazione e le clausole anti-abuso delle convenzioni sulla prevenzione della doppia imposizione,* in *Rassegna Tributaria*, no. 6, 2006, pg. 2049.
[346] ECJ 27 February 1962 case 10/61 Commission v. Italian Republic.
[347] ECJ 28 January 1986, 270/83, *Commission v France ("Avoir Fiscal").*
[348] A general non discrimination principle is laid down in Art. 18 TFEU.
[349] Fundamental freedom can be defined as a species of the genus principle of non discrimination. Fundamental freedoms are: free movement of goods (Art. 28 TFEU), free movement of workers

However, to check if there is a discrimination or if a fundamental freedom has been violated some steps are necessary[350]. Synthesizing as much as possible, we have to check if two situations are comparable[351]. So, if these situations are comparable and the State applied different rules or the same rule in a different manner for the mentioned situation we can say that a discrimination exists and that a fundamental freedom has been breached[352]. But, in this case a sanction is not automatic, since an infringement of the fundamental freedoms may be justified[353].

Anti-abuse[354] is one of the most important justifications[355] in the case law of the European Court of Justice (ECJ) [356].

Taxpayers have a fundamental right of free establishment and it is even in accordance with this fundamental freedom if they choose to allocate their activities in the jurisdiction with the lowest taxes[357]. It is possible also because within the European Union direct taxes are not harmonized and, consequently, Member States are free to decide on their national tax base and on the tax rate they want to apply to persons who are subject to tax in their country.

(Art. 45 TFEU), freedom of establishment (Art. 49 TFEU), freedom to provide services (Art. 56 TFEU) and free movement of capital and payments (Art. 63 TFEU).

[350] P. Piantavigna, *Tax Abuse in European Union Law: A Theory*, *EC Tax Review*, 2011, Issue 3, pp. 134–147.

[351] The classic pair of comparison is that of a person who exercises its freedoms compared to a person who remains in the home state. The factual cross border situation is therefore compared with the hypothetical situation of a taxpayer who remains in the home state. However, there is not a precise rule to establish if two situations are comparable. But the ECJ case by case states if the situations are comparable. However, we can notice that ECJ does not state the comparability when the rules refer to personal elements (see, for example, case *Schumacker* C-279/93).

[352] S. Van thiel, *Justification in Community law for income tax restrictions on free movement: Acte clair rules that can be ready applied by National Courts*, European Tax, Parts 1, 2008, pg. 42.

[353] The TFEU explicitly provides that justifications are public policy, public security or public health. Moreover, ECJ decided (Case 120/78 *Cassis de Dijon*) that infringement of the fundamental freedoms may als be justified by general ground of public interest.

[354] Other justification accepted by the ECJ are: the cohesion of the tax system, the territoriality, the effectiveness of fiscal supervision, the balanced allocation of taxing rights. Conversely, justifications not accepted by the ECJ are, for example: the non-harmonization in the area of direct taxation, the difficulties in obtaining information, the loss of tax revenue and the promotion of national research and development.

[355] M. G. H. Schaper, *The Need to Prevent Abusive Practices and Fraud as a Composite Justification*, EC Tax Review, 2014, Issue 4, pp. 220–229.

[356] B. Kiekebeld, *Anti-abuse in the Field of Taxation: Is There One Overall Concept?, EC Tax Review*,2009, Issue 4, pp. 144–145.

[357] W. Haslemer, *Consistency and Coherence as Conditions for Justification of Member State Measures Restricting Free Movement*, 2010.

On the base of the previous statement, one could expect that some Member States offer especially low tax rates to attract foreign investors[358]. Consequently, in order to reduce their tax burden taxpayers try to benefit from such low-tax countries by using international structures.

So, most of the Member States have national provisions that deny persons using such structures the benefit.

However, not all national provisions that aim to avoid abusive constructions are in line with the non discrimination concept.

From the case law of the ECJ, especially from the *Cadbury Schweppes*[359] ruling, it seems to follow that Member States are only allowed to combat abuse of law in the field of taxation in case of artificial arrangements carried out to escape the national tax normally payable.

Regarding this statement, one of the main questions is whether the goal to avoid taxation should be the main goal or the sole goal of that artificial arrangement.

After *Part Services*[360], it seems clear that the criterion is whether or not the main/essential purpose is tax avoidance. As indicated, the ECJ mentioned artificial arrangements. The question arises of whether the existence of an artificial arrangement is necessary to come to abuse[361]. Based on *Part Services,* one could argue that there is no pre-condition in that respect. The existence of an artificial arrangement is just one of the objective factors that could indicate that transactions are abusive. It could be argued that abuse could follow from all relevant facts and circumstances even if there is no artificial arrangement.

Following the ECJ's development, we can affirm that to justify discriminatory national provisions with the anti-abuse argument the following has to be met.

First of all, it is necessary the through the artificial arrangement the person may benefit from a tax advantage which he would not have benefited from in a pure domestic situation[362].

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[358] P. J. Wattel, *Fiscal Cohesion, Fiscal Territoriality and the Preservation of the (Balanced) Allocation of Taxing Power; What is the Difference? In the Influence of European Lawon Direct Taxation: Recent and Future Development*, Kluwer Law International, 2007.

[359] ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes.*

[360] ECJ, 21 Feb. 2008, Case C-42/06, *Part Services.*

[361] In other words, is it possible that in the view of the ECJ there is abuse even if there is no artificial arrangement or is the artificial arrangement a precondition for abuse?

[362] ECJ 21 November 2001, C-436/00, *X and Y.*

In addition, the aim of the national provision has to be to counteract abusive conduct.

At last, the national discriminatory provision has to be designed as to discriminate against exclusively abusive behavior.

However, even if the above is fulfilled, the justification does not arise automatically. Indeed the principle of proportionality must still comply with. In other words, even though a discriminatory national provision is justified, it may not go beyond what is necessary to achieve its purpose and aim[363].

The application of the proportionality test described above involves the weighting of two different interests of two different sectors. The interest of the private sector, in tax cases represented by a taxpayer on the one hand, and the public sector in tax cases represented by a tax authority on the other.

Strictly regarding our domestic scenario, in Italy there are not other kinds of discussion than the one explained above. Neither the doctrine, nor the judges think that fundamental freedoms may set a restriction on the implementation of BEPS.

4.3 The relationship between SAARs and EU directives

4.3.1 The relevance of Parent-Subsidiary Directive on SAARs

The Council Directive 2011/96/EU of 30 November 2011 (so called Parent Subsidiary Directive) deals with the elimination of economic double taxation arising within group of companies from cross-border distributions of profits[364].

The aim of the Directive concerned is to create within the EU "conditions analogous to those of an internal market"[365]. Indeed the grouping of companies from different Member States is often put at a disadvantage as compared to the grouping of companies[366].

Regarding the topic of this work, it is fundamental to notice Art. 1(2) of the Directive. The mentioned paragraph allows the application of domestic and treaty provisions aimed at preventing "fraud or abuse". Directive shopping is usually based on the interposition of a parent company in an EU Member State in order to

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[363] ECJ 6 October 2011, C-493/09, Commission vs. Portugal; ECJ 7 September 2011, C-371/10, *National Grid Indus, para. 58; ECJ 15 September 2011, C-132/10 Halley.*

[364] D. Weber, *The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect*, Intertax, 2016, Issue 2, pp. 98–129.

[365] See the first preamble of the Directive.

[366] Indeed in most States economic double taxaion was only relieved in purely domestic situations.

obtain the benefits of the Directive in situations that would otherwise fall outside its scope[367]. According to this provision any anti abuse measure must allow the taxpayer to give evidence of the fact that a scheme or operation was not put in place for the purpose of benefiting from the more favorable regime of the Directive[368].

The Ecofin Council of the European Union at its meeting on 9 December 2014 has reached a political agreement on the introduction of a general anti abuse clause in the Directive on parent companies and subsidiaries (n . 2011/96 / EU) . The agreement of the Ecofin Council aims to prevent aggressive tax planning by corporate groups and also the phenomenon of abuse ensuring, at the same time, the uniformity of the application.

In July 2014, the EU Council had already updated the Parent Subsidiary Directive with the Dir. No. 2014/86/EU. The aim of this modification was of preventing cross-border companies to plan intercompany payments. Consequently, the effect was the prevention of the risk to get a double non-taxation of dividends paid in corporate groups thanks to the presence of hybrid financial buildings. The formal adoption follows the political agreement of 20 June 2014, which in turn follows the proposed Commission Directive COM (2013) 814 of 25 November 2013. The last mentioned Commission Directive was aimed to bridging the gap existing in the Parent Subsidiaries Directive regarding the financial incongruities hybrid and to introduce a general anti abuse rule. The introduction of the anti abuse rule meets the Action Plan (COM (2012) 722 of 6 December 2012) which was created to combat fraud and tax evasion.

Going back to the aim of the new anti abuse agreement, it provides that the paragraph mentioned above have to be substituted by three new paragraphs[369]. In practice, according to the wording of the agreement , the Member States do not have to grant the benefits of the Directive to the agreements (arrangements) which

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[367] M. Baldazzi, *Le norme antielusive in materia di dividendi comunitari*, in Azienda&Fisco, no. 17, 2001, pg. 743.

[368] C. Scardino, *Clausola anti-abuso nella Direttiva sulle società madri e figlie,* in Fiscalità e Commercio Internazionale, n. 4, 2015, pag. 36; G. Ficai, L. Rossi, *Modifiche "antielusive" alla Direttiva Madre Figlia*, in Corriere Tributario, no. 22, 2015, pg. 1699; G. Liberatore, *Rivisitazione antielusiva della direttiva parent-subsidiary*, in il fisco, no. 13, 2014, pg. 1-1266.

[369] R Tavares. J.S., B. N. Bogenschneider, *The New De Minimis Anti-abuse Rule in the Parent-Subsidiary Directive: Validating EU Tax Competition and Corporate Tax Avoidance?*, Intertax, Issue 8/9, pp. 484–494.

are in place just with the main purpose to obtain advantages contrary to the purpose of the Directive and that are not genuine because they not reflect a viable economic.

Moreover, Article 4, paragraph 1, letter a) of Dir. n. 2011/96/EU has been modified. In particular, the expression which states that "*Member State of the parent company and the State of its permanent establishment shall refrain from taxing such profits tax*" has been integrated with a sentence. This new sentence states that "*refrain from taxing such profits tax to the extent that they are not deductible for the subsidiary and those profits subject to taxation to the extent that they are deductible for the subsidiary*".

At last, the EU council requires Member States to adopt a common anti abuse clause that allows denying the benefits of the Directive in cases of artificial arrangements put in place in order to obtain an undue tax advantage.

The Parent Subsidiary Directive's modify arose from the Commission's Recommendation 2012/722/EU dealing with the aggressive tax planning and the tax asymmetry.

The deadline for the transposition of the Directive 2014/86/UE expired on 31 December 2015. So, it is very recent[370].

Regarding our country, the Parliament on the 9 July 2015 issued the Law no. 114 which, namely at Art. 44, delegated to the Italian Government the implementation of the Directive 2014/86/EU.

Subsequently, the Government, on the basis if this mentioned enabling law issued the Decree no. 4 of 7 January 2016 which entered into force the 26 of January 2016.

However, the modify occurred by the Directive 2014/86/UE corresponds to Art. 44, par. 2, ITA which already existed. Art. 44, par. 2 ITA establishes that the exclusion from taxation treatment of dividends in respect of remuneration of the securities which in the foreign country are considered debt instruments and then imply the deductibility of interest expense is denied.

[370] L. Miele, *Stop ai profitti fuori imposizione*, in il Sole 24 Ore,2014.

4.3.2 The relationship between the other EU Directives and SAARs

4.3.2.1 The Merger Directive

Another very important EU Directive is the Council Directive 2009/133/EC of 19 October 2009 (so called Merger Directive).

This Directive was enacted since a difference was noticed between a pure domestic reorganization and a cross border reorganization. Indeed, domestic reorganization is tax neutral[371]: it does not trigger immediate taxation at the time of reorganization since taxation of the capital gain is deferred until a later disposal of those assets[372]. The same did not happen for cross border reorganization[373]. Thus cross border reorganization ought not to be hampered by restrictions, disadvantages or distortions arising from the tax provisions of the Member States. It is therefore necessary to introduce tax provisions to make the cross border reorganization as tax neutral as the national one.

However, regarding the topic of this work we have to focus our attention to a single provision: Art. 15.

Art. 15 of the Merger Directive provides that a Member State may refuse to apply or withdraw the benefit of all or any part of the Directive where it appears that the merger, the division, the partial division, the transfer of assets, the exchange of shares or the transfer of the registered office of an SE or SCE has as its principal or as one of its principal objectives tax evasion or tax avoidance.

In our country, this statement generated some debates because the Directive does not include a definition of tax evasion or tax avoidance[374]. So, Italy, (as all the other countries) while transposing the Merger Directive into domestic law, is free with respect to the means to transpose the Directive. Consequently, there is the risk that Member States implement different anti abuse clauses reflecting the different views in what constitutes abuse.

Moreover, Art. 15 (1)(a) provides that if a reorganization is not undertaken for valid commercial reasons, it may be presumed that the whole reorganization has

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[371] J. van der Paal, *Ec Tax Scene: EC Adopts Corporate Merger Directive*, Intertax, Issue 12, 2005, pp. 628-629.

[372] E. van den Brande, *The Merger Directive amended: the final version*, EC Tax Review, Issue 3, 2005, pp. 119-127.

[373] B. Knobbe-Keuk, *Transfer of residence and of branches between freedom of astablishment, the merger directive and German transformation tax law*, Intertax, Issue 1, 1992, pp. 4-12.

[374] ECJ 10 November 2011, C- 126/10, *Foggia*; ECJ 17 July 1997, C-28/95, *Leur-Bloem.*

tax evasion or avoidance as its principal objectives. So, these transactions may not be covered by the Directive.

Strictly regarding the Italian scenario, there is a provision, namely Art. 26, par. 4, lett. c) which assumes relevance importance in this context since it provides exemption from taxes on interest and royalties paid to individuals resident in EU Member States.

4.3.2.2 The Interest and Royalty Directive

Another important EU Directive is the Council Directive 2003/49/EC of 3 June 2003 (so called Interest and Royalty Directive). This 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 States. In other words, an equal treatment of EU cross border and domestic interest and royalty payments should be achieved by the Directive.

Moreover, the Directive is aimed to avoid double taxation and double non taxation in the field of interest and royalty payments. For this reason, the Directive concerned contains numerous specific anti avoidance provisions[375]. Namely they are Art. 1 (4), 1(5) (b), 1(8), 1(10), Art. 3(a)(iii), Art. 5(1) and (2). Substantially, these provisions state that the Directive does not preclude the application of domestic or agreement based provisions for the prevention of fraud and abuse. In addition, Member States have the option to withdraw the benefits of the Directive concerned or to refuse its application if the principal motive or one of the principal motives for transactions is tax evasion, tax avoidance or abuse.

4.3.2.3 The recent draft of the CCCTB Directive

The European Commission proposed on 16 March 2011 a Common Consolidated Corporate Tax Base[376] (hereinafter "the CCCTB") to be applied in the European

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[375] G. Rolle, *La direttiva 2003/49/CE in mateia di interessi e royalties fra società consociate: alcune prime osservazioni,* in Fiscalità Internazionale, no. 4, 2003, pg. 333; M. Poulsen, *Treaty/Directive Shopping and Abuse of EU Law*, Intertax, 2013, Issue 4, pp. 230–251.

376 European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 (Brussels).

See L. Jaatinen, *IAS/IFRS: A Starting Point for the CCCTB?* Intertax, 2012, Issue 4, pp. 260–269; J. C. Borg, *The Tax Treatment of Losses under the Proposed Common Consolidated Corporate Tax Base Directive*, Intertax, 2013, Issue 11, pp. 581–587; L. M. F. Mas, *Consequences of the*

Union (EU) in order to harmonize and provide a single set of rules to calculate the corporate tax base[377].

The aim is to promote Single Market efficiency and functionality through tackling fiscal impediments to growth by removing over-taxation and double taxation. The CCCTB would create an optional system of common rules for calculating the tax base[378] of companies resident in the EU or third-country branches in the EU.

The CCCTB would create a more coordinated system for corporate taxation and especially reduce multinational corporations' difficulties in obtaining several separate accounting systems.

However, for this work it is important to notice that a common tax base reduces incentives to income shifting to a more favorable tax environment, meaning countries with a lower tax burden. So also CCCTB proposal includes anti – abuse rules. In particular, CCCTB proposal include a general anti abuse rule and specific anti abuse rules regarding the CFC and the non deductibility of interests.

In our country, the presence of anti abuse rules within the CCCTB Directive triggered some discussions[379] regarding the relationship of these rules and the anti abuse rules recommended by OECD (especially those included in BEPS' recommendations) [380]. The issue of the mentioned relationship has been also taken into consideration by the VI Commission of the Senate (Commission Finance and Treasury) [381].

Implementation of the CCCTB Regime on EU Member States Tax Collection: Will CCCTB Have a Dramatic or Only a Severe Effect on Public Finances?, 2010, Intertax, Issue 8/9, pp. 394–420; H. Celebi, *The CCCTB as a Proposed Solution to the Corporate Income Taxation Dilemma within the EU*, EC Tax Review, 2013, Issue 6, pp. 289–298; M. J. G. Fernández, *Corporate Tax Harmonization: Key Issues for Ensuring an Efficient Implementation of the CCCTB,* Intertax, 2013, Issue 11, pp. 598–605.

[377] In 2001, the European Commission had announced its aim to improve internal market efficiency and tackle corporate tax obstacles and inefficiencies. In 2004, a Commission working group was set up to develop and to provide technical assistance for a common tax base.

[378] It is important to notice that the harmonization of tax rules would only concern calculation of the tax base. It is not extended to tax rates. In this way a certain amount of tax competition in the EU still continue to exist.

[379] However, in my opinion, to solve these discussions we should look at Article 8 of the proposed Directive foresees that establish that its provisions prevail over any other contrary provision included in the agreements between Member States.

[380] D. Canè, *La proposta di Direttiva per una CCCTB: una analisi per principi,* in Rassegna Tributaria, no. 6, 2012, pg. 1511; L. KovàCs, *Le prospettive della CCCTB*, in Rassegna Tributaria, no. 3, 2008, pg. 699; A. Denaro, *La Direttiva sulla base imponibile comune per l'imposta sulle società (Ccctb) vs. Modello OCSE di convenzione fiscale: una coesistenza possibile?*, in il fisco, no. 18, 2012, pg. 1-2793;

[381] M. Piazza, *La disciplina anti abuso*, in *Fiscalità e commercio internazionale*, no. 7, 2011.

In this manner, it is enshrined the primacy of EU law over international conventional law (as it could be OECD recommendations). Then, the international conventional provision which is in contrast with the EU law has to be set aside.
But it is true that Art. 8 can be applied only to situations which involve EU Member States. So, the problem continues to exist regarding the relation between a EU country and a non EU country. However, the EU Commission is working to find a possible solution to this matter[382].
Regarding the Italian legal system, it is particularly interesting and relevant the speech made in 2011 by Mr. Betunio[383] dealing with the CCCTB Directive's proposal.
Having examined Mr. Betunio's opinion, we can observe that the CCCTB proposal does not provide SAARs.
Moreover, the GAAR included in CCCTB proposal, namely Art. 80, seems to be worded in a generic way. But, at the same time, the concept of "abuse of law" on the base of the CCCTB Directive seems to be too restricted in comparison of the concept elaborated by the courts or contained in other provisions. And, for this reason, in practice, the effectiveness of the future CCCTB Directive could be limited and insufficient.
Lastly, the CCCTB proposal has coordination problems with some national anti-abuse rules. Fr example, CCCTB proposal doesn't coordinate perfectly with Art. 37 *bis* of Decree 600/73 and now with Article 10 *bis* of Law 212/2000.

[382] European Commission, *Working Paper*, *EC Law and tax Treaties*, 9 June 2005.
[383] Mr. Betunio was the director of the Revenue Agency. Look at the entire report at http://www.senato.it/documenti/repository/commissioni/comm06/Agenzia%20entrate%20betunio%2025%20maggio%202011.pdf.

ANALYZED DOUBLE TAXATION CONVENTIONS

Convention for the avoidance of double taxation with respect to taxes on income and on capital and the prevention of fiscal evasion between Italy and:

- Albania
- Algeria
- Saudi Arabia
- Argentina
- Armenia
- Australia
- Austria
- Azerbaijan
- Bangladesh
- Belarus
- Belgium
- Brazil
- Bulgaria
- Canada
- China
- Congo
- Cyprus
- Czechoslovak Republic
- Ivory Cost
- Croatia
- Denmark
- Ecuador
- Egypt
- Estonia
- Ethiopia
- Russia
- Philippines
- Finland

- France
- Georgia
- Germany
- Ghana
- Japan
- Jordan
- Hong Kong
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Israel
- Kazakhstan
- Kuwait
- Lebanon
- Leetonia
- Lithuania
- Luxemburg
- Macedonia
- Malaysia
- Malta
- Mauritius
- Mexico
- Moldova
- Morocco
- Mozambique
- Netherlands
- New Zeeland
- Norway
- Oman

- Pakistan
- Poland
- Portugal
- Qatar
- Rumania
- San Marino
- Senegal
- Singapore
- Slovenia
- South Korea
- Spain
- Sri Lanka
- Syria
- United Arab Emirates
- United Kingdom
- United States of America
- South Africa
- Swede
- Switzerland
- Tanzania
- Thailand
- Turkey
- Tunisia
- Uganda
- Ukraine
- Uzbekistan
- Venezuela
- Vietnam
- Zambia

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Potential impact of BEPS on tax systems

Procedural Aspects in a Post BEPS World

Fabio Fanigliuolo

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Introduction

The OECD's action plan on base erosion and profit shifting has remarked the necessity of providing changes in domestic tax laws in order to face problems arising from a globalized economy.

BEPS Action 14 focuses on the Mutual Agreement Procedure to avoid the double taxation. It tries to solve double taxation problem arising from a bilateral convention thought the involvement of appointed administration of each State. This instrument is becoming more and more important because nowadays a company is able to operate all over the word thanks to technological developments; as a consequence of this, the ability of States to coordinate their tax system with each other and to cooperate to avoid double taxation and provide tax information is essential.

The topic of the second part is the mandatory disclosure mechanism of aggressive tax planning provided by BEPS Action 12 which has not been implemented in Italy, but other ways to tackle aggressive tax planning have been adopted and they will be thoroughly described.

Chapter 1- DIFFERENT KIND OF DISPUTE RESOLUTION MECHANISM APPLIED TO INTERNATIONAL TAX MATTERS IN ITALY

In recent years, thanks to the influence of various OECD's projects, the relationship between taxpayers and administration has changed. This relation is based on cooperation; in fact the possibility for taxpayers to cooperate with administration to determine their tax position has increased and a lot of institutes aimed at this goal have been created in the Italian system.

1.1 Ruling Internazionale (International Ruling)

The "*Ruling Internazionale*" is an Italian institute introduced by D.L. n. 269 of 2003 that could be qualified as an advanced price agreement mechanism. This piece of legislation has been recently abrogated by D.Lgs n.147 of 2015, which added art. 31-bis to the law n. 600 of 1973 that contains the complete description of the *Ruling*

Internazionale. The aim of this instrument is to reach an agreement between the requesting taxpayer and the administration before the tax is due so that they could jointly decide how to apply tax law in the proper circumstances.

Italian government has adopted this instrument in an attempt to introduce new ways of cooperation between administration and taxpayers[1]; in fact one of OECD's aim is to improve this relationship. Thanks to this instrument the administration should be now open to taxpayers' opinions and advices.

A problem in the fiscal field of Italian legislation is the uncertainty about the interpretation and application of norms. The *Ruling Internazionale* has been designed to increase the level of certainty for taxpayers because they can now ask questions to and have discussions with the administration on the issues about their tax compliance.

This instrument is addressed to international operators, through it, indeed, the government is trying to incentive foreign investments giving them certainty and means to avoid litigation.

The interesting outcomes of the *Ruling Internazionale* are the avoidance of double taxation and advanced resolution of potential conflicts. The instrument lets the administration know about the situation of taxpayers and it can decide what to do in accordance with them. The possibility to state with an agreement the situation at stake permits to taxpayers to avoid the filling of a lawsuit that would take more time than a ruling to be concluded.

The procedure starts with the presentation of a request to the office of *Ruling Internazionale*; the office then arranges a meeting with the company to have it disclose documents and to find an agreement on the matter. The result is that the international case has a certain legal framework.

This instrument is different from all the other ones because it ends with an agreement and not with a unilateral decision by the administration.

Only companies whose business has international dimensions can apply for this procedure. The tax matters that can be discussed are the following:

- transfer pricing;

[1] For further details see ROMANO C. E CONTI D. - Accordi preventivi ed interpello per gli investitori: novità, evoluzione e comparazione - Corriere tributario n. 44/2015

- attribution of profit or loss to permanent establishment;
- the qualification of the presence of a company in Italy as a branch or not;
- the taxation of dividends, interests and royalties following to transnational operations.

The agreement has to be reached in 180 days and needs to be signed by both parties that are bound to it for 5 years if the circumstances remain the same. A retroactive effect is possible, the agreement could be applied from the moment of the proposition of the *Ruling Internazionale.* No fees are required to initiate this procedure.

During the period in which the agreement is applicable, the taxpayer has to give the information requested by the administration to check the situation and its applicability.

The ruling could be used to achieve a unilateral agreement or a bilateral one. The legal bases of this multilateral *Ruling Internazionale* are a combination of the law that provides the *Ruling Internazionale* and a disposition of the convention against double taxation. In fact, Italy must have signed a double convention against the double taxation that included the paragraph 3 of art 25 of the OECD model convention with other States in order to use the multilateral form of *Ruling Internazionale.*

The effects that this multilateral ruling can have on the avoidance of double taxation are evident, but the obstacle is that this procedure involves more than one legal system. For this reason it would be better if the procedure and the effects of the reached agreement were harmonized under different legislations. The discipline of ruling has been recently updated towards this direction in order to increase the similarity with rulings provided by other States.

Italy does not have a specific procedure for the bilateral ruling, but law n. 147 of 2015 has provided the possibility to use this instrument following the basic procedure for the unilateral *Ruling Internazionale.* Obviously the procedure does not work well as it is because there are other administrations that participate and require some changes.

The reference to the art 25 of the Model Convention is useful to tie a bond between Ruling and MAP that are very close to each other and this reference makes it clear. For this reason the Italian administration can borrow parts of MAP's procedure to assure the pertinence of the instrument.

1.2 Interpello (Consultation)

Interpello is a unilateral proceeding that has been introduced by art. 11 of the law n. 212 of 2000, recently modified by law n. 156 of 2015. Every taxpayer that has interest in the question could start it. Through this institute, a taxpayer can ask the administration to interpret specific disposition related to tax matters and they can even describe how they think the disposition needs to be interpreted.

Interpello cannot be used if the tax is already due: the question has to be prior to the imposition of a tax. The administration has a duty to answer, generally, within 120 days from the proposition of *interpello* or the receipt of further documents. If the taxpayer does not receive an answer before the time limit can consider his interpretation accepted by the administration.

An important feature of the answer of the administration is that it is bound by the given interpretation for the case at stake in the application[2]. This institute holds taxpayers responsible for the definition of their situation and the administration has no duties to verify the circumstances described in the document of application.

There are four types of *Interpello* that vary so to be applied in different situations, but the core of the institute is the same for all of them:

- *interpello ordinario (ordinary);*
- *interpello probatorio (probative);*
- *interpello anti-abuso (anti-abuse);*
- *interpello disapplicativo (disapplication).*

This instrument is a different form of communication between administration and taxpayers, but the public office maintains its role of authority and it imposes its decision of the case. *Interpello* can be useful to make the administration aware of issues of double taxation that take place in Italy so that the office has the chance to solve the fiscal matter with an unilateral decision.

In the end the effectiveness of the instrument is guaranteed by the provision that gives the administration a short time to respond at the proposed *Interpello* and if this

[2] For further information see FORMICA G. E FORMICA P. - *Omogeneizzazione del sistema degli interpelli* - Il fisco n. 30 del 2015

does not happen, the solution suggested by the taxpayer in his application is considered accepted. This norm is important because it pushes the office to give a solution to the case, but the taxpayer can get what he wants either way.

A deeper examination of this institute will be provided in the second part of this paper.

1.2.1 Interpello per nuovi investimenti (Consultation for new investments)

There is another institute that is called *Interpello per nuovi investimenti,* it has been introduced by art. 2 of law n. 147 of 2015. Instead its name it is not a proper form of *Interpello*; this is the reason why it is not listed in the above-mentioned models. It is a type of *Interpello* because it ends with a unilateral decision of the administration even if the procedure is closer to an advanced price agreement. Moreover a wide documentation is needed related to the circumstances of the case and the party has the possibility to argue before the administration[3]. Only subjects willing to invest more than € 30 million in Italy and to create an employment benefit can apply for this procedure.

The aim of this instrument is to incentive foreign investments in Italy, for this reason targets are mainly foreign companies that want to start a business in Italy. Foreign investors do not know Italian system very well so they need to make some studies to understand it; sometimes it could be difficult to understand a tax system and to foresee the behaviours of the administration: these problems can be solved by *Interpello per nuovi investimenti*. This instrument helps new investors to better understand Italian system letting them ask the administration every question related to tax matter that can potentially interest their investment in Italy.

The *Interpello per nuovi investimenti* is a strategic tool in order to reduce the uncertainty of Italian tax system because the administration has to answer the proposed question in 120 days with a decision. The decision bounds the administration that, after the investment has been completed, cannot adopt behaviours inconsistent with the answer given to *Interpello*.

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[3] For further details see ROMANO C. E CONTI D. - Accordi preventivi ed interpello per gli investitori: novità, evoluzione e comparazione - Corriere tributario n. 44/2015

It is important to analyse the effect of the decision taken by the administration; as it has been said before, it binds the administration so long as the conditions described in the *Interpello* remain the same. Administrative acts that are in contrast with the decision of *Interpello per nuovi investienti* are null and void.
This instrument is provided for foreign actors, so it is likely that double taxation matter will be examined through this procedure. Investors can ask the administration to decide about a problem that involves double taxation and the public office has the possibility to give a solution to the double taxation even before that the problem becomes concrete. On the other hand this procedure is of no help if the double taxation is not depending on Italian acts but it depends on acts of other States.

1.3 Adempimento collaborativo (cooperative compliance)

The *Adempimento collaborativo* is a recent mechanism that is being tested on big companies for a future enlarged application. The aim of this provision is to create an enhanced relationship between administration and big taxpayers. This kind of companies fears the tax uncertainty, so *Adempimento collaborativo* gives them a preferential way to discuss with the administration about tax matters[4]. Only companies that have a tax control framework can ask to be included into this mechanism. The benefits for the undertakings are:

- reduction of administrative sanctions;
- protection from liabilities for criminal offence related to taxation;
- special advanced *Interpello*: it has to be concluded in 45 days, if the company complies with the answer of the administration it will not be possible to apply sanctions or controls. In this procedure the administration can evaluate not only the matter at stake but also consider the general standing of the undertaking.
- certainty about what is considered aggressive tax planning: the administration has a duty to periodically publish on its website the behaviours that can be considered as “aggressive tax planning” and the taxpayers that participate to the

[4] For further details see ROMANO C. E CHIODAROL L. - Regime di adempimento collaborativo: la risposta all’incertezza nei rapporti tra fisco e contribuente - Corriere tributario n. 20/2015

cooperative compliance have to inform the administration about risky situation to benefit of the above mentioned benefits.

A deeper examination of this institute will be provided in the second part of this paper.

1.4 Accertamento con adesione (Tax assessment with acceptance)

The *Accertamento con adesione* is an instrument that has been introduced into Italian system in 1997 by legislative decree n. 218. This is one of the first forms of cooperation between taxpayers and administration and its aims were to let the taxpayer be part of the tax imposition process and the granting of rights to taxpayers.

Of course, this can be considered as an alternative dispute resolution mechanism; the Italian legislator has indeed adopted it to decrease the number of litigations on tax matters and through this instrument, administration and taxpayers shall reach an agreement on the tax position at stake avoiding the judicial proceeding.

The *accertamento con adesione* can be used to define the tax duties of every taxpayer and all the most important taxes can be subject to this instrument.

There are two ways to initiate it:

- administration, usually before the notification of the tax assessment, invites the taxpayer to appear before tax officials;
- a taxpayer sends an application of adhesion to the competent administration, but after that a tax assessment has been notified or the administration has made inspections or verifications.

The adversarial principle is very important in this instrument; in fact the taxpayer and the administration set a meeting to discuss about the tax situation that has been subject to assessment. At the end of the meeting the administration will conclude what is the correct amount of taxes to be paid by the taxpayer.

The administration does not have the power to negotiate about the due taxes, so at the end there will not be an agreement but a proposal by the administration to the taxpayer. This proposal will contain the amount of taxes that the administration

considers "fair" after the taxpayer has expressed his opinion and brought his evidence during the meeting; the administration has then to reduce sanctions of 1/3 of the applicable amount.

Meetings are essential to draft the proposal because the taxpayer can provide information and documents that help administration to define the due taxes and his global fiscal situation.

The taxpayer is free to evaluate the fairness of the proposal, to sign or not and eventually decide to go before a judge. The taxpayer that decides to sign the proposal cannot make any complaint before judges or initiates other procedures because the matter has been settled. The administration is bound to the proposal too and it can not make further tax assessments on the settled matter.

Accertamento con adesione is a general instrument applicable to a wider number of cases with respect to MAPs, but sometimes these instruments are both available for the same matter. The differences between the two mechanisms are huge, also because the *Accertamento con adesione* is not able to avoid double taxation, only MAP can do it. In the end, it is true that both instrument are available, but the effects that they produce are different, so it is the taxpayers that has to choose which one is better for him.

Taxpayers are free to choose which of these to use but some problem may arise when the administration starts the *Accertamento con adesione*. In this case the public office has an instrument to incentive taxpayers to cooperate and to accept the proposed solution. This behaviour can discourage taxpayers to initiate MAPs and it can hinder the spread of this instrument. Overall, both mechanisms are useful and if the administration behaves correctly, it will be unlikely that the existence of an instrument as *Accertamento con adesione* will be a hindrance to the use of MAPs

2 Mutual Agreement Procedures (MAPs)

The MAP is a procedure whose goal is to reach an agreement between administrations of different States about a case of double taxation in order to remove it

or avoid it[5]. It can be used only if the States have signed a double convention against double taxation that includes art.25 of OECD model convention

2.1 Legal basis

Italy has not adopted an internal law that provides regulations about the MAP, but the legal basis for this kind of procedure is considered to be every law that ratifies the convention against double taxation signed by Italian government. This is not yet sufficient because MAP is a delicate procedure and administration needs to adopt consistent behaviours, respect rights of taxpayers and follow the advice of BEPS action plan 14; for these reasons, the director of "*Agenzia delle Entrate*" has published the *Circolare*[6] n 21/E of 2012. To explain MAP, the *Circolare* is fundamental because it is the instrument that contain, all together, the relevant behaviours that have to take place when such a procedure starts. Obviously the procedure changes in relation to the convention against double taxation that has been signed, but the core issues are similar and are described in the *Circolare* n. 21/E of 2012.

2.2 The competent authority

The Italian competent authority is the office of International Relations of the finance department of the Ministry of Economy and Finance; it represents Italy for the internal relationship with the taxpayers and for the external one with other States interested in the procedure. This office receives, during the procedure the technical support of *Agenzia delle Entrate* in particular for writing the position paper, sometimes even decentralized offices can cooperate to the procedure.

[5] For further details see VALENTE P. - Circolare n21/e del 5 giugno 2012- le procedure amichevoli come strumento di risoluzione delle controversie fiscali internazionali - Il fisco 26 2012

[6] Circolare is an administrative general act that officials have to take into account when they are working on the matter discussed in this act; it contains interpretations of norms or administrative practices to follow

2.3 Subjective scope

Every person that reside in Italy who feels damaged by a tax can initiate a MAP. The damage shall come from the breach of norms of a convention against double taxation signed by Italy with other States in which the person is taxable. About Italian nationals, in most conventions there are clauses that let them apply for a MAP, so that it is better to check the relevant convention before applying for the procedure. The word "person" is interpreted in a wide manner: it includes physical persons, juridical persons, associations or bodies that are subjects for tax purposes.

As stated in paragraph 3 of art 25 of OECD Model Convention, even the office of international relations can initiate a MAP if it has doubts about the interpretation or application of some articles of the signed convention: this clause is included in almost all the examined conventions[7].

The office of international relations has the power to settle cases of double taxation even if not included in the convention. It is the same office that cooperates with foreign institutions to write the terms of the conventions against double taxation. In one third of the examined convention[8] though, it is not mentioned the possibility to settle through MAP cases of double taxation not included in the objective scope of the convention.

A MAP started by a competent authority is likely to be of general nature so that the reached agreement could be useful for a wide range of taxpayers, because of this, the *Circolare* provides that the agreement has to be public. The *Circolare* does not describe the form in which this has to be done but it leaves to the office the possibility to choose the appropriate mean that could be different depending on the involved matter.

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[7] Hong Kong, Jordan, Georgia, Croatia, Canada, Saudi Arabia, India, Island, U.S.A., Switzerland, San Marino.

[8] Ghana, Etiopia, Denmark, UK, Ukraine, Turkey, Latvia, Australia, Brazil

2.4 Objective scope

Now I am going to analyse the tax matters that could be resolved using this instrument. In theory, a MAP can solve every kind of juridical or economic double taxation question related to persons or bodies; for instance, double tax residence, wrong application of withholding tax on interest royalties or dividend, transfer pricing related problem or existence of a permanent establishment. The legal basis of a MAP is the Convention in which it is described so it cannot be used for double taxation matters not included into the scope of the convention unless the administration starts the MAP to regulate those exact matters. The contracting States have the possibility to limit the application of MAP to some articles of the convention, but conventions signed by Italy never limit the scope of art 25. However, in some conventions paragraph 2 of art 9 of the Model Convention is missing, so the corresponding adjustments are out of the scope of the convention and MAPs cannot be applied with the partner State in this field.

Finally, this procedure is not banned for taxpayers that have committed tax felonies. In fact, the *Circolare* in describing the European arbitration convention, prohibits the use of a MAP if a tax felony has been judiciary stated[9]. On the other hand, nothing is said about this in the part concerning the MAPs that arise from double conventions. In this case the provision written for the arbitration convention cannot be applicable by analogy means to MAPs because the legislator has considered the problem at stake in the *Circolare,* but it decided to not make any reference in the part that relates to conventional MAPs.

2.5 Time limits to present the application

The time limit to present the application for a MAP by taxpayers is stated in each convention, so it can change from a MAP to another. The model rule provides three years as time limit. Italian policy is aiming at reducing this period; in fact, in most of the signed conventions, the taxpayer has only two years[10] to apply for a MAP.

[9] For further details see TOMASSINI A. E MARTINELLI A. – *L'accesso alla mutual agreement procedure nell'arbitration convention* – Corriere tributario 2012

[10] Hong Kong, Jordan, Ghana, Russia, Etiopia, Denmark, Croatia, Canada, Saudi Arabia, India, Island, San Marino, Turkey, Ukraine.

First, taxpayers might present the application before that the tax is due and previously of a tax audit act. In order to make such an application it is relevant that double taxation matter is at least foreseeable, otherwise the case cannot be treated with a MAP.

An important issue is to state the moment since the two years period starts. The starting point of the time limit is the first notification of the action resulting in taxation not in accordance with the provisions of the Convention. Italian office applies this provision in the most favourable way for taxpayers as it is said in paragraph 21 of the commentary of art.25 of OECD Model Convention. The starting point depends on the kind of taxes:

- for withholding taxes, it is the moment in which the administration notifies the denial of reimburse of paid taxes.
- for taxes that are due after an audit of the administration, it is the moment in which the tax assessment notice that generates the double taxation is notified.

2.6 Content of Application

The taxpayer has to send its application to the office of International Relations of the finance department of the Ministry of Economy and Finance in the form of a registered post with acknowledgement of receipt or through electronic means.

The taxpayer that starts a MAP under Italian legislation does not have to pay any fee for the entire procedure. The Italian government pays the expenses while the arbitration costs are generally divided between the States involved in equal part (this is written, most of times, in the convention).

The essential contents of the application for a MAP are:

- information to identify the taxpayer (name, address, tax code);
- the place where the next notices have to be sent;
- description of the circumstances of the case outlining when the double taxation has occurred or would occur;
- disclosure of all jurisdictional or administrative procedures that have been initiated in Italy;

- remedies to avoid double taxation that he has initiated in the other State;
- copy of acts that have determined the double taxation in contrast with the convention against double taxation signed between Italy and the other State (the document are the administrative acts that make the tax due or foreseeable);
- further documentation that can back up competent authorities to complete the investigation;
- commitment to answer the authority requests in a complete and fast way and to produce any further documents that could be needed.

The documentation requested is clear enough because the *Circolare* makes examples for each of the previous listed point. At first glance, it does not seem too burdensome for the taxpayer since all the items are necessary to understand the case and prove its relevance. The last requirement listed (commitment of taxpayers) is useful to avoid a heavier burden for the applicant. In fact, the competent authority has the possibility to ask more information about cases that are complex and avoid that useless info are provided even when they are not needed. Cases that concern transfer-pricing issues need a deeper documentation because of the complexity of the matter at stake.

2.7 The procedure

The procedure of a MAP can be split up into two steps, the first one involves only the Italian administration that has to check the admissibility of requests. The competent authority with the support of *Agenzia delle Entrate* evaluates whether the subjective requirements and objective ones are met or not. In particular, the administration has to take into account the behaviours of both States involved and it has a duty to evaluate if States takes actions that lead to a taxation contrary to the Convention signed.

The competent authority, that has the duty to notice the decision to the taxpayer, dismisses an inadmissible request. Nothing is said about the interpretation of requisites to access the MAP and this could lead to uncertainty, because the interpretation depends on the State that examines the request.

As suggested in BEPS action 14, interpretation of articles of conventions could vary between treaty partners and this can hinder the possibility to access the MAP by

taxpayers. In the Italian system this issue is not taken into account, in fact the competent authority does not have a duty to communicate to the foreign correspondents, applications for MAP that have been refused, as the Action14 suggests. Interpretation, in some way, is consistent at international level thanks to paragraph 3 of art 25 of OECD Model Convention. In fact, Italian administration can ask the foreign one questions about the interpretation of convention against double taxation if it has a doubt or if it believes that foreign administration is interpreting some norms in a different way. The question is whether Italian and other administration really adopt this instrument or not.

The request containing the asked elements is considered admissible. In this case, the competent authority notifies the acceptance of the request of MAP to the taxpayer. At this point, the administration can ask the taxpayer further information that seems to be relevant and missing documents; these are essential to evaluate the merit of requests.

When the Italian administration has a complete acknowledgement of the situation in which taxes are levied in breach of the convention, it tries to solve the issue on its own. If Italian administration has made the act that has caused the double taxation, it will evaluate the possibility to change it in "*autotutela*": it means that administrative officials that have issued the act will look again into it and the administration can then change it. If the act has been made by a foreign authority the Italian administration evaluates the possibility of granting an exemption or a reimburse of the sum if needed, under the norms of the signed convention.

If none of the above-mentioned solutions fits for the matter at stake, the competent authority communicates to the other State that a request for a MAP has been held. This would be the second step of the MAP, the real procedure.

At this point, contracting States are both involved and they are aware of the situation; the first contacts are, generally, in written form, but if the authority believes that an oral confrontation could help, there is no preclusion. The Italian competent authority helped by *Agenzia delle Entrate* writes its position paper and sends it to the foreign State. Italy uses the English language in relation with other States in MAPs.

A deeper examination of the different positions could need the appointment of a mixed commission made by officials of both States that will analyse the case in a series

of meetings. The juridical bases of this kind of commissions are the conventions against double taxation but sometimes this clause is not included, especially in the old ones[11].

The moment in which the application is presented to the competent authority is the starting date of MAP, if instead documents or clarifications are requested the starting date of MAP is the moment in which the administration receives them.

2.8 The agreement

The aim of the procedure is to find an agreement between the States to avoid double taxation that is in breach of the convention: if they manage to obtain one, both parties must sign it and it has to be notified to the taxpayer. He can accept the agreement or not if an Italian judicial procedure is still pending while the authorities have reached the agreement. The taxpayer has a duty to notify his decision to the competent authority. The options are:

- he accepts the agreement and abandons the lawsuit or, if he has not started a judicial proceeding, he has to accept the MAP's solution;
- he refuses the agreement and decides to continue the lawsuit;

The period of validity of the agreement could fluctuate. The Italian system gives the power to extend the validity for the subsequent period of imposition without stating a time limit, approvals of the taxpayer and the foreign authority are essential for the extension of validity. This is useful for taxpayers that make frequent cross border operations; in fact, they can state for future imposition periods how to avoid double taxation. The application of the extension is subject to the requisite that the conditions of taxpayers do not change, if that is the case, authorities do not have to respect the agreement.

Retroactive application of the agreement is not possible because the *Circolare* specifies that it is valid only for the future. This means that the reached agreement is effective for taxes that are not definitive when the application has been drafted. This rule respects a general Italian norm that prohibits the administration to change decisions of judges or definitive tax assessments.

[11] United Kingdom, Singapore 1977, Brazil, Australia

2.9 The role of taxpayers

It is useful to underline that the only actors of MAPs are the competent authorities; in fact it's just them who sign the agreement. However, the taxpayer is an important actor in the procedure: his role is to describe the case at the best of his capacities.

In this situation taxpayers do not have a right to accede to the MAP so they cannot force the administration to start a MAP, *a fortiori* they cannot force the authority to reach an agreement or to solve the case otherwise. On the other hand, the accession to the MAP provided by the arbitration convention it is seen as a right in the Italian system. In fact, the full chamber of *Corte di Cassazione* has stated in deliverances n. 12759 and 12760 of 2015 that the denial to access the Arbitration Convention for taxpayers can be the reason for a lawsuit before the competent judge.

The above-mentioned deliverances are very clear in limiting the scope of the right only to the Arbitration Convention, but the use that other judges will do of these judgements is not yet foreseeable. Both kind of MAPs are introduced into Italian system through a law, evidently with a different background but with lots of similarities. It is not unlikely that in next future even the refusal to have access to MAPs based on double conventions would give the right to go before a judge. Surely, this change can modify the role of taxpayers in this procedure, because if such a strong remedy is given to them, it means that the Italian law system recognises that taxpayers have a big interest involved inside the MAP.

Another right that taxpayers have is the right to be informed by the competent authority about the acceptance of their application and on the status of the procedure.

The *Circolare*, following the best practice 14 of MEMAP, states that taxpayers have the right to be heard about his case. Taxpayers are an important resource for MAPs and their deeper involvement could lead to an increase of case solvable in a shorter time, because these subjects have the strongest interest in avoiding double taxation.

2.10 Suspension of the levying of taxes

Italian system provides two kinds of suspension for due taxes: the administrative one (stated in art 39 of D.P.R. n. 602 of 1973) and the judiciary one (provided by art. 47

of D.Lgs. n. 546 of 1992). Both are independent from MAP, so no remedies are provided to suspend the levying of taxes during a MAP.

These two procedures take into account:

- the manifest groundlessness of tax levied;
- the "*fumus boni iuris*" (likelihood of success on the merit of the case) and serious and irreparable damage for taxpayers.

Applicants have to demonstrate the presence of one of these requirements in order to have a suspension. This demonstrate that the MAP is totally independent from the levy of tax, in fact even the payment of the contested taxes in a MAP is not needed to initiate the procedure.

2.11 Relationship between MAP and judicial appeal

As said before, MAP is an independent procedure; its application, in fact, does not preclude the right to adopt the judicial remedy. The lawsuit arising from the wrong levying of taxes and the MAP based on the same tax are two parallel tracks which meet only when one of them ends. A MAP can be initiated in Italy even if a judicial remedy has been started in the other State and it is not prohibited under the law of the foreign Country[12].

The *Circolare* hints to go before the competent judge while a MAP is pending. The reason is that a MAP has no effect on the administrative act levying taxes and this could lead the act to become definitive[13]. The *Circolare* states that if the administrative act that levy tax become definitive before the agreement between competent authorities has been reached, the MAP agreement must not be implemented in Italy for the tax period the act refers to. Surely, this situation leads to uncertainty for taxpayers that have to initiate a judicial appeal[14] to ensure the applicability of MAP's agreement.

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[12] For further details see TOMASSINI A. E MARTINELLI A. – *Doppia imposizione internazionale e << mutual agreement procedure >>* - Corriere tributario 2012

[13] In the Italian system an administrative act became definitive after a certain period of time if it is not suspended or no judicial remedies are initiated against it.

[14] For futher details see BARGAGLI M. - Le procedure amichevoli per evitare la doppia imposizione - "A&F" 2013

Some domestic law remedies are available for taxpayers to avoid judicial proceedings, such as the *Accertamento con adesione*. These remedies try to make the taxpayers cooperate with the administration in order to reach an agreement on the amount of taxes to pay. This solution has to meet the approval of the taxpayer who often accepts because the administration proposes a discount in due taxes and the matter is solved in short time. This remedy is adopted on a voluntary basis so, if the taxpayer accepts the agreement or conclude these mechanisms of dispute resolution has not a lawful interest to initiate a judicial proceeding or a MAP because the question at stake has already been set. These remedies do not eliminate the double taxation and their adoption precludes the application of the agreement reached in a MAP. For these reasons, remedies like these reduces the utilization of MAP, but it is better to have both kind of remedies available for a taxpayer so he can choose the one that fits best.

These two remedies can be coordinated in some way if their peculiar characteristics are taken into account. In fact, these national remedies jeopardize the application of MAP, but they give a fast solution for the current tax period so they can be used to settle double taxation for the current tax period; while a MAP, that has a slow procedure because of the involvement of foreign State, can solve the double taxation matter for the following years.

The case in which the MAP and the judicial appeal are both pending is going to be analysed in the following paragraph. This is a common situation under the Italian system given the necessity to avoid the definitive effect of the tax levied. The two remedies can go forward simultaneously without any preclusion but this is a burden for taxpayers. Surely, this jeopardizes MAPs because taxpayers have to waste time filing a lawsuit before the competent judge after the fulfilment of MAP duties. This discourages some taxpayers to fill the application for a MAP because the international procedure is free while a lawsuit has a relevant cost. The absence of a suspension of terms for the definitive effects of administrative acts during a MAP constitutes a barrier to the entry in MAPs and only cases in which important interests are involved can accede to it.
Recently, some judges have granted a suspension of the judicial proceedings because the same case was brought before the competent authority for a MAP. This is not a real solution to problems neither it is generally recognized by Italian judges but it could be useful to relieve taxpayers from the burden of judicial proceedings for a period of time.

The legislator has considered convincing the above-mentioned tendency of competent judges and some months ago it adopted a similar solution.

The art. 9 of D.Lgs n. 156 of 2015 modifies the rule of the tax judicial proceeding stated by the law n. 546 of 1992; in fact it adds the subsection 1-ter at the art. 39 that provides a new kind of suspension of the proceeding. The norm says that the judge has to suspend the judicial proceeding if a mutual agreement procedure has been started pursuant to conventions against double taxation signed by Italy; the taxpayer or the administration have then to ask for the suspension, otherwise the judge cannot give it.

If the MAP ends sooner than the judicial proceeding, taxpayers have the possibility to choose to accept the agreement or refuse it and continue with the judicial remedy.

On the other hand, it could happen that the judgement obtains the authority of *res judicata* before administrations involved in the MAP manage to reach an agreement. In this case the MAP ends without an agreement, because Italian legislation prohibits that an act as the agreement reached by administrations in a MAP could go against a decision of a judge; even if there was to be an agreement it could not have been applied in Italy in this situation. The competent authority has to communicate the decision of the Italian judge to the foreign administration. The result is that negotiation for MAP will be suspended, so in Italy the matter will be regulated by the judgement while the other State has the possibility to adopt the decision of Italian judge or not.

The judicial procedure and the MAP are different mechanism that take into account different part of a problem; this means that the judicial procedure does not focus the attention on avoiding double taxation, but on the right application of Italian law, while MAP is aimed at avoiding double taxation. This premise is useful to come up with the conclusion that often judgments do not eliminate double taxation and they even impede the continuation of negotiation to avoid it.

This is a critical problem of Italian legislation because it lowers the chances to eliminate double taxation; furthermore it leads to a waste of time and resources of the Italian administration. This happens because, from the moment in which a judgement on the case at stake is delivered, the competent authority is no more able to negotiate and the work done become useless. From the perspective of foreign administrations is

foreseeable that they do not appreciate that Italy, at a certain point, could leave the negotiations; this can lower the Italian reliability.

It is useful to underline the difference between a judicial procedure and a MAP. In fact, MAPs cannot be applied every time the taxpayer has a complaint against the tax administration. On the other hand, the judicial procedure is the only procedure through which the plaintiff can complain violation of every kind. For instance, a violation of the procedure of imposition or a violation of the right to be informed made by the administration cannot be brought before the competent authority for MAPs, but the right place to discuss those is the court. This difference is important to understand and solve the problem of coordination that can arise between a judicial procedure and a MAP. The judicial procedure is a general one and because of this, it should remain the ordinary remedy for taxpayers that have complaints on every ground. While MAP is a special procedure addressed only to specific complaints and it would be better if taxpayers were incentivised to use MAPs in cases in which it is not possible to avoid double taxation through a unilateral decision.

Italian government has recently introduced the possibility to suspend the judicial proceeding if taxpayers have started a MAP and this is a convincing way to coordinate the two procedures. It is complex for sure, but maybe a suspension of the validity of the act of tax imposition would have been better because, if this solution is adopted, taxpayers can avoid the burden of starting a judicial proceeding.

Above all, recent norms try to find a solution to the problem of coordination between MAPs and judgements, but the given solution cannot solve the problem. Some changes that can be useful to eliminate the coordination problem in Italian legislation are the following. For instance, Italian legislator can adopt a norm that impose taxpayers to try to solve the tax matter through MAP for a certain period of time and only if the administrations have reached no agreement or a bad one the taxpayer can initiate the judicial proceeding. Another possibility is to oblige the judge to inform the plaintiff about the existence of MAPs and suggest, in cases where the MAP can be useful, to start one.

The suggested ways of coordination can not be implemented before one finds a way to make MAPs capable of giving to taxpayers the certainty that the procedure will

finish with a decision. The arbitration clause can be a way and it will be discussed in the next paragraph.

2.12 The arbitration clause

Paragraph 5 of art. 25 of OECD Model Convention provides a dispute resolution mechanism (arbitration) if the administrations does not reach an agreement in two years. In the Italian system the legal basis for this mechanism is the law that ratifies the convention against the double convention.

The arbitration clause is very important to improve the effectiveness of MAPs, but it collides with the fear of States to lose control over tax matters, a field in which they are careful about the conferral of power to international organizations, to arbiter and the sharing of powers with other States.

Italian situation reflects this feeling: the arbitration clause, as written in the OECD's Model Convention, is mentioned in only one of the examined conventions[15]. Many Italian conventions were signed a long time ago, when the arbitration clause was not included in the article 25 of Model Convention, this could be a reason for the lack of this clause, but even in the newer conventions the arbitration clause does not appear. The reason for the absence should be the refusal to bind itself to this kind of procedure so the position of Italy on the arbitration clause is sceptical.

While examining different conventions, it can be found that in half of the total there is no arbitration clause[16] at all, while in the other half there is one but it is different from the clause written in the Model Convention. Is important to underline that in these conventions, the clauses are very close and some features are recurrent in all of them. The feature that is common in all the conventions is the absence of a duty to start the arbitration[17]; in fact, the consensus of both administrations and the taxpayer is needed.

The Model rule gives the competent authorities two years to find an agreement, Italian conventions mostly follow this rule, but it is not significant since they are not

[15] San Marino

[16] Russia, Ethiopia, Denmark, Saudi Arabia, India, Latvia, U.K., Switzerland, Ukraine, Turkey, Brazil, Australia, South Korea

[17] Hong Kong, Jordan, Ghana, Georgia, Croatia, Canada, Island, USA, Moldova

bound to initiate the arbitration and if they agree later on the arbitration can initiate then.

It is useful to divide the arbitration clauses in two categories:

- the clause that does not provide the specific rules to implement the arbitration clause. Generally, for this kind of clause, the conditions have to be decided at the moment in which administrations want to initiate the arbitration. Most of these clauses state that in addition to the will to initiate the procedure, the competent authorities exchange some memo that define the operative terms;
- the clauses that define the operative terms of the hypothetic arbitration.

In the conventions against double taxation signed by Italy, the operative terms generally contained in the last of the above-mentioned clauses are:

- the presence of three arbiters (one appointed by each administration and the third appointed by the other arbiters);
- the rules that the arbiter should apply (the convention against double taxation, general principles of international law and general principles of national laws of both States);
- procedural rule is chosen by the arbiters;
- the cost of arbitration is divided in equal part between the States.

The two different types of clauses previously described are very far from each other, because the arbitration clause that does not describe the operative terms makes administrations lose more time than the other one. In addition, contracting States have to agree on the proposed condition, so it is foreseeable that more than one memo will be necessary to define all the terms of arbitration. In the end, if administrations are not able to reach an agreement on the terms of the arbitration, it will not take place. For these reasons, the clause that does not contain the operative terms can be an obstacle to the initiation of the arbitration, so the other arbitration clause is preferable.

2.13 The arbitration convention

This instrument has been adopted in every State of European Union. The legal basis at European level is the Convention n.437 of 1990 that has been ratified by Italy in law n. 99 of 1993 that reports the exact words of the convention. The first part of the procedure is the same of a MAP that has as legal basis a convention against double taxation. The differences lay in the second part and precisely when the competent authorities are obliged to start the arbitration. This represents the main difference between the two different MAPs, but this diversity implies other changes, mainly in the coordination between this international remedy and the national judicial appeal. The arbitration convention fully complies with the art. 25 of OECD model convention, it represents a perfect implementation of this article.

The time limit to conclude MAPs provided by the arbitration convention is 2 years and the starting point is the same of other MAP; if this time is not sufficient to reach an agreement, the arbitration is mandatory. To initiate such a procedure it is mandatory to renounce to every other kind of dispute resolution mechanism if started. This creates an alternative instrument of resolution of double taxation that is not the MAP, but the arbitration; in fact during the phase in which the administrations try to find an agreement, it is possible to pursue other means of dispute resolution. A provision states that the time limit of two years given to the administration to end the “friendly” procedure, starts only in the moment in which no other dispute resolution mechanism is pending. This provision creates some problems in the Italian system in which the administration cannot overpass a judicial decision or a definitive act: in these two years, the act could become definitive and the results of the MAP or the arbitration cannot be implemented. The remedy given to taxpayers to avoid this inconvenient by the Italian system is very weak. A special administrative procedure is been adopted to permit MAP applicants to have a suspension of the act that levies tax. The legal basis of this procedure is the art 3 of law n. 99 of 1993 and states that the taxpayer has to ask the suspension to the Ministry of finance that with a decree may authorize the suspension of relevant acts until the MAP ends.. The Ministry can ask for a guarantee made by banks.

The last issue that needs to be examined is the coordination of a MAP with alternatives dispute resolution mechanisms. These kinds of mechanisms are voluntary based so the taxpayer decides to solve the tax matter with the administration in a certain

way; this precludes the successive adoption or the continuance of MAPs to maintain a consistency in the Italian system.

2.14 Italian policy

Italy is not a blacklisted Country so this leads its politics to cooperate and dialogue with other State to find a common solution even in tax matters. For this reason art 25, that constitute an important form of coordination and a procedure that pushes States to dialogue on tax issues, has been implemented in almost every convention against double taxation (without the mandatory arbitration clause).

In the analysed conventions, there are not any significant difference between the MAP provided for developing States and the one for developed States.

In recent years, applications for MAPs have increased in a substantial way, this shows that taxpayers have knowledge of this instrument and they look at it as a real way to solve problems. This means that Italy is doing well in MAP field because otherwise there would be a lack of applications if the competent authority did not work properly in its previous cases.

The Italian policy can be analysed through two conventions signed with States that for some features are opposite: S. Marino and United States. The first one contains an art. 25 that is perfectly equal to the one in the OECD Model Convention; this shows that Italy agrees with the procedure described by the Model Convention, but it needs to trust the contracting State to implement it.

About United States' convention, the only difference from the Model rule is the arbitration clause that provides a not mandatory arbitration. This is comprehensible if it is taken into account that the States are physically far away from one another and in the fiscal system both of them should leave some questions open instead of clashing on differences. A generic arbitration clause helps a lot towards this objective.

Above all, this way of drafting the arbitration clause can also be a kind of precaution to let States think about the different situations and decide case by case.

A general problem is that Italy is unaware of the importance of MAP. The fact is evident when the *Circolare* tried to coordinate the judicial appeal with the MAP. The judicial appeal obviously has a complete discipline while the MAP needs to be

adaptable to the different cases and this is one reason why the Italian system prefers the decision of a judge than a MAP in every situation.

The judge takes into account mainly Italian law while the competent authorities or arbiters evaluate even international parameter; this is another reason for the national preference. The aim is to eliminate double taxation and examining only Italian law often is not enough; Italy should change its rules about the coordination of MAP and internal remedies in the sense of preferring the MAP under special conditions. These could happen when a double taxation cannot be eliminated by a decision of a judge or the administration itself[18].

The most important problem of MAPs is the absence of certainty about the conclusion of the procedure. Italian legislator and taxpayers distrust this instrument because they do not know whether it will ever end with an agreement or not. This is the first matter to solve and the other problems will be overcome easily. In conclusion, MAPs are becoming more and more common and it is foreseeable that in the future they will be an important mechanism of solution of double taxation issues.

Chapter 2 – MECHANISMS AGAINST AGGRESSIVE TAX PLANNING

The European recommendation 772 of 2012 on aggressive tax planning gives this definition: “Aggressive tax planning consists in taking advantage of technicalities of a tax system or mismatches between two tax systems for the purpose of reducing tax liability”.

1. Disclosure of Aggressive Tax Planning

The previous quote of Recommendation 772 of 2012 is necessary because this European act represents the starting point of measures taken by Italy against the phenomenon of aggressive tax planning. As it will be shown later, the influence of the recommendation is been deeper than the one of BEPS action 12. The reasons could be

[18] Some examples of the coordination are made in previous paragraphs.

several: those two acts suggest different solutions to tackle the aggressive tax planning phenomenon, the different solutions could need different timing to be implemented and institutions that draft them are different and its political power is not similar.

Nowadays in Italy there is not a mandatory disclosure rule, but this does not mean that the problem of aggressive tax planning is not taken into account. Until now, Action 12 has had the only effect of focusing on this kind of base erosion of tax revenue: BEPS gives impulses and solutions, but States like Italy need more time to analyse this action and implement it. The problem of aggressive tax planning regards, first of all, large taxpayers that operate in different Countries so OECD is the best place where a solution could be found and it has been found. The fact that States agree in the OECD contest is important because even if they are not obliged to implement such a decision, it succeeds to establishing itself *auctoritate rationis*. A premise is necessary to explain this: the aggressive tax planning phenomenon is a world wide one so fighting it involves the adoption of common instruments that impede taxpayers to take advantage of existent gaps among legislation of different States. Identity of instruments and the adoption of a disclosure rule for aggressive tax planning by some States[19] are the premises; the result is that Countries that have not implemented the disclosure rule yet have no other smart choices than to adopt it as described in Action 12, otherwise the aim cannot be reached. For these reasons is foreseeable that Italy will implement such a rule in the near future.

European Union cannot be underestimated in this field because it has more power over Italy than OECD and it has more influence in OECD than Italy. Considering these three actors, the situation can be represented as an isosceles triangle with the two equal side shorter than the third one; at the two equal corner there are Italy and OECD while at the largest corner the European Union. One of E.U.'s aims is to combat tax base erosion made through aggressive tax planning, this implies that European institutions will push Italy and other member States to do what is necessary to eliminate this matter and also the implementation of a disclosure system as stated in BEPS Action 12.

[19] U.K., Canada, South Africa, U.S., Ireland, Portugal

2 Recommendation 772/2012 of European Union

The European recommendation on aggressive tax planning suggest two instrument that member States can adopt to tackle this phenomenon, the first is a national remedy the second is a supranational one:

- introduction of a national general anti-abuse rule;
- limitation to the application of rules intended to avoid double taxation included in conventions against double taxation.

This recommendation does not include a disclosure rule, but it provides instruments that are not alternatives to the ones suggested in Action 12. Actually, the measures stated by the recommendation are a basic protection against aggressive tax planning while the disclosure rule constitutes an advanced protection against the phenomenon and the second will be meaningless without the first.

The aggressive tax planning is a phenomenon that has a European dimension, it has effects on the European internal market and on competition too; for these reasons the European directive is coherent with the conferral principle[20]. In the next future, it would be desirable that, on the side of the basic instruments already provided, advanced instruments against this kind of arrangements will be approved.

2.1 General anti-abuse rule (GAAR)

In accordance with the recommendation, Italian parliament authorized with the law n.23 of 2014 the government to adopt a general anti avoidance rule. The government exercises this power in the legislative decree n.128 of 2015, Art. 1 modifies the law n. 212 of 2000, here it is added the art 10-bis that contain the GAAR. The law n. 212 is an important one, called *Statuto dei diritti del contribuente,* it is a fundamental norm of Italian law system that contains the general principles of the tax field. The GAAR is of residual application, in fact, its aim is to include tax planning strategies that fall outside the scope of specific anti-avoidance rule so this norm is applicable only if

[20] For further details see VALENTE P. – Le raccomandazioni UE in materia di aggressive tax planning e good governance fiscale – Il fisco 2013

the situation is not regulated under Italian law, but it is equivalent to taxable situation. Four requisites are necessary to identify a tax avoidance:

- one or a series of arrangements that comply with the law, but only in a formal way;
- arrangements frustrate the aims of the rule at stake so even if they respect the words of the law these acts are contrary to its purposes;
- arrangements lack of commercial substance, this happened when acts, facts or agreements do not produce substantial effects apart from fiscal benefits;
- the essential scope of arrangements has to be the attainment of fiscal advantages.

Arrangements that cause a fiscal benefit are admissible under Italian law, the aim of the anti avoidance rule is to prohibit to obtain undue fiscal benefits and this characteristic is underlined by the second of the listed requisite[21]. In fact, a taxpayer is free to choose the tax scheme that is more convenient for him because the achievement of tax benefit is lawful; the problem is that not every tax benefit is permissible. Tax laws have not to be misinterpreted, so tax advantages are lawful only if the behaviours to achieve them are not against the ratio of the laws that allows such a benefit.

Arrangements that fulfil all the above-mentioned requisites are inside the scope of art 1 of the legislative decree n. 128 of 2015 so they are considered mechanisms of tax avoidance. The sanction is that the administration shall ignore such an artificial arrangement. In fact, it shall determine payable taxes applying the avoided principle and it shall treat these arrangements for tax purposes by reference to economic substance.

Tax avoidance does not constitute a breach of law and does not have criminal relevance Italian law, which provides the application of administrative sanctions and not criminal ones.

The taxpayer has the right to be informed before the administration declares that his actions are in breach of the anti avoidance rule; the administration has to notify a document to the taxpayers that contains:

- the request of explanations, the taxpayer has to answer in 60 days

[21] For further details see SCUFFI M. - La codificazione dell'abuso del diritto secondo il decreto legislativo n. 128/2015 – Rivista di diritto tributario 2015

- the reason why the administration believes that such an arrangement is a tax avoidance.

2.1.1 The role of a general anti avoidance rule in the fight against aggressive tax planning

Aggressive tax planning structures are growing in number and often they have different features, but only one aim: granting a tax benefit. The complexity, the wide range of structure and the fact that new ones are developed in short time make the reaction of the State more and more difficult. The adoption of specific anti avoidance rule to prohibit some structures could be inadequate because a small change in the aggressive tax planning structure is sufficient to make the rule useless; in addition, the time that the Italian legislator needs to adopt new rules against new aggressive tax planning structures are too slow to avoid the reduction of tax revenue. In other words, the adoption of special anti avoidance rules creates the problem of inclusion of new aggressive tax planning schemes; in fact every time that a new scheme appears the rule needs to be modified. This modification needs a lot of time and the result is a reduction of efficiency of this instrument in the fighting of aggressive tax planning phenomenon.

On the other hand, a general anti avoidance rule gives an answer to this problem, in fact it grants the necessary flexibility to cover all kind of aggressive tax planning structures because it focuses the attention on the undue fiscal benefit that is the common feature of these structures.

The general anti avoidance rule and the mandatory disclosure of aggressive tax planning are complementary instruments; in fact, the GAAR is the mean through which a disclosed aggressive tax planning structure could be punished, if it is the case.

2.2 Clause to avoid double non taxation

The European recommendation on aggressive tax planning suggests the introduction of a clause in the convention against double convention signed by member States with European or third countries. The suggested clause provides that a State shall be precluded from taxing an item of income only if this item is subject to tax in the other contracting State.

It seems that Italy has still not adopted this clause in its conventions. This changing in convention can surely help the fight against the aggressive tax planning structures but it is not easy to add the clause on the conventions and to make contracting State agree on it.

3 Disclosure initiatives used by Italian tax administration

Italy has not implemented a disclosure rule for aggressive tax planning but this does not mean that the problem of aggressive tax planning is not taken into account in Italian legislation. In fact other disclosure initiatives other than a disclosure rule have been taken:

- *Interpello* (Consultation)
- Cooperative compliance

These instruments are part of a series of legislative interventions whose aim is to shifting the relationship between administration and taxpayers towards a system in which they can cooperate. These instruments are not drawn to combat aggressive tax planning, but they can be used even to achieve this goal.

At a first glance, it seems that a mandatory disclosure rule can be more effective than these instruments, in most cases it is true, but it depends from the effectiveness of the administration and from the cooperation of taxpayers.

About the relation of the above-mentioned instruments and the mandatory disclosure rule, if a State imposes the disclosure of aggressive tax planning, other disclosure initiatives will lose most of their usefulness, so they are not complementary.

3.1 Interpello (Consultation)

Interpello is a mechanism that permits the administration to evaluate and have knowledge of a situation before the execution of tax audit. This is what BEPS Action plan 12 considers other disclosure initiatives and it is compatible with the description, given by this Action plan, for ruling regimes. The legal bases of *Interpello* are the law n. 212 of 2000, but the legislative decree 156 of 2015 has modified this kind of ruling.

The aims of *interpello* are the establishment of cooperation with tax administrations and the increase of taxpayers' accountability[22]. This instrument is useful to reduce the uncertainty of taxpayers about the application of tax rules or special regimes and it can simplify the job of the administration.

Every taxpayer can initiate this procedure: the time limits correspond to the moment in which the taxpayer has to make the tax statement relevant for the question of the *Interpello*, so it is an ex-ante remedy because after that taxpayer adopts a behaviour, he cannot ask the administration whether it is correct or not.

Interpello permits to ask to the administration how a complex norm should be applied in a concrete and personal situation when there is uncertainty about its interpretation. Application for this instrument has to include relevant facts, norms that should be interpreted and the solution that the applicant believes to be appropriate.

The administration asks for more information if it is not possible to correctly evaluate the situation, the taxpayer has to comply with the request to receive the decision by the public office otherwise the administration does not have a duty to deliver a decision of the *Interpello*.

The answer of the administration to the question proposed by taxpayers is not binding for who has asked, because it is a unilateral decision. On the other hand, the decision is binding for the administration that cannot blame taxpayers that have followed its decisions. The binding power is restricted to the case the decision has been given for and only if the circumstances described in the application are true. The administration has to give a ruling before the expiry of time limits, otherwise it means that the public office agrees with the interpretation proposed by the applicant[23].

There are four kinds of *Interpello*:

- *ordinario*: it is the classical form, it can be used to address questions about the application of tax norms if their interpretation is not clear or about the correct qualification of facts relevant for tax norms. The administration has to answer in 90 days

[22] for further details see FANELLI R. - Nuovo regime dell'interpello - basato sulla responsabilizzazione del contribuente - Corriere tributario n. 37/2015

[23] This mechanism is called "*silenzio assenso*" and it means that the silence of administration imply acceptance

- *Probatorio*: taxpayers that want to adopt special fiscal regimes can ask the administration if they met the necessary requirement and if the provided evidences are sufficient to apply the special regime. The administration has to answer in 120 days
- *Anti-abuso*: it is used to know whether acts that taxpayers want to adopt could be considered by administration into the scope of general or special anti-avoidance rule or not. The administration has to answer in 120 days
- *Disapplicativo*: its function is to ask the administration not to apply a fiscal norm whose aim is to eliminate tax avoidance because in the specific case at stake tax avoidance will not take place. Taxpayers have to describe their situation and explain why tax avoidance is not possible. The administration has to answer in 120 days

The *Interpello antiabuso* is the most relevant form for our discourse because it is strictly linked to the disclosure of aggressive tax planning. This instrument permits the administration to have knowledge of aggressive tax planning structure before the taxpayer implements it, in fact, most of these structures are in contrast with the anti-avoidance rule. Even other kinds of *Interpello* can catch some form of aggressive tax planning but not in the same way. *Interpello* lets the administration react: it can state the contrariety of these tax plannings to the Italian fiscal system and it can publish its decisions if they are relevant for a wide number of taxpayers.

The main problem of *Interpello* is that it is not mandatory so taxpayers can use it at their will. If taxpayers use this instrument it can be useful even to help the Italian legislator to adopt good rules against aggressive tax planning, but, in my opinion, too much is left to the taxpayers will and this instrument is not so effective against this problem.

3.2 Cooperative Compliance

The legislative decree n. 128 of 2015 introduced the *Adempimento Collaborativo* (Cooperative Compliance) into the Italian system. The report "Cooperative compliance: a Framework from enhanced relationship to cooperative compliance" made by OECD in 2013 has played a basic role for the implementation of

such an instrument. Before the law was approved, the government had tested an elementary form of cooperative compliance on some companies[24]; the aim of this was to include undertakings in the building of a compliance mechanism that they would use on voluntary bases.

The aim of cooperative compliance is underlined by the role that company have had in deciding the features of the mechanism, which was a role proper of the administration only. The *Adempimento collaborativo* has been the bravest action of the Italian legislator to swap the relationship of taxpayers with administration from distrust and conflict to cooperation, trust and dialogue. Thanks to this instrument companies have now the possibility to start an enhanced relationship with the administration, this permits undertaking to have a preferential channel to interact with tax authorities[25].

BEPS Action 12 includes cooperative compliance into the list of other disclosure mechanism, so to combat aggressive tax planning in another goal of this instrument.
As a tax compliance mechanism, the cooperative compliance has two other aims:

- promote the certainty of law in the tax field;
- decrease the usage of judicial procedure in tax field.

The *Adempimento colaborativo* is addressed to company that pay taxes in Italy and not to every taxpayer. The legislative decree n. 128 of 2015 restricts the access to undertakings that manage a business of above 10 billion euros. As we can see, it is a new instrument and the legislator decides to limit the possibility of access only to big company in this first phase. The cooperative compliance brings into Italian system a great innovation; this instrument will force the administration to radically change its way of acting, although it will need time to adapt itself to this change and to understand how this instrument work. The decision to limit the access to the compliance mechanism is essential to give the administration the time it needs to remain efficient and develop this new instrument in comfort. The objective of the Italian legislator is to

[24] For further details see ALBANO G. - Regime dell'adempimento collaborativo. un modello per la gestione del rischio fiscale - Corriere tributario n. 35/2015
[25] For further details see MELILLO C – Regime di adempimento collaborativo e monitoraggio del rischio fiscale: incentive, semplificazione e oneri – Diritto e pratica tributaria 2015

extend the undertakings allowed in next future; the foreseeable way is to decrease gradually the economic threshold to be part of the mechanism.

To be part of the cooperative compliance mechanism, undertakings must have a tax control framework, the norm does not specify which one because the framework could vary a lot from undertakings depending of their activity or organization but the law fixes some requisite[26]:

- it must clearly define positions and liabilities inside the company;
- it must state effective procedures of control, survey, management and measuring of tax risks;
- it must state effective procedure to solve problem in its functioning and to activate corrective actions.

The tax control framework is useful to make the decision making process on tax matter clear and accountable. The tax control framework has to be checked by the administration to decide its appropriateness. This system permits the administration to trust undertakings and to allow a simplification of tax duties.

Art 5 of the legislative decree lists the duties of administration and taxpayers necessary to enforce enhanced forms of communication and cooperation based on reliability.

The administration has to evaluate the tax control framework of undertakings in an objective way and following the principles of proportionality and reasonableness in order to define whether it is able to permit the achievement of goals of the cooperative compliance mechanism or not.

The administration has to simplify the tax compliance of taxpayers that adhere to the cooperative compliance. The Legislative decree does not list the simplifications for undertakings, but leaves the administration to decide them in an administrative act.

Undertakings that participate to Cooperative compliance can be considered reliable by the administration and, in order to be so, companies have to comply with stricter rules than competitors do. The stricter rules are a burden for companies, so the

[26] For further details see ALBANO G. - Regime dell'adempimento collaborativo. un modello per la gestione del rischio fiscale - Corriere tributario n. 35/2015

simplification of tax compliance is an incentive to adopt the cooperative compliance scheme.

The legislative decree that introduces the cooperative compliance provides new way of dialogue between administration and taxpayers. Who became part of cooperative compliance has now the chance to make an advanced discussion with the administration about situation of uncertainty. This leads to early resolution of tax dispute and also to foresee the tax audit and this constitute a great incentive to participate at the mechanism because two of the greatest problems that undertakings have in Italy are the uncertainty about the interpretation of laws and the slowness of public offices.

A special form of *Interpello* is provided for companies that adhere to the cooperative compliance mechanism. It can be used to ask question about the application of tax rules in concrete cases before the moment in which the tax compliance is due.

Features of this *Interpello* are the time that administration has to file an answer, which is of 45 days, and the fact that companies have to notify their behaviour if it does not comply with the decision of the administration. One more time, this increases the dialogue of companies and administration and it pushes them towards an enhanced relationship of cooperation.

Administrative sanctions for tax purpose are split in half for undertakings that participate at the cooperative compliance mechanism and fines are not enforceable since the audit become permanent; no guarantee is needed to tax reimburse for undertakings that comply with this procedure. These features of the cooperative compliance system are incentives to adhere at it and thanks to them undertaking will have economic advantages. These advantages are stated in the law because the legislator wants to make this instrument attractive for undertakings in order to make them adhere.

The cooperative compliance simplifies the job of the administration and it reduces the possibility to avoid the payment of taxes so it is better for the administration if a large number of companies decides to apply it. Another reason for the reduction of sanctions is that who adheres to the mechanism in exam has more duties with respect to other taxpayers, so the reduction is provided to balance this difference too.

Companies that have the previous mentioned requisite could ask the administration to enter into the *Adempimento collaborativo* mechanism. This request means that the undertaking wants to cooperate with the administration and it does not want to evade

taxes. This choice affects the reputation of a company, so, in order to make the consumer aware of this, the administration has a duty to publish in his website a list of the companies that adhere to the cooperative compliance.

Companies have two main duties, the first one is to answer the administration in the shorter time possible and the second one relates to the disclosure of aggressive tax planning. The undertakings under the cooperative compliance rule have a duty to notify the administration every tax avoidance risk, especially the aggressive tax planning scheme. Here there is a problem of interpretation, in fact, this is the only norm that quotes aggressive tax planning and does not say anything about them. The norm does not care of giving a definition or trying to make taxpayers understand exactly what aggressive tax planning means. This leaves the norm too much abstract and the administration cannot blame a taxpayer that has not disclosed an operation because in his opinion it was not aggressive tax planning. Neither a definition nor generic hallmarks are provided, in this situation the description of such a planning given in OECD or other international contest became relevant. The problem of these definitions is that they are too broad leaving the State free to decide the hallmarks that fits its jurisdiction. The aggressive tax planning is a tricky concept to define because of the risk of leaving certain actions aside, but the absence of definitions does not solve the problem.

The legislative decree n. 128 of 2015 states that *Agenzia delle Entrate* has to publish an act to define the practical matters of this norm, but it has not been published yet. It is foreseeable that the *circolare* will describe what an aggressive tax planning is and maybe it will state some hallmarks but it is not the best legislative source to do so.

Even if the law does not give any definition about aggressive tax planning, the norm obliges the administration to make a list in its website of schemes that can be deemed to be aggressive and to revise it periodically. In this way companies that applies the cooperative compliance mechanism will understand the tax planning to disclose reading the list. This approach is fragmented and is not so effective because a lot of schemes can be left out of the list.

The *Adempimento Collaborativo* has the above-mentioned criticality, but apart from these, it can be a useful tool to combat aggressive tax planning structures. The disclosure of aggressive tax planning allows undertakings to access other benefits such

as reduction of sanctions, shorter *Interpello*, advanced dialog about fiscal issue with administration, and the trust of public offices. This is a smart way to counterbalance the disclosure duties and companies will be strongly incentivised to adhere to cooperative compliance.

The efficacy of this instrument is not invalidated by the fact that only big companies can accede it, because in next future it will be extended to other ones. Not even the voluntary participation diminishes its efficacy thanks to the incentives provided for participating undertaking; also the public opinion can influence the accession to this instrument.

The way of thinking of tax administration can determine the success of this instrument. In fact, the cooperative compliance revolutionizes the relationship between taxpayers and administration; so if the public offices does not change the way in which their job is done, undertakings will not find the instrument convenient. In the end, the question remains whether the administration will be capable of becoming modern or not.

The *Adempimento collaborativo* goes towards the right way to combat aggressive tax planning and if the above-mentioned problems will be avoided, this instrument can be more effective than a mandatory disclosure rule. Repressive rules are needed to punish aggressive tax planning and the more these are effective, more easily the cooperative compliance can become a "win-win" mechanism.

4 Exchange of information

The exchange of information is a subject that is being of central importance to combat tax avoidance and aggressive tax planning. Multinational companies are more likely to adopt aggressive tax planning and the easiest way to do so is to take advantage of gaps in coordination of tax system between States[27].
The matter of aggressive tax planning will decrease its importance if States will be able to exchange useful information in a fast way. States and international organizations are now aware of this and are trying to give birth to interesting projects, such as the

[27] For further details see VALENTE P. – Aggressive tax planning: profili elusivi delle transazioni finanziarie – Il fisco 2013

multilateral competent authority agreement on automatic exchange of financial account information, the foreign account tax compliance act and European directive n. 16 of 2011.

4.1 The European directive on exchange of information

The European Union has published a directive about the exchange of info between Member States. The level of cooperation that European States have is remarkable; because of this, the implementation of such a wide system of exchange of information has been possible.

Italy has implemented the directive with the legislative decree n. 29 of 2014, its core is the division of exchange of information in three kinds:

- Exchange of information on request: a Member State can request an information that is foreseeably relevant to the administration or enforcement of the domestic laws to the Member State that has it or can have it through an administrative enquiry. If the requested administration does not have the information but it has the power to meet the request, the administration has to begin an enquiry and give the information within six months
- Mandatory automatic exchange of information: the competent authority by automatic exchange shall notify periodically to other Member State certain available information about residents of the receiving Country. The information that relates to the following categories of income and capital have to be sent: income from employment, director's fees, life insurance product not covered by other instruments, pensions, ownership of and incomes from real estate.
- Spontaneous exchange of information: the competent authority has to communicate to the interested Member State information that can be useful for it to avoid a foreseeable loss in tax revenue.

Among States that are member of European Union the European directive has overtaken the art 26 of OECD model convention,

The quantity of information that has to be exchanged is considerable and even if there are no specific references to aggressive tax planning the useful information, to

detect such a scheme, are not left aside. The problem remains the availability of information for national administration and the capability to obtain them with administrative enquiry.

4.2 Exchange of information in double conventions against double taxation

The aim of this paragraph is to understand whether art 26 of convention against double taxation signed by Italy permits the exchange of information related to aggressive tax planning.

Talking about States that are not European Union's members, conventions signed by Italy provide only one kind of exchange of information: the exchange on request. This limits the number of information exchanged, but what really has a strong impact on the possibility to have information about aggressive tax planning is the reason the information can be asked for. Some conventions limits the exchange on information that are useful for the application of the convention's norm and national laws[28]; others have a wider scope, in fact these include even the possibility to exchange information to combat fraud or tax avoidance[29]. The extension of grounds for the request of information to tax avoidance permits contracting States to ask information to discover aggressive tax planning if these turn to be a kind of tax avoidance.

Explicitly mentioning the possibility to request information to discover aggressive tax planning directly in art. 26 of the conventions against double taxation would be a big step against this phenomenon.

4.3 Automatic exchange of information

In recent years, the adoption of a system of automatic exchange of information between OECD members has become a reality. One of the best achievement in this direction is the FATCA convention signed by Italy with U.S.A. that permits the automatic exchange of information relating to resident of the other State about bank

[28] Australia, Russia, Hong Kong, etc.
[29] Canada, South Korea, Qatar, Mauritius, etc.

accounts[30]. The financial institution has to communicate to the Italian administration and the last one to the American competent authority.

Another interesting instrument is the "Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information" that is not working yet. Italy is part of the first group of States that will adopt this agreement and it has proposed an early adoption of this instrument. The provision is that this agreement will be implemented from 2017 on.

These last two examples show a clear tendency to take the exchange of information and in general the cooperation in fiscal matter at an upper level. About the information concerning aggressive tax planning arrangements, the previously mentioned improvements did not have a big direct impact. What can be a turn in this matter is the adoption of a system of spontaneous exchange of information similar to the one provided in directive n. 16 of 2011 for European States. This could force Countries to communicate information in its possession that can be useful to detect tax avoidance, an increase of due taxes or a loss of tax revenue in other Member States; all these phenomenon can be symptomatic of an aggressive tax planning.

It is common opinion that companies that operate in different countries find easier to evade taxes with respect to the ones that operate at national level. It is in the first kind that the phenomenon of aggressive tax planning is spread: this is the reason why the improvement of cooperation and exchange of information among States is fundamental to solve this problem.

The exchange of information is an activity that can hinder rights of taxpayers[31] and the European Court of Justice in the "Sabou" case of 2012 has taken into account this issue. In particular, the Court has solved the problem on whether taxpayers have to be informed about the exchange of information or not. The Court states that the exchange of information is an instrument of enquiry and it can not produce negative consequences, so European States are not obliged to inform taxpayers about the request of information or about their exchange. It would be the receiving State that has to give the taxpayer his right of defence if it wants to adopt a measure that affects him. In Italy

[30] For further details see DELLA CARITÀ A. - Evoluzione del contesto internazionale in materia di scambio di informazioni tra stati e ulteriori prospettive future - Corriere tributario n. 15 del 2014

[31] For further details see FERNÀNDEZ MARÌN F. - *La tutela nazionale del contribuente nello scambio comunitario d'informazioni* - Rassegna Tributaria n. 6 del 2014

there is no right to know if information about a taxpayer has been asked or given to others.

5 The desirable mandatory disclosure rule

BEPS action plan 12 seems to be very recent; this is one of the reason why Italy has not adopted a mandatory disclosure mechanism. In fact, this country very often implements OECD's instruments in its jurisdictions but the process to enact laws and make the instrument working needs time.

In the next paragraphs, a possible scheme of mandatory disclosure rule for aggressive tax planning that could fit Italian system will be worked out.

First of all, the duty to disclose would be on the promoter unless there is a particular situation as a professional privilege, where there is no promoter; in these case the obligation will be on users.

A threshold is necessary: it can be related to the monetary dimensions of operations or to the total revenues of taxpayers in the previous year. The second kind of threshold will have the consequence to divide undertakings in two kinds:

- the ones that earn above the threshold have to report the information;
- the ones that earn below the threshold have no duty to report.

About what has to be reported, this is the most complex topic of such a regulation because the legislator has to be careful not to leave gaps in the definition, otherwise it will be too easy for undertakings to find schemes to avoid the payment of taxes that have not to be reported.

A mixture of general and specific hallmarks would be desirable, but the first ones have to be mentioned in a law while the second ones need to be in a position that permits the administration to change them quickly. A ministerial regulation can be the right legal basis for specific hallmarks because it can be easily changed and it has binding force. Here it is not possible to describe specific hallmarks because they have to target a particular aggressive tax planning strategy, while some useful general hallmarks can be:

- confidentiality hallmark: a transaction in which the promoter or advisor places a limitation on the taxpayer's disclosure of tax strategies that he has proposed; those tax strategies should be disclosed;
- contingency fee hallmark: a transaction for which the promoter's fees are contingent on the taxpayer's realization of tax benefits from the transaction; those benefits should be disclosed[32].

The hypothetical application of hallmarks can represent a problem because it extends the number of transaction that has to be disclosed and above all, it leaves a degree of uncertainty about what schemes are included in the hallmark. This is an unwanted result, so at the beginning it is better to avoid misinterpretation of the disclosure rule limiting the application of hallmarks only to defined situations.

The moment when the information has to be reported would be the decision to implement an aggressive tax planning arrangement because if the disclosure has to be made at the moment of implementation, it would be too late. While if it had to be done when the scheme became available, the administration would receive useless information.

The sanction for non-compliance would be financial penalties, in tax matter this kind of sanction is the most effective. The amount of penalties should be proportionate to the tax benefit that the undertakings would have reached through the aggressive tax planning.

6 Future perspectives

In the end, the question is whether a disclosure rule is appropriate for Italian system. A preliminary consideration that would be interesting is that most of the countries that have implemented such a disclosure rule have a common law system, so the problem of compatibility of this instrument in civil law countries can arise.

The duty to report information included in the mandatory disclosure rule can go against the privilege of certain professional figures that under Italian law cannot disclose information about their clients. Above this, even taxpayers in certain situation

[32] pag. 34, 35 of BEPS action 12, parts that refers to US legislation

cannot be obliged to disclose information. This happens when the information is an evidence that the taxpayers has violated a criminal law, this principle is called "*nemo tenetur se detegere*" and it is stated in different articles of the code of Italian procedural criminal law[33]. This is an issue, because these obstacles can decrease the efficiency of a mandatory disclosure rule; on the other hand, these principles cannot be overstepped by the disclosure rule because are core principles of the Italian law system.

The disclosure rule imposes a burden on taxpayers and it does not give any benefits; this seems to be a norm that goes back to the basic relationship between administration and taxpayers. In fact, the result is that administration does not ask for cooperation but imposes a disclosure of certain information. This is contrary to one of the main goals of OECD that is to transform a hostile relationship in a bond of trust and cooperation.

The mechanism of cooperative compliance and *Interpello* already implemented by Italy comply with the OECD's aim and they are useful to combat aggressive tax planning. Therefore, instead of adopting a disclosure rule Italy could focus on the instruments that it has adopted trying to improve and extend their application. This can be an opportunity for Italian administration to modernize itself, instead of remaining devoted to an old-fashioned way of working.

An option can be to extend the application of cooperative compliance and to better specify the duty related to disclosure of aggressive tax planning included in this instrument. This has to be supported by an inflexible application of the general anti avoidance rule, because if it is effective it will be much convenient for taxpayers to adopt the cooperative compliance mechanism.

The focusing of BEPS project on the mandatory disclosure rule is a sign that there is no faith in other disclosure initiatives; in fact, this seems to be a fast and complete way to tackle aggressive tax planning but it may be not the only one to reach the objective.

[33] art. 63 CPP Dichiarazioni indizianti, art. 64 CPP Regole generali per l'interrogatorio, art.198 CPP Obblighi del testimone etc.

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Potential impact of BEPS on Tax Systems

Transfer Pricing in a post-BEPS World

Luigi Spinello

112913

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INTRODUCTION

Globalisation has resulted in an increasing number of multinational enterprises (MNEs) and intra-group transactions between different countries. Transfer pricing, the pricing of transactions carried out between enterprises members of the same group, remains the most important international tax issue MNEs are facing and also presents increasingly complicated problems to tax administrations, particularly in developing countries.

The transfer price manipulation is infact today one of the most frequent techniques used by corporate groups to avoid taxation in the international scope.

The OECD, has made useful efforts to develop a common approach to the application of the arm's length principle, which governs the tax treatment of transfer prices.

In fact, following the release of the report "Addressing Base Erosion and Profit Shifting" in February 2013, the organisation and the G20 countries, adopted a 15-point Action Plan that tried to introduce coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards, and improving transparency as well as certainty.

Through these, Actions 8-10 were fully dedicated to the transfer price matter. Since then, all G20 and OECD countries, Italy included, have worked on an equal footing and the European Commission also provided its views throughout the BEPS project.

In the last October, after about two years of work, the 15 actions have been now completed. The third chapter of the present study deals precisely with the BEPS project recommendations, going through the Final Reports on Actions 8-10 on transfer pricing and the updated chapters 6-8 of the Transfer Pricing Guidelines.

At the moment, following the presentation in Autumn 2015 of the BEPS measures package by the OECD, Italy continues to confirm its intention to introduce new tax rules by way of implementation of internationally shared ideas, bringing its own legislation into line.

In this sense, during the last two years, the Italian fiscal system has been deeply modified in accordance with the delegation law n. 23/2014, which has conferred

the power to the Government to realize a "*more equal, transparent and oriented to growth fiscal system*".

One of the central issues of the delegation law is the revision of the discipline regarding transboundary operations. Nowadays, according to the delegation law provisions, eleven legislative decrees have been supplied. The present paper describes most of those provisions, but since now, it's useful to notice that several measures have been provided following the OECD BEPS project recommendations and further are expected to come.

With regards to the relationship between the OECD work and our national regulations, we notice that Italy makes full reference to the recently updated Transfer Price Guidelines and our treaty network includes most

of the OECD Model Convention dispositions. This latter aspect will be better analyzed in chapter II.

In addition, our national transfer pricing rule for the evaluation of transactions carried out between associated enterprises, the so called "normal value", follows the arm's length principle stated by the organization. The first chapter of the present work purposes to better describe the normal value discipline, its evaluation methods, and more in general the whole transfer pricing national regulations.

CHAPTER I
TRANSFER PRICING AND DOMESTIC LAW

1. National Transfer Pricing Rule: Regulation Basis

The Italian juridical system, similarly to most other countries, has provided for a specific regulation in the transfer pricing matter, in order to prevent tax avoidance operations through taxable income transfer to less taxed countries.

The transfer price manipulation is infact today one of the most frequent techniques used by corporate groups to avoid taxation in the international field.

In this background, our legislator has provided for a special discipline reserved to the adequacy of goods and services transfer prices applied in transactions among two different corporates which are part of the same group, but resident in different states[1].

In particular, statutory rules on transfer pricing are set out in art. 110 (7) and art. 9 (3) of the D.P.R. December 22 th1986 n° 917 our Income National Revenue Code (hereinafter "T.u.i.r.").

Extreme importance also have the following interpretative sources provided by our Income Revenue Authority (Agenzia delle Entrate) :

- Circular 22th September 1980 n° 32, in which an interpretation of the concept of related party is given ;
- Circular 12th December 1981 n°42 , which provides criterion for fair value determination ;
- Circular 10th December 2010 n.58/E on the transfer pricing documental regime ;
- Circular June 5th 2012 n° 21/E which deals with dispute resolution mechanism.
- The Decision of the Commissioner of the Italian Revenue Agency, September 29 th 2010.

Article 110 (7) of T.u.i.r., states that "*Elements of income arising from transactions with non – resident companies which control – directly or indirectly – the enterprise, or are controlled by the enterprise or by the same person controlling the enterprise, are evaluated, in accordance with par. 2 of this article,*

[1] TESAURO F., *Istituzioni di diritto tributario – parte speciale* , Padova , 2012 p. 149.

on the basis of the normal value of the goods supplied, the services rendered and the goods and services received, if they produce an increase in taxable income; this provision shall also apply if the result is a decrease in taxable income, but only in compliance with agreements concluded by the competent authorities of foreign states in accordance with mutual agreement procedures provided for by international conventions for the avoidance of double taxation."

The present disposition is also appliable to "*goods transferred and services rendered by non resident corporates on behalf of which the enterprise carries out selling activities and placement of raw material, goods or output production or manufacturing*".

In the next paragraphs we analyze the requirements of the national transfer pricing rule in a closer way.

2. Subjective requirement

This said, according to art. 110 (7) of T.u.i.r., the transfer pricing rule is applicable to commercial transactions among a resident enterprise and non resident enterprises which – directly or indirectly:

- controls the italian enterprise ;
- are controlled by the italian enterprise ;
- are controlled by the same parent of the italian enterprise

Pursuant to the Income Revenue Authority clarifications[2], with the expression "resident enterprise" the Italian legislator wanted to include "*whoever professionally carries on economic organized activity aiming to produce, or exchange, some goods or services*" making, in this sense, express reference to art. 2082 of the civil national code which includes the definition of entrepreneur. The definition set out by the civil code has to be regarded to the effective enterprise activity, overlooking the juridical form of the subject which carries out it. In the term "enterprise", hence, are included all kinds of commercial company,

[2] Circular letter n°32/1980.

individual enterprises and non resident permanent establishments, as well as, all legal subjects able to product business income.[3]

Art. 110 T.u.i.r. also makes reference to the "non- resident enterprise" ; this expression has been interpretated by the Income Revenue Authority too. [4] The Authority specifies that the mentioned phrase includes all operations carried out with offshore subjects, regardless the form assumed by the legal body, be this a permanent establishment or the household.

Moreover, the Italian Authority has clarified that the term "enterprise" includes every sort of commercial organism recognized in the third country, even though it doesn't hold the plurisubjective requirement .[5]

3. The related party definition

The Italian fiscal system takes into consideration corporate groups for multiple aims, making use, of a specific definition of control in every different case. Infact, our national laws does not include a juridical notion of "group" which has a general validity.[6]

However, frequently used definition of "control" is provided by art. 2359 of the italian civil code which defines a subsidiary as:

1) a corporate in which another equivalent, holds shares that grant the majority of the votes in the ordinary shareholders' meeting (*internal law control*).

2) a corporate in which another equivalent has available a number of votes sufficient to exercise a leading influence in the ordinary shareholders' meeting (*internal de facto control*).

3) the enterprise under leading influence of another equivalent due to particular contractual restictions (*external factual control*).

The fiscal legislator, in some cases, explicitly recalls the mentioned civil code definition, adopting in this way a restricted notion of control[7], while, in others, a

[3] According to art. 55 t.u.i.r..

[4] The mentioned circular n°32/1980.

[5] Such as the French Groupement d'Intèret Economique the German Arge and the Anglosaxon originary trusts.

[6] TESAURO G. *Istituzioni di diritto tributario – parte speciale*, *op cit,* p.150.

[7] e.g. art.. 120 t.u.i.r. (consolidated enterprises) with other requirements.

wide notion of group is used in order to define the field of interest of the antielusive rules throguh which the transfer price one is included.
However, if we have a better look at par. 7 of art. 110 T.u.i.r., it seems clear how the national statutory law does not make any reference to the mentioned art. 2359, highlighting in this way the legislator will to not bind the fiscal notion of control to the civil one. Furthermore, the OECD Model Convention (hereinafter OECD model), at art. 9, does not provide for any definition of control, leaving, instead member states free to adopt the definition they consider the most adequate.[8]
Those circumstances caused a vibrant debate in the Italian doctrine with regards to the most appropriate definition to apply to the phrase.
Earlier before, some authors[9] considered that notion provided by our national civil code was the only applicable.
Hereafter, with the Circular letter n.32/1980, the Italian Income Revenue Authority has supplied a punctual interpretation of the idea of control, stating that the phrase included in art. 110 t.u.i.r. is not exclusively referrable to the meaning provided by art. 2359 of the civil code. The Authority, infact, clarifies in its measure that, what matters in the "control" definition are not only the formal requirements that the civil code article recalls , but alse mere factual situations ; the referral is to those connection situations made up by an economic influence of a corporate on the business decisions of the other equivalent one. In particular, the Income Revenue Authority notices that the connection criterion which causes the alteration of transfer pricing in practice, is very often constituted by the economic influence of an enterprise on the business decisions of the other equivalent, which goes beyond the contractual and shareholding bonds. In this sense the circular letter contains a list of circumstances in which the control position is determined by a potential or actual economic influence.[10] It follows that, the transfer pricing

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[8] UCKMAR V. – CORASANITI G. - DE CAPITANI P. – OLIVA C., *Manuale di Diritto Tributario Internazionale*, Padova , 2012, p. 323.

[9] MAYR S., *La rettifica dei costi e dei ricavi ex artt. 53 e 56 d.p.r. 597/1953 (I parte) presupposti soggettivi,* in *Boll. trib.,* 1975, p.1245; LICCARDI E., *I prezzi di trasferimento nella determinazione dei redditi delle imprese multinazionali*, in *il Fisco*, 1981, p.2396; SACCHETTI G., *Sui presupposti per ricondurre a valore normale costi e ricavi nelle relazioni fra imprese residenti e non residenti*, *retro* , 1997, II, p. 549.

[10] Through these:
a) exclusive sold of products made by the other enterprise:

rule shall find application not only in the control hypothesis set out by art. 2359 of the civil code, but also in any other case of potential and actual economic influence inferable from the single circumstances.[11]

Nevertheless, even though this wider definition of control appears more suitable in connection with the aims followed by our fiscal legislator, the italian jurisprudence has sometimes interpreted this concept exclusively in a civil law sense.

In those terms stated the Alessandria Tax court of First Instance in the 1416/1995 sentence, claiming that the relevant concept of control which should exclusively used in the application of the transfer pricing rule is the one included in the article 2359 of our national civil code.

In a similar way, and more recently, the Gorizia Tax court of First Instance in the 83/2013 decision stated that « The notion of control which article 110 (7) makes reference correspond substantially to the art. 2359 one. »

Therefore, although the prevalent opinion is inclined to extend the notion of control, according to transfer pricing, even to mere economic phenomenons, according to the mentioned jurisprudence we cannot exclude that in a potential judgement this idea could be limited only to the specific hypotesis provided by article 2359 of our civil code.[12]

4. The arm's length principle in our national legislation: the normal value.

In the previous paragraphs it has been told that the national intercompany price rule operates when an Italian corporate transfers goods or renders services to a foreign subsidiary company and, in the transaction among them, the price applied

b) inability of the enterprise to functioning without capital, products and technical
c) cooperation of the other enterprise (e.g. joint ventures)
d) common members of the board of the directors
e) right to nominee the b.o.d. members or the managers of the corporate
f) family relationships among the parties
g) prevalent financial dependency.

[11] However if we look at art. 9 of the OECD Model (see chapter II for further details) it looks evident that this definition is wider than the Italian "provision". Moreover, the idea of control expressed in the circular letter n°32/1980 is confirmed also in European envorinment.

[12] GAGGERO A., *Il transfer pricing(1992-2015)* in *Dir. Prat. Trib.*, n. 5 del 2015, p. 984.

is lower than the normal value, in order to shift profits in other countries with lower taxation.

In addition, we explained that the transfer pricing national rule is applicable even when an Italian enterprise buys goods or services from a subsidiary, paying a higher price than the normal value.[13]

In order to contain these issues, the Italian tax system, does not take into consideration the arranged prices between the companies, but market values established with abstract criteria ; if the entreprise produce a taxable income increase, arranged prices are evaluated on the basis of the so called "normal value". The Italian enterprise that has not quoted a compliant price to the normal value has to operate increasing adjustments in its tax statement. If the adjustment is not made by the enterprise, the Financial Administration is able to adjust, in increase, the sales revenue lower than the normal value. To better describe this latter, we need to make reference to article 110 (2) T.u.i.r. which resends back to art. 9 (3) of the same Legislative Decree.

Pursuant to the definition provided by this article for "normal value" is intended: the price or consideration charged on average:

- to goods and services of equal or similar kind ;
- at arm's length and at the same marketing stage ;
- at the time and place the goods and service have been purchased or supplied (and where such information is lacking, at the nearest time and place.).

As far as it is possible, for determination of the normal value, reference is made to the price lists or tariffs of the person supplying goods or rendering services and, where such information is lacking, to the markets-lists of the Chamber of Commerce, as well as to professional tariffs, taking into account distributor discounts. For goods and services subject to price control, reference is made to the regulations in force.[14]

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[13] The applicability of the art 110 (7) to transactions among tesident enterprises will be discussed in par. 6.

[14] Art 9 (4) completes the normal value definition, according to other goods:
"Normal value is determined: a) 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; b) for other shares, participations of companies not limited by shares, and for securities or shares representing participations in the capital of entities other than companies, in proportion to the company or entity net worth or, for newly established companies or entities, to the total amount of

If we better look at our national rule, it appears very clear how the idea of normal value contained in art. 9 (3) acknowledges the arm's length principle suggested by the OECD to determine the goods' transfer price. The same Italian Authority has explicitely cleared in the circular letter n°32/1980 (hereinafter "the circular") , that "the legislator , through the definition of normal value contained in our national legislation has dopted the arm's length principle suggested by the OECD to determine the transfer price, that would have actually been arranged for similar transactions by independent enterprises".

4.1 Methods applicable to the normal value identificaition.

The Italian Financial Administration[15] stated that for the identification of goods and services normal value, is it possibile to make full reference to the OECD Transfer Pricing Guidelines.

According to these, two different types of method are available to establish whether the conditions imposed in the commercial or financial relations among associated enterprises are consistent with the arm's length principle:

1) Traditional transaction methods[16] (Basic Methods)

Comparable Uncontrolled Price ;

Resale minus ;

Cost plus

2) Transactional profit methods[17] (Alternative Methods):

-Transnactional net margin (TNMM);

-Profit Split

First of all, and before examining in a closer way the listed methods, it's useful to notice that Transfer Pricing Guidelines have been updated in 2010 by the OECD. This last version replaces the 1995 Guidelines and the firm hierarchy methods principle established into it; infact in the previous version an expressed preference

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the contribution of capital; c) for bonds and securities other than those referred to in the above subparagraphs a) and b), 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.".

[15] Circ. n°32/1980.

[16] As defined in Chapter II, part II of 2010 OECD Guidelines.

[17] As defined in Chapter II, part III of the 2010 OECD Guidelines.

in application was given to the CUP method, whereas the Resale Minus and Cost Plus methods were applicable only secondary. Moreover, transactional profit methods were considered as "last resort methods"; their application was limited to extraordinary situations in which no sufficient information regarding independent transactions was available or considered unrealiable or , furthermore the traditional methods were unapplicable.[18] Instead, today, the new Transfer Pricing Guidelines do not contain any sort of methods hierarchy, but a new selection criterion: the so called "best method". According to this latter, the selection of a transfer pricing method shall always aim to find the most appropriate method for a particular case.

For this purpose, the selection process should take account of the respective strengths and weaknesses of the OECD recognised methods ; the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis ; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods ; and the degree of comparability among controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them. "*No one method is suitable in every possible situation, nor is it necessary to prove that a particular method is not suitable under the circumstances.*" [19]

From an Italian point of view, however, the Decision of the Commissioner of the Italian Revenue Agency, September 29 th 2010[20] , states that in case of selection of a transactional profit method and in presence of a potential use of a traditional transaction method, is needed to motivate the exclusion of this last method. A similar motivation is needed even in the case of selection of a different method from the CUP, in presence of a potential use of this last method.

According to a big part of the doctrine is it still possible to talk in terms of "internal hierarchy", seen that, the taxpayer, according to the "best method" rule

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[18] *OECD, Transfer pricing Guidelines for Multinational Enterprises and Tax Administrations,* Paris, 1995, par. 3.50: "*in such cases of last resort, practical considerations may suggest application of a transactional profit method either in conjunction with traditional transaction methods or on its own.*

[19] With reference to. *OECD, Transfer Pricing Guidelines,* Paris, 2010 , par. 2.2 – 2.3

[20] With reference to page 6.

is able to adopt the most appropriate method for the particular case, even though this is not specified in regulations (Other method). In this case, however, he is obliged to explain the reason why the suggested methods were less suitable to the practical case.
After this brief but essential introduction, we take a closer look at the previously listed methods.[21]

4.2. Traditional transaction methods:

Pursuant to the OECD definition, traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and financial relations among associated enterprises are established at arm's length. This is because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and the arm's length conditions can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction. The application of the three mentioned basic methods is advised in particular for material goods transfers. The application of those methods is much more complicated in transactions regarding intangibles, that due to their distinctiveness and peculiarity are difficult to compare with others.

[21] For further information on the methods below see, VALENTE P., *Manuale del Transfer Pricing,* Milano *, 2015 ,* p. 2141 ss ; VALENTE P., DELLA ROVERE A., SCHIPANI P., *Analisi di comparabilità nel transfer pricing: metodologie applicative*, Milano , 2013 p. 123;WITTENDORF J., *Transfer pricing and the Arm's Length principle in International Tax Law , Kluwer Law International BV*, 2010; BORKOWSKI S. C., *Choosing a transfer pricing method: A study of the domestic and international decision making process* , in *Journal of International Accounting,Auditing and Taxation,* Volume1, Issue 2 , 1992 ; HUGHES E., NICHOLLS W., *The different methods of Tp: pros and cons* , 28th september 2010 , in http://www.taxjournal.com/tj/articles/different-methods-tp-pros-and-cons; ELLIOT J., EMMANUEL C., *International transfer pricing: searching for patterns, in European Management Journal,* Volume 18 , Issue 2, April 2000 , p.216 ; AMERKHAIL V., *Functional Analysis and Choosing the Best Method* , in *Tax Management Transfer Pricing Report*, 16th may 2007 ; SILVA A. E., *Transfer Pricing under Gross Profit Methods: Adjustments for Functions performed* , in *Global Transfer Pricing,* August-September, 1999.

4.2.1. Comparable Uncontrolled Price (CUP)

According to the CUP method, the adequacy of the transaction is verified by comparing the price under examination with the charged price for property or services transferred in a comparable transaction between independent enterprises (external comparison), or one of the enterprises which carried out the transaction and an independent company(internal comparison).

Art. 9 T.u.i.r. clearly gives preference to the internal comparison[22], whilst the external comparison is merely considered secondary.[23]

The same Italian Income Revenue Authority clarifies[24] that the internal comparison is preferrable, because it makes more probable the comparison with similar transactions, whilst, where the reference market is foreign, the external comparison raises some criticism in search of these objectives. To identify comparable transactions, what is it considered relevant, the goods beneficiary market.

Furthermore, in the comparison between transactions other elements, such as goods quality, transport, advertising, seller general conditions will be crucial. [25]

4.2.2. The Jurisprudence position

In addition to the Italian Income Revenue Authority, the Italian Courts, as well, suggest to resort to the CUP method and in particular to the internal comparison.[26]

The Court of Cassation (judgement n.22010/2009) has stated that: «Through the different criterion indicated in the 1995 OECD Model to the evaluation of the commercial transactions prices between associated enterprise of a multinational group, the Italian legislator has selected the comparable uncontrolled price method, whose discipline is included in the first and second part of article 9 (3)

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[22] For determining the normal value, infact , the mentioned article speaks about *"as far as it is possible, to the price lists or tariffs of the person supplying goods or services"*.

[23] And "*where such information is lacking, to the markets-lists of the Chamber of Commerce as well as to professional tariffs, taking into account distributor discounts*".

[24] Circ. n°32/1980.

[25] In case of different features it will be possible to make adjustments.

[26] For a complete landscape of the jurisdiction in this matter see GAGGERO A. *Il transfer pricing (1992-2015) , cit.* , pp. 986-989.

T.u.i.r.»

Over the years, with the decisions 17953/2012, 22010/2013 and 24005/2013[27], the Supreme Court has continued to express the same interpretation on the matter. The last decision looks, between the others mentioned, the most complete to well understand the most recent thoughts of the Court :

«In the application of the CUP is needed to give preference to the so called internal comparision, based on the price lists or tariffs of the subject supplying goods or services in the transaction between the subsidiary and an independent enterprise. Only secondary, the Financial Administration should make reference to the markets-lists of the Chamber of Commerce as well as to professional tariffs in examining the comparable transactions between independent enterprises (external comparision) belonging to the same market. Exclusively in a suppletive and lastly way, then, the Administration could make use, according to the first part of article 9 (3), of the price charged on average to goods and services of equal or similar kind, at arm's length and at the same marketing stage, at the time and place the goods and services have been purchased or supplied and, where such information is lacking, at the nearest time and place ; being those determined from foreign markets closer to the national seller's market. »

In addition, in the cited decisions, the Supreme Court also highlights how the CUP method could, sometimes, have limited application in practice ; this could happen due to the difficulty in finding perfect comparables and, as a result, this method will be not applicable to the operations under investigation. In those cases the Court admits the application of the other methods included in the 2010 OECD Guidelines that we are analysing.

4.2.3. Resale minus method

The Italian Financial Administration states, in the circular letter, that if the CUP method results not applicable due to the features of the transactions we are dealing with, is it then possible to make reference to the resale minus method.

[27] A more complete comment of the mentioned decisions is available in VOZZA A. *Prospettive giurisprudenziali sulle rettifiche del "Transfer Pricing" fondate sui metodi reddituali* in *Corr. Trib* n° 25/2014, p. 1952.

The resale price method begins with the price at which a product, that has been purchased from an associated enterprise, is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin on this price (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated enterprises.[28]

To determine the resale price margine, it's clear that a similar resale should be found. According to the Italian Financial Administration, into evaluating the similarity of the transactions it should consider:

a) the type of the good sold ;

b) functions carried out by the reseller in relation to the good which is going to be resaled ;

c) effects of particular functions on the resale price (e.g. intangibles incorporation);

d) geographical market in which functions are carried out also in relation to the enterprise business politics.

In the case the reseller is carrying out a general brokerage business, the resale price margin may be related to a brokerage fee, which is usually calculated as a percentage of the sales price of the product sold. The determination of the resale price margin in such a case should take into account whether the broker is acting as an agent or a principal.

The OECD Guidelines highlight that this method is probably most useful where it is applied to marketing operations. Its application will be considered less appropriate if the goods are subject to another manufacturing production or incorporated in a more complex product.

4.2.4. The cost plus method

[28] With specific reference to parr 2.21 to the 2010 OECD Transfer Pricing Guidelines.

The cost plus method can be used when the subsidiary does not limit its duty into selling the product but also transforms it.
This method begins with the costs incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to an associated purchaser. An appropriate cost plus mark up is then added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.
The cost plus mark up of the supplier in the controlled transaction should ideally be established by reference to the cost plus mark up that the same supplier earns in comparable uncontrolled transactions ("internal comparable"). In addition, the cost plus mark up that would have been earned in comparable transactions by an independent enterprise may serve as a guide ("external comparable").
Likely the resale minus method , the Italian Income Authority restates that, the most relevant factors to determine the similarity of the transaction are:
a) the type of the good sold ;
b) functions carried out by the reseller in relation with the good which is going to be resale ;
c) effects of particular functions on the resale price (such as intangibles incorporation) ;
d) geographical market in which functions are even carried out in relation to the enterprise business politics
This method, probably, is most useful where semi-finished goods are sold between associated parties, where associated enterprises have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is constituted by the provision of services.
In addition, the Italian Income Revenue Agency, having regard to the complexity of the evaluations to make following the cost plus method, does not suggest its application in cases of transactions between an italian subsidiary and a foreign household: in this case it could not be possible to have available adequate

knowledge according to costs systems, functions carried out and utility margins practiced in the foreign country.

4.3. The "Alternative methods": introduction

If no one of the three basic methods earlier analyzed cannot be applicated in a particular case (due to the lack of comparable situations or to the impossibility to make a comparision between the sell operated by the subsidiary and another one conclued between independent subjects), the circular letter considers applicable the so called alternative methods.
More in particular, the Financial Administration cleared that those methods are applicable:
- subsidiarely, in the case
a) that after the application of one of the three base methods uncertainty arises;
b) there is in need to identify the differential element between two transactions to apply one of the three methods;
-alternatively, if the basic methods results unapplicable.

4.3.1. Transnactional net margin (TNMM)

The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction.
Thus, a transactional net margin method operates in a similar manner to the cost plus and resale price methods. This similarity, means that, in order to be applied reliably, the transactional net margin method shall be applied consistently to the manners in which the resale price or cost plus methods are applied. This means, in particular that the net profit indicator of the taxpayer from the controlled transaction (or transactions that are appropriate to aggregate)
should ideally be established by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions, (e.g. by reference to "internal comparables"). Where this is not possible, the net margin that would

have been earned in comparable transactions by an independent enterprise ("external comparables") may serve as a guide. A functional analysis of the controlled and uncontrolled transactions is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results.

The Italian Income Revenue Agency, claimed in the circular, that this method is not suggested both for the high grade of relativity and discretionality that can follow, but also because it does not take into consideration market conditions and the economic situation of the enterprise in general. Moreover, this method could imply the abandonment of the juridical-fiscal autonomy principle of the single enterprises, to endorse the princple of the fiscal unity.

4.3.2. Transactional profit split method

According to this criterion, the global enterprise profits, calculated as percentage of the income related to sales or operating costs, are compared with those earned by another subject operating in the same economic branch.

The comparison is made determining the gross sample profit of every enterprise, expressed in percentage terms, in relation to the sales business amount or operating costs.

The Financial Administration provided for some exemplifying criteria, in order to address itself in the use of the transactional profit split method:

a) the comparison should have, as exclusive aim, the income realized by the enterprise through goods sale or services rendered ;

b) the comparison should take into consideration the specific branch in which the checked enterprise operates. (A comparison with more enterprises is recommended);

c) the comparison should also have regard to profits realised by foreign enterprises. This analysis could be carried out by the Financial Administration in coperation with other competent authorities. (e.g. through the exchange of information) ;

d) the comparison should be extended to more than the single fiscal year, in order to better appreciate the effects of the cyclical economic fluctuations which are part of every financial system;
e) compared enterprises should present, as far as possibile, equal dimensional features;
f) the comparison should take into consideration, analytically, single tasks carried out by the enterprises (distribution, advertising, ecc.), that sometimes are delegated to the buyer/distributor.
The main strength of the transactional profit split method, is that it can offer a solution for highly integrated operations according to those a one-sided method would not be appropriate.[29]
On the other hand, a transactional profit split method would ordinarily not be used in cases where one party to the transaction performs only simple functions and does not make any significant unique contribution (e.g. contract manufacturing or contract service activities in relevant circumstances), as in such cases a transactional profit split method typically would not be appropriate in view of the functional analysis of that party.

4.3.3. Other alternative methods

Differently from the OECD Guidelines, the Italian Income Revenue Agency, in the circular letter deals with two other alternative methods:
a) the invested Capital profitability method;
b) the Gross margin of the economic branch.
The first method, according to the circular, is based on the annuity rate of the invested capital of the checked enterprise. The Financial Administration recognises the arbitrariness of the determination, considering that the real profit sample vary, depending on risks and economic factors.
In the second, the gross margin of the enterprise is compared with the margin of the economic branch of activity. Everytime the alternative methods are applicable a normal income rather than normal transfer price will be established.

[29] With specific reference to par 2.109 of the 2010 OECD Transfer Pricing Guidelines.

5. Safe harbours in transfer pricing transactions: the case of intangibles. A brief introduction on the international landscape.

The application of the analyzed methods looks complicated in transactions regarding intangibles. Infact, those particular kind of goods, due to their distinctiveness and peculiarity, are difficult to compare similar equivalents. This well known difficulty, as well as the consciousness that the management analysis assumed extreme importance in this process, has pushed OECD to evaluate the possibility to generate simplified tools in this field. The so called "safe harbours".

The "Safe harbours"[30] are particular provisions which find application to determined taxpayer categories or to particular operations or negotiations and can concern:

- technical rules of transfer pricing determination ;
- value range inside which the transfer price can vary ;

-the documentation to justify the application of a particular transfer price method to be supplied to the Financial Administration.

Those particular provisions can originate by the interested party request , (ruling safe harbours) ; or can be created by the legislator for general cases (general safe harbours)[31].

In this way entitled taxpayers are exempted from the application of ordinary law rules established in a particular country in transfer pricing matter, and subjected to peculiar fulfillments according to which the identified transfer prices are authomatically accepted by the Financial Administration.

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[30] For further information see the "Revised section E on safe harbours" in chapter IV of the OECD Guidelines, May 2013 Nel luglio 2010 OECD approved the new versione of Transfer Pricing Guidelines, but at the same time started a revision procedure of Chapter 6 (Special considerations for intangibile property) and Chapter 8 (Cost contribution arrangements) of the same. This process brought in July 2013 to the issue of the OECD Revised Discussion Draft on TransferPricing aspects of Intangibles. Simultaneously the BEPS Action Plan was approved.(see last chapter for further information).

[31] The general safe harbours are divided in:

- *threshold safe harbours* if excluding from the application of the transfer pricing rule some operations
- range safe harbours if they establish a range value inside which the transfer price can swing.

5.1. *Safe harbours: the Italian perspective.*

Regarding to the Italian landscape, our Income Revenue Authority in the circular letter, has relied on safe harbours in matter of intangibles transfer, seen the complexity in determining the normal value in transactions regarding those goods.[32]

Pursuant to the Financial Authority interpretative source, some intangible rent values are considered "suitable"

a) rent > 2% of the sales volume when:

-the transaction results from a written agreement signed before the rent payment ;

-the good usage is adequately documented (and then the inherence of the cost) ;

b) rent between 2 and 5% when:

-conditions mentioned before are verified;

-technical data warrant the declared rate (the perform of researches and experimentations , higher/lower one-year intangible obsolescence , its useful life , the results obtained by the licenser through the use of the fabrication ;

-declared rate is warrant by juridical data emerging by the agreement (exclusive right, non compete agreement, the right of conceding sub-licences, patent and so on.);

-utility obtained by licensee is proved.

c) Rent < 5% of the sales volume, only in particular cases, justified by the high technological level of the economic branch in question or by other circumstances.

d) every rent paid to enterprises resident in tax havens countries, that could be fiscally detracted and recognized adequate only to the conditions presented at point c).

The safe harbour mechanism presents some advantages either for the enterprises or for the Fiscal Administration. Enterprises will benefit of a remarkable simplification in the matter of transfer pricing, as well as in terms of tax planning[33]; on the other hand the Fiscal Administration will certainly encounter

[32] Furthermore, in the note n.9/2014 on transfer pricing, Assonime(the Association of the Italian joint stock companies) has noticed the absence of specific instructions according to transfer pricing transactions in particular with reference to intangibles.

[33] Corriere tributario, 2015, fasc. 41, pagg. 4099-4105.

less complexity from an administrative point of view in the proceedings and in matter of resource optimization. [34]

However, the mechanism we are dealing with presents even some disadvantages, as well as remarked by the OECD.

In the first place, the adoption of a safe harbour can bring to the selection of a method that could not represent "the most appropriate for a particular case" Moreover, in case of adoption of unilateral safe harbour (without involving other countries Authorities) the risk of double imposition results exponentially increased.[35]Finally , by implementing a safe harbour is it possible sometimes to create two distinct sets of rules in the transfer pricing area, so it's necessary to fix equity and uniformity problems, to avoid that similar taxpayer categories and transactions could be subjected to a different fiscal treatment.

6. Transfer pricing rule applicability to transactions among resident enterprises

In the previous paragraphs, national transfer pricing rule, its requirements and the applicable methods to establish the normal value, have been analyzed.

In particular, from a subjective point of view, we noticed that article 110 (7) of T.u.i.r. is applicable to transactions carried out among intercompany resident enterprises and non resident equivalent. No reference is made, in this article, to transactions carried out exclusively by national enterprises.[36]

The report "*Multi-country analysis of existing transfer pricing simplification measures"* released by the OECD in June 2011, in this sense, has noticed that our national law system does not contain rules in the matter of internal transfer pricing

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[34] VALENTE P., Manuale del Transfer Pricing, pg 1772.

[35] The OECD in the "Discussion Draft" claims that the use of multilateral safe harbours between the competent authorities through agreement, could relieve the risk of double imposition. Precisely in order to stimulate countries to those agreements, attached to the chapter IV of the OECD Guidelines, "sample memoranda" have been published; these ones represent a very important reference to the authorities of different member states "*to establish multilateral safe harbours in appropriate situations for common classes of transfer pricing cases"*.

[36] With reference to parliamentary work in preparing T.u.i.r. we remember that in the original draft the transfer pricing rule was either applicable to national enterprises transactions. This extention was however deleted before the voting process.

,whereas in most part of the European countries and in the U.S.A. the transfer pricing rules are applicable even to national transactions.[37]

If no reference is made by article 110 (7) to national transactions, is the national transfer pricing rule applicable either in those cases?

The Italian Jurisprudence has discussed on this topic and has provided its interesting point of view in many decisions.

The Supreme Court has stated, in cases regarding transactions among national enterprises part of the same holding group, that even if in this case the transfer pricing rule is not applicable, article 9 (3) constitues an antielusive clause which finds reference:

-in the european abuse of law principles;

- in the general elusive principle contained in art. 37-bis D.P.R. n°600/1973[38];

- in the normal value principle stated by the art. 9 (3) of T.u.i.r., which , according to the Court , constitutes an antielusive general clause to make reference to in the internal law.[39]

Then, in the Supreme Court intepretation, the normal value criteria is considered as a general principle of our Income Tax Code, and in this way it's applicable either exclusively with reference to transactions carried out among national enterprises.

Recently, however, the proposed reconstruction has been emended by the tax reform that the Italian legislator has produced.

The D.lgs 147/2015, infact, introduces an authentic interpretation rule, its article 5 (2), that explicitly clarifies that the transfer pricing discipline contained in art. 110 (7) has no value for operations carried out among resident enterprises[40].

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[37] However,according to art. 160 (2) t.u.i.r. the transfer pricing discipline has been explicitly extended, in order to the tonnge tax , to resident enterprises part of the same commercial group.

[38] Now canceled and replaced by art 10-bis.

[39] In this sense Cass. N. 17955/2013 n.8849/2014 n.12844/2015. See further in FERRANTI G., *"Transfer Pricing Interno" e valore normale: la Cassazione persevera nell'errore IL COMMENTO* in *Corr. Trib*. n. 29/2015, p. 2223.

[40] We believe it is useful to remind that the authentic interpretation disposition presents the following features in our law system:

a) the interpretated provision is not modified by the interpretative provision, which is uniquely added to the present law ;

b) the interpretative provision, provide a unique interpretation between lots ;

c) consequently, the interpretative provision, puts aside the other interpretations , that suddendly became not compatibile with the disposition.

In other words, the mentioned transfer pricing rule is not extendable to transactions carried out among national enterprises part of the same commercial group and, considering that art. 5 (2) of the D.lgs is an authentic interpretation rule , this provision has also application for the past.
Moreover, we notice that the provision in comment, instead of specifying the preferred government interpretation, points out the one disapproved by the legislator. [41]
From a literal point of view, is it possible to claim that there was no need of an "*ad hoc*" disposition to clear the unapplicability of the discipline contained in article 110 (7) to operations carried out among resident enterprises only. Nevertheless, the delegated legislator, seen the Court of Cassation mentioned interpretation, has considered worth an authentic interpretation to disperse doubts.

7 .Cost Sharing Agreements: brief international introduction

Pursuant to the OECD definition[42] the cost sharing agreement (CSA) is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles ,tangible assets or services, with the understanding that such goods are expected to create direct benefits for every participant.
This particular agreement has found strong developement is the last years, being frequently used by multinational enterprises because of its relevant advantages[43]:
- in terms of "timing difference", because the related costs are financed in advance or however recovered much more quickly than normal agreements stipulated with third parties ;
- from a fiscal point of view, permitting the group to optimise the fiscal charge among the enterprises respecting the current law.

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[41] BEGHIN. M., *"Transfer pricing interno", interpretazione autentica "rovesciata" e prova della fattispecie elusiva* di in *Corr.Trib.* n. 47/2015, p. 4571.
[42] Following BEPS Action 8 on april 29th 2015 the OECD has published a document on cost contribution agreements "BEPS ACTION 8:Revisions to Chapter 8 of the Transfer Pricing Guidelines on Cost Contribution Arrangements(CCAs)".
[43] In this way Ordine dei dottori commercialisti e degli esperti contabili di Padova, Commissione di studio di diritto tributario internazionale: *Il transfer pricing nei contratti infragruppo*, E-book, Datev Koinos , p.22.

Generally, cost sharing agreements are used to share the intangibles production in order to obtain economies of scale and reduce risks associated with the activity ; the contribution of every participant is commensurated to the value that this could obtain from the use of the good developed.[44]

7.1. Cost sharing Agreements in Italy: first considerations

With respect to Italy, it is important to begin the analysis highlighting that our national system does not provide any specific tax regulations regarding cost sharing agreements.
The unique sources available in matter are the OECD dispositions and the already mentioned circular letter n° 32/1980 of the Italian Income Revenue Agency.
The circular letter, whose main theme is transfer pricing , at paragraph 6 deals with intercompany cost sharing agreements. According to the latter, even in those agreements, in the identification of transfer price between enterprises, a reference to the normal value principle must be done. As said before, this value is identified by making a comparison among the verified transaction and others similar concluded by the same group enterprises.
However, in most cases, services supplied among intercompany enterprises, present lots of peculiarities that are difficult to find in other transactions, because, responding only to internal management logical, they are rarely provided in favor of external group subjects. As a result, for a correct evaluation, we should value the incurred costs to perform services and add a margin in favour of the services performer for the ones that constitute its main activity. The circular also notices, that transactions among associated companies shall be took into consideration because the services price can be included in the price of the goods acquired from the enterprise that has received the services. [45]

[44] According to the OECD op.cit. Par 8.21: "It's not excluded that a cost sharing agreemeent has the aim to share costs and risks associated to services rendering. Those services could either be rendered by an enterprise participating to the agreement or even by a third enterprise that should receive adequately payment for its activity".
[45] The services price is likely to be a discount offered by the associated enterprise in favour of the holding.

In practice, two types of CSAs are commonly encountered: those established for the joint development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets (development CSAs) and those for obtaining services (services CSAs).

The Italian Income Revenue Authority claims that the scope of the CSA can also include:

-use of resarch and development results operated into the group ;

-technical assistance ;

-administrative assistance ;

-marketing activity

From a civil law point of view the cost sharing agreements can be generally included among service contracts, even though the variety of activities included can frequently bring to a different configuration. (licence, procurement contract).[46] No particular form is required for the agreement validity, however is better to conclude a written contract in which costs and criteria are clearly determined.

7.1.1. *The italian general principles on negative income elements and its applicability to cost sharing agreements.*

Just like any other negative corporate income element, expenses due to enjoy intercompany services in the execution of a sharing agreement, must follow some general requirements.

Those, according to the provisions set forth in art. 109 t.u.i.r. are:

A) accrual basis ;

B) certainty and objective determinability ;

C) Inheritance.

We now briefly go through those principles, noticing that, in order to determine the corporate income, our national tax system makes reference to balance sheets results, allowing then, fiscal adjustments.

[46] Originally, infact, those agreements had similar structure to cost funding arrangements related to a specfic target or program.

The accrual basis principle (art. 2423 civil code) states generally that sales and expenses are taken account of, in the accounting period in which they occur (and are included in the income statement for that period), whether or not cash was received or paid out. From a fiscal point of view art 109 (1) is our main reference and its provisions clarify when a good sale or a service rendering occurs from a tax law point of view.

With reference to cost deduction, the certainity and objective determinability principle is strictly linked with the accrual basis rule.

In our national regulations there is difference among tax law and civil law according to costs. [47] The civil code provisions, infact, consider those negative components includable in the balance sheet, even if only considered probable; our tax regulations, instead, require certainty and objective determinability of those costs (even if included in the balance sheet) to be deducted in the competent fiscal year.[48]

If, at that time, costs do not present these features, they are not deductible in that accounting period, but in one of the next in which (and if) they became certain and determinable.

According to the inheritance principle (art. 109 (5) T.u.i.r.), expenses and other negative incomes, different from passive interests, are deductible only if referrable to activities or goods that contribute to produce (even indirectly) incomes, other profits and utility in general.

Therefore, the enterprise should documentate and demonstrate not only a connection between services rendered and those effectively worth to the single group enterprise, but also a relationship among the same services, the specific activity carried on and income produced by the enterprise. [49]

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[47] TESAURO F. *Istituzioni di diritto tributario – parte speciale , op. cit.* p. 126.

[48] Art 109 T.u.i.r. (1-2). Therefore, a cost, even if registered in the balance sheet, must be certain and determinable to be deducted.

[49] Costs paid for extra-commercial scopes (e.g. for the personal interest of the entrepreneur) are not deductible.

So, to determine the fiscal relevance of those services, it's required to prove that those generated a utility for the specific enterprise that received them and not only for the group in general. [50]

Now, without prejudice of the general requirements examined, the circular letter n°32/1980 states that intercompany services expenses should be divided among the different associated enterprises, in relation to the specific benefits that each company can obtain from its use. In order to determine the expenses adequacy, the subsequent factors are considered relevant by Italian Income Revenue Authority:

-inclusion of the service considerationin the price ;

-effective use of the service by the italian associated enterprise ;

-effective cost reductions for the affiliated enterprise ;

-relationship between operating profit, costs reduction and consideration paid ;

-advantages achieved by the affiliated enterprise regarding the service s rendering

Therefore, the Income Authority, in cost sharing agreement cases should (and not simply could) value with particular attention reporting modes and documentation of the costs sustained by the group enterprises.

7.1.2. The jurisprudence position on management fees

In the previous paragraphs we stated that cost sharing agreements has to be evaluated making reference to the normal value and that the basic criterias are difficult to use in this case, seen that intercompany services are often not included in the main activity of rendering enterprise, responding solely to global needs. In those cases infact, the rendering enterprise does not supply its activity to independent enterprises ; the internal comparision method as a result is not applicable. We should, then, examine in a subsidiary way a similar transaction concluded among independent enterprises.

Though, in most practical cases the intercompany services present so particular features linked to the financial and productive enterprise structure, that even the external comparision criterion it's going to be often inapplicable.

[50] The circular itself highlighted the holding need to pursue a real and effective advantage, well distincted from the general direction and control activity.

The difficulty to identify a specific revenue to which reconnect the incurred cost, seemed at first to have brought jurisprudence to believe that a particular example of cost sharing, the management fees even though actually incurred, were no inherent and therefore not deductable by the associated enterprises.[51]

This stance, has been soon abandoned by the Court of Cassation, that in decision n°10062/2000 has stated that «In the evaluation of business income, speaking of an holding enterprise, the cost inheritance principle has to be referred not to revenues, but to the enterprise activity. So, the choice of a foreign holding company, to attach to its Italian permanent establishment a share of the costs incurred, even though these expenses do not produce any revenues is considered legal.».

The subsequent Court of Cassation decisions followed this idea too.

The decision of the Supreme Court n° 4416/2008 has restated that: «the cost decuction operated by an enterprise having its permanent establishment in Italy,but part of a multination group, of a share of general expenses incurred, it's considered legal unless the Income Authority establishes either the insussistancy of the incurred expensed or the non inheritance to the corporate activity.» [52]

Established the opportunity for associated enterprises to deduct management fees[53] when these have been incurred and are inheritant to the entrerprise activity, the Court asked itself how the normal value could have been calculated, seen, as said before, that in practice, is hard to apply typical transfer pricing methods in

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[51] Cass., 14 dicembre 1999, n. 14016, n. 99, in *Banca dati Ipsoa-Bigsuite*. For further information on the mentioned judgement see: VALENTE P., *Il transfer pricing nelle prestazioni di servizi infragruppo*, *il Fisco*, 2011, p. 707.

[52] Aligned to the previous decision the Court of Cassation n° 6532/2009.

[53] For a deeper analysis about management fee: UCKMAR V. – CORASANITI G. - DE CAPITANI DI VIMERCATE P. – OLIVA C., *Manuale di Diritto Tributario Internazionale*, *op. cit*., p. 330; BIANCHI F. – DAMIANI M. – LUPI R. – STEVANATO D. – VARESINO M., *Quale documentazione per i costi comuni infragruppo ovvero tra sede centrale e stabili organizzazioni?* ,in *Dial. trib.*, 2009, p 323; CACCIAPUOTI E., *Sulla deducibilità delle spese generali sostenute dalla* Pacchiarotti, *Spese di regia: criteri di deducibilità nell'evoluzione delle interpretazioni della prassi e della giurisprudenza*, in *Fisc. intern.*, 2008, p. 130; PANIZZOLO A., *Il principio di insindacabilità delle scelte imprenditoriali in diritto tributario: conferme e limiti*, in *GT - Riv. giur. trib.*, 2001; *Deducibilità dei servizi intercompany sotto la lente della giurisprudenza*, in *Fisc. e comm. inter.*, 2012, 37 ; DELLA VALLE E., *La deducibilità dei costi per servizi infragruppo*, in *Corr. trib*., 2008, p.3397;

this case.

Regarding to this, the cost adequacy should be linked to the application of a correct allotment of this expenses among all enterprises that benefit of them in general.

In the decisions 10062/2000 and 5926/2009, the Court of Cassation has considered as a reasonable method the one based on the relationship between the holding turnover and the intercompany ones.[54]

Either The Milan Regional Tax Commission (decision n° 115/2011) and the Lecco Provincial Tax Commission (decision n° 100/2013) aligned to the mentioned idea of the Court of Cassation, adding[55] that another way to evaluate the adequacy of the management fee distribution could be the number of employees of the associated enterprise.

8. Advance Pricing Agreements(APAs) – Brief general introduction

The increasing of the transactions among multinational enterprises and the intensified revenue audit in matter of transfer pricing, brought to a stricter cooperation among taxpayers and Financial Administration, as well as between of different States income Authorities. In addition, we must take into consideration that, traditional technics and methods, adopted posteriorly, to audit the adequacy of intercompany transactions to arm's length price, generally involve difficulties and high costs with reference to time and resources.

In order to put an end to those problems, the OECD Transfer Pricing Guidelines analyzed administrative procedures that member states can use in order to prevent ,or settle, a dispute in transfer pricing matter, namely:

-Advance Pricing Agreement (hereinafter "APA")

-Mutual agreement procedures (MAP) provided by Bilateral Conventions against double taxation and EU Arbitration Convention[56]

In this chapter we will deal with APAs.

[54] In this sense also circular letter n°271/E.

[55] In particular the Lecco Commission in the decision n° 100/2013.

[56] To which the second chapter is fully dedicated.

Between the dispute resolution instruments, the Advance Pricing Agreements (APA) are featured by their preventive nature[57],constituting a favourable occasion both for the taxpayer, and the Financial Administration to consultate each other, in order to prevent potential disputes in transfer pricing matter.

According to the subject taking part to the agreement, the APA can take the shape of unilateral, bilateral and multilateral agreement. [58]

The OECD Guidelines, to implement the effectiveness of this kind of agreement, wishes for the conclusion of multilateral APAs, including all Financial Administrations in which the group acts, in order to avoid dissimilarity into evaluating income components and prevent double taxation.

8.1. The Italian perspective on APAs: the international standard ruling. General landscape.

Before going in depth with the analysis of the Italian perspective on APAs, is important to consider the situation that Italy has faced in last years and the changes recently occurred.

During the last decade, in the field of international taxation, our country has witnessed a big increase in audit notifications operated by the Financial Administration. All that is, on one hand, due to the frequent off-shore operations concluded by the italian enterprises, and on the other, due to excessive aggression shown by the Financial Authority in the interpretation of abuse of law and elusion questions.[59]

In this way a laceration in the relationship between Fiscal Administration and taxpayer has occurred, and, as a result, this obviously generated a big increase of

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[57] Infact, according to the definition provided by the document OECD "BEPS ACTION 14" a APA is defined as: *"arrangement that determines,in advance of controlled transations, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time"*.

[58] The Unilateral APA is an agreement stipulated among Financial Administration (only one) and taxpayer. It's obvious that this kind of agreement does not put an end to double taxation problems; the Fiscal Authority competent to tax the enterprise income which took part to the transition, infact, not having been part of the agreement could restate independently transfer prices, baffling how stipulated in the unilateral agreement among a single taxpayer and single Administration.

[59] As explained in TOMASSINI A., MARTINELLI A., *Il nuovo ruling internazionale* in *Corr. Trib*. 24/2015 p. 1843.

trials promoted in the field of taxation, which has seriously pushed our legislator to think to a systemathic reorder of our national tax system.

The recent delegation[60] law n°23/ 2014 has, therefore, conferred delegation to the Government to realize a "*more equal, transparent and oriented to growth fiscal system*".

One of the central issues of the delegation in word is the revision of the discipline regarding transboundary operations. Nowadays, in execution of the delegation law ,eleven legislative decrees have been supplied.[61] Those kind of measures deal with various aspects of the international taxation:

1) create a much more certain context, even eliminating some national regulations gaps ;

2) reducing enterprises fullfillments and correlative administrative costs. ;

3) adequate our national law to the recent jurisprudencial decisions of the Court of Justice ;

4) delete some distortions in the national regulations.

For the purposes of our analysis, what is relevant between those changes is the d.lgs 147/2015 on the international standard ruling.

8.1.1. From the "old"international standard ruling to the new one

As previously said, the international standard ruling has been, recently, exposed to important reforms :

infact, the original art. 8 of d.l. n°269/2003[62], that introduced ruling into our regulations, has been firstly modified (with d.l. 145/2013) then , cancelled by the new art. 31-ter of the D.P.R. 600/1973, introduced by the mentioned art. 1 of the d.lgs 147/2015 ("Decreto Crescita e internazionalizzazione"). ; the international standard ruling revision goes properly in this direction. This legal institution, infact, has historically had a weak appeal in our country.[63]

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[60] See more in FERRONI B. *La delega fiscale e il transfer pricing il fisco,* n. 2/2015, p. 161.

[61] To learn more about the recent tax reform see next paragraphs.

[62] Converted with modification in to l. n°326/2003.

[63] ROMANO C., SQUITIERI M., *Rilancio del ruling internazionale per risolvere i conflitti in via preventiva ed eliminare le doppie imposizioni*, in *Corr. trib* n. 10/2014, p. 792.

For a long period of time, under art 8 d.l. n°269/2003, the international ruling was considered an unilateral agreement stipulated between the taxpayer (in particular enterprises with international activity) and the Financial Administration, without involving the competent authority of the counterpart state of the transaction. The agreement, in other words bound only the tax payer and the Italian Financial Administration for three years after drafting[64] and was not suitable to grant the elimination of double taxation risks, as such as it did not bound the foreign Administration, which resulted free to non adequate itself and to make its own price adjustments.[65]

Therefore, in order to give more efficiency to the Financial Administration activity and provide a favourable context to multinational groups in order to transfer pricing policies, in 2010 the system has been updated, allowing taxpayers to present bilateral or multilateral international ruling requests.

The legislator intervention aims to resolve this critical aspect that featured international ruling since its very beginning. In the next paragraph we analyze the changes provided by the tax reform.

8.1.2. The international standard ruling in the new d.lgs 147/2015: First considerations

The new article 31-ter of the D.P.R. 600/1973 named "Accordi preventivi per le imprese con attività internazionale", substitutes art. 8 of d.l 269/2003 with the aim to provide for an organic settlement of the law institute, and empower the existent measures with attractive changes for new foreign investors.

Let's start our analysis of the new international standard ruling with making some systematic considerations in order to better understand the reasons that pushed the legislator to apply those changes.

The new art. 31-ter is included in title IV of the D.P.R. 600/1973 entitled "Assessment and Audit procedure".

[64] Then modified and extended to four years by the d.l. 145/2013 starting from 2013 fiscal year.

[65] This has been an importante change in our regulations: if we remind what expressed in the APA general paragraph, the OECD advises multilateral APAs in order to avoid double taxation phenomenons.

This settlement, firstly, confirms that the present discipline results also applicable to IRAP (Our regional income tax) in compliance with art 25 of d.lgs 446/1997 and, secondly, that the new provision shows coherence, being the advanced agreements an expression of the Italian Income Revenue Agency powers.
Art. 31-ter is infact located halfway between art. 31-bis (exchange of information) and art. 32 (that contains the Financial Authority Powers). This choice is aligned to the legislator will to intend the traditional power controls as a mere eventuality in the relationship with the taxpayer, encouraging instead, advanced dialogue possibilities, avoiding in this way unuseful and expensive tax litigations.[66]
Prosecuting our analysis from a systemic point of view, it's important to highlight the difference between the international standard ruling and the other tax rulings[67] today available in our national system.
If in the other tax rulings, the Italian Income Revenue Authority carries on an autonomous evaluation of the cases subjected under its attention, establishing if in those, a tax rule is applicable in practice and issuing an unilateral opinion which has direct effects in front of who demanded it[68] ; the international standard ruling is much more comparable to the typical law institute of the negotiated agreement, because it is stipulated through a series of meetings and a consultation procedure (between taxpayer and administration) respectful to the applicable law and based on convenience evalutation by both sides.
In this way, in our regulations, the international standard ruling can be considered as a hybrid arrangement, halfway between an agreement and a interpretative opinion.

[66] TOMMASINI A., MARTINELLI A., *Il nuovo ruling internazionale* , cit. p. 1845.
[67] We remind that others tax ruling available in our regulations have been reordered by the d.lgs 156/2015. The concept of fiscal "compliance" imported by the EU law is a focal point of the recent reform.
[68] There is always the opportunity for the taxpayer to unfollow the Financial Administration opinion.

8.1.3. Objective and subjective scope of application

The international standard ruling request, according to art. 31-ter, is presentable by "international enterprises"[69], independently from the corporate sizes, which carry on a potential or actual internactional activity. Considered that the activity can solely be potential, the ruling request is either presentable by subjects not even established in Italy to understand if, according to national rules, it is possible to identify a permanent establishment inside the national boundaries.

The objective scope of application of the new international ruling is contained in (1) of art. 31- ter ; more in particular, is possible to request a ruling in order to:

-the advanced definition, in consultation with the administration of: the normal value methods applicable for evaluate intercompany transactions ; entry or exit tax values in case of residence transfer[70]; the discipline applicable in practical cases to royalties, dividends and other income components delivered by/to non resident subjects.

- the advanced definition of requirements which perform a permanent establishment in the Italian territory, with reference to art 162 t.u.i.r. criteria in matter, as well as the ones established by double taxation conventions. [71]

-the advanced definition in order to apply the optional lighter tax regime provided for incomes coming from trademarks, intagibles, patent boxes.[72]

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[69] The Decision of the Italian Revenue Agency Commissioner, 42295/2016, of March 21st also includes the definition of "international enterprises". Any resident enterprise (qualified as such according to the income tax provisions) that alternatively or jointly:
a) is, with respect to non resident enterprises , in one or more relationships indicated in paragraph 7 of art. 110 T.u.i.r. ;
b) its capital , fund or asset is shared by non resident subjects, or (the resident enterprise) shares capital, fund or asset of a non resident enterprise. ;
c) has collected/remitted dividends, interests , royalties by/to non resident enterprises ;
d) carries out its activity through a permanent establishment.

[70] According to artt. 166, 166 bis T.u.i.r..

[71] According to the parliamentary relation to the d.lgs 147/2015 "with reference to requirements which form a permanent establishment in the italian territory, the advanced evaluation is an attractive measure for new foreign investors (…) as well as provision in order to create a much more certain activity complex for the already settled investors".

[72] D.M 30th july2015, so called Patent Box decree. The mentioned rule contains art 1 (37-45) of L. n 190/2014 implementation dispositions.

8.1.4 The international ruling procedure and recent clearings provided by the Italian Income Revenue Authority

Art 31-ter (2) provides on the agreement duration, stating that the international ruling binds the involved parties for the stipulating fiscal year and the subsequent four (five total years)[73], without considering changes in the factual circumstances. However, according to the same paragraph, if the international standard rulings are posterior to other agreements, concluded by the enterprises with the competent Authorities of other foreign states, (e.g. according to MAP against double taxation), they bind parties according to what established in the agreement signed in the other state, starting from the precedent fiscal years.[74] This makes international standard ruling a preventive arrangement with respect Mutual Agreement Procedure(s) (MAP).[75]

Respect to the procedural scope, the taxpayer is able to start the ruling procedure depositing the application to the competent Income Revenue Agency office.[76]

According to the procedural aspects, the long awaited Decision of the Italian Revenue Agency Commissioner, 42295/2016, of March 21st , includes clearings in order to clarify the scope of application of the new international ruling disposition.

The Agency claims that, to be accepted the enterprise ruling request shall include:

a) the enterprise denomination, its registered office or the tax domicile if different by the registered office, its fiscal code and/or the VAT number and ,eventually, the indication of the enterprise national domiciliary, different from the enterprise itself where the Agency will deliver the communication related to the procedure. ;

b) the permanent establishment address in the Italian territory, whether the request is, presented by a non resident enterprise and eventually the national domiciliary equivalent ;

c) a clear indication of the preventive agreement subject ;

[73] Maintaining in those sense the changes provided by d.l. 145/2013.

[74] But not before the tax year in course at the presentation of the application.

[75] Whose sources are art 25 of the OECD Model and Eu arbitration convention

[76] The Decision of the Italian Revenue Agency Commissioner, 42295/2016 has clarified that taxpayer shall present the request to the International Ruling Office based both in Rome and now in Milan.

d) attached to the reques, a suitable documentation in order to prove the international enterprise requirement. ;
e) the legal representative or other appointed person signature.
Further than those information, the request made with reference to transfer pricing operations shall include, in addition:
a) a brief description of the art 110 (7) t.u.i.r. operations with a detailed indication of goods and services included in those ;
b)the non resident enterprises with those operation are carried out and the reasons why the relationship among them and the resident enterprise is included in one of the situations claimed by art 110 (7) t.u.i.r. ;
c)explainations with reference to the normal value determination criteria and methods in the mentioned transactions and the reasons why those methods are believed in compliance to the national transfer pricing rule ;
d)explanatory documentation
The request is declared valid within 30 days from its delivery, whether the mentioned requirements are present, with a communication sent by the International Ruling Office to the requesting enterprise.
The Office, completed this preliminary activity, invites the enterprise legal representative to compare, in order to jointly verify the completeness of the provided information, to possibly request further information and to define the consultation procedure terms. This latter can be structured in more meetings. The procedure shall be concluded within 180 days from the ruling request. It's important to notice how during the development of the procedure the Financial Administration is able to audit the enterprise or permanent establishment headquarters, in order to acquire useful elements to the evaluation. The Office, whether necessary, will be able to require the international dispute resolution instruments activation (MAPs) to the competent authority of another stat ; in this case the previous term (180 days) shall be suspended for a period of time necessary to obtain the requested information to the equivalent competent authority.
We notice that the International Ruling Office has the possibility to verify the agreement respect by the enterprise and assess that modifies are incurred in the

conditions that constitute premise of the arrangement. In case of total or partial agreement violation, the taxpayer has 30 days to justify its behavior through defense brief. In case of not suitable defenses or the mentioned term is elapsed, the agreement is considered resolved from the violation assessment date.

It's important to remind that according to art. 31-ter (4) *«pursuant to the european regulations, the Financial Administration sends copy of the agreement to the fiscal competent authority of the resident states of the enterprises with the taxpayer has carried out transactions »*

The explicit referral made to "Eu regulations" in the mentioned provision, finds a reason in order to adequate the national discipline to the most recent UE regulations in tax ruling matter.[77]

Moreover, with reference to supranational discipline, the OECD noticed that, according to APAs, some parts of the agreement could be relevant with reference to precedent fiscal years not considered in the time of the concluded APA. Studies carried out by the organization, enlighted that in case of identity between factual elements and circumstances, some countries already allow retroactive APA application[78]. The d.lgs 147/2015, aligned both with the most updated Court of Justice decisions and the OECD Guidelines, has introduced, in art 31-ter (3) a provision with similar features, the so-called ruling "roll back". This rule finds applications in two cases:

a)Whether the agreement with the Italian Income Revenue Agency follows a precedent arrangement signed with the competent authorities of another state in the scope of Bilateral Conventions MAP.

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[77] Infact, the 2015 EU Commission Tax transparency Package contains a proposal to modify the 2011/16/UE directive on the administrative cooperation and provides that every member state authority which emits a ruling or concludes an APA must authomatically inform the EU Commission and the competent authorities of the other member states. Moreover, at the same time, the compent authority of a member state must communicate to the same subjects information regarding fiscal rulings or APA emitted in the last ten years.In addition BEPS ACTION 5 has restated how the automatic exchange of information on "rulings" carries into national regulations transparence, certainity, and prevedibility principles.

[78] At the same time, In the document "*BEPS ACTION 14:MAKE DISPUTE RESOLUTION MECHANISM MORE EFFECTIVE*" the OECD noticed that sometimes the agreement procedure request, holds issues relevant not only for the running fiscal year,but also for previous or subsequent ones.

In this case the agreement signed with the italian taxpayer is authomatically extended to the past. (howeve no preferential treatment with regards to sanctions is provided.)
b)During the ordinary ruling procedure the taxpayer[79] can give its consent to "roll back" the agreement effects to the moment the ruling request was presented, without any sanctions application. In this case the roll back acknowledgment is subject to the existence and the audit of the identity of circumstances and factual elements.
Furthermore, the agreement retroactivity could be extended as well to other cases. In fact, if the similar circumstances upon ruling is relied exist for one or more tax periods, precedent to the agreement, but not to the one regarding the application date, with reference to those years (to better understand those included between the application date and the agreement sign) the taxpayer will have the discretion to request the retroactively effectiveness as regards to those agreement periods. In the case the enterprise conduct is in need to be corrected , regarding to those fiscal years, the taxpayer will be able to redempt itself actively (the so-called ravvedimento operoso)[80] and either to present an integrative tax return, according to art. 2 (8) D.P.R. n° 322/1998, without the application of the relative sanctions. In the end, is useful to remark that pursuant to art 31-bis (5), for fiscal years in which the agreements is valid, the Financial Administration exercise the powers provided art. 32 and following (poteri istruttori) only with reference to issues not part of the agreement.

8.1.5. Persisting Criticalities

One of the best issues that regards international standard ruling is linked to the

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[79] As stated by the EU Commission in the communication *"on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for APA within the EU"* – 26/02/07.
[80] With this arrangement, is it possible to regularise either inadequate/ not paid income taxes or other fiscal irregularities; the benefit is the sanctions inapplicability. All taxpayers can make us of the active redemption. The active redemption rules have been modified recently ; art. 44 (14) of the l.190/2014 (2015 Stability Law) has modified art. 13 of d.lgs n° 472/1997, extending the redemptions possibilities offered to the taxpayer. For further information on the theme see: GUERRA R.C. *La riforma del ravvedimento operoso : dal controllo repressivo alla promozione della"compliance" in Corr. Trib,* n. 5/2015, p. 325.

amount of time needed to complete the whole procedure. Infact, according to the Italian Income Revenue Authority[81], the average period of time employed to conclude an advanced ruling agreement is estimated in 16 months. This big amount of time, needed to conclude the procedure, discouraged many taxpayers to promote the international ruling arrangement.

In addition, the legislator has not dealt with ruling tax-penal aspects at all. We notice that our regulation is in lack of a safeguard clause regarding the matter ; for this reason, we cannot prior exclude any penal consequence as regards to international ruling.[82]

Morevore, another criticity regards the possibility that the foreign Financial Administration involved evaluates in a negative way the content of the agreement: in this case a Mutual Agreement Procedure is the unique way to solve the dispute. It's unclear if the national agreement effects can remain valid or they should be suspended until the dispute definition.

9. Transfer Pricing criminal aspects and sanctions in the italian regulations

Referring to the tax-criminal transfer pricing issues, we have to wonder what are potential risks related to an evaluation considered improper by tax auditors. The matter, has been initially been regulated by l.n°516/1982 , but, time after time has faced drastic changes ; the original disposition has been abrogated by the d.lgs n°74/2000 firstly, then this latter has been modified in turn by the most recent d.lgs 158/2015 ("Decreto Sanzioni").

The latter decree, following the fiscal delegation law n° 23/2014, has deeply modified the criminal tax penalties system with a series of measures aiming to implement the delegation itself. The legislator, infact, has reduced the scope of criminal relevant behaviors in favour of tax-administrative sanctions in order to

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[81] "Bollettino del Ruling di standard internazionale", 2nd edition, 2013. According to this document, between 2010-2012 the number of ruling request has increased to 83; only in 2012 the Ruling International Office has received 38 requests.(21 of those asked for a bilateral/ Multilateral APA).

[82] TOMASSINI A., TORTORA A., *Profili Penali e riflessi sull'attività di controllo del ruling internazional*e , in *Corr.Trib.* , n 2/2005 p.111-112.

facilitate our national economic system competitiveness[83] ; criminal sanctions, infact, are now provided exclusively in most serious cases and an explicit preference is made for the application of administrative penalties.[84] This important change has obviously affected the transfer pricing matter, even though we observe that even with the former system the criminal relevance of this legal instrument was very limited and case law is always been restricted. [85] The reason of the limited intervention of the criminal justice in the field of transfer pricing is mostly due to the essential evaluative nature of these operations , and, furthermore to the existence of a provision, art 7 of d.lgs n°74/2000, that states that «evaluations and detections do not give rise to punishable facts if the criteria applied are included in the balance sheet » (1)
« in any case, evaluations that deviates by less than 10% to correct ones, do not give rise to punishable facts, according to art 3 and 4 of the same decree » (2)[86]
Thus, is it natural that the evaluations matter is reserved to the Tax Commissions and the eventual penal reports for "unfaithful tax statement"(art 4) and "fraudulent statement through other arrangements" (art 3) are often submitted to dismissal or acquittal decisions.
The mentioned reform has modified the previous mentioned regulations by:
-increasing considerably the punibility quantitative threshold[87]
-introducing in art. 4, some interpretative criteria which are intended to limit the penal relevance in the only case of absence of those elements.[88]
Precisely, a new 1-bis paragraph has been added to art 4.
According to this provision:
-the uncorrect classification of incomes ;

[83] For further information in matter of fiscal delegation and transfer pricing see FERRONI B. *La delega fiscale e il transfer pricing*, *cit*. p..161.
[84] The explanatory memorandum of d.lgs 158/2015 in particular identifies the relevant penal behaviours, to the only cases that brings to "a particular juridical,ethical and social disvalue."
[85] Differently from other international taxation matters, such as: permanent establishment and controlled foreign companies regarding to which, as a result of fiscal audits, lots of trials are started and consequently a larger case law is found.
[86] ZIZZO G., *Transfer pricing, valutazioni e reati fiscali in Rass. Trib*. 2/2015, p. 425.
[87] But this does not seem to be the main reason of the reduction of the penal relevance in transfer pricing matter, considering that we are dealing with disputes involving multinational enterprises.
[88] See more in VALENTE P., CARACCIOLI I., : *Transfer pricing : valutazioni estimative e irrilevanza penale* in *Corr. Trib* n. 2/2016, p. 98.

-the evaluation of positive or negative elements objectively existing and whose method applied are indicated in the balance sheet or in other fiscal relevant documentation ;
-the violation of inheritance, accrual basis and non deductability are not taken into account for the purposes of the applying the disposition of the first paragraph.
This latter states that: *«Excluded cases regarding article 2 and 3, anyone who, in order to evade income taxes or VAT declares a lower amount of positive income or non existent passive elements ,*
is punished with imprisonment from one to three years if, jointly:
a) the tax evasion exceeds 150.000 € (with reference to VAT or income tax individually)
b) the total amount of positive incomes evaded, even through passive non existent elements, exceeds 10% of the total active elements amounts stated, or exceeds 3.000.000. €.
In addition, the updated version of art. 4, has replaced the phrase "fictitious elements" that generated a big debate in our national doctrine, with the expression "not existent elements". [89]
This seems to be an important change. In the past, infact, in the transfer pricing matter a "fictitious element" brought frequently to a possible criminal relevance. Nowadays, instead, speaking of incorrect income elements evaluations, in transactions mentioned by art 110 (7) T.u.i.r., the criminal relevance should be excluded.
In conclusion, we hope that the Italian Income Revenue Agency will soon issue interpretative measures to clarify the reform scope.

9.1. Transfer pricing documentation: art. 26 of the d.l. n.78/2010 and the exclusion of administrative sanctions

Art. 26 of the D.L. n° 78/2010[90], following the OECD recommendations in

[89] To learn more about the doctrine debate see:
DONEDDU G., LA CANDIA I., *Violazioni nel transfer pricing: rilevanza penale e riconducibilità al reato di dichiarazione infedele*, in *Corr. Trib*. n° 5/2012, p. 373.
[90] Converted into l.122/2010.

transfer pricing documentation matter, has included a new paragraph 2-ter in the d.lgs n°471/1997; this latter provides for the exclusion of administrative sanctions if suitable documentation is presented to the Fiscal Authority to demostrate the compliance to the normal value (according to art 110 (7) T.u.i.r).

In Italy the adoption of a specific rule related to transfer pricing documentation was long overdue[91]; furthermore the analyzed disposition permits the alignement of our regulations to most other developed countries rules , even with different modes.[92]

The new disposition, infact, does not impose any specific documental obligations to the taxpayer and, for this reason, is considered peculiar in the landscape of our taxation law. The documentation exhibition is not compulsory, then its missed preparation / communication to the Fiscal Administration does not represent any specific rules violation.

In this sense, therefore, the suitable documentation presentation by the taxpayer, impose to the Income Authority to disapplicate tax penalties whether a major taxable income is assessed.

The new paragraph 2-ter main aim is to reward the taxpayer cooperative attitude in order to make the relationship between the Income Agency and the taxpayer itself more transparent. [93]

Moreover, the disposition shows benefits for the Income Revenue Authority too. It's the same Authority[94]to claim how the rewarding system "facilitates, when checking, the intercompany transaction compliance to the normal value" ; the surprising and advanced Government waiver to impose sanctions, it's infact only explainable by making reference to the difficulty in which the Authority incurs during the international intercompany prices checking operations.

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[91] L'ordinamento italiano si è così adeguato alla prassi internazionale in materia; oltre che alle OECD Guidelines, come già rimarcato, anche al *Code of Conduct* di cui alla risoluzione 2006/C176/01 della Commissione Europea. La norma tace quanto alle sanzioni penali ma questa è una caratteristica comune a diversi provvedimenti legislativi ai quali la prospettiva penal-tributaria è completamente sconosciuta.

[92] VALENTE P. *Documentazione nel transfer pricing: dalle linee guida OCSE alla riforma italiana*, in *il fisco* n. 5/2016, p. 439.

[93] MARRAFFA L., *La definizione di transfer pricing ai fini del regime premiale*, in *Corr. Trib*. n. 12 /2012 , p. 905.

[94] Circular letter 58-E/2010.

The documentation acquired by the taxpayer, then, is a valid reference base for the Income Authority activity and could, step by step, help the Authority into creating a database certainly useful in the future.[95]

Another important issue with regards to the suitable documentation, is the relationship among its communication and a potential audit procedure.

On this point , the circular letter n°25-E/2014 of the Italian Income Revenue Agency cleared that the communication itself does not exclude the Agency possibility to control the sender enterprise, and in case this happen, further motivations that brought to this decision should exist and be explained.

9.1.1. The suitable documentation: the circular letter 58/E/2010

With the Commissioner decision 29th september 2010 and circular letter n° 58/E The Italian Income Revenue Agency has intended to provide clarifications with regard to the introduction, in our legal system, of the mentioned transfer pricing documentation regime.

The circular letter, states, in particular, that the rewarding system we dealt with in the previous paragraph is subject to the condition that the taxpayer delivers to the Agency a “specific“ documentation, that deals with transfer pricing exclusively, and suitable to:

- recognize the transfer pricing compliance to the normal value;
- grant an easier audit process

Whether during the audit procedure or other investigation activities, the Authority is in need of additional information compared to what is contained in the taxpayer documentation, the circular letter explains that those should be provided until seven days from the request, except in the case of complexity, in which a wider term is allowed. Whether, instead, the request is made for information that go beyond the ordinary content of the documentation, the eventual missed delivery is not condition to disapply the premial regime.

[95] Unless the Administration decides (motivating) not to recognize the taxpayer provided elements. In this way: VENERUSO A., *Transfer pricing: primi chiarimenti in materia di oneri documentali*, in *Bilancio e reddito d'impresa* n. 3/2011, p. 32.

According to the circular, the documental regime is diversified among different kind of enterprises. Moreover, specific indications are provided for permanent establishments and small and medium enterprises

The Joint Transfer Pricing Forum in its approach "EU Transfer Pricing Documentation" indicates the adoption of

- a standard documentation set which contains common and relevant information for all enterprises *(so called Masterfile)* ;
- more standard documentation sets, each one concerning information related to the specific country *(so called Country-Specific Documentation)*. ;

The Masterfile should be composed of chapters, paragraphs and subparagraphs. The circular letter restated the possibility to present more than one Masterfiles if the multinational group carries out industrial or commercial activities with different transfer pricing policies.[96]

Moreover, the circular letter provides information on the National Documentation, stating that the general structure is not so different from the Masterfile, however noticing that this kind of document is uniquely referred to the single enterprise, to its placement inside the group and to its intercompany operations. [97] Paragraph 10 of the circular letter, deals with requirements needed for a suitable documentation in order to avoid penalties. The provision, claims that the Income Authority is not bound to the penalties disapplication in matter of unfaithful tax statement, if the documentation shown during the audit activity, even if correct from a formal point of view (according par 2.1. and 2.2. of the decision) does not present complete information and they also not correspond, totally, or partly to the truth.[98] This statement is based on the fact that the concept of suitable documentation, in order to avoid administrative penalties, should be evaluated in a substantial way rather than a formal one.

[96] We make reference to multinational groups with a decentralized structure and made of divisions.

[97] The whole documentation should be presented in e-format (not modifiable). In the case the taxpayer presents it in paper format the delivery should be immediate; in lack of this, however the taxpayer has the option to provide the documentation within 10 days from the request.

[98] With reference to AVOLIO D., SANTACROCE B., *Come valutare l'idoneità della documentazione sul transfer pricing*, in *Corr. Trib.* n.40/2011 p. 3275.

Therefore, a documentation will be considered suitable if through it the taxpayer is able to provide to the Income Authority data and elements worth for a complete and detailed transfer pricing analysis. [99]

Reasoning in this way, if the documentations shows a partial omission this fact does not authomatically compromise the reliability of the analysis made by the enterprise and consequently the premial regime in comment.

In addition, it's very important to highlight that, if during the audit procedure an instrumental use of the documental regime is made (and discovered), the sanctions exemption benefit will be revoked, and, whether the behavior it is judged as particularly serious, the sanctions provided for transfer pricing violations could be worsen.

The documentation should also explain the practical reasons that brought the taxpayer to select a specific method in the evaluation of income elements.

10. Burden of proof in transfer pricing matter.

To conclude our analysis on transfer pricing and domestic law, we now examine how the law courts of our country allocate the burden of proof between taxpayer and tax authorities in transfer pricing cases.

Before to start, it's important to notice that in our national regulations the general burden of proof discipline is set forth by art. 2697 of the civil code. This provision states that "who is asserting a right, must prove the facts that constitute it", acknowledging the latin phrase: *onus probandi incumbit ei qui dicit.*

After this brief introduction, we can now deal with the italian case law on the burden of proof matter , analysing firstly the Supreme Court jurisprudence, then the Tax Commission decisions.

10.1 The Supreme Court judgements

The Court of Cassation has faced the burden of proof issue for the first in time in 2006 with the decision n° 22023.[100] After qualifying the transfer pricing discipline

[99] The provisions make explicit reference to the principles provided by the UE Code of Conduct and by the OECD Guidelines in order to minimise the discretionality on the suitability judgement.

as an antielusive clause, the Court stated that “is the Fiscal Administration that has the burden to demonstrate its demands“ and that «
this finds confirmation also in the transfer pricing matter, considered that the OECD guidelines (…) in 1995 had expressly underlined that the taxpayer has to demonstrate the transfer prices fairness, only after that the Fiscal Authority has proved that the arm’s length principle (normal value) is not respected. » In the judgement n° 1709/2007 (the so called Ford case)[101] the Supreme Court has confirmed its interpretation, restating that the burden of proof in the transfer pricing disputes is up to the Fiscal Authority that intends to make adjustments to the taxpayer statement.

However, the idea expressed in the mentioned decisions has been submitted to a *revirement* with reference to cost adjustments.

The Supreme Court, infact, in the 1709/2007 decision, regarding a dispute on costs exhistance and inheritance, has also dwelled on the transfer pricing rule (art. 110 (7) T.u.i.r.) application. In this case the Court restated the general principle, according to which, in presence of a negative income element, the burden of proof of its existence and inheritance is up to the taxpayer.

With the decision 11949/2012, the Court has better specified this idea, restating that in case of cost adjustments made by the Income Authority and according to the general principle set forth in art. 2697 of the civil code, the burden of proof concerning the difference between the arranged consideration and goods/services normal value is up to the Administration, while with reference to cost existence and inheritance, as well as to any other element that allows the Office to verify the normal value in accordance with the proof vicinity principle, is up to the taxpayer.[102]

The mentioned position has become more radical with the 10739/2013 decision, according to which, the Italian Income Revenue Authority should only demonstrate the existence of transactions among associated enterprises and it

[100] To a deeper analysis of the mentioned decision see: BERGAMI D., “Onere della prova a carico dell’Amministrazione nel transfer pricing”, in *Corr. Trib.* , 2006 , p. 3727.
[101] For more details on the case see VALENTE P. *Manuale del Transfer Pricing , op.cit.* p. 1222.
[102] With reference to AVOLIO D., SANTACROCE B., *Oneri documentali e prova nel transfer pricing ,* in *Corr. Trib.* 3/2012 p. 2866.

should be up to the taxpayer to demonstrate that transactions have been carried out according to normal values.

10.2. The Tax Commissions Judgements

Regarding to the Tax Commissions interpretations, with the decision n°158/2005, the Milan Provincial Tax Commission has dealt for the first time with the burden of proof issue.
With reference to this topic, the Commission stated that : "according to the general principles that govern the burden of proof in our legal system, lies to the Italian Income Revenue Authority to prove the existence of the major taxable income elements, while, the taxpayer is burden to prove negative income elements and ,between those, costs, having regard either to their existence or to their inheritance. This idea has been followed by the Pisa Provincial Tax commission (decision 52/2007).
However, the most recent decisions n° 83/2013 and 84/2013 of Lombardia Regional Tax Commission provided for an innovative vision on the burden of proof matter. The judges established that the burden of proof in transfer pricing matter has to be distributed between taxpayer and administration according to the proof vicinance civil processual principle.
In particular: "The proof vicinance principle is the most suitable and can find full application according to burden of proof transfer price disputes".
Therefore, according to the second instance judges, the Administration is substantially burden to prove to have carefully selected the compared operations.
The doctrine has discussed on the mentioned interpretation ; according to an author, even though the Tax commission position is considered interesting, it allows excessive discretionality to the judges in the determination of the burden subject.[103] According to another author is instead necessary to abandon the strict formalism that features the burden of proof in transfer pricing matter and adopt methods similar to the one proposed by the Tax Commission. [104]

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[103] See GAGGERO A., *Il transfer pricing (1992-2015),* cit., p. 987.
[104] According to TOMASSINI A., *Ripartito tra Fisco e contribuente l'onere della prova nel transfer pricing*, in *Corr. trib*., 2013, p. 121.

10.3. The new art. 10 – bis of the Taxpayer Statute : changes occurred in the burden of proof issue

After the case law analysis provided by the Courts of our country, it's now essential to conclude our analysis, speaking of the of the abuse of law and avoidance discipline, that also provides changes in the burden of proof matter.
Infact, art. 1 of the D.lgs 128/2015 named "*Abuse of law or tax avoidance discipline*" includes a specific discipline of the abuse of law, on one hand abrogating art 37-bis d.P.R. n° 600/1973, on the other, introducing the new art. 10-bis in the Taxpayer Statute (l. 212/2000).[105] The first three paragraphs of the new art 10-bis detect the abuse of law features, specifying:
-the abuse of law definition: "*one or more operations without economic substance, that, even in the formal respect of tax regulations, in practice achieve unlegal fiscal benefits* (paragraph 1).
-constitutive elements of the provision :
A) economic substance absence, defined as: *"facts, acts, contracts, also linked between them, not suitable to produce significant effects* different from advantages." (paragraph 2 a).
B) the achievement of improper fiscal advantages "*benefits, even though not immediate, realized against tax provisions purposes or tax law system principles"* the exemption, constituted by *"valid extra fiscal reasons, not marginal, even managerial, that respond to the enterprise structural and functional improvement"*.
Paragraph 5 to 10 are procedimental dispositions. Through this, according to our burden of proof analysis, it's important to have a look at paragraph 9.
This latter states that: *The Financial Administration has the burden to prove the existence of the abusive behavior, not on its own motion, in relation with elements indicated in parr. 2-3. The taxpayer has the burn to prove the extra fiscal reasons exposed in paragraph 3.*

[105] FERRAJOLI L., *Onere della prova e abuso del diritto nel d.lgs 128/2015, in http://www.ecnews.it/fisco-lavoro/onere-prova-abuso-diritto-d.lgs.-128/2015.*

This means, therefore, that differently to what could happen in relation to art 9 and 110 T.u.i.r. where the Financial Administration only needed to demonstrate the differential between the consideration and normal value and, furthermore, no exemption linked to economic reasons could have raised, according to this new provision the Income Agency has the burden to demonstrate that the executed operation has brought fiscal benefits not approved by the tax system. [106]

[106] With reference to BEGHIN M.,*"Transfer pricing interno" interpretazione autentica "rovesciata" , cit. ,* p. 4573.

CHAPTER II
TAX TREATIES

1. The double taxation issue: introduction

Whenever the taxable income of one or more states overlap and, afterward, different national regulations subject to taxation the same income elements, a double international taxation issue arises.

This phenomenon originates from the independent taxation power that each state hold. Most countries, and Italy as well, have selected a worldwide income principle, based on the residential criteria ; in this way any income produced, whenever, is subjected to taxation if produced by a resident entity.

Other states, instead, provide for a source principle either for residents or non resident, based on the geographical income location ; in this way income realised abroad are exempted from taxation.

Then, in presence of a transnactional income element, the simultaneous and legitimate exercise of the right to tax by different states can bring to double taxation with reference to some income elements.

2. International Double Taxations Conventions – the Mutual agreement procedure (MAP) and Art 9 of the OECD Model

In this landscape, the International Conventions can be very useful ways into trying to avoid the double taxation problem. Those bilateral measures against double imposition, have the function to limit the taxation power of single states, adding to the internal regulations. Their main purpose is to divide the right of taxation between the contracting countries, to avoid differences, to ensure taxpayers' equal rights and security, and to prevent evasion of taxation.[107]

In the transfer pricing matter, Double Taxation Conventions provide for an international dispute resolution arrangement, the so called "Mutual Agreement Procedure" (hereinafter "MAP"). The current International Conventions, in order to the avoid the length of the ordinary diplomatic procedure, include procedural

[107] VALENTE P. *Convenzioni internazionali contro le doppie imposizioni*, Milano, 2012 , p. 22

rules containing simplified consultation forms to solve problems arised in practice in the same convention application.
Whether a taxpayer's income is subjected to taxation in two or more states due to the erroneous and not compliant convention application, the MAP grants the opportunity to solve this issue through the establishment of an agreement among the contracting States Financial Administrations.
In this sense, the "OECD Model tax convention on Income and Capital against double taxation" (hereinafter OECD Model) represent a fundamental base for the contracting states in the redaction of bilateral treaties in the tax matter. [108] The model is not considered an international source (general or particular) but only a not binding recommendation to the OECD member states. [109]
Art. 25 of the OECD Model deals with three different types of MAPs:
1)"specific case method" ;
2) "interpretative method" ;
3) "legislative method"
For what concerns the current study and then, the transfer pricing matter, in the next paragraphs we take into consideration the "specific case method" procedure.
Art. 25 (1) of the OECD Model , that contains the mentioned MAP discipline, takes into consideration a "*taxation not in accordance*" with the provisions of the Convention, having regard to the actions of one or both contracting states.
In general, we are in presence of a wide requirement ; a "*taxation non in accordance"* is realised in every case the conventional disposition are not correctly applied or interpreted, leaving aside the double taxation cases. It is simple to observe that , in the procedure scope of application is includable, without any doubt, the international double economic taxation linked to the transfer pricing matter. In this sense ,
Art. 9 of the OECD Model (Associated Enterprises) provides for some transfer pricing regulations.[110]

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[108] We notice that the first OECD model has been issued in 1963. In 1977 the same organisation has updated the model with a second version.
[109] On the OECD model structure see, BAKER P., *Double taxation conventions and international tax law* , London , 1994 , p.6 ; CROXATTO G., *Diritto internazionale tributario* , in *Rass. Trib*., 1989 , p. 447.
[110] Paragraph 1 states that:

The second paragraph of the article 9 states that in the case a contracting state *"includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profit*s.

"In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other. "

The mentioned paragraph then, explicitly has the aim to solve the associated enterprises double economic imposition issue too, trying to avoid it through the correlative adjustments.

Therefore, since no contracting state is obliged to reduce automatically the declared income by the resident enterprise in its territory, whether it believes that the assessments made by the other contracting state to the associated enterprise are not coherent with the arm' s length value, the possibility to start a MAP is enabled in order to define the issue jointly.[111]

Actually, for a long period of time the OECD itself has doubted about the possibility to activate a MAP even to solve double economic taxation cases, seen that the Bilateral Conventions are specifically born to face double juridical taxation.

However, after the initial hesitations, the OECD Commentary has identified art. 9

"1. Where a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.".

[111] This adjustment as inferable by the letter of the mentioned paragraph 2 of the art 9 finds the "arm's length" limit. Our country makes reference instead to the normal value. (art 9 (3) – art 110 (7) T.u.i.r.).

(2) as the main juridical base to solve the double economic taxation issues with reference to the transfer pricing matter too.

Hence, the double economic taxation and in this way also transfer pricing adjustments are part of the "specific case method" MAP.

2.1. Italian treaty network with reference to Art 9 of the OECD model.

Referring to the tax treaty network of our country, we notice that in most Bilateral Conventions signed by Italy, there is no reference to a similar disposition to art. 9 (2) of the OECD model.

In fact, regarding to correlative adjustments discipline, the italian treaty network shows some gaps due to the time in which the Conventions have been concluded, but also to the traditional caution with those arrangements have been included in our national tax system. [112]

The 1963 OECD model on which lots of Italian Conventions are based on, at that time did not contain the current disposition related to correlative adjustments, included only in 1977 with the model updating.

Moreover, until 1992 our country kept (through a Reservation in the Commentary) a contrary position to the insertion of art. 9 (2) in its treaties. For this reason the disposition appears only in most recent conventions.[113]

Then, most of the next conventions signed, even though not all, include a corresponding disposition to art. 9 (2).

We remark that, the italian tax treaty network includes also, equivalent dispositions to art 25 of the OECD model that makes reference to MAP ; the dominant opinion in doctrine, is that the disputes can regard transfer prices even in absence of a specific disposition on the correlative adjustments.

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[112] With reference to: ROLLE G. "*Transfer pricing": i criteri di confronto fra transazioni e gli strumenti di composizione delle controversie,* in *Corr. Trib*., n. 2/2015, p. 123.

[113] The correlative adjustments provision is included in the Italian conventions with: Armenia, Azerbaijan, Belarus, Canada, Croazia, Denmark, Ethiopia, Georgia, Ghana, Iceland, Lebanon, Moldova, Oman, Qatar, Slovenia, Syria, Turkey, Uganda, U.S.A, Uzbekistan and Vietnam; it the convention protocols with Albania, Estonia, France, Germany, Israel, Kazakhstan, Latvia, Lithuania, Macedonia,Netherlands, Russia, Senegal, South Africa and UAE , as well as in the diplomatic note exchange among Italy and United Kingdom of October 21 th 1998.

In some Italian conventions protocols is, infact, established that the mentioned adjustments should be uniquely made in conformity to the MAP procedure according to art. 25 of the OECD model. [114]

Properly with reference to the case in which in a specific Convention a similar disposition to art. 9 (2) is missing, paragraph 10 of the OECD Commentary on art.25 of the OECD model clarifies that the MAP can find reference in the art 9 (1) that deals with the arm's length principle in the associated enterprises taxation.

In our country, as seen in the first chapter, we make reference to the normal value , according to art 9 (3) and art 110 (7) T.u.i.r. . Moreover, the second part of this latter disposition states that: *"art 110 (7) shall also apply if the result is a decrease in taxable income, but only in compliance with agreements concluded by the competent authorities of foreign states in accordance with mutual agreement procedures provided for by international conventions for the avoidance of double taxation."*

In conclusion, the Italian Income Revenue Authority, with the circular letter n°21/E (5 july 2012) has cleared that *"in the art 25 (1-2) of the OECD model are included all those cases that generate double economic taxation,, through which the transfer pricing adjustments."*.

2.2. The Italian regulations with reference to Bilateral Convention MAP

In our country, in matter of International Conventions, a central interpretative source is constituted by the circular letter n° 21/E issued by the Italian Income Revenue Authority in 2012 (hereinafter the "circular").

This latter provides clearings on the MAP procedure in order to guarantee adequate coherence of the Italian Authority activity to the international recommendations.

The circular illustrates the different procedure features depending on what source is used to activate the MAP. In particular, those sources are represented by the

[114] Albania, UAE, Estonia, France, Germany, Kazakhstan, Lithuania, Macedonia, Netherlands, Southafrica, United Kingdom, USA. For a complete landscape on the double taxation conventions signed by our country see: http://www.finanze.it/opencms/it/fiscalita-comunitaria-e-internazionale/convenzioni-e-accordi/convenzioni-per-evitare-le-doppie-imposizioni/.

mentioned Double Taxation Bilateral Conventions and also by the "European Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises".[115]
In addition, the MAP requirements, the different phases of the procedure , along with the relationship among agreement and internal law are analyzed.
In the next paragraphs we analyze the clearings regarding Double Taxation Conventions whose source is art 25 of the OECD model. [116]

2.2.1 The notion of "Competent authority"

The mutual agreement procedure is a direct consultation instrument, in which the *"competent authorities*" of the contracting states dialogue , in order to achieve an agreement on the double taxation issue arised in practice.
In general, with the term *"competent"* the authority that represent a contracting state in the relationships originated by a treaty is appointed.
The circular letter clarifies that the Italian competent authorities are the Minister for the Economic Affairs and Finance (Finance Department in particular) and the Italian Income Revenue Authority.
Most of Double Taxation Conventions signed by our country include an equivalent disposition to art. 25 of the OECD model[117]

2.2.2. Objective and Subjective scope of application

The objective scope of the MAP is limited to the taxes included in the OECD model. Having regard to our country, IRPEF (personal income tax), IRES

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[115]This can be activated in double economic taxation cases generated by transfer price adjustments carried out among associated UE enterprises. In order to the applicate the EU Convention we also shall make reference to recommendations included in the "Code of conduct for the effective implementation of the arbitration convention", 22 december 2009 (hereinafter "Code of Conduct").
[116] We will deal with the EU Arbitration Convention in par.
[117] In order to favor a more efficient and transparent MAP management , since 2004 the OECD has started a project to improve the functioning of the MAP. This project has brought to the issue of the MEMAP (Manual on Effective Mutual Agreement Procedure that provides for best practices useful either for taxpayers or Financial Administration.

(corporate income tax), IRAP (regional income tax) are the ones included in our treaty network. [118]

Speaking of IRAP, we have to notice that the regional tax has been subjected to lots of changes in the last decade and even recently.

Through the mentioned modifications, the legislator in 2007 has introduced, regarding to the IRAP taxable income, the derivation principle from the balance sheet results, abrogating the previous connection with the IRES fiscal adjustments.[119]After those changed, the transfer pricing adjusments did not have any effect on the regional income tax and then the requirements to activate a MAP were missing. However, the 2014 Stability Law has extended the application of the transfer pricing rules to the determination of IRAP taxable income too.[120]

It follows then, that is it now possible to activate a MAP also in order to IRAP[121].

Pursuant to art. 25 (1) of the OECD model, legitimate to introduce a MAP request is anyone indicated with the phrase *"person"* which is *"resident"* in one of the contracting states.

Art. 3 of the OECD model notices that the term *"person"* is to be intended in a wide sense, that also includes *"an individual , a company and any other body of person "* and that the term *"company"* includes *"any body corporate and any entity that is treated as a body corporated for tax purposes"*

We highlight that not all Italian treaties contain, next to the residence, the reference to the nationality.[122]

Hence, in the case the taxpayer wants to exercise the non discrimination principle , the reference shall be made directly to the single bilateral conventions signed by our country in order to verify it is possible or not to be legitimate to activate the MAP.[123]

In any case, even in presence of a literal difference, in order to request a MAP

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[118] VAT and penalties are then not included.

[119] The 2008 Financial Law (L.n. 244/2007, art. 1, comma 50) has cancelled the mentioned principle , abrogating art 11-bis of d.lgs n.446/1997 , and subsequently creating uncertainty on transfer pricing adjustment effects on IRAP.

[120] L. n. 147/2013 parr. 281-284.

[121] COMI G., MARCONI M., *Transfer pricing: l'estensione all'Irap allarga l'ambito "Mutual Agreement Procedure"*, in *Fiscalità e Commercio Internazionale* , n. 6/2014, p. 5.

[122] In the Italian conventions the subject has mostly been identified with the term "resident" ; in the others it has been used either the term "person" or "taxpayer". The Italy-France convention includes this latter term.

[123] With reference to circular letter 21/E pg. 9.

activation, the essential subjective requirement remains still the residence in one of the contracting states,as established in art. 1 of the OECD model. Fixed this, we remind that one of the most controversial issues has regarded the partnerships subjective legitimation to request a MAP.

The Commentary on the OECD Model clarifies[124] that partnerships are without any doubt included in the *"person"* definition, both because they are part of the enterprise definition and because they represent, in any case, a *"people association"*.

However, they can't be considered as resident in every single case.

Having regard to this requirement, infact, they have to be included among subjects taxable by the corporate income tax.

The partnership legitimacy issue originates then, substantially, from the approach of every single contracting state on the case.

With regards to our taxation system, according to some doctrine authors, partnerships shall be considered as taxable subjects and then, in the case they were either resident, they shall be considered as included under the Convention.[125] This interpretation looks uncertain. Infact, for what specifically concerns our personal income tax, if we better look at our national tax regulations on partnerships, we notice that for those, our legislator has provided a *pro quota* taxation for the individuals partecipating to those associative phenomenons.

The partnership, infact, became a simple transparent screen that does not assume any legal subjectivity in order to the tax obligation.[126] This is the so called transparence principle.[127]

Then, according to the Italian law system, in presence of a partnership, the legitimacy to activate a MAP is given to the single associate, being, in conclusion , this latter the unique subject damaged by a potential double economic taxation.

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[124] Art. 3 (2).

[125] In this sense ADAMI F., LEITA F., *La procedura amichevole nelle convenzioni bilaterali per evitare le doppie imposizioni ,* in *Riv. dir. trib*., 2000, p. 366 ; MAYR S., *La nuova Convenzione Italia - Francia per evitare le doppie imposizioni sul reddito*, in *Boll. Trib*., 1993, p.482.

[126] TESAURO G., *Istituzioni di diritto tributario – parte speciale , op.cit.* p.151.

[127] With reference to Art 5. (1) T.u.i.r.

Our conclusions shall be valid even for the resident trust [128] or to those corporates able to electively choose the transparence regime.[129]

Again with reference to the subjective requirement, we notice that permanent establishments are not included in the definition of *"person"* and therefore they are not suitable on a subjective point of view to start a MAP.

The same circular letter n° 21/E does not include permanent establishments in Italy of non resident enterprises in the subjects able to present a MAP request.

To conclude our analysis on the subjective aspect, it's useful to remark that the Commentary on the OECD model claims that the MAP request presentation shall be presented to the residence state, but at same time, the contracting states can allow their taxpayers to present the request to both competent authorities. Italy does not follow the commentary on the point ; the fiscal authority does not accept non resident subjects requests.[130]

2.2.3 Presentation terms

Briefly and in general terms, we notice that the MAP presents a double phase:

- the first, internal, starts with the presentation of the request by the taxpayer to the competent authority ; this phase is concludable with the rejection/acceptance of the MAP request.

- the second, international and merely potential, tooks place between the competent authorities of the contracting states ; this phase is concludable with a measure called *"mutual agreement"*

Assumed this, according to the OECD model, the taxpayer is able to activate the MAP if *"considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention (...)"*[131]

[128] Transaparent according to art. 73 (2) T.u.i.r.

[129] According to art. 115-116 T.u.i.r.

[130] With reference to paragraph 19 of the commentary.

[131] With reference to art. 25 (1) OECD Model.

We notice that, even solely is presence of a risk of a*"taxation not in accordance with the provision of the Convention*" the taxpayer has the right to start the procedure in respect with the terms provided.[132]

The Italian doctrine, jointly ,believes that a measure provided by the Financial Administration is needed, even though not definitive.[133]

According to the presentation term of the request, the OECD model states that this shall be presented within three years from the notification of the measure that caused the *"taxation non in accordance"*[134]

The OECD commentary clarifies that the previous term shall be intended as a *minimum,* therefore the contracting states are left free to fix a larger/shorter amount of time. Infact, most part of the Italian Conventions include shorter terms ,in general 2 years.

With regards to the *dies a quo*, this is identified by art. 25 as the first notification moment of the measure that brought to a "*taxation not in accordance".*

This term shall be, as clarified by the Italian Authority, in any case, intended in the most favourable meaning for the taxpayer.[135]

Seen that, the taxpayer is able to request a MAP even in presence of a mere risk of a *"taxation non in accordance with the convention"*, the circular letter states that the taxpayer has the discretion to present the MAP request, previously to a measure notification. It's possible for example, to request a MAP following the notification of a report on findings (the so-called PVC).

In any case, the taxpayer is able to demonstrate that the fact has been acknowledged in a posterior date ; in this case the term will start from this last term.[136]

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[132] GARBARINO C., *La tassazione del reddito transnazionale ,* Milano , 2008 p. 580.

[133] The measure can consist in an omissive behavior too.

[134] Last period of art. 25 (1) OECD Model.

[135] As also clarified by the circular letter 21/E/2012.

[136] Ar.t 25 , par 24 of the OECD commentary.

2.2.4. The procedure development and the (potential) agreement signing

Whether the competent authority recognize as valid the taxpayer request, but is not able to manage independently a satisfying solution, it has to strive for solving the case jointly with the other state correspondent authority.

Then, as said briefly in the previous paragraphs, we can distinguish two different phases in the MAP development. In the first one, the competent authority that has received the request has the task to pronunciate on its validity. In particular, the mentioned authority has to evaluate the presence of the requirements we dealt with in the previous paragraphs.

Regarding to this, we notice that the power to evaluate the validity of the taxpayer request represent one of the most relevant features of the MAP and looks reasonable in order to avoid mere delaying requests.[137]

In our country, in practice, the competent authority proceeds to a complete analysis of the validity of thetaxpayer request. The circular letter provides for a preliminary consultation with the taxpayer that presented the request.

Its presentation obligate the competent authority to pronounce on the validity of the MAP request and taxpayer has a legitimate interest to obtain the pronunciation. In any case the compente authority is able to reject the request, but in this case its choice has to be motivated ; in this sense either the OECD commentary, or the national regulations.[138]

To conclude the analysis of this first procedural phase, we need to consider the potential contestability of the request rejection.

In Italy no regulations take expressly into consideration this case, neither some practice has developed in the matter.

According to some authors (we agree with them) is reasonable to believe that the taxpayer is able to appeal to the competent jurisdiction, in this case the

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[137] The only disposition that makes reference to this power is art 25 (2) of the OECD model. No reference is made to meaning of the term "validity". On this point the Oecd Commentary states that the competent authority has the duty to evaluate the request.

[138] Art. 25 (34) of the Commentary states *"An application by a taxpayer to set the MAP should not be rejected without good reason"*. This means that the rejection shall be adequately motivated. According to our country regulations the duty to motivate is set forth in Art. 7 l.212/2000 (Taxpayer statute) and in art. 3 l.n.241/1990 on the administrative proceeding.

administrative judge, because the taxpayer has a legitimate interest to receive the answer. [139]

In the eventuality the request results valid, we enter into the second phase of the procedure. Firstly, the competent authority, has to evaluate the possibility to unilaterally fix the *"taxation non in accordance"* with the convention, through the adoption of measures ; without then starting a MAP.[140]

If it's not possible to fix unilaterally the case, the taxpayer request is notificated to the competent authority of the other state.

The procedure then, will be started in the case the competent authority is not able to solve unilaterally the case, because, for example ,the contested measure has been issued by the other member state.

Moreover, if we joinly read art.25 (2) and its commentary[141] we notice that if the authority into evaluating the request, believes that the "*taxation not in accordance* " originates by measures issued by the other state ,it has the duty to start a MAP.

So, in this second phase the main actors of the procedure are uniquely the contracting states, through their respective competent authorities. The MAP in question, therefore, originates from a taxpayer request, but is then developed exclusively through the contracting States.[142]

In practice, in this part of the procedure, the competent authority requested, prepares a position paper that is sent to its foreign equivalent and in which the taxpayer and the Administration positions on the issue are represented.

This position paper is considered as a good point to start with the negotiations, that hopefully will be concluded with an agreement achievement. We used the phrase "hopefully" because in practice, often , the issue presented to the competent authorities does not find a solution.

This is due to the fact that the Contracting States interested in those kind of MAP have no obligation to conclude it.

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[139] In this sense ADAMI F., LEITA A., *La procedura amichevole nelle convenzioni bilaterali per evitare le doppie imposizioni*, cit. p. 369 ; FILIPPI P., *Dalla procedura amichevole... alla procedura arbitrale: osservazioni* , in *Dir. Prat. Trib*., 1997, p.1174.

[140] In this case the italian law system provides the administrative acts self protection. According to d.l. 1994/564 converted with modifications by l. 654/1994.

[141] Paragraph 33.

[142] The competent authority , naturally , informs the taxpayer with reference to the validity of the request.

It’s the same art. 25 (2) that claims that:

“The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention.”

This interpretation is confirmed also by Commentary on the OECD model that highlights the non jurisdictional nature of the procedure.[143]

2.2.5 Relationship with the internal disputes.

Art. 25 (1) of the OECD model states that the opening of a MAP is requestable by the taxpayer *“irrespective of the remedies provided by the domestic law of those States”*

Regarding to this, most part of the Double Taxation Conventions signed by Italy contain in their accompanying protocol, an interpretative disposition of the OECD model art. 25. According to this, the activation of a MAP is not alternative to the national dispute prooceding, that ,in any case has to be previously activated, if the dispute concerns the application of a *“taxation non in accordance with a Convention”*.

Generally, next to a MAP activated according to a Bilateral Convention, a jurisdictional proceeding started according to our national legislation is settled.

The opportunity to request to the tax commissions corresponds to the need to avoiding, that in the development of a MAP, the taxation assessed in Italy becames definitive and, therefore, not modifiable by the potential agreement reached by the competent authorities.

Furthermore, the simultaneous development of a MAP and of an internal dispute proceeding, makes possible the issue of a judgement in contrast with the eventually signed agreement between the competent authorities.[144]

[143] With reference to par 37 of the Commentary on art. 25.

[144] In this sense the Italian Income Revenue Agency in the circular 21/E/2012 par 4.2.5.

And, as far as we know, according to the italian law system sources hierarchy, the MAP agreement has only administrative nature and can't disregard the previous decision issued by a national court.

Consequently, whether the competent authorities are able to sign an agreement that avoids double taxation, in lack of a judgment, fundamental requirement to the execution of the agreement is the acceptance of its content by the taxpayer and the simultaneous renounce to the national appeal proceeding.

In the opposite case a judgement is issued before the agreement, the competent italian authority shall limit itself to communicate the results to the other equivalent authority.

Furthermore, the taxpayer will evaluate the opportunity to request the Trial Suspension during the development of the MAP.

With regard to this, we need to underline that the recent tax reform has provided for changes also on the Tax Trial Procedure; infact, the d.lgs 546/1992 has been modified in most parts.

For the purposes of our discussion, what results relevant is the addition of a new paragraph 1-ter in the scope of art. 39 of the mentioned decree named, indeed, "Trial Suspension".

The new provision expressly states, the opportunity for the parties to jointly obtain a trial suspension when a MAP is started, independently by the source of activation.[145]

This in full harmony with the intense debate developed inside the OECD (e.g. Beps Action n. 14) and the European Union on making dispute resolution mechanism more effective.

Naturally, in case of missed agreement between competent authorities the national proceeding should be reactivated.

2.2.6 Collection Suspension

We do not have to forget that, during a MAP, the taxpayer could be subjected to previous collection measures of the major taxable income assessed.[146]

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[145] This last clearing has been provided by circular letter n°38/E/2015 parr. 1.9.1.

Nowadays, however, for what concerns the suspension of the tax collection in the development of a MAP no *ad hoc* remedies are provided. In those cases, then the taxpayer has the opportunity to make reference to the art. 39 (1) of d.p.r. 602/1973 that provides for the administrative suspension.

We notice that the suspension of the tax collection during a MAP, is not compulsory but is the Italian Income Revenue Agency that has the power to concede it or not even conditioned to a specific bank guarantee.[147]

In addition, the taxpayer can make use of another remedy that, however, implicates the activation of an internal trial ; infact art. 47 of the d.lgs n.546/1992 deals with the jurisdictional suspension of the tax collection.

2.2.7 MAP conclusion in case of agreement

In case of agreement among the contracting states, generally, the competent authority that received the MAP request, has the duty to inform the taxpayer about the content of the arrangement; the Italian Income Revenue Agency commands instead the agreement execution, providing to the non- due tax refund / relief and related interest and penalties.

The circular claims specifically that, in a MAP consequent to a transfer pricing adjustment, the italian competent authority, generally informs the resident taxpayer even if the MAP request has been presented to the foreign equivalent one by the non resident taxpayer.[148]

The circular, moreover, in the exclusive scope of application of the Bilateral Conventions and, upon evaluation by the competent authorities, states that the effects of an agreement signed during a MAP can be extended either to taxpayer's immediately subsequent fiscal years, but only if the examined elements will present equal features.

Then, the Italian competent authority, after reaching an agreement has the possibility to jointly evaluate with the other state equivalent, the temporary

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[146] According to the OECD Commentary , during the MAP development , the suspension of the collection shall be allowed to the taxpayer to avoid cash flow burdens , deriving from the financial payment in advance of taxations that could be not conform to the convention.

[147] This arrangement is strictly linked to the request validity.

[148] With reference to circular letter 21/E /2012 par. 4.2.9.

extension of the understanding for next fiscal years upon also the taxpayer consensus.

2.2.8. Relationship with national Deflationary dispute tools

A different theme regards the compatibility of the MAP activated through Bilateral Convention, with the potential deflationary dispute tools (tax settlement, tax mediation, judicial conciliation) provided by our national regulations.[149]
Those instruments are featured by a clear settlement attitude and precisely will bring to the tax obligation latching towards the Financial Administration. On this point, the Italian Income Revenue Authority states that those arrangements involve the same effects of the missed appeal of a measure, that is the non modificability of the taxes in question.[150]
Is precisely this will to close the obligation with the Financial Administration that blocks the MAP Activation which source is the bilateral convention.

3. Arbitration Clause: introduction

In the previous paragraph we noticed that, according to art. 25 (2) of the OECD model, the Contracting states of a Double Taxation Convention are not bound to conclude an agreement according to the MAP procedure activated through this source. Infact, the competent authorities are not subjected to a specific result obligation but merely to an obligation of means and it's frequent that they don't reach any agreement.
In order to make MAP much more efficient, the OECD in 2008 has introduced in art. 25 of the model convention a new paragraph 5, in which is expressly provided the recourse to international arbitration, in the case of missed agreement among the two Financial Administrations.

[149] On this point we have to clarify that the OECD with regards to the Double Taxation conventions (art 25 OECD model) has stated in point 19 of Beps Action 14 *Make dispute resolution mechanisms more effective* that tax settlements cannot have blocking effect with respect to MAP.
[150] According to circ. 21/E/2012.

In particular : *"any unresolved issues arising from the case shall be submitted to arbitration if the person so requests"*

This new mechanism is not an alternative procedure for disputes resolution arising from the specific Bilateral Convention and it's non dependant on a previous authorisation by the competent authorities.

After two years, infact, every unsolved issue that obstructs the signing of an agreement between the states , has to be submitted to arbitration "*if the person so requests"*.[151]

Then, meanwhile the main issue is resolved into the MAP context, only those specific unsolved questions, from which the case definition depends, are submitted to the arbitration procedure. In this way, the procedure in comment is distinguished from other agreement forms of arbitration ; in those the jurisdiction of the arbitration committee is extended to the exam and resolution of the whole case[152].

We can correctly consider the arbitration provided in paragraph 5 as a MAP extention, in order to improve its effectivity.

3.1. Arbitration clause: the Italian perspective

After this brief presentation of the new arbitration clause, we specify that, in transfer pricing matter it's essential for the OECD member states that are also members of the European Union, to apply the art 25 (5) OECD model disposition in coordination with the EU Arbitration Convention n° 90/436/CEE.

As regards as the Italian perspective, since the new paragraph 5 has been introduced only in 2008, it is applicable only if its admission is negotiated (or renegotiated) in the new (or current) Double Taxation Conventions. The current treaty network of our country is composed of about 90 treaties in force , 4 ratified and 12 signed. According to the circular letter, thirteen Double Taxation

[151] Logically, there' s no reason to recur to the arbitration procedure when the competent authorities have reached an agreement and all issues regarding to the conventions applicaiton have been solved.

[152] VALENTE P., *Convenzioni internazionali contro le doppie imposizioni , op cit. ,* p.855.

Conventions signed between Italy and partner states include an arbitration clause.[153]

It's necessary to specify, however, that the mentioned clause is present even in treaties negotiated before the insertion of the new paragraph 5 in the OECD model , usually providing the arbitration activation only after the approval of both states and the taxpayer.

In these "old" clauses, there is no trace of a mandatory arbitration for the contracting states in the case of missed agreement among the competent authorities.

Moreover, we notice that in some cases the clause effectiveness is submitted to a diplomatic note exchange.[154] This last, express the will of the contracting state to both implement the arbitration clause and to define the related terms (arbitration committee composition , selection criteria, cost sharing , language) [155]

Neverthless, the contracting states choice of not establishing a mandatory arbitration or, either to keep the diplomatic note exchange reservation before including the arbitration clause into the Convention, convert one more time the MAP into a "blunt weapon".

3.1.1 The Arbitration Clause in ITALY-U.S.A. Double Taxation Convention

Among the thirteen Italian Double Taxation Conventions that include an arbitration clause, the one signed with the United States stands out.

We clarify, briefly, that the ratification process of the Convention Italy-U.S.A signed in 1999, has been featured by complexity and length ; the ratification law

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[153] Nowadays the partner states whose convention contains an arbitration clause are: Armenia,Canada,Croazia,Georgia,Ghana,Jordan,Kazakhstan,Lebanon,Moldova,Slovenia,Uganda, Uzbekistan,U.S.A.

[154] Nowadays the following treaties with : Canada , Ghana , Kazakhstan , U.S.A. , Uzbekistan.

[155] An example of those disposition is the art. 8 of the protocol of the Italy– Kazakhtstan convention: "*With regard to Article 25: If any difficulty or doubt arising as to the interpretation of the Convention cannot be resolved by the competent authorities pursuant to Article 25, the case may, if both competent authorities and the taxpayer(s) agree, he submitted for arbitration, provided that the taxpayer agrees in writing to be bound by the decision of the arbitration board in a particular case shall be binding on both States with respect to that case. The procedures shall be established between the States, if appropriate, pursuant to paragraph 4 of Article 25, and by notes exchanged between the two competent authorities. The provisions of this paragraph shall have effect after the competent authorities have so agreed through exchange of notes.".*

(l.20/2009) has been published in the italian Official Journal only in march 2009.[156]

In the mentioned convention, the opportunity to activate an arbitration procedure has been provided in article 25 of the treaty. Its fifth paragraph prefigures the chance to go over potential disputes among contracting states, even after the activation of the MAP , through the international arbitration instrument. In particular:

"If an agreement cannot be reached by the competent authorities pursuant to the previous paragraphs of this Article, the case may, if both competent authorities and the taxpayer agree, be submitted for arbitration, provided that the taxpayer agrees in writing to be bound by the decision of the arbitration board. The competent authorities may release to the arbitration board such information as is necessary for carrying out the arbitration procedure. The award of the arbitration board shall be binding on the taxpayer and on both States with regard to that case. The procedures shall be finalized by the Contracting States by means of notes to be exchanged through diplomatic channels after consultation between the competent authorities. The provisions of this paragraph shall not have effect until the date specified in the exchange of diplomatic notes."

We notice that the arbitration activation is submitted to the missed agreement between component authorities, within two years from the start of the MAP. (whose discipline is contained in other paragraphs of art 25)

The taxpayer is involved not only into the procedure start, but also in the following phases through the presentation of a memorandum. [157]

In this clause, differently from the art 25 of the OECD Model convention last version, it's not explicitly requested that the arbitration procedure shall be necessarily started by the taxpayer.

The last period of art 25 (5) of the Convention states that its provisions shall not have effect until the exchange of diplomatic notes.

Actually, an arbitration regulation has been outlined in the Memorandum of Understanding concluded in Washington in august 1999. At that time, however

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[156] For further information on the Convention Italy-USA see ROLLE G., TURINA A., *Condizioni applicative e profili temporali della convenzione Italia-USA*, in Corr. Trib. , n. 11/2010, p. 888.
[157]VALENTE P. *Convenzioni Internazionali contro le doppie imposizioni* , *op.cit.* p.878.

nothing has been specified with regards to the time in which the clause will be applicable.[158]

3.1.2. The Arbitration Clause in Ital y- Republic of San Marino Convention

With the d.m 12th Februrary 2014, the Republic of San Marino has been eliminated by the italian black list supplied by the d.m. 4th May 1999.[159]

In the mentioned evaluation, a fundamental role has been played by the entry into force in October 3rd 2013 of the Double Taxation Convention between Italy and Republic of San Marino.[160]

Regarding the arbitration procedure activation, a specific clause is included in art 25 paragraph 5-6 of the mentioned Convention.

According to paragraph 5 the activation of the arbitration procedure is subjected to the case that within two year the contracting states are not able to reach an agreement through the MAP. The activation of the arbitration procedure is also subjected both to the condition that the taxpayer obligates itself to commit to the related decision and to the preventive surrender (without any reserves or conditions) to the trial proceeding. [161]

In the convention protocol is also clarified that, within three years from the Convention entry into force, the contracting states will evaluate the opportunity to proceed to a diplomatic note exchange in order to make the arbitration procedure effective.

In addition, we notice that, according to art. 3 (2) lett a) of the protocol, art.25 dispositions are applied uniquely to disputes concerning the fact that a provision is part or less of the scope of application of the Convention.

Then, we notice that the MAP provided by this Convention is different from the OECD model procedure; in this latter, the arbitration procedure does not depends on a previous authorisation by the competent authority. In presence of the

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[158] With reference to MAISTO G., *Convenzioni Internazionali per evitare le doppie imposizioni* , Milano , 2015.

[159] The mentioned decree contains a list of states and territories that have a privileged fiscal regime.

[160] Signed in rome in year 2002.

[161] For further information on the San Marino Republic-Italy convention see: VALENTE P. *San Marino: Fiscalità degli accordi internazionali ,* Milano , 2012 , p.211.

temporal requirement, infact, according to the model issued by the organisation, every unsolved question that blocks the reaching of the agreement between the states, shall be subject under the arbitration procedure.
In addition, whereas art 25 (5) of the OECD model contemplates a precise amount of time within the competent authority must find an agreement (2 years) before starting the arbitration procedure, art 25 (5) of the Italy - San Marino Republic convention does not provide for any temporal requirement.

4. European Arbitration Convention MAP: Introduction

In the previous paragraphs we dealt with Bilateral Conventions MAP, noticing that this constitutes an international dispute resolution mechanism, based on the cooperation of the contracting states competent authorities. However, we also noticed that the arrangement is lacking of compulsoriness, due to the fact that the involved authorities "*shall endeavour*" to solve the dispute ; there is no specific result obligation.
In the European Union landscape, in order as well to provide for this limit, the Council of European Communities has approved in , 23th July 1990,the 90/436/CEE Convention (hereinafter "Arbitration Convention" and then "Arbitration Convention MAP) on the elimination of double taxation, in connection with the adjustment of profits of associated enterprises. The main aim of the Arbitration Convention is to avoid, in the European landscape, the double economic taxation originating from a transfer pricing adjustment ; Italy has ratified the EU Arbitration Convention with l. n°99/1993. [162]
In order to apply the Arbitration convention, reference shall be made also the specific recommendations included in the Code of Conduct issued by the European Council in 22th December 2009 (hereinafter Code of Conduct.)[163]

[162] We have to remind that the Arbitration Convention has had a complicated developement through the years. Infact it is entered into force , with a five year duration on January 1st 1995 , many years after its conclusion and in the next a Modification Protocol has been introduced. The Document has been ratified by all member states only in 2004. According to art 3 (2-3) of the mentioned Modification Protocol the agreement has retroactive effects starting from the January 1st 2000.
[163]In the European Union Official Journal n°322/1 of 30 december 2009. It's the update of the previous Code of conduct issued in 2006. (2006/C 176/02).

This latter, seems to propose, as expressly claimed in its preamble, the widespread soft law model ; infact, the Code of Counduct represents only a *“political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the European Union resulting from the Treaty on European Union and the Treaty on the Functioning of the European Union”.*

4.1. Subjective requirement

Subject legitimate to present an Arbitration Convention MAP request to the Italian competent authorities are:

A. Resident enterprises , with reference to holding relationships among the same and other European resident enterprises.[164]

B. Permanent establishments in Italy of European resident enterprises ;

According to lett b) and the permanent establishment issue, differently from the BilateralConvention MAP, those subjects are in the Arbitration Convention, considered as equal to the enterprises of the member state and then they have the right to request a MAP.

4.2. Objective requirement

The Arbitration Convention is applied to double taxation issues that may regard an enterprise (or its permanent establishment) of a European Union member state, in the case income are adjusted in application of the transfer pricing discipline.

Just like the MAP Bilateral Conventions, IRPEF(personal income tax), IRES (corporate income tax) and IRAP (regional income tax) constitute the objective Arbitration Convention scope of application. [165]

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[164] Speaking of the “enterprise” definition, this shall be found:
a) firstly in the speciific Double Convention between member states ;
b) in lack, in the OECD model.
The Arbitration Convention , infact does not provide for any definition of the used terms.

[165] What we said about IRAP about Double Convention MAP is also valid with regard to Arbitration Convention MAP. With reference to chapter 2 par.2.2.2.

Properly with reference to the objective scope of application of the Arbitration Convention, we notice that the Italian Income Revenue agency, in the mentioned circular letter 21/E/2012 has clarified that the starting of a Arbitratation Convention MAP is blocked for those taxpayer that include in the request different objection arguments from the transfer pricing adjustments. (e.g. the adjustment linked to the inheritance of some expenses between associated enterprises).

In this case the competent authority, consults the Financial Administration, and then rejects the taxpayer request.[166]

In particular, the Arbitration Convention shall apply where, profits which are included in the profits of an enterprise of a Contracting State are also included (or are also likely to be included) in the profits of an enterprise of another Contracting State on the groundsthat the principles set out in Article 4 (free competition) and applied either directly or in corresponding provisions of the law of the State concerned have not been observed.[167]

4.3. The Procedure development and the agreement signing

Pursuant to Art 6 (1) the procedure we are dealing with starts :

"Where an enterprise considers that, in any case to which this Convention applies, the principles set out in Article 4 have not been observed,(...) it may, present its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated. The case must be presented within three years of the first notification of the action which results or is likely to result in double taxation (...)".

Then, we notice that, the procedure is again introduced by the taxpayer and looks divided into four different phases, strictly linked between them. Infact, whether the compent authority has considered the enterprise request as justifiable, but is not able to solve unilaterally the complaint double taxation issue , informs the other contracting state of the decision to start a MAP ; in this part of

[166] GARBARINO C., – COMI L., *Mutual Agreement Procedure: la Convenzione Arbitrale Europea sul Transfer Pricing*, in *Fiscalità e Commercio Internazionale*, n. 8-9/2012, p.5.

[167] According to what jointly disposed by art 1 and art 4 of the Arbitration Convention.

the procedure there is no difference among the developement of this kind of MAP and the others we dealt with in the previous paragraphs (those provided by the OECD model and single Double Taxation conventions). [168] For this reason most of the considerations made in the previous paragraphs are valid also for the Arbitration Convention MAP.

If the competent authorities do not reach an agreement that eliminates double taxation within two years of the date[169] on which the case was first submitted to one of the competent authorities in the MAP environment [170], they shall set up an Advisory Commission charged with delivering its opinion on the elimination of the double taxation in question.[171] The advisory commission referred shall deliver its opinion not more than six months from the date on which the matter was referred to it.

As third phase it's provided for a new issue evaluation by the competent authorities that shall take a decision that eliminates the double taxation.

This evaluation has to be given within six months of the date on which the advisory commission delivered its opinion.[172] It's natural that during this phase the competent authorities take into consideratiion the opinion delivered by the Advisory Commission, but it is also specified that they may take a decision which deviates from the Advisory Commission's opinion. However, as fourth phase, if they fail to reach an agreement, they shall be obliged to act in accordance with that opinion : they are then obliged to eliminate the double taxation in conformity what stated by the Advisory Commission.[173]

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[168] In practice, as said with reference to Bilateral Conventions MAP , the competent authorities of the different member states involved plan a series of meetings to negotiate and try to reach an agreement to solve the double taxation issue and *"shall endeavour"* fo find a solution to the presented double taxation case.

[169] We clarify that what we told about procedure timing on par. about Double Conventions MAP on timing procedure is still valid for Arbitration Conventions MAP.

[170] In the mentioned circular letter 21/E/2012 the Italian Income Revenue Agency points out a series of circumstances that does not allow to respect the two years term (such as the different evaluation that the other competent authority can make of the issue in discussion.).

[171] According art 7 of the Arbitration Convention 1 , the advisory commission referred shall consist of *"in addition to its Chairman: — two representatives of each competent authority concerned; this number may be reduced to one by agreement between the competent authorities, — an even number ofindependent persons ofstanding to be appointed by mutual agreement from the list of persons referred to in paragraph 4 or, in the absence of agreement, by the drawing"*.

[172] According to art 12 of the Arbitration Convention.

[173] According to art 12 (1) of the Arbitration Convention.

Then, under the Arbitration Convention, competent authorities do not only "shall endeavour" to reach a solution to eliminate the double taxation, but they are obliged to solve the problem following the procedure presented in this paragraph.

Moreover, we highlight that, similarly to the Bilateral Convention MAP, in this case, the sole actors on the scene are the residence states of the enterpries ; the taxpayer only presents the case and is constantly informed of the MAP development by the authorities.[174]

In conclusion, with signing of the agreement, EU member states has provided for a specific result obligation in order to eliminate international double taxation arisen between them. [175]

4.4. Jurisdiction of the Italian Tax Judge on Administrative Acts Denying Access to the Arbitration Convention on Transfer Pricing.

An interesting point on which is important to stop momentarily, is constituted by the potential rejection of the Arbitration Procedure request and the recent Supreme Court decisions on the theme.

Infact, with the injunctions n° 12759 – 12760, for the first time the Court of Cassation has pronounced in matter of European Arbitration Convention and regarding to the MAP request rejection.

First of all, with the twins mentioned orders, the Supreme Court has acknowledged the jurisdiction of the Italian tax judges on administrative acts denying access to the Arbitration Convention on Transfer Pricing. [176]

Two Italian companies belonging to the same international group received an assessment containing, *inter alia*, a transfer pricing profit adjustment. In relation to this assessment, the two companies presented to the Ministry of Finance (the Competent Authority according to the Italian legislation) two different requests

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[174] The taxpayer is informed about all the significant develpoments of the procedure , in conformity with the recommendation of par 6.3. lett b) Code of Conduct. Moreover, according to the same Code of Conduct, the taxpayer has to cooperate with the autorities, describing specifically its case and supplying the further information potentially required by the authorities.

[175] ADONNINO P., *Some thoughts on the EC Arbitration Convention*, in *European Taxation*, n. 11/2003, p. 233.

[176] ROMANO C., CONTI D., *Giurisdizione tributaria sul diniego di accesso alla Convenzione arbitrale IL COMMENTO* in *Corr. Trib.,* n°34/2015, p. 2601.

for a MAP under the Convention. The Ministry issued two different notes denying access to the Convention for inadmissibility, and in particular on the grounds that, with reference to that assessment, the two companies had already agreed on an audit settlement with the Italian Revenue Service. The two companies challenged the two Ministry notes with separate proceedings before the Tax Commission (i.e. the court of first instance for tax matters). Appearing before the court in both proceedings, the Ministry objected to the court's jurisdiction over the Ministry notes arguing that these notes had been issued by the Ministry in its capacity of Competent Authority under the Arbitration Convention. In other words, according to the Ministry's argument, the communication on denial of access was to be considered as a phase of the mutual agreement procedure under the Convention, which is an international multilateral convention subject to the rules of international treaties. Since this procedure was essentially an intergovernmental negotiation envisaging States as only parties and involving their prominent interests concerning their taxing power, no domestic jurisdiction over this procedure could exist, as this could amount to an undue interference with State sovereignty and an infringement of the principle of State immunity. In order to resolve the preliminary question of the Italian court's jurisdiction by means of a final and unchallengeable decision, the Ministry submitted a request for a preliminary ruling before the Court of Cassation, which replied with the orders under examination. [177]

In rejecting the Ministry's argument, the Court of Cassation made a distinction between on the one hand the submission of a request for a MAP under the Convention, and the assessment of its admissibility and on the other hand the subsequent mutual agreement procedure in the proper sense: the former was a preliminary phase of the mutual agreement procedure and fell completely within national law, whereas the latter featured a confrontation between Competent Authorities, involved States' prominent interests and therefore was subject to international law. In particular, with relation to issues arising within the

[177] For a complete exam of the two decisions see DE CAROLIS D., *Jurisdiction of the Italian Tax Judge on Administrative Acts Denying Access to the Arbitration Convention on Transfer Pricing: Towards a Dispute Resolution Procedure Ever More Independent of State Control,* in *Intertax*, Issue 2, pp. 180–184.

preliminary phase of the mutual agreement procedure – as it was the issue of denial of access for lack of admissibility requirements –, since they fell within national law, they could not a priori be removed from judicial review and, more specifically, from the court of the State in which the request for a MAP was presented. And with reference to Italian law, the competent judge was deemed the tax court, having general jurisdiction whenever the dispute involved a tax obligation.

The Court of Cassations decision are of capital importance; their effects are likely to extend beyond national borders especially if we consider the debate that took place within the Joint transfer Pricing Forum on the denial of access to the European Arbitration Convention.

5 .Unapplicability of the Arbitration Convention in "serious penalty" cases: .The notion of "serious penalty" included in art. 8 of the Arbitration Convention.

"The Arbitration Convention, includes, in art. 8 a specific disposition , that, with reference to enterprises states that: *"The competent authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or to set up the advisory commission referred to in art 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under art 4 one of the enterprises concerned is liable to a serious penalty"*. The *"serious penalty"* concept is clarified, for every contracting state, in the specific unilateral declarations attached to the single Convention ; in this way, every single state provides for a different definition. For what specifically concerns our country the term *"serious penalty"*is referrable to any case of fiscal crime. Therefore, according to the Italian interpretation no difference is made among administrative and penal offense, even though those latter can be considered more serious.[178]

[178] VALENTE P. Arbitration Convention 90/436/EC: Inapplicability in case of serious penalties, in Intertax, Vol. 40, Issue n. 3/2012.

5.1. The "serious penalty" Italian Income Revenue Agency interpretation

The Code of Conduct restates the opportunity of a restrictive interpretation of the term *"serious penalty"* [179]

Following those recommendations, our country has limited the number of cases that block the beginning of a MAP, to the criminal and artificial behaviors. The cited circular n°21/E clarifies that those cases occur in presence of criminal relevant violations of art 2 (false statement) e 3 (fraudulent statement through other artifices) of the d.lgs 74/2000, excluding the art 4 violation (unfaithful declaration). However, it's the same Italian Income Revenue Agency that asserts that violations regarding art. 2 and 3 are not recurring in transfer pricing matter.

In the thoughts of the Financial Administration, the transfer price determination policies can bring to criminal relevant sanctions ex art. 4 del D.Lgs. n. 74/2000, even though the same situations shall be considered also with regard to the non punibility clause, provided for those kind of evaluations by art. 7 of the same decree. [180]

Those circumstances, states the Italian Authority itself, could however bring to a preclusion according to art. 8 in the cases (difficult to verify) of demostration of a clear existence of specific fraud.

Definitively, according to the Financial Administration, the arbitration procedure preclusive cases shall be limited to exceptional hypotesis based on evident fraudulent behaviors.

The italian doctrine, commenting on the mentioned clearings issued on the *"serious penalties"*, has noticed uncertainty.

Infact, following the circular letter, the potential preclusion to the arbitration procedure in presence of transfer pricing criminal relevant notifications ex art 4

[179] In this way the art 3"As Article 8(1) provides for flexibility in refusing to give access to the Arbitration Convention due to the imposition of a serious penalty, and considering the pratical experience acquired since 1995, Member States are recommended to clarify or revise their unilateral declarations in the Annex to the Arbitration Convention in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud".

[180] The importance of taking always in consideration the non punishability causes is underlined also by the Government report to the d.lgs 74/2000 in which is clarified that occurs "to avoid that the new punishing provisions can rbe applicable with extreme harshness or determining the uprising of a criminal risk also in the regards of subject not pushed by real evasive aim.

d.lgs n°74/2000 seems to be subordinate to the preliminary (and subjective) investigation made by the Financial Administration, requested to pronounce on specific criminal relevant issues and not of its strict competence.
Actually, especially in the multinationals audit it's very simple to pass the threshold considered by the art 4.[181]

6. *Relationship with the internal disputes*

To this specific regard we remark that considerations made in the previous paragraph regarding the Bilateral Conventions MAP are either valid to Arbitration Convention agreements.
We only want to remind that the same Arbitration Convention, with a provision that our country has expressly declared to applicate [182] dispose that "*Where the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decisions of their judicial bodies, paragraph 1 shall not apply unless the associated enterprise of that State has allowed the time provided for appeal to expire, or has withdrawn any such appeal before a decision has been delivered"*
Naturally, since the decision constitute obstacle to start of the arbitration phase, it looks right that it shall also be an obstacle to the prosecution of the previous friendly procedure if this decision is issued during this first phase.
On the another hand we have to notice that, as long as the internal appeal is pending, the two years amount of time, provided for the developement of the procedure, and beyond that we shall pass to the arbitral phase , does not elapse.[183]
Infact, although nothing prohibits to the national authorities to start the negotiations to the solution of the issued case , the mentioned two-year term does not start until the taxpayer has given up the national appeal.

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[181] MARTINELLI A. – TOMMASINI A., *L'Accesso alla MAP nell'Arbitration Convention*, in *Corr. Trib*., 2012, p.2494.
[182] With reference to Art. 7 (3).
[183] Art 7 of the Arbitration Convention states that: "If the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6 (1), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question."

In practice, the lack of a deadline for the negotiations slacken the pressure on those and, usually, the national authorities that should renounce to the major income produced in its territory, have, for this reason, no interest at all to accelerate the conclusion of the agreement.[184]

This is the reason why the taxpayer that wants to achieve a solution with the Arbitration Convention, shall not only verify not to have received a national court decision (that couldn't be modified by the next arbitration solution), but also renonunce to the proposed appeal.

Is then clear that the alternative choice among the two possible ways to solve disputes (the jurisdictional one and the conventional) that is established after the beginning of the procedure put the taxpayer infront of a choice: evaluate the perspective to accomplish an useful result in both the alternative procedures, before renonuncing to the jurisdictional protection.

Infact, the appeal remains uncompromised in the case this regards different elements from the procedure we are dealing with.

The Financial Administration, then, affirms the alternativity among the dispute resolution deflective remedies (tax settlement ?) and the conventional procedure, even in lack of the Arbitration Convention provisions.

We notice that on the point the Italian Authority interpretation appeared excessively restrictive.

Precisely due to the mentioned alternative principle among Arbitration Convention and domestic tax litigation, contrary to what highlighted in relation with the Bilateral Conventions MAP, the Italian Authority confirms that from the missed appeal of the assessment notification in case of Arbitration Convention MAP does not derive the definitivity of the tax assessed in Italy.

This, then, does not impede the definition of the dispute among the competent authorities of the two member states, but is rather expression of the aim to rediscuss the dispute in a different scope and through a different arrangement.

7. OECD Statistics on MAP

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[184] GARBARINO C., COMI G*, Mutual agreement procedure: la convenzione arbitrale europea sul transfer pricing*, *cit.,* p. 43.

As part of the OECD's work to improve the timelines of processing and completing mutual agreement procedure cases under tax treaties and to enhance the transparency of the MAP process, the OECD makes availalbe to the public annual MAP, statistics of all its member States and of partner economies which agree to provide them.[185]

The first year of such reviews was the 2006. From that year, Costa Rica entered for the first time in history in the partner economies cooperating with OECD supplying data. Differently the previous years was the first time of Latvia and the Popular Republic of China. Above all, the only States not participating to this sharing of information are five : China, Latvia, South Africa, Argentina and Costa Rica.

On the 23rd November 2015, the OECD released its annual statistic publication on the Mutual Agreement Procedure (MAP) caseloads of all OECD member States and partner economies for the reporting period 2014.[186]

The report covers the opening and ending inventory of MAP's cases for the mentioned year, the number of new MAP cases initiated, the number of MAP cases completed, the cases closed or withdrawn with double taxation, and also the average cycle time for cases completed, closed or withdrawn.[187] Last year, this procedure had an influence in recording a pick of new opened cases ,either in terms of effectively opened case or procedures still pending at the end of the observation period.

In fact, at the international level, 2.266 MAP were initiated, almost 19% more than 2013.

The questions resolved by the states were about 1.400 and this lead to an increase of the pending procedures of almost 900 units.Between the 10 countries with the

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[185] For further information on MAP statistics see: *OECD Mutual Agreement Procedure Statistics for 2014* , in http://www.oecd.org/ctp/dispute/map-statistics-2014.htm.

[186] With reference to: *OECD releases 2014 Mutual Agreement Procedure statistics - EY Global Tax alert (News from Transfer Pricing)* – December 17th , 2015 in http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-releases-2014-Mutual-Agreement-Procedure-statistics;

[187] The release of this data by the OECD is part of its effort to improve dispute resolution processes, in line with theMultilateral Strategic Plan on Mutual Agreement Procedures launched by the Forum on Tax Administration, as well as Action 14 of the OECD's BEPS (Base Erosion and Profit Shifting) Action Plan. Both initiatives set out to achieve more effective dispute resolution results and the availability of this data enables interested groups to access the effectiveness of the MAP processes in the OECD member countries and partner economies.

highest number of new cases, Italy is at second place. In fact, our country presents an increase of 71% (from 52 in 2013 to 89 in 2014), following only Luxembourg who had the highest growth among all member states. (158% - from 45 in 2013 to 116 in 2014). Only in 2014, in the Italian Financial Department 89 were presented 89 new cases of taxpayers which were complaining about cases of double taxation. Although, the agreements concluded with the foreign counterparts were only 7, bringing the pending cases from 173 at the beginning of 2014 to 250 at the end of the same year. (+44%)

Thus, we are witnessing a real explosion of the phenomenon of double taxation for the multinational companies and the OECD is working hard to eliminate them. As mentioned before, during the last decade, the OECD has issued guidelines to improve dispute resolution mechanisms, including the including the *Manual on Effective Mutual Agreement Procedures* (MEMAP) in 2007. Moreover, it is almost completed the Action 14 of the BEPS project, entitled “Make Dispute Resolution Mechanisms More Effective”.

The more recent data exchanged through the procedure of MAP, they mostly regard the prices of transfers in the intra company operations. Although, there is the existence of MAPs on permanent establishments or on the possible attribution of profits to the PE.

7.1. Average cycle time for cases completed , closed or withdrawn.

With reference to mutual agreement procedure length, the average time for the completion of MAP cases with other OECD member countries in 2014 was 23.79 months, a slight increase of the 2013 cycle time of 23.57 months. Only 17 OECD member countries reported average cycle times in 2014, but interestingly, Iceland and New Zealand reported average cycle times of less than 10 months. It from one side is true that the time procedure for the MAP is reduced to 23 months (in 2015 was 25), form the other the complexity and difficulties of the arguments treated in these MAPs make it difficult to deal with this very strong increase of new cases.

Moreover, it is true that most of the MAPs last 24 months but it has also to be underlined that many cases could last years, leaving companies in an uncertainty

status and depriving the State from the possibility to collect taxes in the short term.

CHAPTER III
Base Erosion and Profit Shifting

1. Brief Introduction on the BEPS OECD developement

International tax issues have never been as high on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years, putting a strain on the international tax rules, which were designed more than a century ago. Weaknesses in the current rules create opportunities for base erotion and profit shifting (BEPS) requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created. [188]
Following the release of the report Addressing Base Erosion and Profit Shifting in February 2013 , OECD and G20 countries adopted a 15-point Action Plan to address BEPS in September 2013. The Action plan identified 15 actions along three key pillars :
introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards , and improving transparency as well as certainty. Since then, all G20 and OECD countries, Italy included , have worked on an equal footing and the European Commission also provided its views throughout the BEPS project.
After two years of work, the 15 actions have now been completed and all the different outputs , including those delivered in an interim form in 2014, have been consolidated into a comprehensive package.

2. *The Italian situation, changes applied following BEPS project.*

The recovery of a tax base improperly transferred abroad is now an urgent necessity given the size and the speed of growth of the phenomenon which is even more evident within the ambit of the digital economy, but is also the solution that

[188] OECD (2015) , *Aligning Transfer Pricing Outcomes with Value Creation , Actions 8-10 – 2015 Final Reports , OECD/G20 Base Erosion and Profit Shifting Project , OECD Publishing , Paris.* http://dx.doi.org/10.1787/9789264241244-en.

the current Italian government wants to adopt in order to finance the reduction of some internal taxes to assist in reviving the domestic economy.

More in general, the recent law n° 23/2014 has conferred delegation to the Government to realize a "*more equal, transparent and oriented to growth fiscal system*".

One of the central issues of the delegation in word is the revision of the discipline regarding transboundary operations. Nowadays, in execution of the delegation law , eleven legislative decrees have been supplied. Those latter, touched on and started to address the issues covered by the BEPS project as well as more general aspects of international taxation.[189]

The same "Balance Service" of the Italian Senate, highlighted [190] that the legislative decrees, in implementation of the mentioned delegation, introduced different innovations, even making use of the first BEPS results, with reference for example to permanent establishment, to transfer pricing, to the mentioned international ruling ; abuse of law ; patent box[191] ;assessment terms ; cooperative compliance (d.lgs 128/2015)[192].

However, the most significant new regulations are still to come and it is certain that they will have a significant impact on the structure of multinationals. But what is the timing and the manner in which these developments will be introduced? Much curiosity has arisen as to how the main themes from the BEPS project will be developed at the national level.

Some multinationals have already started, within Italy, a process of adapting their corporate and tax structures, but we are only at the beginning. In any case, for multinational groups, it will be essential to monitor and promptly evaluate the regulatory changes as they are introduced.

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[189] With reference to: *BEPS: Italy, an update* 3rd November 2015 in http://www.osborneclarke.com/connected-insights/publications/beps-italy-an-update/.

[190] For further information see: Servizio del bilancio del Senato , *Il progetto Base Erosion and Profit Shifting* XVII legislatura , Nota breve n. 13 , October 2015.

[191] We will specifically deal with in the following paragraphs including the intangibles discipline.

[192] Properly with reference to this latter topic , in order to promote a more transparent and compliant relationship among taxpayer and Financial Administration , on the last 14th October the Ministry of Economics and Finance has announced the role conferring of to IMF and OECD to pointout the international best practices according to taxpayer – Financial Administration that could be introduced in Italy.

In conclusion, our country is facing a junction into the definition of its fiscal policy. In fact, after the mentioned changes provided by the fiscal delegation law, Prime Minister Dr. Matteo Renzi and its government squad, shall now decide if became promoters of a medium-long term fiscal strategy, necessary condition to the economic developement of the country after the 2008 crysis or not.
At the moment, following the presentation in Autumn 2015 of the BEPS measures package by the OECD, Italy continues to confirm its intention to introduce new tax rules by way of implementation of internationally shared ideas, bringing its own legislation into line.

3. A general look to BEPS Actions 8-10 on Transfer Pricing.

Reforming the transfer pricing regime is not merely one of many equal tasks faced by the BEPS initiative; it is its core task. The (OECD) has responded to the challenge with an ambitious plan to reform the substantive transfer pricing rules so that they could realistically meet the challenges of sophisticated tax planning , particularly of transactions involving intangibles , and to standardize reporting to reduce compliance and enforcement costs for all stakeholder.
The first step was taken on February 12th, 2013, when the OECD issued the original BEPS report, declaring that BEPS is indeed a problem that requires a vigorous response.
The report identified, of course, transfer pricing for intangibles as a key pressure area: “Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents.”[193]
It asserted an intention to revise the transfer pricing rules that “produce undesirable results from a policy perspective,” and mentioned the already ongoing project on intangibles that the OECD had started years before.[194]

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[193] BEPS *Report*, at §48.
[194] BEPS *Report* , at §52.

Appropriately, Action n° 8 (Intangibles) is the first transfer pricing action item[195]: "Develop rules to prevent BEPS by moving intangibles among group members." [196] This has involved:

(a) adopting a broad and clearly delineated definition of intangibles;

(b) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation;

(c) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; (d) updating the guidance on cost contribution arrangements."[197]

One can immediately observe the tension between the possible goals of the BEPS project in this action item. On the one hand, it promises to deliver quite a significant reform by: establishing the principle that profits should follow value creation, and a willingness to divert from the arm's length standard as necessary (for hard-to-value intangibles). On the other hand, the narrow view of the project as aiming at prominent BEPS schemes creeps in as well: the specific, and misguided, mention of Cost Contribution Arrangements (CCAs), the focus on the definition of intangibles, and the unwillingness to explicitly seek alternatives to the arm's length standard all represent a more conservative side of the project.

The next action item introduces two specific intangible elements that are difficult to use within the current paradigm. This is action item 9 (Risks and Capital): "Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This involves the adoption of transfer pricing rules or special measures to ensure that inappropriate returns do not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules developed showed an alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments."

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[195] OECD, Action Plan on Base Erosion and Profit Shifting, (Sep. 19, 2013), available at http://www.oecd.org/ctp/BEPSActionPlan.pdf .

[196] Into presenting Actions 8-10 general features we made strong reference to BRAUNER. Y. *Transfer Pricing in BEPS: First Round — Business Interests Win (But, Not in Knock-Out)* in *Intertax* , n.43/2015, Issue 1 , pp.72-84.

[197] OECD, Action Plan on Base Erosion and Profit Shifting, supra n. 8, ACTION 8.

Capital is another chink in the armor of arm’s length taxation because it is obvious that the circumstances of MNEs are fundamentally different from those of unrelated corporations, even when these corporations would engage in similar transactions. Related parties operate as single economic units, effectively capitalized as such, while unrelated companies obviously are separately and independently capitalized. The work on the 2010 OECD Model’s Article 7 has exposed this difficulty and there the OECD simply ignored the problem. It is difficult to see how the OECD could achieve progress here within the framework of a literal arm’s length approach. Risk presents a trickier,yet , and not a less difficult case, because it is a matter of legal creation completely controlled by the taxpayers, supposedly regardless of value creation. Risk and intangibles go hand-in-hand in the BEPS context since the fundamental case is that of what is commonly called a “cash-box,” i.e., a legal owner of an intangible that merely finances its creation and manages its exploitation. Under the current OECD approach the mere financing may be viewed as risk taking and as such deserves a significant profit margin, perhaps even a residual profit margin, which tends to be the largest and clearly is the most important in the exercise of transfer pricing for intangibles. An alternative approach that seems to conform to the value creation principle advocated by the BEPS action plan would be to assign to financing a minimal profit margin that is equivalent to any other similar financing (market interest rate).

Action item 10 takes the above action items a step forward by explicitly acknowledging that certain related party transactions can never take place on the market between unrelated parties, and thus do not conveniently fit the arm’s length paradigm. Action item 10 (Other Highrisk Transactions) reads: “Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This has involved the adoption of transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii)

provide protection against common types of base eroding payments, such as management fees and head office expenses."[198]

This action item largely follows and reinforces the conclusions of the above action items. It also demonstrates the struggle within the OECD on this matter. On one hand, this is essentially covered by action item 8 (intangibles), yet the OECD chose to separately emphasize the situations where literal arm's length does not make sense because there are no market comparables and none can occur. In that sense, nothing new is expected to come from this action item; although it does specifically mention profit split, it is mentioned as an honorable defeat solution to save face for the arm's length apologists.

On October 5th 2015, the Organisation for Economic Co-operation and Development (OECD) issued its final report on transfer pricing under Actions 8-10 of its Action Plan on Base Erosion and Profit Shifting (BEPS).

The document, *Aligning Transfer Pricing Outcomes with Value Creation*, contains revisions to section D of Chapter I of the OECD Transfer Pricing Guidelines, guidance on commodity transactions, revisions to Chapter VI of the OECD Transfer Pricing Guidelines regarding intangibles, revisions to Chapter VII of the OECD Transfer Pricing Guidelines regarding low value-adding intra-group services, revisions to Chapter VIII of the OECD Transfer Pricing Guidelines regarding cost contribution arrangements, and scope of work for guidance on the transactional profit.

4. Focus on Intangibles: the revised chapter 6 of the Transfer Pricing Guidelines

Before starting our analysis, to better analyze the matter developement, let's go quickly back to the start. In July 2010, as said in the previous chapters, the OECD approved the new Transfer Pricing Guidelines(hereinafter ("TPG") version , but at the same time, a revision procedure of chapter 6 (*Special considerations for intangible property*) and 8 (*Cost contribution arrangements*) of the same TPG

[198] OECD, Action Plan on Base Erosion and Profit Shifting, supra n. 8, ACTION 10.

started. In 2013, this process brought to the pubblication by the OECD of the *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles.*[199]

However, simultaneously, the BEPS Action Plan was approved.

The revision process of Chapters 6 and 8 of the Transfer Pricing Guidelines were, in this way, included in the more expansive and ambitious BEPS project, and was developed with the publishing by the OECD of the *Deliverable Guidance on transfer pricing aspects of intangibles* of september 2014 and then, concluded with the mentioned *2015 Final Report* on *Action 8-10.*[200]

The 2015 Final Report, with reference to TPG Chapter 6 does not provide, in general, several substsantial changes with respect to what exposed in the *Revised Discussion Draft* of 2013 and then in the *Deliverable* of 2014.

The OECD document main points can be in this way summarized:

- intangibles (wide and general) definition (§ 6.6): in these Guidelines (the phrase has main importance), the word intangible represents:
- "something" which is not a physical asset or a financial asset ;
- "something" capable to being owned or controlled for use in commercial activities;
- "something" whose use or transfer would be compensated, had it occurred in a transaction between independetn parties in comparable circumstances.

The "something" mentioned, according to the domestic legislation, shall not necessarily be reflected in the balance sheet and are not relevant in order to its determination:

a) the intangible fiscal ordinary treatment ;

b) its eventual legal/contractual protection , neither ;

c) its hoped portability or less.

Are considerable as typical intangibles: (§§6.18-6.31):

- patents ;
- know-how and tradesecrets ;

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[199] MAYR. S. – FORT G., *Il Progetto BEPS ed i beni immateriali* , in *Corr. Trib.*, n. 7/2014, p. 547.

[200] This last document is composed by 186 pages through which lots of examples and its major part is dedicated to intangibles in order to transfer pricing.

- trademarks , trade names and brands ;
- rights under contracts and government licences ;
- licenses and similar limited rights in intangibles ;
- goodwill and similar limited rights in intangibles ;
- goodwill and ongoing concen value

Even if in the national legislation (e.g. the Italian one) the goodwill is not transferrable separately from the other assets, according to the OECD it is able to represent the most important part of a transaction, reason for which its value determination is fundamental into determining the arm's length price.

Therefore, according to the OECD, the goodwill shall be considered an intangible (even though this has value only in the TPG). [201]

Essentially, a transaction including goods or services, even remaining equal from a fiscal and civilistic point of view, could (but only with regards to the TPG) be qualified as goodwill trade with the consequence that those particular evaluation criteria provided for intangibles shall be applied instead of the goods and services ones. [202]

The limited application of the new principles in the scope of the transfer pricing evaluations means that the determination of a single right or assets intangible, in order to TPG, does not imply that the payment recognised for its utilization necessarily constitutes a royalty according to art. 12 of the OECD model (and viceversa) (§ 6.13). Then:

- the payment for "something" recognised and evaluated (according to art. 9 of the OECD model) as goodwill, has no influence on the royalties definition included in art. 12 of the model (that then remains independent) and then on the relative conventional discipline. This qualification, therefore, can have effects only on the evaluation but not on the taxation modes supplied by the conventions ;
-correlatively, the payment e.g. for technical services (that can , sometimes and in presence of some requirements constitute royalty in order to art.12) does not necessarily imply that the same shall be evaluated with regards to transfer pricing

[201] With express reference to FORT. G., *Beni immateriali e transfer pricing: un punto finale,* in *il fisco n.* 2/2016*,* p. 1-149.
[202] To see the Italian Income Revenue Agency position on intangibles see chapter I.

as intangible. In this way, then, evaluation principles provided for services are appliable.

The OECD restates that the new principles introduced in this way, cannot be relevant in the national regulations of the involved states (§ 6.14) ; infact, art 9. Of the OECD model limits only to split the taxation power between contracting States and cannot create taxation powers if the same are not provided by the national legislation. So, those latter, seems not compatible with our Income Tax Code (t.u.i.r.).

According to the distinction, between intangible legal property, and economic one , the OECD states that income coming from the intangible exploitation and use, have to be taxated in the head of the legal owner if:

a) this controls and carries out all functions linked to the development and protection ;

b) provides all the necessary assets ;

c) bears and controls all risks associated with the activity;

d) also another associated enterprise (or more) carries out functions provides asset and/or bears risks linked to the intangible development, all incomes attributable to the intangible exploitation have to be taxated in their head in proportion with the contribution given to the creation of the intangible value.

4.1. The new Italian Patent Box Discipline . Brief Analysis

Having regard to intangibles, the Stability law 2015 [203] provides for a new national discipline according to those particular kind of goods, in particular for the so called patent box. The new Italian regime aligns to the other European Union member state disciplines (Belgium , France , Luxembourg , Netherlands , Spain United Kingdom) and its pursuant to principles stated by the OECD with reference to the fiscal discipline for the taxation of incomes coming from intangibles exploitation.[204]

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[203] l. 190/2014. In particular IP Patent box regulations are included in art. 1 par 37-45.

[204] AVOLIO D., SANTACROCE B., *Arrivano i primi chiarimenti dell'Agenzia delle entrate sul "Patent Box",* in *Corr. Trib. n. 4/2016 , p. 274.*

More in particular, patent box is an option tax regime, under which a certain percentage of income attributable to the use of qualifying intangible assets[205] or IP (i.e software protected by copyright , patents , formulas and so on) is excluded from the tax base. Resident entrepreneurs and non resident companies/entities are eligible for the incentive. The benefit is available for income arising from the tax year following that in progress on 31st December 2014 (i.e. 2015 for calendar-year taxpayers). The election lasts 5 years and is not revokable.

Some clarifications are contained in the Implementation decree[206] and in the Italian Income Revenue Agency circular letter 36/E of 1st December 2015.From tax year 2017, infact, the election must be made in the income tax return and the 5 year regime will start from the year of the tax return. The legislative report accompanying the Implementation Decree clarifies that the election can be made for one or more intangible assets, and not necessarily for all the intangibles held by the same beneficiary.

For 2015 and 2016, the Implementation Decree clarified that the election must be made and notified to the Italian Revenue Agency in the ways established by its director, and that the regime will last for the year of the notification and the following four. The form of application is simple. Basic details of the beneficiary and its legal representative must be given, as well as the start date and end date of the year of election. The purpose of the form is to allow all entrepreneurs to apply , even if they cannot evaluate whether they fulfil the conditions for the regime, or whether the regime is actually advantageous for them. Circular n°36/E clarifies that there should be no adverse consequences if, after the election, the entrepreneur decides not to pursue the benefit, because he is ineligible or because the regime is not actually advantageous.

In addition, the law does not establish what to do when the Patent Box mechanism results in a loss. This may occur especially in the early stages of development,

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[205] 30% in 2015 , 40% in 2016 and 50% from 2017.

[206] Approved on 30th july 2015 by the Ministry of the Economic Development together with the Ministry of Economy and Finance.

when the qualifying costs usually more than offset the income earned from the intangible use.[207]

In conclusion, we can see that, following the OECD principles and the example of other EU member states, the patent box regine rewards enterprises which undertake and bear the costs of research and development that may increase the value of an intangible asset located in Italy.

5. BEPS Actions 9-10: The OECD Final report specific revisions .

The OECD Final Report on BEPS Actions 8-10 includes significant changes compared to the "discussion draft on risk and recharacterization" in December 2014 and compared to the 2010 OECD Transfer Pricing Guidelines. More in particular, the OECD Final Report provides for specific changes of the this latter, modifying, in particular, section D of the first Chapter of the OECD TPG , following the results obtained under BEPS Actions 9 and 10. To deal with the perceived focus on contractual allocations of functions, risks and assets under the current guidance, the Final Report provides that the revisions clarify and strengthen the guidance on the arm's length principle to ensure that transfer pricing outcomes are consistent with the economic activity conducted by multinational enterprises group members. The report highlights the importance of accurately delineating the actual transactions, provides a new six-step framework to determine which party assumes risk and updates the guidance on recognition of the accurately delineated transaction, including criteria for determining when it would be appropriate for the actual transaction not to be recognized.[208]

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[207] The circular letter clarifies that such losses will be recovered in the year when the intangible asset begins to generate income: losses accrued in previous years will offset this income. In other words the benefit offered by the regime will only materialize in the year when the intangible asset generates income net of any past-year losses.(a decrease in IRES and IRAP tax base are the potential advantages).

[208] With reference to: *Guidance on risk and recognition under actions 8-10* , in *Global Tax Alert (News from Transfer Pricing)* in http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-releases-final-transfer-pricing-guidance-on-risk-and-recognition-under-Actions%C2%A08-10 .

The Final Report extends the comparability analysis, with an important first step. It highlights two different aspects of a comparability analysis:

(a) the identification of the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated ;

(b) a comparison between the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated, with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises. [209]

The Final Report states that the economically relevant characteristics or comparability factors of a transaction between associated enterprises should be identified in order to accurately delineate the actual transaction.

These comparability factors can be broadly categorized as follows: (a) contractual terms, (b) functions performed taking into account assets used and risks assumed, (c) characteristics of property and services, (d) economic circumstances of the parties and market, and (e) business strategies.

The Final Report contains additional new guidance on the analysis of risks, which is an integral part of a functional analysis. Because the assumption of increased risk would be remunerated by an increase in expected return, it is key to determine what risks are assumed, what functions are conducted in connection with the assumption or impact of the risks and which party or parties assume these risks. The Final Report provides the following six-step analytical framework for analyzing risk:

Step 1: Identification of economically significant risks with specificity

Step 2: Determination of contractual assumption of the specific risk

Step 3: Functional analysis in relation to risk

Step 4: Interpreting steps 1–3

Step 5: Allocation of risk

Step 6: Pricing the transaction, taking into account the consequences of risk allocation.

[209] The discipline of this first aspect is included in chapter I the OECD TPG , while Chapters II and III deal with the second aspect.

Those steps naturally imply that one needs to ensure that all MNE group members are appropriately compensated for the activities they perform, the assets they contribute , and the risks they assume. Consequently, a legal owner of intangible will only be entitled to retain the whole income coming from the exploitation of the intangible in case (a) it performs all the functions; (b) contributes all assets used; and (c) assumes all risks related to the development, enhancement, maintenance, protection, and exploitation of the intangible.

6. Transfer pricing changes and European Law perspective.

The recommendations coming from the OECD regarding BEPS Action Plan may probably cause issues with the European Union Law, even though the European Commission involvement. This latter, infact, takes part to the OECD work, without voting rights, next to the individual European Union member states, that are also OECD Members.[210] However, so far, it has appeared that no big attention has been made to the possible issues that may arise in the relationships between the proposed OECD solutions and European Law.

Examining the OECD BEPS recommendations, various sources of EU Law could be considered as potential European Law issues. The most relevant ones are:
-The “fundamental freedoms” , included in the TFEU ;
-The EU direct taxation directives[211] ;
-State Aid provisions (art 107 TFEU)[212].

According to the restriction on the free movement provisions, precisely a fundamental freedom, a difference in treatment between a mere domestic situation and a cross-border equivalent, is admittable only in the case it is justified by an overriding the public interest reason. It is necessary in such a case that the

[210] Today 23 states are both part of the European Union and the OECD.
[211] Through this prominent importance is constituted by the Parent-Subsidiary.
This latter’s main aim is to ensure that profits distributed by european subsidiaries to qualifying european parent enterprises are taxed only once. This objective is achieved by prohibiting to the Member States of the subsidiary from levying a withholding tax on such a distribution.
[212] Which claims that: "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods".

restriction is appropriate to ensure the attainment of the objective in question and does not go beyond what is necessary to attain that objective.

According to the interpretation by the CJEU in the judgement D (C-376/03)[213] of the State Aid provisions in the TFEU, if two transactions are comparable, then any differential tax treatment has to be justified with respect to public policy both with regard to the purpose and proportionality to avoid being considered as State Aid.

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[213] D. v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen. Reference for a preliminary ruling: Gerechtshof te 's-Hertogenbosch – Netherlands , judgment of the Court (Grand Chamber) of 5th July 2005 in http://curia.europa.eu/juris/showPdf.jsf;jsessionid=9ea7d0f130d5c988b65a693c4fbaa1f3c03e2d3429f8.e34KaxiLc3eQc40LaxqMbN4OchiLe0?text=&docid=59873&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=625957.

CONCLUSIONS

In the last few years, thanks to the OECD, the integration of national economies and markets has increased substantially in order to avoid weaknesses in the current international legislation that may create opportunities for base erotion and profit shifting.

About 90 countries are working together since two years and it will be interesting to see, now that the BEPS project is almost concluded, if the further changes provided will actually bring to the gaps closing in the existing international rules that allow corporate profit to disappear or be artifically shifted to low/no tax environments.

The work under Actions 8-10 of the BEPS Action Plan will ensure that transfer pricing outcomes will better aligned with value creation of the MNE group. Moreover, the holistic nature of the BEPS Action Plan will ensure that the role of capital-rich, low-functioning entities in BEPS planning will become less relevant.

In this context, the present paper has shown that the current Italian legislation is fully pursuant to OECD BEPS project and furthermore to the other organisation recommendations regarding transfer pricing and that changes provided in accordance with l.23/2014 also follows BEPS project recommendations.

More in general, the next months will be very important for our country ; Italy, shall now decide if became promoter of a medium-long term fiscal strategy, necessary condition to the economic developement of the country.

Nowadays, infact, corporate entities, are too much taxed in our country and this both discourages enterprises to invest their money in Italy, and pushes multinational enterprises to shift profits in less taxed countries.

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