Eucotax Wintercourse 2007
Taxation on global actors

Mario Bendoni
Giulia Ceccarani
Roberto Formisani
Giuseppe Labate
Andrea Melchiorri
Fabio Massimo Silvetti

Coordinamento della ricerca: Alessio Persiani e Federico Rasi

Direzione della ricerca: Giuseppe Melis ed Eugenio Ruggiero

[Maggio 2007]

Si tratta, in particolare, 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 *Handelshögskolan i Stockholm*, 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.

Hanno formato oggetto dell’ultima edizione del *Wintercourse* – tenutosi presso l’Università di Tilburg dal 29 marzo al 7 aprile 2007 – i problemi fiscali che un’economia globalizzata deve affrontare, così articolati:

1. principio di territorialità vs. principio del reddito mondiale;
2. scambio di informazioni e cooperazione in materia fiscale;
3. convenzioni contro la doppia imposizione e tassazione delle imprese multinazionali;
4. distorsioni alle politiche fiscali: WTO e aiuti di Stato;
5. Organizzazioni no profit;

I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti, nell’ordine, dagli studenti Giuseppe Labate, Giulia Ceccarani, Fabio Massimo Silvetti, Roberto Formisani, Mario Bendoni e Andrea Melchiorri.


I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero.
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TERRITORIALITY AND WORLDWIDE TAXATION: EFFICIENCY OF THE EXISTING MODELS
AND COMPATIBILITY WITH INTERNATIONAL COMMITMENTS

Giuseppe Labate
Matr. 075473
I TERRITORIALITY OR WORLDWIDE TAXATION: EFFICIENCY OF THE EXISTING MODELS

1.1. The Fundamental Aims of Tax Systems

During the XX century the constant growing of international trade marked the change from a system of mostly self-sufficient nations and limited exchanges as regards importance and size, into a world characterized by a very large interdependence and in the last decades of the XX century there has seen an exceptional acceleration which has brought the nations to face stronger and stronger phenomena of wealth dematerialization and capital mobility.

Such phenomena have created the development of a harmful competition which pushes States to move most of the taxation weight, necessary to finance the expensive machinery of welfare state, from capital to work and to less movable income, in order to make themselves more attractive to foreign capital and to avoid the escape of international wealth.

The movements of taxation weight has been well synthesized by OECD in the 1998 Report “Harmful tax competition: an emerging global issue” which has stated that “globalisation has had positive effects on the development of tax system and has encouraged countries to engage in base broadening and rate reducing tax reforms. However, it also created an environment in which tax heavens thrive and in which governments may be induced to adopt harmful preferential tax regime to attract mobile activities. Tax competition in the form of harmful tax practices can distort trade and investments patterns, erode national tax bases and shift part of the tax burden onto less mobile tax bases, as labour and consumption, thus adversely affecting employment and undermining the fairness of tax structures”¹

This scenery has lead to a reconsideration of the existing model of allocation of tax liability and especially of the worldwide taxation model, accused of putting unjustifiable barriers to international trade, of not granting enough neutrality of

economical choices from taxation and of leading to an unequal system through a share of tax burden not consistent with taxpayer’s benefits.

What we said must be kept in mind when we go on analysing attractiveness and efficiency of the opposing models of worldwide and territoriality: this analysis implies a difficult balance of contrasting interests and needs considering the economic efficiency, the national and international equity and conformity to the purposes of international organization of the two contrasting models.

Before dealing with the single subjects, it is necessary to remind clearly the fundamental aims the tax system goes back to, so that we could choose the best balance to fulfil such aims.

The principal purpose of every welfare state legal system is clearly written in Article 53 of the Italian constitution, which expresses the ability-to-pay principle. According to it everyone is due to contribute to public expenses according to its ability to pay and the tax system is based on criteria of progressive taxation ².

The quoted law introduces rules of tax equity in the sharing of the tax burden obliging all those people who take part into the state community (not only citizens but also all residents) to contribute to public expenses in proportion with their ability to pay and not with the benefits received.

Then, the Italian tax system has a strong redistributive character and it states for every single person a contributive obligation which is not determined by the benefits received from the participation to the state community, but it is only determined by the ability to pay, although the existence of a benefit for the taxpayer is necessary to find a link between himself and the state, the existence of a greater benefit received by the taxpayer in another country is not sufficient to exclude the taxation in the state of residence. It may be, however, a criterion for the attribution of the taxation rights, but this is a matter of international equity.

The tax system has, moreover, to ensure the equity of the distribution of tax expenses meant as horizontal equity (people in the same circumstances have to be treated in the same way) and vertical equity (people in different conditions have to be treated in different ways), according with the provisions of Art. 3 of the Italian Constitution.

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² “Tutti sono tenuti a concorrere alle spese pubbliche in ragione della loro capacità contributiva. Il sistema è informato a criteri di progressività.”.
In addiction, in order to obtain economic efficiency a state has to grant the highest degree of fiscal neutrality: only if economic processes are not affected by fiscal influences a tax system could be considered efficient.

The economic effects of credit and exemption in international taxation have been described in terms of capital export and capital import neutrality. Worldwide taxation, in combination with tax credit method, is considered to grant capital export neutrality (“investors are subject to the same level of taxes on capital income regardless of the country in which income is earned”) and territoriality principle is thought to produce capital import neutrality (“investments within a country are subject to the same level of taxes regardless of whether they are made by a domestic or foreign investor”).

In fact, as well pointed out by prof. Klaus Vogel neutrality is a negative concept and so it cannot be divided “neutrality only with regard of a particular influences, to a selection out of their totality, leaves other influences untouched. Therefore it is non-neutrality”. Neither capital import neutrality nor capital export neutrality can be considered neutrality properly speaking; they only stand for the absence of particular influences.

1.2 Worldwide and Territoriality: Definitions

In order to go on clearly with the exposition of the different argument about the attractiveness of the models, it seems reasonable to make a deeper analysis of the concept of worldwide and territoriality.

Worldwide taxation is defined as the “basis on which tax is levied in many countries by including income from all sources, i.e. irrespective of their geographical origin”.

This global taxation of income finds its basis in the personal attachment of the taxpayer to the national community. The criterion which better expresses this participation is residence. However, there isn’t an international common definition of residence and this

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5 K. VOGEL, Worldwide taxation or source taxation of income, in Rassegna tributaria, 1988, p. 259.
definition has to be found in the internal law of different States. That often implies a
double attribution of residence and, consequently, a double taxation if there isn’t a
double tax convention between the interested countries.

It’s more difficult to give a complete and clear definition of territoriality because, even
if it could be said that territoriality is “the principle of levying tax only within the
territorial jurisdiction of a sovereign tax authority or country. (...) Both residents and
non-residents of a state adopting this principle are only taxed on the income from
sources in that country (...). Residents are not normally taxed on any foreign-source
income (sometimes, however, subject to anti-avoidance measures 8)” it is not so easy to
define what source is. The term source is used by tax legislators, scholars and judges in
many ways: for example, it is referred to as the State in which the tangible or intangible
property is located or used, in which services are performed, which is affected by the
services, in which the contract is signed, whose laws governs the contract, with which
the identity of the payer is linked, in which the payer is located, from which the
payments are made or which bears the expenses. In order to make the term
unambiguous, I would like to make clear that I will use an “origin based” interpretation
of source, that is the situs where a person who receives income or has a property is
physically located. I must refer to the completely agreeable restatement of the question
made by prof. Kemmeren 9 in order to explain this choice, as I am unable to give a
justification because of the limited purposes of this text and the complexity of the
argument.

1.3. Attractiveness and Efficiency of The Existing Models

A traditional school on income tax has argued in favour of worldwide taxation that an
income tax is global by its very nature and therefore that it would be inconsistent to
exempt foreign incomes because a personal taxation method falls naturally on all types
of income, but this school does not consider that there are multiple national economies
that are bound to coexist. Leaving the income produced in a foreign state to be taxed

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9 E. KEMMEREN, Source of income in globalising economies: overview of the issues and a plea for an
only in that foreign state is not incoherent with the global character of income tax, considering that it is necessary to share out the taxation rights among different nations. Equally unfounded seems to be the other classical arguments in support of worldwide taxation: American law teachers argue that a taxpayer would not understand if his neighbour, who receives the same income, has to pay less tax only because his income has a foreign source. In fact, this argument is only apparently founded because the two taxpayers are not really in the same situation: foreign investments imply bigger risks than the domestic ones (i.e. income may be devaluated or remittance may be forbidden by foreign exchange control law). From all this it follows that the exemption of foreign income is not incompatible with the horizontal equity.

Nevertheless, worldwide taxation method could perhaps be preferred on the basis of vertical equity because the territoriality principle, granting an exemption for foreign income and consequently shifting the tax weight on less movable income (which are often linked with a lower ability to pay), could lead to a paradox in which a taxpayer provided with bigger ability to pay contributes to the public expenses less than a taxpayer who has a lower economic power. This situation is clearly opposite to the fundamental aims of the tax system, but this contrast becomes real only if the application of the exemption system causes a reduction of fiscal revenue.

Therefore, in order to make a right balance of pros and cons of the two systems we must mainly look at the economic effects of their application. It is often claimed that worldwide taxation presses residents to invest in the national market, levying an additional imposition on foreign income and so nullifying any reduction of tax burden given by the foreign country (maybe in order to compensate lacks of infrastructures or particular risks).

So credit system could hold up the economic and social growth of developing countries and could influence the economical choices of taxpayers, stopping the positive tax system competition.

It cannot be denied that these criticisms are valid but also the principle qualities of credit system are hidden in its faults: decreasing the capital exit, worldwide taxation normally limits also the reduction of fiscal revenue. It is a matter of fact that the credit system constitutes an obstacle to harmful tax competition and helps to realize a progressive tax system.
As pointed out by prof. Gutmann, capital export neutrality is not real neutrality, but an efficient method to avoid that people who can take advantage from the economic globalization can also benefit from the difference of tax system. This internal tension in the residence principle makes us think that, all things considered, the taxation in the residence state is a cynic method that assumes the unity of economic space and the impossibility of unifying politic and tax system. Nevertheless this cynism is justifiable in order to keep fiscal revenue on an acceptable level and to prevent globalization effects 10.

So, in my opinion, it’s impossible to pass completely to exemption method, without sacrificing the weakest classes and the entire model of welfare state itself. This claim is supported by the general inclination of developed countries for credit system and, in the few countries which use the territoriality taxation model, the numerous exceptions to the application of this method.

Nevertheless a gradual passage, by a conventional way, to territoriality could be opportune when this transition doesn’t cause unacceptable damage to fiscal revenue.

So it’s desirable to pass to a mixed system that makes a general use of worldwide taxation in order to limit harmful competition and a particular use of exemption system when allowed by the closeness of tax rate and by a certain degree of political unity.

We hope that international organizations will press countries in this direction, also considering the partial incompatibility of credit method with the aims of these organization. Furthermore, it seems to me that this shifting from credit to exemption must be done, preferably, by multilateral agreements and so I look hopefully at the future Common Corporate Consolidated Tax Base as a way to create a more equal and efficient system.

2 Domestic Issues

2.1 Taxation of Foreign Income of Domestic Taxpayers

2.1.1 The Criterion of Residence

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The Italian tax system is based on worldwide taxation so it is a matter of the greatest importance to make clear how the internal law defines a domestic taxpayer before going on to a more detailed analysis of the single aspect of the tax system. In order to subject a taxpayer to a global imposition, Italy chooses the criterion of residence as many countries do. The fiscal meaning of residence is bigger than the civil one in the Italian law system: this meaning finds its basis in the concept of economic allignance as defined by Luigi Einaudi who, during the debate originated within the United Nations in order to establish what State should have the right to tax, has pointed out that the principal criterion must be residence defined as “the place where the taxpayer has the principal seat of his business and interests”\footnote{G. MARINO, Residenza fiscale, libertà fondamentali e normative antielusive nazionali, in Rivista di diritto tributario internazionale, 2001, n. 2, p. 195}

The concept of residence in Italy is splitted in two categories: the residence of physical persons and the residence of legal persons. The fist one is defined in Art. 2 of the Corporate Income Tax Act \footnote{The Italian law on income tax was approved by the Presidential Decree December 22nd 1986, n. 917.} (hereinafter, CITA), the second in Art. 73 of the same law. Both categories present a formal test, respectively, the registration in the civil registry of resident persons and the legal seat and two factual test, domicile and civil residence for physical persons and effective management and principal object for companies. These tests are alternative and so the integration of one of these conditions is enough to consider a natural or legal person as resident. Both rules require that these conditions should be fulfilled for the major part of the tax period, that is, at least for 183 days a year, but whenever the subject is considered as a resident person, the tax is also due in those periods when the requirements are not integrated, also on foreign income. Among the criteria concerning physical persons the registration in civil registry is a formal test necessary for an efficient activity of tax administration, but in its actual formulation it is considered inappropriate and even unconstitutional by many scholars. In fact, this criterion constitutes a \textit{iuris et de iure} presumption: the registration is a sufficient condition to levy a tax even if it is possible to demonstrate that the registered person is not really resident. So we should hope that this rule will become a relative presumption and make proving otherwise possible.
Every person who has his residence there and every person of no fixed address who has his domicile there is obliged to register himself in the registry of his own town.

The legislator refers for the other two criteria to Art. 43 of the civil code that defines residence as the place where a person has got his habitual abode \(^{13}\) and domicile as the place where a person has established the main seat of business and interests \(^{14}\). Although the exact meaning of these criteria is discussed by scholars and judges \(^{15}\), we can consider residence as the “permanent home” and domicile as the “centre of vital interests”, as defined by art. 4 of the OECD Model Convention and its commentary. It’s necessary, however, to clarify that the concept of permanent home moves away from civil residence giving importance to the formal test of permanent availability of the home rather than the effective residence considered by Italian law.

In addiction, on the basis of the relative presumption raised by the subsection 2-bis of Art. 2 CITA Italian citizens erased from the civil registry and emigrated to tax havens are considered residents except for contrary proof. So a citizen emigrated to one of the s.c. black list countries must give proof of the not subsistence of the other residence criteria, otherwise he will be considered a resident of the State.

Let us look now to the criteria concerning legal persons. The formal test of the legal seat is easy to define because it refers to the seat declared in the memorandum of association. This rule could lead in theory to abuses and treaty shopping, but as far as I know phenomena of such kind have not happened yet, probably because of the not favourable Italian tax burden.

The place of administration is the place where decisions about the company activities are kept and so it is where the administrators meetings are held. Therefore, this criterion essentially coincides whit the concepts of effective management defined by the OECD Model Convention. So if a company has only its headquarters in Italy it is considered resident for tax purposes.

It’s much more difficult to define the principal object that, according to Art. 73, parr. 4 and 5, is the activity finalized to realize the essential aims of the company fixed by law

\(^{13}\) In Italian it is “dimora abituale”.

\(^{14}\) In Italian it is “sede principale dei suoi affari ed interessi”.

or memorandum of association and it is determined for the non resident persons on the basis of the effective activity practised in Italy. Although, it is clear that for non resident persons the principal object is located where the principal business activity of the company takes place and not where the properties of the company are mainly located, it is questionable how to prove the existence of this condition also considering the quite total absence of cases regarding this matter.

The Law Decree July 4th 2006, n. 223 16, converted by law August 4th 2006, n. 248, has added another paragraph - the 5-bis - to Art. 73 17. This paragraph introduces a strong presumption of residence with an anti-avoidance purpose: the management of every foreign company that has a controlling interests in a domestic company is considered located in Italy if the company is controlled, directly or indirectly, by a resident person or if its board of directors consists mostly of resident administrators. This rule became necessary in order to solve the problematic application to the static holdings of the traditional residence tests. These holdings, in fact, have not got a regular activity of management, are provided of the greatest mobility and can be controlled with a very few acts, even without a physical meeting of directors. So it’s very easy to give these companies, a formal foreign residence in spite of the substantial national activities. The effective management is, in fact, very difficult to apply to these situations and maybe completely not suitable for ruling such phenomena. So the legislator was forced to introduce this presumption in order to avoid tax avoidance and to limit harmful tax competition. This rule can be applied to many situations, but it could have a very little practical relevance because it is not difficult for a company to build the proof of a formal location of management activities abroad, considering the restrictive interpretation of effective management given by both national judges and OECD.

16 Decreto Legge, that is decree with the force of law.
2.1.2 Localization of Income

The Italian tax system is based on the taxation of global income of domestic taxpayers regardless of where the income is earned, nevertheless it’s a matter of the greatest importance to establish when an income has a foreign source in order to grant a tax credit to the taxpayer. Equally important it is to decide when an income has its source within the country because also foreign taxpayers are taxed on domestic income. For Italian law an income is considered foreign only if it satisfies the same conditions required to be considered domestic in a foreign state.

These criteria are stated by Art. 23 CITA, if a foreign state levies a tax on incomes different from those identified by Art. 23, no tax credit is granted in Italy and the taxpayer is taxed twice if a double tax convention between the two states cannot be applied.

The criteria used to establish a link between income and territory are:

1) the place where the property is located. All incomes raising from real estates (Art. 23 lett. a, CITA) and capital gains raising from the selling of goods located in Italy (Art. 23 lett. f, CITA) are considered domestic.

2) the place where the business activity is located. All income from employments (Art. 23, lett. C, CITA), self-employment (Art. 23, lett. D, CITA), and business income earned by permanent establishment are considered domestic.

3) the residence of the subject who pays the income. The capital incomes paid by the State, by a resident person or a permanent establishment (lett. b) are considered domestic.

Furthermore, independently from these criteria, if paid by the state, by resident state or a permanent establishment, pensions and other social security payments; incomes assimilated to employments (i.e. students’ grants or income of priest); royalties for the use of patents, trademarks or know-how and all incomes paid to non-resident enterprises

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or companies for professionals or artistic activities provided within the country, are considered domestic income.

Also this short discussion makes self-evident how far the Italian legislator is from the desirable origin based interpretation of source.

In Italy there isn’t any significant rule for the localization and taxation of e-business yet. The only provision on this argument is Art. 162, par. 7 which states that computers used for the collection and the transmissions of data and information used to the selling of goods or services are not permanent establishment. We can share this provision because the only presence of a server on the national territory is not an evidence of a link between the taxpayer and the national community. A server, in fact, can be used by a remote control and with a little maintenance, often carried out by a third party, not rarely without any payments.

2.1.3 The Italian Credit System

The Italian credit system is ruled by Art. 165 TUIR which in its first paragraph defines the conditions of the system application:

1) the income must be earned abroad by domestic taxpayers. Apart from what I have already said about residence, I’d like to underline that Italy grants a tax credit also to permanent establishments of foreign taxpayers for all the incomes earned abroad charged to the permanent establishment itself.

2) the foreign income must be added to global income. No tax credit is given for the income exempted from taxation in Italy, or, what is more important, on income levied by withholding tax (i.e. a foreign tax on bond interest gives no credit to the taxpayer because in Italy this income is withheld at source). Only the withholding tax regarding foreign dividends, concerning non-qualified participations, is calculated once foreign taxes have been deducted.

A tax credit is given to the taxpayer for the taxed part of partially exempted incomes (i.e. participation exemption), but paragraph 10 of Art. 165 clarifies that if a foreign

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19 S. MAYR, credito d'imposta prima parte, in Bollettino tributario d'informazioni, 2005, fasc.10, pag 741; S. MAYR, Credito d'imposta seconda parte, in Bollettino tributario d'informazioni, 2006, fasc.9, pag 725; G.M. COMMITTERI and G.F. SCIFONI, Il nuovo meccanismo del credito per le imposte pagate all'estero, 2004, corriere tributario fasc1 pag13
income contributes partially to the formation of the global income, also the foreign tax must be equally reduced.

3) Taxes must be paid abroad definitely. Only the foreign income taxes paid are creditable but, considering the difficulties of a comparability valuation, the concept of income tax should be intended extensively, excluding just the taxes characterized as indirect taxation.

In order to define when the tax is to be considered definitely paid it is suitable to refer to the circolare n. 3 of 1980 of the Tax Administration which says “it may happen that for a non-definitive income a tax has already been paid in a definitive way and so it can’t be recovered, though later on, after a new assessment of the same income, the taxpayer should pay an extra tax, beside the one already paid. So the concept of a definitively-paid tax coincides with that of non-recoverability of the tax itself and so those taxes paid in account or temporarily and, generally speaking, those for which there is the possibility of a partial or total refund, can’t be considered definitively paid.”

4) As the 2° paragraph of art 165 states, only if an income can be considered foreign by the Italian law on the ground of inverse criteria to such used to consider an income produced in the state territory (see 2.1.2).

Briefly examining the application method of the tax credit we can see that:

1) considering that, as a principle, a foreign tax is creditable just within the limits of the Italian tax on such income, it is necessary to fix the tax share relating to foreign incomes. Such part has to be obtained multiplying the total gross tax amount by the ratio between foreign income and the total net income deducted former losses.

The tax share must be calculated state by state, according to the method of “per country limitation”, so that, if the foreign income is produced in different countries, it is necessary to fix the tax share related to the income received in every country and to deduct the tax credit from this share.

The method of “per country limitation” can be overcome resorting to cross-border consolidation regime (see 2.3.1)

When the foreign tax is lower than the relative tax share the taxpayer has to pay the difference, but if the share is lower than the tax paid abroad the taxpayer has no rights to
the refund of the excess tax paid abroad, as it happens in all the countries which adopt the credit method.

Nevertheless, the excess tax is not definitively lost by the taxpayer: actually paragraph 6 of art 165 allows to bring backward and forward the foreign tax paid in a definitive way when it exceeds the Italian tax share relative to the business income produced in the same country. In fact, the above-mentioned excess constitutes a tax credit to be used in the present financial year for a maximum amount which corresponds to the Italian tax share excess of the previous financial years up to the eighth concerning the same foreign activity. If there isn’t any excess in the previous eight fiscal years the above mentioned tax credit will be carry-forwarded in the following eight fiscal years and it can be used if an excess of the Italian tax share occurs.

2) Concerning the application of the credit method, it has to be made clear, now, the moment in which the definitely paid foreign tax is recognised as a deduction from the Italian tax. The answer is given, generally, in the paragraph 4 of article 165 and, as regards the rules concerning the foreign income produced by a permanent establishment, in the paragraph 5.

Generally speaking the foreign tax must be deducted from the Italian tax which results from the income tax return concerning the fiscal year the foreign income belongs to, provided that the foreign tax is paid definitively before the tax return concerning that period. If the tax is paid after the end of the fiscal year in which the foreign income takes part in the global income, the tax must be assessed again, considering an eventual bigger foreign income, and the credit can be deducted from the tax related to the income tax return in which the deduction has been requested.

Just for the incomes charged to a permanent establishment, the deduction is allowed although the payment occurs within the term of presentation of the tax return concerning the next first tax period. That option is, however, conditioned by the indication in the tax return, of the taxes deducted for which the definitive payment has not occurred yet.

Then the Italian credit method presents a regulation very favourable to the taxpayer, which mostly guarantees all the benefits proper of the credit export neutrality, especially thanks to the carry backward and forward of the credit exceeding the relative tax share.

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20 Circolare n. 3 del 8/2/1980 in Bollettino tributario, 1980 pag. 446
In spite of its efficiency, however, it doesn’t show substantial differences from the abstract model of credit system such as justify a revision of what I’ve already said in the general part about its positive and negative effects on the national system.

It’s important to point out that in Italy dividends are exempted from taxation for the 95% of their amount, if they are paid to a resident company or to a permanent establishment of a foreign taxpayer.\(^{21}\)

Instead capital gains on shares are exempted for the 84% of their amount and the capital losses are completely undeductible from the business income, if earned by companies or for the 60% if earned by individual entrepreneurs or partnerships if some conditions required by art. 87 CITA are fulfilled.

The legislator has introduced these provisions in order:

1) to relief economic double taxation on dividends which, otherwise, will be taxed many times by the corporate income tax of receiving companies before being taxed definitively during the distribution to physical persons.\(^{22}\)

2) to solve the problem of compatibility of the previous legislation with EC law.\(^{23}\)

2.2. Taxation of Domestic Income of Foreign Taxpayer

2.2.1 The Taxation of Foreign Taxpayers.

As already stated, the income of a foreign taxpayer is taxed in Italy only when it can be considered domestic income according to the already examined art 23 (2.1.2)

If some of the criteria included in this article are clear and they can be considered sufficiently developed, within the limited aims of this paper, some others need a wider treatment.

In fact, there is still much to say about the regulation of passive income and about the concept of permanent establishment and its force of attraction, but at the moment I’m

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\(^{21}\) This exemption is not given to dividends paid from companies located in tax havens. Also the ordinary tax credit is not granted to these dividends.

\(^{22}\) When distributed to physical persons dividends are computable in the income for the 40% of their value if paid to an entrepreneur or to a person who detains a qualified share capital (more than 5% of the authorized capital of companies quoted on the stock exchange or 25% of not-quoted companies and the 2% or 20% of the vote rights), or subjected to 12.50% withholding tax if earned by other physical persons. For the taxation of dividends paid to foreign taxpayers see 2.2.3.
going to postpone such consideration to when this themes will be dealt with in a more methodical way.

However, something must be said about the necessity of subdividing income into different categories in order to determine its source and, more generally, to provide rules suitable to the different characteristics of the different types of income.

The Italian legal system, however, widens the concept of business income which, endowed of a particular force of attraction, includes all types of income earned by companies or some particular types of income (immovable property income, capital income and other income) if earned by natural person in the exercise his business activity. 24

If such a criterion was applied indiscriminately also to foreign companies, without a permanent establishment, the income produced by them in Italy would be exempted from the imposition. To get out of this risk, art.152 paragraph 2 CITA states that when a permanent establishment is absent, the types of income which contributes to constitute the global income are determined according to the rules relative to the categories they belong to.

As regard the characteristics necessary to define business income the income earned by a non-resident taxpayer in his business activity without a permanent establishment the inquiry “has to concern the activity carried out by the subject himself in order to establish if the such income qualify, integrate his business activity carried out also outside the national territory. In this case, it must be considered that the income can’t be divided from the activity of the subject and then it is a business income” 25 and so they it isn’t taxed.

However in the Italian regulation there are many provisions introduced in order to tax also such income. In particular there are three kinds of intervention lines: 1) a generalization of the territorial link performed by the second paragraph of art 23 (2.1.2) which gets away from the character the income can assume in relation to the receiver activity and refers to the payer’s activity; 2) an expansion of the application field of withholding taxes used also for services performed by foreign taxpayers in the exercise

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23 In order to answer to question II 6 of the questionnaire, only concerning this matter there was in Italy a significant debate about compatibility between credit system and European law.

24 C. GARBARINO, *Tassazione del reddito transnazionale*, cit., p.153
of their business activity; 3) an enlargement of the application of territoriality principle for foreign companies, in fact, the paragraph 2 of art. 151 CITA states that, concerning foreign companies, dividends distributed by resident joint-stock companies and all kinds of taxable capital gains are always considered domestic incomes. The already examined rules concerning the taxation of foreign taxpayer are all sourcing rules, that is criteria to locate the income. It is necessary now to start the analysis of taxing rules, that is of the rules which establish the taxation condition of income taxable according to the above-mentioned sourcing rules. Art 2 CITA lists the non-resident natural persons among the taxpayers of personal income tax and art 3 points out that towards them the taxation is levied only on domestic incomes. The determination of the tax due by a foreign taxpayer is subject to the same definition mechanism of the residents’ tax. However it’s not possible for foreign taxpayers to benefit of most of the deductions and detractions granted to domestic taxpayers. Further some types of income earned by non-residents are levied by a withholding tax. Among these the 30% withholding tax on self-employment income and on business income paid by resident persons to foreign taxpayers not provided of a permanent establishment and the withholding tax on passive incomes we are going to deal with later. According to art 73 CITA, the foreign company are levied by the corporate income tax and the definition of their global income is made in conformity with the criteria of art 153 of the same law, according to which, only incomes produced in Italy are computable in the global income of non-resident companies and therefore are considered domestic income:1) the kinds of income indicated by art.23, considering, as regards business income, also capital gains and capital losses on goods relative to business activity, even if not obtained by a permanent establishment; 2) dividends distributed by companies; 3) capital gains deriving from selling goods located in Italy. The case sub 1 is an application of the so-called permanent establishment force of attraction and is applied, according to the opinion of the main scholars, only to the companies provided of a permanent establishment. The aim of this rule is to include in

the taxable base also business income which, as being obtained without a permanent establishment, wouldn’t be otherwise taxable.

As for the natural persons, the payable tax concerning companies provided of a permanent establishment will be assessed according to the same criteria used for the domestic taxpayers and any kind of domestic income will be considered business income. Also companies can enjoy just a limited part of the deduction and detraction generally granted.

2.2.2. Permanent Establishment

Considering the importance that the presence of a permanent establishment assumes in the taxation of foreign taxpayers it’s right now to examine how laws and judges define this concept.

In spite of some differences26, Art 162 CITA, which defines the permanent establishment, is quite a translation of Art 5 of the OECD model. Such behaviour of the legislator is moreover in line with the traditional attitude of the Italian case law which has always referred to the OECD model and its commentaries. The notion of permanent establishment is divided into material permanent establishment and personal permanent establishment. Both judges and scholars have always pointed out four conditions necessary to consider a material permanent establishment existent:

1) Place of business. The idea of place of business has been considered as it “means all the tangible assets used for carrying on the business”27.

In order to identify such assets, we can refer to art 5 par. 1-3 OECD model, but the existence of such assets on the national territory is not essential to consider a permanent establishment existent.

In fact the presence of a simple space or place that a company uses for its business activities is sufficient to fulfil this condition.

26 A building site or construction or installation project constitutes a permanent establishment only if it lasts more than 3 months and some provisions about server and other argument are stated.

2) fixed place of business. According to this condition, business activity has to be performed regularly even if not necessarily with continuity. According to the Italian case law\(^{28}\) also an asset destined to be performed temporarily can be considered permanent, unless it present the characteristic of precariousness. Stability is also open to a spatial interpretation, that is a necessary link with a geographical place. It’s not necessary, however, the presence of an immovable property, in fact also a movable good can be considered a permanent establishment.

3) the business connection. The permanent establishment has to be functional to the business activity. Substantially it is necessary, in order to fulfil this condition, that the asset hasn’t got a merely static function, it doesn’t matter that the permanent establishment performs its activity in commercial, financial, accounting or technical fields.

4) Productive character. Italian scholars don’t agree about the necessity of such a character. Nevertheless, the Corte di Cassazione, the Italian supreme court, has often stated that the permanent establishment is not asked to be able to produce income\(^{29}\).

The definition of personal permanent establishment is ruled by the paragraph 5 art 5 of the OECD model and from paragraph 6 art 162 CITA. The concept of personal permanent establishment moves around the idea of representation. Nevertheless a common notion of representation does not exist in the model and so the lawyers will be conditioned by the different qualification of representation given by the different legal system.

The model makes a distinction between dependent and independent agent and consider just the first a personal permanent establishment. To shape a personal permanent establishment it is necessary to establish if the agent can stipulate contracts on the behalf of the foreign company, exercising regularly his activity.

The activity of the agent also has to be done following detailed instructions and under the control of the represented company.

Then the Italian notion of permanent establishment is substantially based on the international one, but nevertheless some new interpretation have occurred in the Italian

\(^{28}\) Comm. Centr 1\:02\:2001 n.765, inedita.

\(^{29}\) Cass. 27\:11\:1987, n.8815; cass 27\:11\:87 n.8820; cass 19\:09\:1990 n.5580.
case law in the Philip-Morris Case\textsuperscript{30}, which has introduced the concept of hidden permanent establishment, of multiple permanent establishment and of the prevalence of substance over form.

These concepts, although deriving from the OECD discipline to which the Supreme Court referred\textsuperscript{31}, seems to constitute a deep novelty in the permanent establishment definition.

The judgments deal with the possibility of considering I. S.p.A., a company entirely controlled by the Philip-Morris group, the permanent establishment of such group.

Actually, in the Tax Administration opinion, I. S.p.A. was guided by the directives and decisions of the Philip-Morris group in its whole activity, from the managers’ pension to the training courses, from the staff’s transfer to the prices and the supplying condition of the products sold on licence by the state monopolies.

The companies of Philip-Morris group moreover made use of I S.p.A. collaboration and assistance to control the exact performance of distribution contracts stipulated in Italy with the monopolies and other companies.

From the group interest point of view the role of I. S.p.A. consisted in giving assistance to European companies of Philip-Morris group involved in the tobacco distribution and it was necessary to guarantee the correct execution by the state monopolies of the services of distribution and selling of Philip-Morris products.

Further, was found by the tax administration a document concerning legal opinions demanded by I. S.p.A. management about transnational intracompany relations and the possibility that a permanent establishment has been settled in Italy.

Then the Tax Administration has argued that Philip-Morris has created an apparent autonomy between the two companies to enjoy the most favourable tax regulation for the foreign companies.

After the first and the second jurisdiction verdicts favourable to the Philip-Morris, the Supreme Court was invested of such a matter. Considering all the judgments as a whole,

\textsuperscript{30} B. ACCILI, 	extit{Caso Philip Morris}, in 	extit{Diritto pratica tributaria}, 2004, fasc1 pag 65; S. GIORGI, 	extit{Società indirettamente controllate e stabile organizzazione: il caso philip morris}, in 	extit{Diritto pratica tributaria}, 1998, fasc.4, pag 559

\textsuperscript{31} Cass. 7/03/2002 n3368 in fisco, 2002,1,3008; Cass. 7/03/2002 n3369, Cass. 25/05\textbackslash2002 n7689; Cass. 25/7/2002 n100925; Cass. 6/12\textbackslash2002 n17373 consultabili in rete al sito http://dt.finanze.it/doctrib/silverstream/pages/jpagetesto.html
an univocal trend comes out on the ground of which the Supreme Court decided to accept the tax administration thesis.

At first Cassazione states that it’s incontestable the assumption according to which I. S.p.A. would have acted as a permanent establishment of the whole Philip-Morris group and not of single foreign companies, acquiring so the role of multiple permanent establishment. Nevertheless it’s certainly innovative that a group, that has not got in the Italian system a legal status, may be considered unitarily to single out a permanent establishment.

The Court reaffirms the irrelevance of legal control in order to maintain the existence of a dependence relation, but affirms that it’s exactly in multinational companies that a hidden permanent establishment finds fertile ground.

The Court singles out the following indicators of hidden permanent establishment:

1) the non-formal constitution of the permanent establishment. The court maintains that a permanent establishment had not formally established and with regard to this it highlights the fact that I. S.p.A. has assumed a company name different from other Philip-Morris companies in order to avoid that such name could expose the company to a more pressing tax control.

2) The exercise of an activity out of its ordinary business. The reference is to the activities out of the prevailing business provided in the social object (selling, marketing and production of cigarette filters produced on licence of Philip-Morris) such as the supervision activities of tobacco and cigarette distribution performed by I. S.p.A. on the behalf of Philip-Morris companies.

3) The foreign companies acute control on I. S.p.A.. In the Court’s opinion this control can assume such proportion to make the company, formally endowed with autonomous status, a simple management structure of business activity of the Philip-Morris group.

The Court in its judgments identifies I. S.p.A. as a multiple and hidden permanent establishment of the Philip-Morris group, introducing concepts up to then unknown to the scholars.

Besides the meaningful novelty as far presented, the Court’s methodological approach used for the evaluation seems to be interesting.

In fact, the Court used, to solve the case, the prevalence of substance over form principle.
By respecting this principle, as neglected in the civil law systems as deep-rooted in the common law systems, the Supreme Court argued of basing the analysis on the substantial aspects of the business activity of the Philip-Morris group and of its multiple and hidden permanent establishment, without limiting itself to the juridical characterization of the group. Nevertheless in the Italian legal system a general principle which permits to go over the form to the advantage of the substance doesn’t exist. To apply this principle the court referred to art 5 of the OECD model and its commentaries, although none of them clearly mention the prevalence of substance over form principle.

2.2.3 Passive Incomes

In the Italian juridical tradition a concept perfectly corresponding to that of passive income is absent.

The most similar income category is the capital income one which includes, among others, interests and dividends (differently royalties are considered Other Income when they are not included among the self-employment income).

As regards the capital income an homogenous defining criterion, which goes beyond the survey definition made by art 44 CITA, is absent.

Among the categories dealt with in the art 44 the most important ones are interests and dividends.

The capital income are usually taxed in Italy by a withholding tax. We should remind that capital income paid by the state, by residents or by a permanent establishment are considered as produced in Italy, with the exemption of the interests resulting from bank or post accounts. However, foreign taxpayers resident countries which allows information exchanges, not included in the black-list, enjoy a tax exemption on interest deriving from loans and other capital incomes.

The dividends’ rules are more complex. First of all, we should remind the exemption for the 95% of the dividends’ amount, allowed to capital companies, I have already dealt with (2.1.3). Differently foreign taxpayers, as regards shareholdings not charged to a permanent establishment, are levied by a 27% withholding tax. This tax is reduced to 19.50% for saving shareholders. Moreover the foreign taxpayers have the right to a
refund of the tax up to a maximum of 4/9, when they show that they have already paid it on the same income abroad.

According to the “parent subsidiaries” directive, meant to avoid double tax on the distribution of dividends among European companies, companies which own an at least a 25% direct shareholding of the capital of the company which distributes the profits, are entitled to a tax refund if: a) they hold one of the forms required in the enclosure in the directive n. 435/90/CE (capital company); b) they are resident in one of the EU countries; c) they are subject to corporate income tax, without the possibility of enjoying any options or exemptions which are not limited territorially or temporally; d) the sharing has been held for one year at least.

2.3 Group Taxation

The non-deductibility condition of capital losses on shares has removed the mechanism by which inside a group it was possible to deduct the losses of the controlled companies before the 2003 reform.

Previously, in fact, despite the lack of a group taxation, controlled companies losses were deductible by the deduction of the capital losses on their shares. Then before 2003 reform, just a very mild form of “financial consolidation” was provided for, which allowed the transfer tax excess.

So the legislator decided to provide an optional consolidation system, which allows to determinate a consolidated tax base, composed by the algebraic sum of the incomes earned by the companies which belong to the consolidation.

In this way the legislator doesn’t mean to assign a structural prominence to the companies group, which remains fiscally irrelevant, but to find a remedy to the non-sufficiency of the new discipline of participation exemption.

The legislator actually chooses to charge the parent company with the only algebraic sum of the different incomes and losses calculated by every company of the group and not with the single economical facts performed by controlled companies, allowing an unitary determination of the group tax base according to a consolidated balance.

The calculation of taxable incomes at the level of single controlled companies implies that some rules, which depend for their application to subjective condition or overall
amount, may give results different from the ones they might have if applied to a consolidated tax base determined by the parent company.

The reform states two different systems, although based on the already mentioned common principles, which are the more favourable national consolidation 32, reserved just to the resident controlled companies, and the less favourable worldwide consolidation, also open to foreign companies.

Fundamental characteristic of the national consolidation are: 1) the above mentioned method of the sum of taxable incomes determined by the controlled companies. The consolidated tax base is the result of the total amount of the normally determined incomes of the controlled companies and so the incomes deriving from the foreign permanent establishment of such companies are naturally included in the consolidation.

A partial neutrality of infra-group transaction is provided

2) the consolidation is total and not proportioned to the share participation.

3) the national consolidation is totally optional for the choice both of the system and of the companies to include in the group taxation.

4) all controlled companies, independently from requirements of organizational unitary or activity integration, are part of the group.

In conformity with art 117 CITA, besides the resident parent companies and their controlled companies, are admitted to the option for the national consolidation also the foreign parent companies, provided that they are resident in a state participating to a double tax convention with Italy and that they perform in Italy their business activities through a permanent establishment to which the controlled companies shareholding is charged.

Concerning the notion of control, art 117 refers to both art 120 CITA and art 2359 paragraph 1 of the civil code. From the agreement of the articles a sharing superior to 50% both of profits and capital results to be necessary in order to shape the control. The indirect shareholding is also relevant, but in this case the demultiplication effect produced by the control chain must be considered (i.e. if A controls the 70% of B,

32 A. FANTOZZI, La nuova disciplina Ires:i rapporti di gruppo, in Rivista di diritto tributario, 2004,p 489; G. FRANSONI, Osservazioni in tema di responsabilità e rivalsa nella disciplina del consolidato nazionale, in Rivista di diritto tributario, 2004,p 515
which, in its turn, controls the 80% of C, A, as regards consolidation, control the 56% (70%*80%) of C).

Every controlled has to fill in the form of the income tax return in order to communicate its whole income to the controlling company.

In its turn, the parent company, calculates all the global profit; introduces some changes among which I must remind those relative to the controlled company dividends (totally exempted in the consolidated taxation) and to the capital gains on infra-group transfers which enjoy a regime of fiscal neutrality, as it may take place in continuity of fiscal value and presents the consolidated income tax return.

The partial and total tax payment, based on the presented income tax return, is just due to the parent company.

The parent company is responsible: A) for the largest tax assessed referring to global income; B) for the amounts which are considered due after control activity; C) for the accomplishment of the obligations related to the global income calculation; D) jointly for the payment of the sanctions imposed to the controlled companies as a consequence of their taxable income calculation.

Differently the controlled are responsible: A) jointly with the controlling company for the largest tax assessed referring to global income as a consequence of a correction made on its own profits; B) for the sanctions about which we said in D of parent company responsibility and for every other sanctions.

Before considering the discipline of worldwide consolidation it would be advisable to say something about the ability to pay principle in the consolidation discipline. The main doctrine has argued that in the consolidation system the ability to pay is anyhow referred to the single companies of the group. Actually we can easily exclude that the taxed ability to pay is the group’s, as such a theory implies an attribution of subjectivity to the group which doesn’t found any base in the Italian legal system. In the same way we must exclude that the taxed ability to pay is the parent company’s. In fact, we can justifies such a thesis only if we suppose that in the group there is just one real business activity or that, in the presence of more business activities, only the results and

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33For a deeper analysis of the question see G. FRANSONI, Osservazioni in tema di responsabilità e rivalsa nella disciplina del consolidato nazionale, in Rivista di diritto tributario, 2004, p 515, still valid in its conclusions even if it is relative to a modified law text.
not the activities themselves are attributed to the controlling company. Nevertheless the
set of rules seems to be consistent to none of the two possibilities. The former is not
coherent with the optional nature of the consolidation and with the calculation of the
global income by summing the incomes of the controlled companies, the latter with the
total attribution and not pro quota of the subsidiaries’ income.
The consolidation discipline has to be considered, then, as a mere advantage permission,
without any systematic claim and aiming at allowing the consolidation of losses and the
complete exemption of dividends.
The discipline of the worldwide consolidation 34, which presents some relevant
differences with the national one, seems to be more consistent with a will to refer only
to the parent company the taxed ability to pay:
1) in spite of the optional character of the cross-border consolidation, once opted for the
group taxation, the controlling company should put all the group companies into the
consolidation (all in all out principle)
2)the subsidiaries’ income is attributed to the parent company not totally, but pro quota
3) not only the losses but also the foreign companies incomes are considered by the
Italian taxation, although if they are produced in countries where the corporate income
tax has a lower rate than the Italian one.
Domestic capital companies placed at the top of the control chain can choose the
worldwide consolidation, provided that:
1)such companies are quoted on the stocks exchange;
2) the companies are controlled by the state or natural persons who are not controlling
any other resident or non-resident companies.
The ratio of the provision we have dealt with at the point 2 is to avoid the elusion of the
all in all out principle by creating familiar holdings.
Companies quoted on the stock exchange, however, can exercise the option even when
they are in turn controlled by other resident companies , but, in this case, they can’t
choose, as controlled companies, the national consolidation.
The control requirement is regulated, although if with formally different terms,
substantially in the same way of the national consolidation control we are referring to.

34 G. TURRI, riforma fiscale: disciplina del consolidato mondiale, in Diritto e pratica tributaria, 2006,
fasc.1, pag95.
It is necessary, however, to notice that the control chain demultiplication of shareholdings may be used by companies to elude the all in all out principle. To avoid such an elusive phenomenon, the legislator has stated that the parent company, which opt for the cross-border consolidation, must also choose the national consolidation and that the demultiplication of shareholding must start from the resident inferior grade controlled, as the resident group is considered an unitary subject. The option for the worldwide taxation is irrevocable for a period of at least five years. The determination of the global income by the parent company must be preceded by the new determination of the income obtained by the foreign controlled on the basis of the Italian law, although with relevant simplification. Only a partial neutrality is granted to infra-group transfer in order to avoid transfer pricing phenomena. The maximum amount of the tax credit is calculated, as already said, per company and not per state. Such amount must be calculated, then, by the ratio between the subsidiary income and the group’s total income. These are the fundamental rules concerning cross-border consolidation. As regards the many aspects neglected because of the complexity of the subject and the necessary synthesis on this occasion, I send back to the extensive article by Turri already quoted in the footnote. The cross-border consolidation system seems to be too much onerous for companies considering both higher tax burden and legal formalities. These high costs together with the five years term of the choice made of the system an extrema ratio for companies which will choose other ways, and also elusive ones (i.e. transfer pricing), in order to consolidate cross-border losses. Then the legislator should simplify the cross-border consolidation rules, even if some critical matter seems to be innate in the system. Also for these kinds of reasons I forebode the introduction of a European common consolidated corporate tax base, which is probably the only efficient solution to the enterprises’ need of a consolidation method for cross-border losses. Before going on with the discussion, I must add something about the compatibility between the worldwide consolidation method and the freedom of establishment provided by the Community Law.
As starting point we can assume that the Marks&Spencer decision had a minimal impact on the Italian legal system. In fact, the Italian cross-border consolidation method is a complete alternative approach comparing to the English group relief system. As seen before, the Italian system provides both deducibility of foreign losses and taxability of foreign incomes. Some doubt arises about the compatibility between EC law and “all in all out” principle which constitutes a relevant disparity with the national consolidation system. This difference, however, is justified by the necessity of avoiding the double exemption that could be obtained transferring losses from the consolidated foreign company to another company of the same group not included in the consolidation, if the laws of the state where the consolidated company is resident admit such transfer.

The rule that forbid companies controlled by natural persons, who detain control shareholdings in other companies, to use the cross-border consolidation seems partially to be in contrast whit EC laws. In fact, such provision, compatible in its aims EC laws, forbid the use of cross-border consolidation also if the second participation is not detained for an elusive purpose. Then it seems desirable that such rules becomes a relative presumption in order to prevent any doubt about its conformity to treaty law.

2.4 Controlled Foreign Companies

Italy, as the most of developed countries do, has stated in 2000 a legislation on controlled foreign companies in order to prevent the use of tax havens in tax evasion. The aim of these measures is to tax resident persons for the income produced by foreign companies located in tax havens and controlled by residents. In fact the taxation of dividends is not able to eliminate tax avoidance because the principal shareholder of a company could boundlessly delay the distribution of dividends postponing indefinitely the tax payment.

Art 167 CITA states that if a resident person controls, directly or indirectly, a company located in a tax havens, the income earned by this company is attributed to the resident

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shareholder proportionally to his participation. Concerning controlled foreign subjects, this provision includes every company or organization located in a tax haven. This rule considers companies located in tax havens, as pointed out by The VI commission of Senato, that companies which effectively takes advantage from a privileged tax regime of a state of the black list, whatever the connection which grants these advantages may be.

The art 167, in order to define which companies must be considered controlled, refers to art 2359 of the civil code. According to this provision there is a control condition: when a company has got more of the 50% of the vote rights, when a company has a number of votes sufficient to control the general meeting of shareholders or when a company has a dominant influence because of a contractual bound. Nevertheless, some scholars have argued that this third case of control can’t be applied to the controlled foreign company because without a share participation the income can’t be attributed to the controlling company. The contractual control could be used, however, in order to attribute the income of the foreign company to a controlling company which has only a non-relevant participation.

Furthermore, according to art.168 TUIR, the controlled foreign companies rules can be applied also to domestic taxpayers who detain at least a 20% share in the profits of a foreign company reduced to 10% for companies quoted on the stock exchange. These provisions are not applied if the domestic taxpayer proves that the foreign company has in the foreign state its principal business activity or that the participation doesn’t grant any privileged tax regime; but, in order to take advantage from this exception, the taxpayer must preventively ask the tax administration consent.

A credit is given for the taxes paid on the foreign income, which is taxed in Italy with the rate of the resident and anyway with a tax rate not lower than 27%. This minimum tax rate involves a taxation even if globally the national taxpayer has no income and so it seems to have a punitive aim.

If these provisions are compatible with treaty law and community law is discussed by scholars. The argumentations in support of the incompatibility between legislation on controlled foreign companies and treaty law are based on a literal interpretation of the OECD model and especially of the text of art 7 par1 which states that “The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise
carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”. In fact, the art.7 limits the tax rights of the source state to the taxation of income produced by permanent establishment and differently legislation on controlled foreign companies concerns the taxation of controlling subjects in their residence state. Further, as pointed out by the commentaries to OECD model, the legislation on controlled foreign companies must be considered compatible with the treaty law because of the anti-avoidance aim of double tax conventions.

In the analysis to the relation between controlled foreign companies rules and European law we must consider the recent judgement of European Court of Justice about the “Cadbury case”36. According to this case “the separate tax treatment under the legislation on CFCs and the resulting disadvantage for resident companies which have a subsidiary subject, in another Member State, to a lower level of taxation are such as to hinder the exercise of freedom of establishment by such companies, dissuading them from establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to such a level of taxation. They therefore constitute a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC”. Such a restriction is permissible only if it is justified by overriding reasons of public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it.

The above-mentioned judgment stated that “it is settled case-law that any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company. The need to prevent the reduction of tax revenue is not one of the grounds listed in Article 46 EC or a matter of overriding general interest which would justify a restriction on a freedom introduced by the Treaty. It is also apparent from case-law that the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a
general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty”. On the other hand, a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.

The aim pursued by the freedom of establishment presupposes an actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there. It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory. In the light of those considerations, it must be determined whether the restriction on freedom of establishment arising from the legislation on controlled foreign companies, which can be justified on the ground of prevention of wholly artificial arrangements, is proportionate in relation to that objective.

The taxation provided for by the legislation on controlled foreign companies may not apply if the domestic taxpayer proves that the foreign company has in the foreign state its principal business activity or that the participation doesn’t grant any privileged tax regime. Then, because the opportunity to produce evidence that the controlled foreign company is actually established and that its activities are genuine is given to the resident company, the Italian legislation on controlled foreign companies can be considered compatible with the European law.

Furthermore, in order to discourage the use of offshore companies to produce untaxed income, Italy has from 1992 a mechanism limiting payments to foreign entities located in privileged tax regimes. According with the provision of paragraph 10 of art 110 CITA payments and other negative components, relative to transaction between domestic taxpayers and companies located in tax havens, are not deductible from the domestic taxpayers income. This rule, introduced only referring to intra-group transactions, in 2000 was broadened to a more general prohibition shifting its fundamental aim from an anti-avoidance purpose to a discouraging measure. This

36 ECJ, 12 September 2006, C-196/04, Cadbury.
regime was recently extended to payments made to self-employers by law decree 3 October 2006 n.262.

Art 110 applies to all residents and to permanent establishment of foreign taxpayers. The generic reference to “other negative components” makes subject to the non-deductibility regime all elements suitable to reduce the domestic payer’s tax base. According to paragraph 11 of art 110 this regime is not applied if the domestic taxpayer can prove that the foreign company has a real business activity in its state of residence or that the transaction between the resident and the foreign company suits to an effective economic interest once it really took place\(^{37}\). The taxpayer must separately register these costs in order to benefit of this exemption. The tax administration maintains that the taxpayer cannot deduct the payments to foreign entities located in privileged tax regimes if he doesn’t fulfil this separate registration. There is a great debate about this administrative practise because it isn’t consistent with the main trend of the Italian case law on similar matter\(^{38}\) and also it doesn’t well fulfil the constitutional condition of ability to pay.

3 INTERNATIONAL ISSUES

3.1 Compatibility of Existing Models with EC Law

The EC Treaty does not force the member states to accept one of the existing models in their tax system, as the European Court of Justice stated in e.g. Saint-Gobain “in the absence of unifying or harmonising measures adopted in the community, in particular under the second indent of article 220 of the EC treaty (now the second indent of article 293 EC), the member states remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, inter alia, of international agreements. In this context, the member states are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxations as

\(^{37}\) The requirements of this proof are pointed out by the tax administration in Risoluzione n.46/E del 16/03/2004 and in circolare 12/02/2002 n.18/E, in Il Fiscovideo.

\(^{38}\) Comm. Trib. Centr. 23/11\89 n 7781 and Cass. Sez. Trib. 16/11\2004 n 21646 in Il Fiscovideo
between themselves.” However, the powers of the state are not unrestricted: whatever system they choose, they must exercise their taxing powers consistently with community law.

The creation of a common European market analogous in its nature to the domestic market of a single state is fundamental for the achievement of the essential aims of the European community. Nevertheless a genuine common market still does not exist and it must be created through the harmonization of different legislation and the elimination of the barriers to free movement of persons, goods, capital and services.

As argued in the first part of this essay, the territorial taxation model is certainly the best choice in order to create an open market economy and to increase international commerce so it is probably the model that better fulfils the objectives and principles of the EC treaty. In a capital import neutrality system labour and capital originating in the member states will compete on equal conditions in the labour and capital markets of any single state irrespective of the worker’s or investor’s place of residence. This allocation of tax jurisdiction enables enterprises to compete on a level playing field with their foreign competitors and so in this way freedom of establishment, and thus the internal market, will be promoted.

In fact the European Court of Justice in the “Futura case” seems to prefers the territoriality principle. The case deals with the carry-forward of losses derived from a Luxemburg permanent establishment of a French resident company. The carry-forward was made subject to the condition that the loss be economically related to the income earned by the taxpayer in Luxemburg. The European Court of Justice has stated that a system of calculating the basis of assessment for non-resident taxpayers which, when calculating the tax payable by them in Luxemburg, take into account only the profits and losses arising from their Luxemburg activities is in conformity with the tax principle of territoriality and cannot be regarded as entailing any discrimination, overt or covert, prohibited by the EC treaty.

39 ECJ, 21 September 1999, case C-307/97, Saint-Gobain, para. 56; see also ECJ, 12 May 1998, case C-336/96, Gilly

40 ECJ, 15 May 1997, case C-250/95, Futura; see also ECJ, 10 March 2005, case C-39/04, Laboratories Fournier; and ECJ, 13 December 2005, case C-446/03 Marks & Spencer
Otherwise, the EC directives seem to support the worldwide principle. For example in the interest and royalties directive⁴¹, a choice was made to abolish the taxation of interest and royalty payments in the member state in which they arise and according to the Savings Tax Directive⁴² the tax jurisdiction with respect to the interest income is given to the state of residence of the beneficial owner of the interest.

3.2 Common Consolidated Corporate Tax Base

As argued, the exemption method is better than the credit system in order to realize a real common market between the EU member states, but nevertheless it doesn’t solve the barriers created by the existence, in the European Union, of 27 different tax systems. This plurality of tax systems, with their different aliquots and sets of national financial accounting rules, constitutes a relevant cost for cross-border activities. So the EU commission is working on a common consolidated corporate tax base project⁴³.

“"The Common Consolidated Corporate Tax Base (CCCTB) would significantly reduce the compliance costs of companies operating across the internal market, resolve existing transfer pricing problems, allow for the consolidation of profits and losses, simplify many international restructuring operations, reduce some of the complexities arising from the co-existence of the classical and exemption approaches to international taxation (without extending into the personal tax field), avoid many situations of double taxation and remove many discriminatory situations and restrictions. The CCCTB would contribute to greater efficiency, effectiveness, simplicity and transparency in company tax systems and remove the hiatuses between national systems."⁴⁴

The level of taxation will not form part of the CCCTB provisions, in fact the group would establish only the single EU tax base for its EU-wide activities and this overall

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⁴³ S. GIANNINI, l'evoluzione dei sistemi di imposizione societaria nei paesi dell'unione europea e le prospette di coordinamento comunitari, in Diritto pratica tributaria, 2004, fasc1, p. 57; F. ROCCATAGLIATA, Prospette comunitarie- una base imponibile consolidata per eliminare gli ostacoli fiscali per le imprese nel mercato unico, in Rivista di diritto tributario internazionale, 2001, n. 3, p.343.
base would be allocated or 'apportioned' to the Member States concerned which will apply the national aliquots.. Central to the establishment of a consolidated tax base is the mechanism for sharing the tax base between Member States. This mechanism would have to be equitable and transparent and be as administratively straightforward as possible. It would both have to satisfy sound economic principles and meet with the political approval of Member States. Although the sharing of the tax base could theoretically be carried out on a macro level, i.e. at the level of Member States, work has concentrated on sharing at the micro level, i.e. at the company level. At this micro level two main possibilities exist: either a value-added basis or a formula-based system. It seems reasonable that the base should be introduced from the beginning as a consolidated tax base and accordingly, as outlined in the original CCCTB WG work plan, work will commence on consolidation during 2006. Although ambitious, this approach will bring the greatest benefits to the Internal Market. The alternative of a two-stage process, first a common base without consolidation and second a consolidated base, does not address the problems associated with a lack of cross-border loss relief, nor does it simplify the existing difficulties of transfer pricing. Additionally, unless work is directed towards a consolidated base there is a danger that consolidation may be made more difficult in the long term if, for example, a lower level of common treatment of certain structural elements, or methodologies, is accepted. It is also desirable that the CCCTB should initially be proposed as optional for companies. In fact, not all companies operate in more than one Member State and there is no need for such companies to change their tax base. While the simultaneous operation of two corporate tax bases – the CCCTB and the national tax base – admittedly may raise specific issues for tax administrations, it is also reasonable that an optional CCCTB is more likely to gain the support of all Member States and of business than a compulsory CCCTB. Regarding the accounting rules necessary to calculate the common tax base international accounting standards (IAS/IFRS) statements represent a neutral starting point. In fact some EU companies are reporting profits according to such common
standard\textsuperscript{45} but, although the definition of the common tax base can be conceptually inspired by corresponding international accounting standards (IAS/IFRS), according with the latest position of the European Commission and of the CCCTB working group, no formal link between the two should be established, because not all companies are able to use IAS/IFRS and the standards change frequently. The CCCTB legislation should therefore be a self-standing document containing all the necessary definitions for determining taxable profits.

The CCCTB will require a greater level of commonality, including perhaps a common line in respect of relations with third countries.

As regards companies resident in the EU a vast majority of experts would favour taxation of their world-wide income while companies tax resident outside the EU would be taxed on income with the source in the EU only. This means that any income earned by tax resident companies from sources in or outside the EU would be taken into account for CCCTB purposes. Other experts would prefer the territoriality principle for CCCTB purposes, meaning that income from sources outside the EU would not be subject to tax in CCCTB. However, many experts point out that the choice of the policy of worldwide taxation or territoriality system represents a fundamental element of their fiscal policy. Therefore, a system that presupposes an obligatory switch to a different principle might limit the number of Member States interested in joining the CCCTB. It was also pointed out that in certain circumstances combining exemption with a worldwide approach produces similar results to territoriality.

Whereas the rules of how the taxable income should be calculated and the way it should be added to the share of the CCCTB after apportionment should be common, for the elimination of double taxation the majority of experts seem to prefer applying the national rules modified by bi-lateral tax treaties in force. In other words these experts were not in favour of a common approach to the elimination of double taxation. For practical reasons, and particularly because such an approach would enable member states to maintain the existing bilateral tax treaties, experts seemed to prefer to exclude foreign income from the consolidation. However the method of calculation of taxable

foreign income (e.g. rules on allocation of profits to foreign permanent establishments in case of business profits) would have to be common, and would probably have to be done on the arms length basis.

Nevertheless the double-taxation agreements of Member States will continue to be subject to review by the ECJ. In particular, the problems resulting from the current lack of co-ordination in this area, notably in triangular situations and with regard to third countries, will increase even further. Possible approaches for solving this matter include, inter alia, the development of an EU model tax treaty or the conclusion of a multilateral tax treaty between all EU Member States.

As regards taxation of companies resident outside the EU there is a wide agreement that business income earned through permanent establishments situated in the EU should be covered by CCCTB.

3.3. Compatibility Between Exemption System and WTO Agreements

In order to establish which principle best fulfils the requirements of the World Trade Organization agreements we must start from the Agreement on Subsidies and Countervailing Measures (hereinafter, SCM Agreement). In the view of the Panel in Brazil – Aircraft, the SCM Agreement aims to “impose multilateral disciplines on subsidies which distort international trade”.

The broader description elaborated by the Appellate Body in U.S. – Lumber CVDs Final seems more complete: the object and purpose is “to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions”.

Pursuant to the SCM Agreement, a subsidy shall be deemed to exist if two distinctive elements are present: 1) a financial contribution by a government 2) that confers a

47 Panel Report, Brazil – Export Financing Programme for Aircraft (WT/DS46/R, adopted on 20 August 1999), para. 7.26
benefit. Article 1.1(a)(1) SCM Agreement points to three different kinds of financial contributions:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
(iii) a government provides goods or services other than general infrastructure, or purchases goods.

For the discussed theme we must analyze the second kind of financial contribution. As to the question when a tax measure is to be considered a financial contribution, WTO adjudicating bodies provided some insight in the U.S. – FSC case. In this politically sensitive case, the EC challenged the U.S. income tax exemption for Foreign Sales Corporations (“FSCs”) under the SCM Agreement. The U.S. tax system is a world-wide tax system since it taxes, in general, income of U.S. citizens and residents earned anywhere in the world. Nonetheless, foreign-source income of FSCs was exempted from ‘worldwide’ taxation (“FSC exemption”). Consequently, the EC argued, and the Panel as well as the Appellate Body agreed, that the U.S., by virtue of the FSC exemption, was foregoing revenue otherwise due. So, even if the question should deserve a deeper analysis, for the limited purposes of this text, we can argue that the exemption system, in certain condition, can create distortion to international trade and so the credit system better satisfies the requirements of World Trade Organization agreements.

50 The FSCs are foreign corporations responsible for the sale or lease of goods produced in the U.S. for export. If these FSCs are foreign subsidiaries of U.S. corporations, they receive greater benefits under the FSC laws.
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EUCOTAX Wintercourse 2007

Tilburg

Università LUISS – “Guido Carli” – Roma
Facoltà di giurisprudenza
Cattedra di Diritto Tributario

INTERNATIONAL EXCHANGE OF TAX INFORMATION

Giulia Ceccarani
Matr. 076563
1. INTERNATIONAL EXCHANGE OF TAX INFORMATION

1.1 Introduction

The International Exchange of tax information has as its main purpose the fight against tax evasion and tax avoidance. In fact the collaboration between State’s tax administrations is considered the better way for the correct assessment of direct and indirect taxes. This phenomenon has been firstly regulated by bilateral conventions between states, based mainly on art. 26 of the OECD Model tax treaty, but also on the same article of the U.S.A. Model and the U.N. Model tax treaties. Subsequently, due to the increase of the multinational aspect of the phenomenon, this mean turned out to be not appropriate and insufficient to the new international requirements.

Today, the most innovative and successful means in this field are probably the OECD/Agreement on Exchange of Information on tax matters, adopted also by a very wide range of non-OECD countries, and obviously, the detailed discipline of the phenomenon within the European Union.

In fact, the International exchange of tax information has assumed a great prominence within the European Community due to what is recognized to be the “hard core” of the Community: the internal market. According to art.14 par. 2 of the European Community Treaty the internal market: “...shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty”. In order to reach such a goal the European Treaty provides for a specific provision at art. 93 of the EC Treaty regarding the harmonization of tax legislation of the Member States, that has led to several measures on exchange of information.

It is also recognized a special link between the freedom of capital movement and the exchange of information (or its absence) within the European Union. This is due to the fact that capital, that is to be considered “money not as a form of payment, but for its

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51 For an outline of the Agreement see p. 21.
52 Hereinafter, the EC Treaty.
53 Art. 93 of the European Community Treaty states: “The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market within the time limit laid down in Article 14”.
own purpose”, is an intangible good and for this reason its free movement among numerous States may led to relevant cases of tax evasion. In fact, we should also take into consideration the fact that this phenomenon is usually characterised by big amounts of money, and States are really interested in the correct assessment of tax on capital. Countries like Italy, whose economic history turned them into capital exporting states\textsuperscript{54}, are, obviously, really interested in a functioning exchange of information system for the correct assessment of taxes, with the purpose of subject to taxes the worldwide income of their residents, no matter where they are produced\textsuperscript{55}.

The first measure adopted by the Community in this regard is the Council Directive 77/799 of 19 September 1977 on mutual assistance concerning, at the moment, of its adoption only direct taxes but then extended to VAT\textsuperscript{56}, excise\textsuperscript{57} and insurance premiums\textsuperscript{58}. Another important measure is definitely the Regulation n.218/92 then abrogated by Regulation n. 1798/2003 that analyses every single aspect of VAT.

Italy, as a member of the European Union, has adopted the community discipline about exchange of information adapting its legal system. It is also, then, important to remind that, the Italian tax system doesn't provide for a specific statute of limitations which is different for domestic tax matters.


1.2.1. The Directive and its implementation in Italy

In 1977 the Council of the European Community approved the Council Directive 77/799 of 19 September 1977, that sets out the rules under which the competent Authorities of member States provide mutual assistance and exchange of information in order that they may apply tax effectively. The competent Authority of Italy is the “Capo

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\textsuperscript{54} This statement is proved by the measure adopted by the italian government of the last legislation, the so called “Scudo Fiscale”. The aim of this provision was, in fact, the attempt to repatriate the capital that, at the moment of this measure, was abroad.

\textsuperscript{55} Within the limits due to the source state's taxes, for the avoidance of double taxation.

\textsuperscript{56} By Directive 79/1070/EEC of 6 of December 1979

\textsuperscript{57} By Directive 92/12/EEC of 25 of February 1992

\textsuperscript{58} By Directive 2003/93/EC of 7 of October 2003
del Dipartimento per le politiche fiscali or an authorized representative. This directive has been implemented by the Italian legal system by adding to the D.P.R. 29 September 1973 n. 600, art. 31-bis, entitled: “Assistance in the exchange of information among the competent authorities of member states of the European Union”, concerning the exchange of information of tax on income and capital. This article contains provisions about the methods and the limits of exchange of information, the professional secrecy and its breakage and finally the cooperation between the authorities of the member states. Then, the D.P.R. 26 October 1972, n. 633 that regulates VAT, has been supplemented, precisely at art. 65-66, by provisions on exchange of information among the competent authorities of the member states of the European Union for the correct assessment of VAT.

Both the EC legislator and the Italian one, (while implementing the Directive), use the terms: “correctness in the assessment” of taxes to define the main purpose of their provisions. This mean that the aim of their discipline is to tax every individual, even when the activities of this one have as their result the fact that the income comes from different states. There is a clear linkage between the above mentioned terms and the fundamental principle contained in art. 53 of the Italian Constitution, the “ability to pay”. With this article the Italian Constitution wants to guarantee that everyone has to contribute to public expenses, but taking into consideration his/her taxable capacity.

All provisions about exchange of information are, first of all, for the benefit of the States and are not to be considered a remedy to double taxation (that finds its goal in the protection of the taxpayer), even though many jurists, among which many Italian ones, have upheld this thesis, especially before the 90’s.

1.2.2. Definition of information and the three types of exchange.

59 It is one of the Italy's highest tax authorities
61 This decree regulates the tax assessment.
62 These subjects are going to be treated in detail in the next pages.
A definition of the term “information” is not given by neither the EC legislator, nor the Italian one. The greatest part of the doctrine\textsuperscript{64} prefers the most comprehensive meaning of the term, that would include all documents, official certificates, inquiry’s results and every necessary element in order to better define the concrete case.

This Directive makes provision for three types of information exchange:

- Information on request;
- Automatic exchange;
- Spontaneous exchange.

The first procedure initiates with a request of the competent Authority of a member State to the competent Authority of another member State in a particular case. The competent Authority of the requested State need not comply with the request if it appears that the competent Authority of the State making the request has not exhausted its own usual sources of information, which it could have utilized according to the circumstances, to obtain the information requested without running the risk of endangering the attainment of the sought after result\textsuperscript{65}.

The automatic exchange of information procedure consists of a regular exchange of information between the competent Authorities of member States without prior request. According to the third and last procedure, the competent Authority of a member State communicates information to the competent Authority of another member State without any request, in certain circumstances listed by the same art. 4, paragraph 1 of the Directive. This cases mostly related to all situation in which the Authority assumes that there is a fiscal irregularity.

1.2.3. Dispute about the duty to give the requested information

We must, then, analyse that there is or not a general obligation to give the requested information to the competent Authority of the requesting State, we can definitely solve

\textsuperscript{64} F. SAPONARO, Lo scambio d’informazioni tra amministrazioni finanziarie e l’armonizzazione fiscale, in Rass. trib., 2005, II, p. 469.
\textsuperscript{65} Art.2, paragraph 1 of Directive 77/799/EEC.
this problem thanks to articles 5\textsuperscript{66} and 8\textsuperscript{67} of Directive 77/799, fully implemented in Italy by the above mentioned art. 31-bis (3) D.P.R. 600/73 that analyses the cases in which the competent Authority of Italy may or must refuse to give the information. These cases are:

- when the exchange of information may reveal a professional or industrial secret;
- when the disclosure of the information may contrast with the public policy;
- when the state that request the information may not, in the same circumstances, provide the requested state with the same kind of information.

This is an apparent proof of how much wide is the discretion of the States in the enforcement of Directive 77/799.

Analysing the Italian legal system, we notice the absence of a unilateral discipline of the cooperation of Italian Authorities with foreign ones without the presence of a treaty or an agreement between Italy and these other states. Then, the exchange of information will function only in this latter case, in respect of the international legal uses.\textsuperscript{68}

1.2.4. Collaboration of officials

The Italian legal system has also implemented art.6 of the Directive 77/799 about collaboration of officials by the already cited art. 31-bis of D.P.R. 600/73, paragraph 1. This article argues that the Italian tax authorities can authorise the presence, in the Italian territory, of officials from tax authorities of other member states. Another form of collaboration is included in paragraphs 6 to 9 of art. 31-bis that goes under the name

\begin{itemize}
  \item [66] Art.5 of Directive states: “If it encounters obstacles in furnishing the information or if it refuses to furnish the information, it shall forthwith inform the requesting authority to this effect, indicating the nature of the obstacles or the reasons for its refusal”.
  \item [67] Art 8 of Directive 77/799 states: “Limits to exchange of information:
  \begin{itemize}
    \item This Directive shall impose no obligation to have enquiries carried out or to provide information if the Member State, which should furnish the information, would be prevented by its laws or administrative practices from carrying out these enquiries or from collecting or using this information for its own purposes.
    \item The provision of information may be refused where it would lead to the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information whose disclosure would be contrary to public policy.
    \item The competent authority of a Member State may refuse to provide information where the State concerned is unable, for practical or legal reasons, to provide similar information.”
  \end{itemize}
\end{itemize}
of “simultaneous controls”. In these latter case, the cooperation among officials consists of controls made by the tax authorities each in its own country but at the same time. The exchange of information will take place, here, as soon as the officials obtain them, in order to render the controls more effective. Paragraph 7 of art. 31-bis specifies that the Italian tax authority has to identify the taxpayers that wants to subject to the simultaneous controls and communicate it to other involved European tax authorities. In this communication the Italian tax authority needs to indicate the reasons of this controls and the their time limit. Paragraph 8 of the above mentioned art. 31-bis, then, argues that the European tax authorities may accept or refuse the collaboration requested by another state but in the latter case they are supposed to explain the reasons of the refusal. The final paragraph 9 states that in case of “simultaneous controls” the tax authorities will designate a “representative” which will direct and coordinate the controls.

1.2.5. The secrecy

About the secrecy, the Italian legislator, with paragraph 4 of art. 31-bis D.P.R. 600/73, states that all information are to be kept secret within the limits and procedures described by art. 7 of the Directive. This article states that: “All information made known to a Member State under this Directive shall be kept secret in that State in the same manner as information received under its domestic legislation”. It also states that the information are to be accessible only to certain persons\(^69\), they may be made known only in certain circumstances\(^70\) and they shall be used only for specific purposes\(^71\). Right after, precisely in paragraph 3 of the same article, there is an exception to this last rule: “Notwithstanding paragraph 1, the competent authorities of the Member State providing the information may permit it to be used for other purposes in the requesting

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69 Art.7 par. 1.1 “- may be made available only to the persons directly involved in the assessment of the tax or in the administrative control of this assessment,”

70 Art.7 par. 1.2 “- may in addition be made known only in connection with judicial proceedings or administrative proceedings involving sanctions undertaken with a view to, or relating to, the making or reviewing the tax assessment and only to persons who are directly involved in such proceedings; such information may, however, be disclosed during public hearings or in judgments if the competent authority of the Member State supplying the information raises no objection,”
State, if, under the legislation of the informing State, the information could, in similar circumstances, be used in the informing State for similar purposes”. In Italy the information collected by tax authorities can be used for other purposes for an only reason: in the case in which these information can be actually useful for the prosecution of crimes.

The next paragraph of the same article says that there is not breakage of secrecy in sending information to the competent Authorities of other member States in order to enable them to effect a correct assessment of taxes on income and on capital. The same provision is included in art. 66 of D.P.R. 633/72, relating this time to VAT.

1.3 Regulation n. 1798/2003/EC

Another important measure at Community level is definitely regulation n. 1798/2003/EC of 7 of October 2003 that abrogated the previous one on the matter, Regulation n. 218/92/EEC of 27 of January 1992. This new regulation contains provisions about cooperation for the correct assessment of VAT.

Regulation 1798/2003/EC is, obviously, directly applicable in Italy since it is a member of the European Union.

2. PERSONAL DATA PROTECTION IN CASE OF INTERNATIONAL TRANSFER: ART. 25-26 OF DIRECTIVE 95/46/CEE

In Italy, the taxpayer has a privacy right that comprises, besides the physical confines, the domicile and the correspondence, every data and information related to him. The Italian legislator, with D.LGS. of 30 June 2003 n. 196, the “Codice in materia di protezione dei dati personali” so called “Code of Privacy”, tried to organise the Italian

71 Art.7 par. 1.3 “shall in no circumstances be used other than for taxation purposes or in connection with judicial proceedings or administrative proceedings involving sanctions undertaken with a view to, or in relation to, the making or reviewing the tax assessment.”

72 Hereinafter Regulation 1798/2003/EC


74 Hereinafter D.Lgs.196/2003.
discipline over the protection of personal data, adding new provisions on the matter, that was previously regulated only by Law of 31 December 1996 n. 675 75. Art. 1 of D. Lgs 196/2003 argues that “everyone must have the right of the protection of personal data that concern himself”, so it definitely finds an application to the treatment of personal data by tax authorities against tax evasion and tax elusion. This provision apply to all those investigations towards the taxpayer himself but also in all those cases in which investigations are actually toward “thirds” that for professional reason are in the possession of the taxpayer’s personal data. This latter individuals might proceed to the Exchange of information with tax authorities, but in respect of art. 11 of the “Code of privacy” the exchange must be “necessary, pertinent and not excessive”.

In 1995, the principle expressed in art. 11 of the “code of Privacy” found a direct implementation in the tax system, with the “Provvedimento of 25 May 1995” enacted by the “Garante per la Privacy76”. This measure states that the tax authorities might use the collected information on personal data for tax purposes, only in respect of the principles of the necessity of the procedures and the proportionality between the requirements of tax authorities and the right of privacy of the tax payer.

The Italian legal system does not provide for specific provisions on protection of personal data in case of its international transfer. Subsequently, the discipline above illustrated, included in the “Code of privacy”, that usually apply to the transfers of personal data within Italy, will also apply to all those cases in which there is an international exchange of personal data.


76 The Italian “Garante per la privacy is the authority that has been set up in order to supervise the respect of the provisions included in the “Code of privacy”.
The first April 1995 entered into force the Multilateral Convention on Mutual Administrative Assistance in Tax Matters elaborated by the European Council together with the OECD, opened to signature since the 25 January 1988. This Convention has many parts in common with Directive 77/799, but also many differences in which we can probably find the reason of its failure. The most important critics moved to this Convention, that represent also the main distinction with the Directive, are:

- **Insufficient protection of industrial secret.** The Convention allows exchange of private information, that constitutes a secret, from a country to another, without a provision that assures respect of the legal systems of the States. On the contrary, the EC Directive 77/799 makes a list of the limits of Exchange of information;

- **Excessive measures for the Exchange of information.** It has been noticed that in the spontaneous exchange of information procedure the Convention far exceeds the necessary requirements and imposes to the States duties that go against fundamental rights recognized by most legal orders to their citizens. Another critic has been moved against the automatic exchange of information procedure since it could let escape information that are not relevant for taxation purposes. The Directive 77/799 states, at art. 7 par. 1, that “such information shall in no circumstance be used other than for taxation purposes”.

- **Strictly “multilateral convention”,** that should be applied to all Member States of European Council and OCSE, even if, at the moment in which the Convention was written, (1988), the legal systems of these numerous states were really different and such a provision was felt “premature and to “be rejected”. On the contrary the

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77 Since now on, the Convention.
79 Art. 7 of Directive 77/799
80 Art. 6 of Convention
81 To see those cases in which the information might be used for other purposes go back to page 11.
Directive, even though was obviously direct to all EC states, has been implemented in most of the cases in many years.

_The Industrial and commercial secret_, was still felt as an essential part of the patrimony of each state and every single rule of the States concerning the matter should have to prevail over any other interest (especially a foreign one!).

Only eight states signed this Convention (United States of America, Denmark, Finland, Island, Norway, The Netherlands, Poland and Sweden) and Italy actually did not because agreed with all the critics moved against it.

4. _PROFESSIONAL SECRECY: EVOLUTION OF THE DISCIPLINE AND EXCEPTIONS IN THE ITALIAN LEGAL SYSTEM_

The professional secrecy finds its legitimisation, in the Italian legal system, in art. 200 of the C.P.P. (the Italian Penal Procedural Code). This article states that religious ministries, lawyers, expert witnesses, authorised private investigators, notaries, doctors, pharmacists, midwives, professional journalists and every other professional person indicated by the law, can not be obliged to give testimony of information in their possession due to their ministry, office of profession. Then, in the same article there is an exception: the obligation to reveal this information to the jurisdictional authority subsists only in the case in which the judge has good reasons to believe that the matter in question doesn’t actually need to be covered by the secrecy.  

The implementation of this provision is assured by art. 622 of the C.P. (the Italian Penal Code), that punishes the breakage of the professional secrecy. 

The justification of this great advantage granted to all clients of this kind of services is traced by the Italian doctrine in the fact that the disclosure of this kind of private information might lead to an unfair damage to the clients. This is, probably, also the reason why many exceptions have been actually allowed through the years to the professional secrecy: the economic prejudice that might derive from the communication

83 See art. 200 of the Italian “procedural penal code”.

84 For a detailed outline cf. ARENA M., _La normativa antiriciclaggio per i professionisti_, available in www.previdenza-professionisti.it
of this kind of information, in case of tax avoidance or tax evasion, does not seem to fit in the law protected sphere.

In Europe, a revolutionary step in this field is represented by Directive 2001/97/CE on money laundering. This Directive has been implemented in Italy by D. lgs. of 20 of February 2004 n. 56. This decree, actually extends the application of the obligations provided by a previous law, Law 5 July 1991 n. 197, also to lawyers, notaries, doctors, and accountants. This obligations consists of:

- the duty to identify all clients;87
- the duty to keep the collected information;88
- the duty to signal suspicious operations of the client.89

In art. 2 par. 3 of the same D. lgs. there is a sort of a “safeguard clause” that regards the special nature of the legal profession. In fact the cited article states that the duties contained in the two previous paragraphs will not apply to those information collected during the examination of the juridical position of the attorney's client, during the prosecution of the defence duties and legal representation.

The fact that this decree has been extended to lawyers has been criticised because the professional secrecy, related to this profession, is considered strictly connected to the Constitutional granted right of defence, recognised in the Italian legal system as a fundamental fight of the individuals. This critics seem not to be satisfied by the “safeguard clause” of art.2 par. 3, that, on the contrary, according to the Italian legislator represent a good way to assure the respect of the professional secrecy.

5. A FORM OF PROFESSIONAL SECRECY: THE BANKING SECRECY AND ITS NUMEROUS EXCEPTIONS IN THE ITALIAN LEGAL SYSTEM

In the Italian legal system, the legitimisation of banking secret is found in art. 10 of the R.D.L. 12 March 1936 n. 376 as it was modified by art. 7 par. 1 of the D. lgs. 1 September 1993 n. 385. This article states that every information and data that are in the

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86 The so called “ Anti-money laundering law”
87 Art. 3 par. 1 of D. lg. 56/2004
88 Art. 3 par. 1 of D. lg. 56/2004
possession of the “Banca d’Italia”\textsuperscript{90} are covered by professional secrecy\textsuperscript{91} even when the information are requested by public authorities. The next statement, though, focuses, two exceptions:

- in the case in which the request is made by the “Ministry of Finance”\textsuperscript{92};
- in the case in which these information are necessary for the prosecution of crimes.

The discipline of banking secrecy has gone through many relevant changes that all opted for its restriction through more and more exceptions to it. In fact, if before and during the 70's, the exceptions were only allowed for direct taxes and in certain particular circumstances, all listed by the law, in 1982 with the D.P.R. 15 July 1982 n. 463, the same exceptions were extended to VAT. But then, the real turning point has to be traced in the law n. 413 of 1991 and in the ruling n. 51 of the Italian Constitutional Court in 1992. With this law and the later decision of the Constitutional Court, it has been stated the supremacy of the transparency of the relationship between the tax authorities and the taxpayers over the banking secrecy. The reason of such a revolutionary position has been found in the perception of the banking secrecy as a “useful shelter for tax evasion and economic-related crimes”\textsuperscript{93}.

At the moment in which we are writing, there are no more limited cases described by the law in which there is an exception to banking secrecy, there is not even a need of any authorisation by the “Commissioni Tributarie”\textsuperscript{94} as they were requested in the past: according to the above mentioned law n. 413/91 just an authorisation by a jurisdictional of an administrative organ of the state will be necessary.

By following this trend, the past art. 35 of D.P.R. 600/73, that provided for the banking secrecy and its exceptions, was abrogated by art. 18 of Law 30 December 1991, n. 413. Art. 35 argued that the direct taxes assessment authority can request documents, data and information indicated by par. 7 of art. 32 of the same decree, even when they are owned by banks and post office authorities, but with the authorisation of the competent tax inspector and only in a five cases, all listed by this article.

\textsuperscript{89} Art. 2 par. 2 of D. lg 56/2004
\textsuperscript{90} It is the Italian Central Bank.
\textsuperscript{91} For an detailed outline about professional secrecy see p. 14.
\textsuperscript{92} The Italian Ministry of Finance.
The things explained so far do not mean that there are no more guarantees for the taxpayers. One of them, in fact, is definitely art. 32 n.7 of D.P.R. 29 September 1973 n. 600 that states that the investigation about a taxpayer through the information in the possession of the bank can not be the starting point of the tax authorities' activities but only a single phase of a tax assessment that got started previously. This principle is also included in “circolare” n. 36 of 2006, that, while regulating the behaviour of tax inspectors towards trust companies, states that the so called “fishing expeditions” are to be avoided. By the terms “fishing expeditions”, the “circolare” means those investigations that are not included in a existing tax assessment and are not strictly necessary. According to the “circolare n. 36/2006”, when the authority that is supposed to give the authorisation necessary for the beginning of the investigations believes that these are to be considered “fishing expeditions”, it shall refuse the authorisation. Another guarantee is the fact that the information collected not in respect of the provisions on protection of personal data will not ever be available for any use95.

6. THE LEGAL CONSEQUENCES IN THE ITALIAN LEGAL SYSTEM OF INFORMATION DISCLOSURE OR BREAKAGE OF SECRECY AND CONFIDENTIALITY.

The needs of investigations, exchange of information and breakage of secrecy requested for the correct assessment of taxes, sometimes, might restrict the sphere of the fundamental rights and liberties guaranteed by the Italian Constitution to the citizens and they also might, indirectly, go against the right of privacy of the taxpayer. In fact, in all cases in which the tax authorities make investigations towards “thirds”96 that are in possession of necessary information of a certain taxpayer, there might be a breakage of the professional secrecy usually recognized to all clients of this kind of services.

In this regard, we have just analysed the trend of the Italian legal system to reduce the sphere of the enforcement of the duty of professional secrecy by numerous exceptions to it.97

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94 The Italian tribunal for tax suits.
95 See the “Provvedimento del Garante della Privacy of 25 May 2005”.
96 Here for “thirds” we mean banks, lawyers, doctors, trust companies, and all those who have the duty of professional secrecy.
A long debate took place in Italy about the nature of the duty of the professional secrecy and its possible breakage. Then, in 1992, the Italian constitutional court, with the ruling n. 51, stated that the duty of the professional secrecy does not correspond with a “personality right” of any other constitutionally protected right, since the right of privacy that characterises this kind of services has as its goal the security and the good state of commercial traffics. According to the Constitutional Court, for this reason, the extension of the professional secrecy can be limited by the ordinary law that need to consider, on the one hand, the constitutional provisions on freedom of economic activities (art. 41 of the Italian Constitution) and the private property (art. 42 of Italian Constitution) and, on the other hand, the principle of “ability to pay” contained in art. 53 of the Italian Constitution.

In the past, another important debate over this subject took place about the possible use or not for the correct assessment of taxes of the evidence that has been acquired irregularly.

This contrast was even present within the Italian Tax Session of the “Corte di Cassazione”\(^{98}\) that between the years 2000 and 2002 gave two opposite solutions to the problem. In fact, with ruling n. 15209 of 30 November 2000 and ruling n. 15230 of 3 December 2001 the court stated that a tax assessment measure that finds its roots in evidence that has been acquired irregularly, is not valid, because that evidence can not, for any reason, be used. A year later, on the contrary, the same court, with ruling n. 1344 of 1 February 2002, in a similar case, argued that the judge can not preclude the use of evidence irregularly acquired because he is not competent to take such a decision.

Then, the United Sessions of the “Corte di Cassazione”\(^{99}\), with ruling of 21 November 2002, n. 16424, did not leave any doubt stating that the evidence acquired irregularly can not be used, and so they fully agreed with the initial position of the court.

The next jurisprudence completely agreed with this ruling, arguing that even though there is not a general principle in the Italian tax legal system that states the impossibility

\(^{98}\) The “Corte di Cassazione” is the last instance of the Italian system of Justice

\(^{99}\) The “United Sessions” of the “Corte di Cassazione” intervene when there is a discrepancy within the jurisprudence of the different sessions of the “Corte di Cassazione”. 
to use the evidence irregularly acquired, this principle can be deduced by the same Italian Constitution\textsuperscript{100}.

\section*{7. OECD Agreement on Exchange of Information on Tax Matters: Legal Nature and Inclusion in Art. 10 Par. 2 of Directive 48/2003/EC}

The 18 of April 2002, the \textit{Global Forum Working group on Effective Exchange of Information} of OCSE, approved the Agreement on exchange of information on tax matters. This Agreement has had a great success: in 2004 thirty-three states that are not member of the OECD, actually gave their adherence to the agreement. According to the OCSE, this new model of agreement is not a legally binding instrument\textsuperscript{101}, but it has to represent the fundamental basis to reach the goals indicated by the OECD Report \textit{Harmful tax competition: an emerging global issue}, of 1998\textsuperscript{102}. This means that the states are actually free to adopt other instruments as long as they are appropriate to satisfy the aims of the Agreement, with a cooperation amongst states that has to be equal or superior to that one described by it.\textsuperscript{103}

Even though this Agreement does not have binding force, it has been included in art.10 par. 2 of Directive n. 2003/49/EC on interests savings. In fact the article states that \textit{“the transitional period”}, that is provided by the same article, but in par. 1, \textit{“shall end at the end of the first fiscal year following the later of the following dates: - the date of entry into force of an agreement between the European Community...and the last of the Swiss Confederation, the Principality of Liechtenstein, the Republic of}

\footnotesize{\textsuperscript{100} For example, by art. 14 of the Constitution about the domicile that can not be violated.}\textsuperscript{101} This is a relevant distinction from the OECD Model against double taxation, that a recommendation of 30 of July 1963 considered to be binding for all Member states.\textsuperscript{102} With this Report, the OECD underlined the fact that in order to contrast those states that are considered to be “tax havens”, a good instrument is an effective international exchange of tax information. The Report argues: “In1998, as part of its harmful tax practices initiative, which aims at reducing harmful tax practices-especially for geographically mobile activities- the OECD focuses on lack of effective exchange of information as one of the causes of harmful tax practices. Similarly, lack of effective exchange of information due to secrecy laws also is noted as a principal element of harmful preferential tax regimes in OECD countries...”\textsuperscript{103} For a detailed outline cf. P. SELICATO, \textit{Il Modello di convenzione OCSE del 2002 in materia di scambio d’informazioni: alla ricerca della reciprocità nei trattati in materia di cooperazione fiscale}, Riv. dir. trib. int., 2004, I, p.11-34.
San Marino, the Principality of Monaco and the Principality of Andorra, providing for the exchange of information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released on 18 April 2002 (hereinafter the OECD Model Agreement) with respect to interest payments....

-the date on which the Council agrees by unanimity that the United States of America is committed to exchange of information upon request as defined in the OECD Model Agreement with respect to interest payments...

The inclusion of the OECD Agreement in the European directive is a clear sign of how, at the moment, it is considered to be, the most completed, effective and the best accepted Model of Agreement on international exchange of tax information throughout the world.

8. A CHANGE TO ART. 26, PAR. 1 OF OECD MODEL: ITS MEANING

In 2004, in art. 26 par.1 of OECD Model, the word “necessary”, referred to the information to be exchanged by the competent authorities of the Contracting States, was changed into “foreseeably relevant”\(^\text{104}\). This new expression seems to extend the application of this article to more cases, in order to satisfy all requirements for the correct assessment of taxes. In fact, now, in all situation in which the competent authority of a Contracting State will suppose that the information at its disposal is to be considered “foreseeably relevant” to the competent authority of the other Contracting State, it shall exchange such information even though there is no certainty that it will be “necessary”.

The Italian legal system, on the other hand, contains many provisions that aim to make a balance between the needs of tax authorities and the rights of the taxpayers. Two articles are relevant in this proposal: art. 7 and 12 of law 27 July 2000, n. 212, the so called “Statuto del Contribuente\(^\text{105}\)” (Taxpayer's Statute). Through these provisions the

\(^{104}\) Art. 26 par.1 of the OECD Model now states: “The competent authorities of the Contracting States shall exchange such information as is foreseeable relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention...”

\(^{105}\) The “Statuto del contribuente” is a law that contains some general principle of tax law, in particular about the guarantees of the taxpayers. Then, in the Italian legislation there is not an organic “tax code”
Italian legislator allows the competent authorities to collect and eventually exchange information only in those cases in which there is a real need of this kind of activities.

9. Extension of Public Policy

In the Italian legal system, as much as in every other legal system, while there are many attempts toward the harmonisation of tax discipline and international exchange of tax information, there are also, on the contrary, measures adopted in order to preserve the perfect unity that should characterise all legal systems. Among these measures, the most important is definitely the public policy clause or exception.

This public policy clause precludes the application of certain provisions about international exchange of tax information in the case in which this application may cause juridical effects that go against the economic, ethic and social principles that are considered to be fundamental in a legal system.

Examples of this public policy clause can be found, for what concern the international exchange of tax information, in the above mentioned European Directive 77/799/CEE, art. 8, par.2 that argues: “The provision of information may be refused where it would lead to the disclosure...of information whose disclosure would be contrary to public policy”. The same exception is present in art. 26 of the OECD Model, par.3, let. C), in the same tone.

In the Italian legal system, then, we find the public policy clause, related to the international exchange of information, in art. 31-bis of the already mentioned D.P.R. 600/1973, that in paragraph makes an explicit reference to it while implementing the Council Directive 77/799/CEE.

Even though we are treating the notion of public policy in strict relation to international exchange of information, it also assumes a particular importance in that branch of the law that goes under the name of “international private law”.

In the Italian legal order “international private law” is mainly disciplined by law 31 May 1995 n. 218, that in art. 16 states: “The foreign law will not be applied when its effects...
go against the public order"\textsuperscript{106}. The Italian doctrine\textsuperscript{107}, on this regard, makes also a distinction between the international public order and the local one. By local public order, these scholars mean a limit to the private contractual autonomy that prohibits private individuals to go against the law with a private agreement. By international public order the same jurists mean a limit to the application of the foreign law in the cases in which it contrasts with the national one. Only the international public policy is relevant to the international private law.

\textit{10. FINAL CONCLUSIONS}

To conclude, we can definitely say that the international exchange of tax information has improved, out of all proportion, in a few years, due to the increase of the movement of producing factors all over the world and, in general terms, to the international trend towards the globalisation phenomenon. The States, through the years, have understood that cooperation in this field is crucial, especially because they all have the same final interest: the fight against tax evasion and tax avoidance.

The countries part of the European Union, among which, of course, Italy, probably felt this need more than any other state, due to the strong liberalisation that characterises the commercial traffics within the European Internal Market. This is the reason why so many measures have been taken by the European community institutions.

This does not mean that the international exchange of tax information is not recognised as being fundamental in other states. This can be proved, on the one hand, by the fact that both the UN tax treaties-Model and the USA tax treaties-Model\textsuperscript{108} contains provisions that regulate the international exchange of tax information as much as the OECD- Model. On the other hand, it is relevant to remind that many states that


\textsuperscript{107} For a detailed outline cf. FOCARELLI C., \textit{Lezioni di diritto internazionale privato}, Morlacchi, 2005, p. 72.

\textsuperscript{108} The USA tax treaties -Model contains even much wider provisions compared to the OECD one, and because of this reason is not accepted in its entirety by Italy.
are not OECD members complied with the Agreement on exchange of information on tax matters of the 18 of April 2002\textsuperscript{109}.

\textsuperscript{109} At the moment of the OECD 2004 Progress Report, the total number of the states that complied with this Agreement was 33.

ARENA M., *La normativa antiriciclaggio per i professionisti*, available in www.previdenza-professionisti.it


FOCARELLI. C., Lezioni di diritto internazionale privato, Morlacchi, 2005, p. 72.


MOSCONI F.- CAMPIGLIO C., Diritto internazionale privato e processuale, parte generale e contratti, UTET, Torino, 2005, p. 181.


SPERDUTI S., Ordine pubblico internazionale ed ordine pubblico interno, in Riv. Dir. Int., 1954, p. 82.


EUCOTAX Wintercourse 2007
Tilburg

Università LUISS – “Guido Carli” – Roma

Facoltà di giurisprudenza
Cattedra di Diritto Tributario

TAX TREATY POLICY IN RESPECT TO MULTINATIONALS

Fabio Massimo Silvetti
Matr. 072373
I - DOMESTIC LAW

RESIDENCE

1.1. Residence of corporations

Accordingly to art. 73, par. 3 d.P.R. 22nd December 1986, n. 917 (so called T.U.I.R. Testo Unico Imposte sul Reddito - Consolidated Act on Income Taxes), corporations and bodies are regarded as residents for personal income taxes purposes if they have in Italian territory, for greater part of tax year and alternatively, their a) own place of incorporation b) place of management c) main business purpose.

Place of incorporation must be sought as it results from the enterprise’s articles of incorporation. This purely formal criterion, however, seems to doctrine (110) unsuitable to ground worldwide taxation nor, if strictly scrutinized, orthodox by a constitutional point of view, as art. 53 of Italian Constitution obliges “everybody” to concur to public expenditure according to their capacity to pay, but also clearly infers an effective and lasting link between the person and the territory of the State.

Place of management is, instead, where direction and control of economic activities are effectively held, i.e. the place where directors usually meet in order to fix guidelines for enterprise’s activities, assessed irrespective of directors’ domicile, nationality or fiscal residence and of coincidence with the place where these guidelines are implemented (111).

Some problems arise in relation to the concept of “main business purpose”. On one hand, doctrine and jurisprudence (112) agree to read this notion in light of a “principle of

111 C. GARBARINO, Manuale di tassazione internazionale, Milano, 2005, pag. 252.
112 L. PERRONE, Problemi vecchi e nuovi in materia di imposizione sul reddito delle società e degli enti non residenti, cit., pag. 1229. The author of this piece refers, in relation to doctrine, to MARINO, La residenza nel diritto tributario, Padova, 1999, pagg. 89 e ss.; and, with respect to jurisprudence, to Cass., 10 December 1974, n. 4172, in Dir. Prat. Trib., 1975, II, pag. 948. The Supreme Court stated there that
effectiveness”, so attention should be paid to concrete activities performed in Italian territory; on the other, par. 4 of art. 73 T.U.I.R. states that the main or exclusive business of the resident body is determined according to law and to articles of association, but only in case this last results from public deeds or legalized private deeds; if the articles of association do not fulfil the formal requirement, the main object is determined in relation to the activity which is effectively performed in Italian territory; in any case, this last provision applies to non resident bodies (the last two rules are read from par. 5, art. 73 T.U.I.R.).

1.2. Holding Companies

No special rules apply in order to determine the residence of holding companies. Anyway two new paragraphs (5-*bis* and 5-*ter*) have been recently added to art. 73 T.U.I.R. by (law decree 4 July 2006, n. 223 converted with amendments by State Act 4 August 2006, n. 248) in order to introduce an anti-avoidance clause.

Par. 5-*bis* states that, if no opposite proof is given, it is deemed to be in Italian territory the place of management of companies which control incorporations mentioned in art. 73 par. 1 letters a) (resident joint-stock companies, limited partnerships, limited companies, cooperatives, mutual insurance companies) and b) (public and private bodies different from companies, resident in Italy, with commercial activities as exclusive or main business purpose) alternatively if:
- they are controlled, even indirectly, under the terms set at art. 2359 Italian Civil Code, by persons who are resident in Italy
- the are managed by a board, or equivalent body, in which most part of directors are resident in Italy.

Requirements for control are set by art. 2359 of Italian civil code (*113*)

Par. 5-*ter* states that, for the purposes of par. 5-*bis*, it is considered the situation that

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*113* According to art. 2359, par. 1 of Italian civil code, a company is regarded as controlled if another company owns the majority of votes in its shareholders’ meeting or, at least, sufficient votes in order to perform a dominant influence on such meeting, or if the controlling company is dominant due to special contracts or relations entertained with the controlled one. Par. 2 states that, in case control is carried out
results at the end of commercial period of the foreign company. For the same purposes, in relation to physical persons, votes pertaining to wife or husband, relatives within third degree of relationship and relatives by marriage are taken in account.

In relation to the residence of directors (and, broadly, of physical persons), art. 2 T.U.I.R. follows the rule that the resident is a person who, for greater part of tax year, is registered in general register’s office (114) or has in Italy domicile or residence in as these notions are pointed in the Italian Civil Code (more will be said further, in relation to residence of physical persons and art. 2 T.U.I.R.)

The main consequence of this anti-avoidance provision is that foreign holdings, when falling in one of the two categories, are taxed in Italy according to worldwide income principle.

The Italian Minister of Finance has explained its interpretation of this provision with circular 4 august 2006, n. 28/E. It must be noted that Tax Administration is free to find out cases of deemed residence even if conditions set in par. 5-bis are not met, but the burden of proof would be on its side.

Moreover, the taxpayer who wants to win such legal presumption is asked to demonstrate, by showing concrete evidences and facts, that the holding has a genuine link within the foreign country, notwithstanding the fulfilment of par. 5-bis criteria.

However, despite these and other opinions addressed by tax Administration in the mentioned circular, the anti-avoidance clause as it is probably clashes with EU law freedom of establishment, since impedes European citizens to freely choose where starting an economic undertaking (and, especially, a company) within the Union and, moreover, does not fix detailed circumstances and conditions (e.g. for the sake of creditors, shareholders’ minorities or workers) nor distinguishes between State and State in light of their taxation regimes, these last being the only restrictions allowed by the ECJ in its wide interpretation of the freedom in question. Furthermore, such clause do

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114 Registers where name, age and address of people living in a district are kept and updated.
not operate if a Convention sets the place of management as a criterion in order to ascertain a company’s (and a holding’s) residence (115).

1.3 Partnerships and transparency issues

In relation to taxation of partnerships, T.U.I.R. provisions distinguish between resident and non-resident ones (the abovementioned criteria of art. 73, par. 3 T.U.I.R. apply here): in the first case, the enterprise is treated as a “look-through entity”, and so incomes are taxed in the hands of both resident and non resident shareholders, whose residence is to be ascertained accordingly to art. 2 T.U.I.R.; in the second case, partnerships are non-transparent taxable units (art. 73, par. 1 letter d), subject to corporate income tax.

A partnership is defined as “an agreement by means of which two or more persons combine their efforts an/or funds with a view to realizing profits”, used in business because of his valuable flexibility (116).

Business activity can be carried on in Italy by general partnerships (Società in Nome Collettivo, SNC) and limited partnerships (Società in Accomandita Semplice, SAS). Both types of partnerships have a degree of legal capacity (but not legal personality) and a capital separate from that of partners that constitutes primary guarantee for creditors. The main difference between the two kinds of partnerships is that SNC members are jointly and severally liable for entity’s debts and obligations and regarded as managing partners if not otherwise stated in partnership agreement, while a SAS has general and managing members alongside to limited members. The liability of such members is restricted to the amount of their contributions, but only in case they do not interfere with management (117).

Resident partnerships are, as said before, look-thorough entities, regarded as mere tools to produce an income, that is going to be taxed in the hands of members in proportion to

116 R. RUSSO and E. PEDRAZZINI, The only way out is the way through: taxation of partnerships in Italy, in European Taxation, April 2005, pag. 138
117 R. RUSSO and E. PEDRAZZINI, The only way out is the way through: taxation of partnerships in Italy, cit., pag. 139
their quota in the partnership, that are deemed to be equal if not otherwise indicated in partnership agreement.

Such income is regarded as business income, if the partnership pursues commercial activity (118); if the firm instead carries on non-commercial activities, every single income is assessed according to rules for each category of income (e.g. capital gains, income from immovable properties).

Despite its transparency, the resident partnerships keep obliged to accounting and declaration of incomes, and are subject to assessment. This apparent contradiction between transparency and fiscal duties is explained by reasons of prudence and because of the structure of a partnership, that is usually established by few individuals, often with family ties (119).

Residence of partners, as physical persons, is determined pursuant to art. 2 par. 2 T.U.I.R., “for the purposes of income taxes, persons who for the greater part of tax year are enrolled into general register’s office or have domicile or residence accordingly to the Italian Civil Code are deemed to be resident”.

This provision sets an objective element (enrolment in general register’s office) and adjourns to civil notions of residence and domicile, then endorses a time requirement.

Art. 2 par. 2 T.U.I.R. characterizes the Italian tax law system as a personal and worldwide income based one, and links to fiscal residence the possibility to customize the capacity to be a taxpayer, for example by the grating of deductions because of family reasons (120).

Provided the fulfilment of the time requirement, a person is considered resident by falling, alternatively, under one of the three criteria (enrolment or civil residence or civil domicile).

General register’s office is a methodical collection of information about individuals and families who reside in a municipality and about individuals with no official residence.

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120 G. MELIS, La nozione di residenza fiscale delle persone fisiche nell’ordinamento tributario italiano, in Russ. Trib., 1995, VI, pag. 1034
having their domicile in such municipality, with statistical, economical and publicity aims (121).

Because of this nature of general register’s office, the enrolment criterion has been criticized under a constitutional point of view: art. 53 of Italian Constitution endorses the principle that everybody shall contribute to public expenditure in accordance with his means. This obligation is a consequence of the paramount principle of art. 2. of Italian constitution (the Republic demands the fulfilment of the intransgressible duties of political, economic, and social solidarity) and requires a proper link with the territory of the state. This link must be of real nature (e.g performance of an economic activity) or personal nature (e.g citizenship or habitual presence in the territory of the State).

Enrolment in general register’s office has mainly statistical aims, and it is not itself a proper link with the territory of the State. It has been, therefore, proposed to transform this criterion into a *juris tantum* presumption of residence (122) since usually such enrolment goes along with residence (which is by definition a proper link).

In relation to the adjournment by art. 2 par. 2 T.U.I.R. to Italian Civil Code notions of residence and domicile, attention should be paid to civil doctrine and jurisprudence (123).

Art. 43 of Italian civil code finds domicile where a person sets the main place of his/her business and interests, and residence where a person has his/her habitual stay (comparison can be entertained with legal persons, since art. 46 of Italian civil code disciplines a unique notion of seat).

Jurisprudence sees domicile as “a matter of law”, in which is decisive the subjective element or the intention to set somewhere the main place of business and interests (124), and residence as the effective presence in a place (the intention to stay there is necessary, but it is deemed until the opposite proof is given).

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121 d.P.R. 30th May 1989, n. 223, implementing State Act 24th December 1954, n. 1228.
123 G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell’ordinamento tributario italiano*, cit., pag. 1034
124 Cass. 21th March 1968, n. 844. The Supreme Court rules that domicile presupposes an objective element, but consists mainly in the legal situation and will to set in a determined place the main place of business and of moral and social relationships.
Doctrine does not agree to such distinction between domicile as “law and intention” and residence as “fact”: both residence and domicile are effective situations in which subjective and objective elements coexist, but the last one should prevail, because of the “real” nature of these notions (125).

Jurisprudence (126) and some doctrine (127) find “business and interests” of domicile not only in patrimonial situations, but even in moral and family ones. Tax administration has adopted this last interpretation, in order to apply fiscal rules to a larger extent (128). The place of “business and interest” must be “main”. This prevalence should be assessed through facts (129), regarded in their quantity. The quality of facts must be taken in account, anyway, if the abovementioned jurisprudence is followed.

Residence displays two elements: stable and continuous permanence in a given place and a corresponding intention. The first element prevails over the second, and the lack of intention, in presence of the objective element, must be specially proven. The permanence should so be regarded in relation to the place where a person lives, and not to other ones (e.g. workplace) that might be relevant in order to assess domicile.

Art. 10 of State Act 23rd December 1998 n.448 added to art. 2 T.U.I.R. par. 2-bis, an anti-avoidance provision, stating that Italian citizens who erased themselves from general register’s office and emigrated in States or territories regarded as tax havens are deemed Italian residents (subject to worldwide income taxation) until opposite proof is given (130).

This provision applies to Italian citizens who have moved their residence from an Italian municipality to a foreign country; these citizens must compulsorily register at A.I.R.E. (Anagrafe degli Italiani Residenti all’Estero, Registry of foreign resident Italians 131). It is therefore necessary that the foreign country in question results listed as a “tax haven”.

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125 TEDESCHI, Domicilio, residenza e dimora, in Nss. Dig. It., Torino, 1982, pag. 165  
126 Cass. 5th May 1980 n. 2936 in Giur. It, Mass 1980 n. 2936  
127 TEDESCHI, Domicilio, residenza e dimora, cit., Torino, 1982, pag. 165  
129 G. MELIS, La nozione di residenza fiscale delle persone fisiche nell’ordinamento tributario italiano, cit., pag. 1034. Reference is made by the Author to Cass., 15th March 751, in Foro it., Mass. 1954, pag. 157  
130 d. m. 4th May 1999 sets a “black list” of tax havens.  
131 Discipline for A.I.R.E. is set by State Act 27 October 1988, n. 470
Important critiques have been moved to this art. 2. par. 2-bis T.U.I.R. (\(^{132}\)).

Firstly, from a constitutional point of view, such deemed residence seems in contrast with principle of equality (art. 3 par. 1 of Italian constitution): Italian citizens residing in tax havens can demonstrate that this circumstance is not fictitious and not aimed to avoid Italian tax system (based on taxation of worldwide income for residents) while keeping *de facto* in Italy habitual stay or the place of main business and interest. Italian (and foreign) citizens enrolled in general register’s office for greater part of tax year, instead, are regarded as residents, for the purpose of income taxes, without any chance to show the opposite.

Secondly, and in relation to the burden of proof (which is laid to the citizens, since he/she is assumed to be avoiding the Italian tax system accordingly to *id quod plerumque accidit* and because of his/her acknowledgement of facts and better access to proofs), nothing seems really changed when in trial; on one hand, the taxpayer will show only ordinary expenses in relation to his/her foreign residence, and, when possible, the presence of his family and his/her subordinate work abroad, but of course not other (and maybe much more relevant) foreign properties or activities; on the other, Tax Administration can collect signs of fiscal residence only, or mainly, in Italy (and not abroad) and will probably find very hard to analytically assess the taxpayers’ worldwide income, which is an incentive for the last one to be very careful when giving proof of his foreign fiscal residence, both from a domicile and “civil” residence view.

Thirdly, countries listed as tax havens entertain with Italy conventions against double taxation (that is the case of Switzerland), and so conventional provisions, and not art. 2 par. 2 T.U.I.R., shall apply if the Italian citizen is regarded as resident in both countries, according to their domestic law. Moreover, the black list is set by a decree of Ministry of Finance, which is, by definition, totally unqualified for overriding a convention (and the State Act, or equivalent act, that implement it in Italy (\(^{133}\)).


\(^{133}\) B. CONFORTI, *Lezioni di Diritto Internazionale*, Napoli, 1992, pag. 303. A provision passed after a convention must, in order to repeal it, not only give a different discipline, but also declare the explicit will not to attend the international obligation.
The effectiveness of the anti-abuse provision is affected by the large number of citizens that might fall under its scope (420.000 in 1999 according to the economic newspaper *il Sole 24 – Ore*).

### 1.4 Group Taxation System

Group members are usually taxed as separate entities: they can only choose to be taxed as a group, while residence will continue to be ascertained member by member. The Italian system of consolidation requires the controlling and consolidating company to be resident, and distinguishes between “national” consolidation, with resident controlled companies, and “world” consolidation, with non resident controlled companies.

Art. 117, par. 1 T.U.I.R. states the right to jointly choose national consolidation regime for a controlling and consolidating company or body and for each controlled and resident body (as long both are entities listed by art. 73 par. 1 letters a) and b) (134) when a situation of control, described by art. 2359, 1 n.1 of Italian civil code (135) and art. 120 par. 2 T.U.I.R. exists.

Such right to choose consolidation regime is denied for companies that enjoy a reduction of tax-rate on C.I.T. and in case of bankruptcy or winding up (art. 126 T.U.I.R. paragraphs 1 and 2). It must be noted that it is enough a potential reduction of applicable tax-rate in order to apply the first mentioned preclusion (136). Non resident companies or bodies can switch to national consolidation regime only if they fulfil requirements set by art. 117 par.2 T.U.I.R.: a position of control, residence in countries that entertain with Italy a Convention against double taxation, pursuit of a business activity (art. 55 T.U.I.R.) through a P.E. (art. 162 T.U.I.R.) in Italy; participations in each controlled company must be included in P.E.’s estate (137).

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134 Letter a) (joint-stock companies, limited partnerships, limited companies, cooperatives, mutual insurance companies); letter b (public and private bodies different from companies, resident in Italy, with commercial activities as exclusive or main business purpose)

135 A company holds in another company’s shareholders’ meeting the majority of votes

136 Report to D. lgs 344/2003

137 Please look at pag. 17 for business incomes and point 2.4 for P.E. notion.
Companies that move in Italy their residence for tax purposes and meet the requirements for residence (art. 73 par. 3 T.U.I.R.) are entitled to choose the regime from the financial period in which the change is accomplished.

In relation to world consolidation, a company or body listed in art. 73, par. 1 letters a) and b) T.U.I.R. – pursuant to art. 130 par. 1 T.U.I.R. – can choose to include in its taxable basis incomes gained by each non resident controlled company. The relevant notion of control comes from the above mentioned art. 2359, par. 1 n.1 of Italian civil code and from art. 133 T.U.I.R., so controlled entities must be held directly or indirectly with no less than 50% share of votes and entitlement to profits.

Art. 130 par. 2 T.U.I.R. requests the controlling and consolidating company to be at the “apix”: it must be the highest-in rank person resident in Italy and it must not be controlled by non resident companies or bodies. This realizes the so called “all in, all out” principle, and impedes a controlling and consolidating company to choose such regime only in relation to foreign controlled companies in loss or to companies resident in countries with tax-rates similar to Italian ones.

A derogation is enclosed for companies and bodies if their shares are negotiable in Stock Exchange, since fiscal interests seem protected by rights enshrined to minorities in shareholders’ meeting (138).

Circular 165/E finds “stock Exchange” in markets regulated by Law in Italy and in OECD countries. A second derogation covers companies and bodies controlled pursuant to art. 2359 par. 1 n.1 and n.2 of Italian civil code by resident physical persons who are not in control of other resident or non resident company or commercial body (139). This last provision is granted to (resident) companies, since in substance at the apix in Italy. A third derogation applies to companies or bodies controlled according to art. 2359 par. 1 of Italian Civil code solely by the State or by a public body.

For the purposes of world consolidation, art. 133 par. 1 T.U.I.R. regards controlled entities (as long as a proper relationship of control is entertained) companies and bodies of every kind, with or without legal personality and non resident in Italy. This definition

138 C. GARBARINO, Manuale di Tassazione Internazionale, Milano, 2005, pag. 1105
139 The notion of control that applies to this last derogation includes art. 2359 par. 1 n. 2 case: a company is controlled if the controlling one possesses enough votes to rule a dominant influence in the controlled company’s shareholders’ meeting.
coincides with the one given by art. 73, par. 1 letter d) in relation to persons subject to C.I.T.

As a matter of consequence, partnerships (resident in a foreign State and taxed there as a non-transparent entity), companies with a P.E. in Italy, or resident in a tax haven and transparently taxed when not consolidated (according to CFC discipline) can be all consolidated as controlled entities.

2. RELEVANT TAX PROVISIONS FOR MULTINATIONALS

2.1 Intra-group relations

2.1.1. Tax Regime applicable to dividends

Pursuant to art. 89, par. 2 .T.U.I.R. (as reformed by D. Lgs 12th December 2003, n. 344 140) proceeds of any kind, distributed under any name by resident companies, do not concur, in the commercial period in which they are paid, to determine the income of the receiving resident company or body up to 95 per cent of their amount (141).

Circular 16th June 2004, n. 26/E makes clear that dividends concur to determine the income of the receiving company or body at cash basis, even though the newly reformed provision does not explicitly set such principle. The same circular allows such exclusion as well when dividends have not been taxed in the hands of the paying company and also in case of renouncement, exclusion, re-purchase and reduction of overabundant capital or winding up. The provision, moreover, explicitly refers also to payments relative to associative agreements (142) when a contribution different from

140 This act has reformed taxation of proceeds arising from participations in companies and bodies. The former system, based on credit and to imputation to the receiver, has been changed in favour of an exemption system. Relief from economic double taxation is so achieved by taxing proceeds only once and in the hands of the company which pays them, while their receiver is free from tax obligations. On this topic, L. BELLUZZO and E. LO PRESTI VENTURA, “La tassazione dei dividendi e plusvalenze da partecipazioni tra norme in vigore, recenti interpretazioni ministeriali e schema di “correttivo”: società di capitale ed enti commerciali residenti”, in Il Fisco, 2005, n. 22
141 According to art. 81 T.U.I.R, Such proceeds are considered as business profits when gained by persons subject to C.I.T.
142 According to art. 2549 of Italian Civil Code it is a contract in which a contracting party attributes a participation to proceeds that may arise from one or more businesses and the other brings a contribution, which is usually a sum of money; the associated contractor risks the capital he has brought and
work and services is agreed and to interests for financings exceeding thin-capitalization limits when directly granted by the shareholder.

Art. 109, par. 5 T.U.I.R. admits deductibility of expenses and other negative elements (not passive interests) insofar they pertain to activities or goods from which proceeds arise that concur to income, or that are excluded from concurrence. The above mentioned circular has interpreted this provision, by pointing out that expenses relative to management of participations are fully deductible.

In relation to dividends distributed by a resident subsidiary to a foreign parent company, art. 23 par. 1 T.U.I.R. states that capital incomes paid by the State or by residents in the State or by P.E.s (excluded interests and other incomes arising from bank or post accounts) are regarded as arising from the Territory of the State in order to tax them in the hands of non residents. This provision must be read alongside to art. 10 OECD, that allocates taxations rights on cross-border dividends both to the source State to the Residence State.

Art. 27 par. 3 d.P.R. 29th September 1970, n. 600 sets a withholding tax on dividend at 27 per cent rate, but also grants to non resident persons, as long as they’re not saving shareholders, a right to be reimbursed up to 4/9 of the withholding tax when taxed on the same income abroad (an appropriate certification by the foreign tax Administration is requested).

On conventional rules’ side, such rate must be reduced, pursuant to art. 10 par. 2 OECD reduces, when such dividends are paid to a beneficial owner (143); moreover, dividends shall be taxed only in the residence State and according to its domestic law if the beneficial owner of the dividends carries on a commercial or industrial activity through a P.E. in the source state and the participation effectively pertains to the P.E. (art. 10, pr. 4 OECD).

143 “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% of the capital of the company paying the dividends; b) 15 per cent of the gross amount of the dividends in all other cases”.

participates, up to that amount, to losses in businesses covered by the agreement, anyway this contract does not set up a common organization between the contractors. For more details, G.F. CAMPOBASSO, *Manuale di Diritto Commerciale*, Torino, 2004, pag. 490
Doctrine requests an economic increase to be determined for the P.E. by such participation, and OECD Commentary entitles States to apply their own anti-avoidance rules when assessing such effectiveness 144.

These so called outgoing dividends give way to problems under a Community law perspective (with special regard to EU Law freedoms of establishment and free movement of capitals) when paid by a company that resides in a Member State to a person in another member State; subjection to a withholding tax implies a worse tax treatment than the one secured to the resident receiver of the same dividends, even when the rate is reduced due to a Convention entertained by the Source State and the Residence State.

The European Commission has claimed in front of the ECJ on 25th January 2007 that domestic law of Italy, as well as the ones of Belgium Spain, Netherlands and Portugal, might not be in line with the mentioned freedoms with respect to taxation of outgoing dividends, and its point seem to be grounded, at least when requirements for Parent-Subsidiary Directive are not met.

Italian domestic law in fact states taxation, at 33 per cent tax rate, of only 5 per cent of dividends distributed by a resident company to another resident enterprise; besides, a withholding tax corresponding to 27 per cent of gross amount is levied on outgoing dividends, unless a Convention or Parent-Subsidiary Directive apply in order to reduce or the rate or to eliminate the tax.

2.1.2 Transfer Pricing Rules

Italian Tax Administration is entitled to equalize a price of a transaction to the one in a similar operation when such operation is entertained between a resident and a non resident, both members of a group, and falling under the scope of transactions subject to transfer pricing rules.

In relation to subjective requirements, art. 110 par. 7 T.U.I.R. states that incomes coming from operations between a resident company and a non resident one that controls it or is controlled by the resident company itself or by the same parent company

144 C. GARBARINO, *Manuale di tassazione internazionale*, cit., pag. 379-81
which own the resident one are all esteemed at the normal value (145), when such operation determines an increase of income.

Tax Administration gives a wide interpretation of “resident company”, by referring to the notion of entrepreneur stated in art. 2082 of Italian civil code (anyone who carries on professionally an organized economic activity aimed to production or trade of goods and services”). The notion of non resident companies is read with a similar width by Tax Administration: it includes every kind of social and corporate body as long as disciplined in a foreign State (e.g French Gruopment d’interet economique, German Arge, Anglo-Saxon trusts), foreign companies’ non- Italian P.E.s, and P.E.s arranged abroad by an Italian (and resident) company (146).

Art. 110 par. 7 covers also goods and services sold in Italy by non resident companies when a resident enterprise performs, on its behalf, manufacturing tasks or sales of raw materials or goods. The link described by T.U.I.R. between these two entities is solely economic, and so in this case tax Administration is not requested to demonstrate any legal relationship.

With regard to the relationship between resident and non resident company, art. 110, 7 T.U.I.R. is interpreted as pointing out an autonomous fiscal notion of control, for transfer pricing goals. An implicit reference is made to art. 2359 of Italian Civil code: no proof is requested by Tax Administration when a company owns the majority of votes in another company’s shareholders’ meeting; on the other side, such proof must be shown when control is exercised pursuant to art. 2359, par. 1 numbers 2 and 3 of Italian civil code (147), and, a fortiori, in every single relevant circumstance of potential and actual economic influence, not codified by T.U.I.R, but suitable to influence

145 Default provision for normal value is art. 9 T.U.I.R.: the price usually agreed for goods and services of the same kind, under free competition and at a certain point of sale procedure, in the time and place when goods and services are bought or performed or at least in the closer and comparable time and space; reference is made as possible to price-lists of the vendor and, if there is no such price list, to those of Chambers of Commerce or to professional tariffs; if prices of goods and services are set by law or regulations, reference is made to these. Special rules apply to share and bonds, by reference to the average price within a month or to company’s net estate, in relation to the nature of the company and its presence in a Stock-Exchange.

146 Since such P.E. has a degree of capacity in relation to assessment of business income produced abroad, if it was not regarded as a non resident body for the purposes in question, transfer pricing rules would be easily avoidable by transactions between the Italian company and its P.E.

147 Control ruled by means of sufficient votes in order to perform a dominant influence on shareholders’ meeting, or dominance due to special contracts or relations entertained with the controlled company.
entrepreneurial decisions (148) or when the companies might have potential and common interests in not negotiating at arm’s length (149).

There are four kinds of operations to which transfer pricing rules apply. The first is the exchange of goods, both finished and semi-finished, that is particularly relevant because different steps of manufacturing and trade are commonly divided between group members or since these might entertain special degrees of cooperation. The second is the transfer of services ordinarily performed by a company. Such services consist, *e.g.*, in consultancy about matters related to legal systems, taxes, finance, accountability, business, recruitment & training of employees. OECD reports distinguish between services performed by the parent company and suited for one single or many group members. The third lies in Research and Development endeavours: such tasks are usually assigned to special units within a group, and these last transfer intangibles, as trademarks, patents and know-how to other group members, ordinarily by means of licence agreements stating an obligation to pay royalties for the licensee. The fourth and latter category of operation subject to transfer pricing rules are loans by a group member to another, that will have to pay interests to it: these last can be adjusted by tax administration to normal value.

Special methods to determine normal price apply to these types of operations. These methods are based on a comparison between price or gross profit in the operation to be verified and a comparable operation. The first method is so called Comparable Uncontrolled Price (CUP): the practice price must be compared to the one in a comparable transaction between a group member and an independent person (internal comparison) or between independent persons (external comparison). According to circular n. 32/9/2267 internal CUP is the favourite method and should be used as long as possible. Adjustments might be need, with special regard to the economic notion of relevant market (*e.g.* transport costs). Provided that compared products are almost identical, doctrine prefers external CUP when the group in question

148 *e.g.* exclusive sale of goods produced by the other company, a joint-ventures, right to appoint directors, family ties, financial subordination, participation to trusts (*in specie*, when aimed to fix prices), agreements liable to suspicion of monopolistic situations.
acts as a monopolist and in relation to transaction on commodities, while it would not work on goods of different brands.

A second method is the re-sale price: normal value arises from the price practiced by a group member that buys goods or services and then sells them to an independent person (internal re-sale price); such price must be decreased by the gross profit, which consists of net profit and costs met to realize the sale. Tax Administration applies this method when CUP is not feasible and a group member usually buys and sells a certain kind of goods in a short meanwhile, by carrying only activity related to the sale, without any remarkable increase to the value of the goods in question. Gross profit must analyzed in light of the different entrepreneurial risks that are taken case by case. Re-sale price between two independent persons (so called external) is only residually used by Tax Administration, and only as a term of comparison.

According to Cost plus, which is the third ranked method, normal value of the good traded in the transaction to be verified coincides with its cost price increased by gross profit. Tax Administration prefers again an internal view (price practiced by a group member to independent persons) and applies it to transfers of semi-finished products by a group member to another, that will increase their value by completing the manufacturing process or bringing technologies, patents or brands. Manufacturing costs are assessed, pursuant to circular 23/9/2267, at their effective amount, which makes this method unfit for transfers from a foreign parent company to an Italian subsidiary.

Alternative methods, based on comparison of net profit, can be applied jointly with the abovementioned one (known as traditional methods) or when their use is impossible (150). OECD discourages the use of these methods, because of lacks of internationally accepted criteria and because they do not strictly follow basic principle of international taxation (Incomes must be all taxed and this chance is to be divided between States).

2.1.3 Special tax regimes for holding companies (reference)

Please look at par. I.1.3 for the relevant anti-avoidance clause.

150 Circular 9/2267 lists profit sharing and comparison, profitability of the investment, sectoral gross margins, transactional set margin method and profit split method.
2.1.4 Group taxation regime

D. lgs 344/2003 has granted groups the right to choose consolidation regime, both at national and at cross-border level.

National consolidation is a hybrid between tax consolidation and group relief: one hand it consists in one taxable bases, relative to the controlling body or company and arising from the addition of each controlled company’s taxable bases. On the other, the group is not an autonomous entity and has no incomes different from controlled companies’ one.

Art. 120 par. 1 states that a SPA, a SAS and a SRL are regarded as controlled, for the purposes of national consolidation, when:

a) the controlling company or body possess, directly or indirectly, more than 50% of its shares, taken de-multiplication in account, but not shares without right to vote in shareholders’ meeting

b) the controlling company or body participates, directly or indirectly, to more than 50% of controlled company’s profits, taking de-multiplication account, but not profits relative to shares without right to vote in shareholders’ meeting.

Art. 120 par. 2 T.U.I.R. requires these conditions to continue through all tax-year in which consolidation regime is chosen.

Circular 20th December 2003, n. 53E/2004 makes clear that control, under art. 2359 par. 1 n.1. of Italian civil code and art. 120 T.U.I.R. is essential in order to choose national consolidation regime. Art. 2359 par. 2 applies to such control, so it can be either directly performed by the controlling and consolidating company or, indirectly, through controlled companies, fiduciary companies or a nominee. In this last case, Tax Administration asks the controlling and consolidating entity to carry on such “second level” control through a company that is directly possessed.

Foreign elements can take place in a national consolidation. A resident company, controlled by a non resident one, can consolidate one or more resident subsidiaries; a

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151 E.g. company A holds 80 per cent of company B, that owns 70 per cent in company C: company A results to own 56 per cent of company C.
foreign consolidation regime, if present, can continue to produce its effect in relation to the non resident parent company.

Non resident companies and bodies, with or without legal personality (art. 73 par. 1 lett. d) can choose to consolidate, pursuant to art. 117 par. 2, only in position of parent company and if residents in a State that entertains with Italy a DTC and if they carry on business activity (art. 55 T.U.I.R.) through a P.E. (art. 162 T.U.I.R.), which must include in its estate control shares of every single subsidiary and so head their governance.

Art. 55 par. 1 T.U.I.R. defines business activities, by reference to art. 2195 par. 1 of Italian civil code, as the habitual and professional undertaking of industry, mediation in exchange of goods, transportation, banking and auxiliary tasks to them, or agricultural activities when exceeding limits set by art. 32 par. 2 letters b) and c) art. 55 par. 2 T.U.I.R. subsequently includes activities arranged as an enterprise, even if aimed to services not listed in art. 2195, par. 1 of Italian civil code, and exploitation of mines, quarries, peat-mosses, salt-mines, lakes, ponds and similar waters. Circular 20/12/04 retains that pursuit of business activity criterion, in light of its wide (but effective) notion, is not met by P.E.s when they seem used by non resident entities only as a tool to manage ownerships of resident companies.

Art. 117 T.U.I.R. implicitly excludes from the scope of national consolidation non resident parent companies without a P.E. in Italy; moreover, a P.E.s owned by a non resident parent company can not be consolidated with resident companies controlled by the same parent company: this is probably a breach of EU law right of establishment, since a fiscal disincentive comes form a an organizational choice, such establishing in Italy a P.E. or a subsidiary; neither it is possible for a non resident parent company with no P.E. in Italy to consolidate resident subsidiaries, since Tax Administration wants a resident entity to be responsible for obligations set by the tax system for resident taxpayers, in primis incomes’ declaration and their duly payment. Art. 130 par. 4 forbids to a resident company to choose national consolidation as controlled by another resident company after having preferred cross-border consolidation as a parent company.

Once national consolidation in chosen, it must be determined, pursuant to art. 118 par. 1, a general income of the whole group, corresponding to the sum of subsidiaries’ net
incomes; these are taken in account for their entire amount, independently from how many shares the parent company owns (as long that control requirements, as described above, are met).

According to art. 9 par. 1 D.M. 9th April 2004, the consolidating company has to declare group’s income and ascertains it by taking the adjustments disciplined by articles 122, 124 and 125 T.U.I.R.

Subsidiaries’ obligations are set by art. 121 T.U.I.R.. Each must file both to the parent company and Tax Administration (but without obligation to duly pay) its declaration, comprehensive of the whole income, deductions, withholding taxes and tax credits. Subsidiaries must moreover send to the parent information relative to exchange of goods in fiscal infra-group neutrality regime (art. 123 T.U.I.R.\(^{152}\) and assess residual difference between book value and fiscal value. Art. 121 letter c) contains a final and default obligation to cooperate with the parent company in order to achieve fulfilment of its obligations towards Tax Administration.

In respect to cross-border consolidation, which must be expressly chosen and lasts for five years, and not three like the national one, it enables the “highest” resident parent company to sum non resident subsidiaries’ taxable incomes and losses, not regarding their effective distribution and in proportion to the share in profits owned in each of them. Before the option is taken, subsidiaries’ budgets must be duly revised and checked-up, pursuant to art. 132 par. 2 letter c, and each non resident subsidiary is requested to certify 1) its assent to budget’s revision and 2) its cooperation with the resident parent company in order to determine group’s taxable base and to comply with Tax Administration’s demands within 60 days from their notification. the whole amount is taxed in the hands of the controlling and consolidating resident company, according to Italian domestic law, and a tax credit is granted for taxes paid abroad by non resident subsidiaries. As a matter of consequence, foreign incomes gained by non resident subsidiaries get taxable in Italy according to world wide taxation principle. The option must be taken in relation to all subsidiaries (the relevant notion, further, arises from art. 133 T.U.I.R.), pursuant to so called “all in, all out” principle, unless, e.g, the parent

\(^{152}\) Exchange of goods can take place with continuity of fiscal values, as agreed by the vendor company and the buyer one; the contract must be written, and the difference between book value and fiscal value attributed to the good in question must result from the holding’s income declaration. Goods that generate proceeds and those under participation exemption regime are excluded.
company obtains by Tax Administration the chance to exclude by consolidation small subsidiaries residing in countries not listed as tax havens (art. 132 par. 4 T.U.I.R.).

Resident parent companies are defined by art. 130, par. 1 T.U.I.R. as the ones by art. 73 par. 1 letters a and b T.U.I.R. (153) that control subsidiaries, listed in art. 133 T.U.I.R., according to art. 2359, par. 1 n.1 of Italian civil code (154).

For cross-border consolidation purposes, the parent company has to possess, directly or indirectly, more of 50 per cent of the capital and profits of non-resident subsidiary bodies, taking account of de-multiplication, both in order to control and for attribution of incomes to the parent company (while it is considered, in national consolidation, only in relation to control).

Tax credit applies to tax paid abroad by non resident subsidiaries, and the relevant part of Italian tax that corresponds to the foreign one is to be ascertained for each non resident subsidiary separately (art. 136, par. 3). Tax credit in excess can be carried backward and forward for eight commercial periods.

A derogation to the ordinary regime is enclosed by art. 165 par. 5, stating that deductions can be accounted in their own tax period even though it becomes definitive in the course of the next tax period’s declaration. Foreign incomes deducted and not conclusively paid must be expressly indicated in incomes’ declaration.

The resident parent company ascertains group’s taxable base and the corresponding tax, and is obliged to payments in account and as full settlement (art. 131 par. 5 T.U.I.R.).

2.2. Anti-abuse provisions

2.2.1. Thin-capitalization rules

Art. 98 T.U.I.R. is aimed to impede deductibility of interests paid by an enterprise from its taxable base, in relation to financings granted or secured by qualified shareholders or their correlative persons, when the amount of such financings exceeds an allowed limit. This provision is often applied to trans-national groups and is justified by the tendency to prefer debt to capital, since interests are tax deductible and dividends

153 Please look at page 2 for art. 73 par. 1 letters a and b
154 please look at page 3 for art. 2359 of Italian Civil code
are not. Moreover, a fiscal limit to thin capitalization pursues the greater political and economic goal to incentive capitalization, in a view of improving competitiveness of the economic system as a whole. This ratio is confirmed by an enclosed derogation, enabling the debtor enterprise to demonstrate that exceeding financings’ quota corresponds to its solvability and reliability, so that a loan would have been granted by third parties also, due to capacity of company’s estate.

The rule stated by art. 98 T.U.I.R. applies when subjective and objective requirements are met. It is firstly necessary to identify the financed persons, the qualified shareholders and his/her correlatives; then it must be assessed the amount of financings granted or secured by such persons and the percentage of capital referable to them as a whole. Finally, if the first outdoes the second by four to one, the main rule will apply, and interests paid by the debtor, in relation to financings granted or secured by the abovementioned shareholders and correlatives over four to one ratio with their own capital shares, won’t be deductible from enterprise taxable base. If, instead, financings do not get over, the rule does not apply, even to those qualified shareholders or correlatives who might have secured or granted financings worth four times more than their shares.

Debtor enterprise are resident partnerships and family enterprises, and C.I.T. subjects:
1) resident joint-stock companies, cooperatives and mutual insurance companies
2) resident private or public bodies (of commercial nature and not)
3) non resident bodies or companies, with or without legal personality, that own a P.E. in Italy

A shareholder is “qualified”, pursuant to art. 98 par. 3 letter c), when alternatively:
1) directly or indirectly (by a correlative person) controls the debtor enterprise according to art. 2359 of Italian civil code.
2) Owns at least 25 per cent of debtor’s shares; participation possessed by correlatives are take in account.

The State and public bodies can never be qualified shareholders.

Art. 98 par.3 letter c) defines correlatives as companies controlled by the qualified shareholder according to art. 2359 of Italian civil code; if the shareholder is a physical
person, his/her wife (or husband), relatives by marriage within the third degree of
family tie and within the second.

Debts are financings granted by the qualified shareholder or his/her correlative
persons or financings secured by the qualified shareholder or his/her correlative persons.
Both kinds of debt must be considered in their average consistency through the tax-year
in question.

Art. 98 par. 4 includes within granted or secured financings loans, bails of
money and any other contribution of financial nature. This last default provision is
widely interpreted by Tax Administration, so to include, e.g., financial leasing, bonds
reserved to shareholders; delays of payment in relation to purchase of goods and
services, damages, securities and payments by shareholders with no obligation to refund
are not relevant debts (155).

Art. 98 par. 6 considers guaranteed by the shareholder or his/her correlative persons
debts secured by real or de facto warranties, and also by behaviours or legal acts (not
formal guaranties) that obtain the same goal.

An example of such behaviour or legal acts is a letter of patronage in which the holding
company commits itself to look after a subsidiary in its efforts to keep an engagement
(156). Circular 17th March 2005, n. 11/E regards similar letters as a guaranty for the
purpose of thin-cap rules when it determines a creditor’s belief (e.g. a bank) in relation
to the capacity of the debtor (as controlled by the holding) to fulfil its own obligations.
Financings granted or guaranteed by third parties are not relevant.

Capital shares of the qualified stockholder and his correlatives are related to accountable
net estate, as it results from the former financial period and inclusive of net and not
distributed profits (157).

Art. 98 par. 2 points a derogation. Thin cap main rule does not apply if the debtor can
show that the amount of financing (over four to one ratio) is due to its estate’s effective

155 Circular 17th March 2005, n. 11/E
156 F. GALGANO, Diritto Privato, Padova, 2001, pag. 407
157 Four adjustments in reduction are stated: debtor’s credits in relation to contributions of capital not yet
fulfilled; value of own shares kept in portfolio by the debtor; losses bear if, before the approval of budget
of the second commercial period next to the losses, net estate is not refund by saving profits or by
payments, in money or of other nature; book value or of participation in controlled companies by art. 73
par. 1. letter a T.U.I.R. (companies) and art. 5 T.U.I.R. (partnerships).
capacity to appeal credit, so that loans would have been granted by third parties also (158).
Circular 17th March 2005 11/E allows financings collected by bonds, since company law provisions by Italian civil code secure in that case a balance between capital and debt.

2.2.2 Exit tax rules

Art. 166 T.U.I.R. contains a discipline for exit taxes: a change of residence to a foreign country, by persons (both physical and legal) in charge of a commercial undertaking, when implying loss of residence in Italy for income taxes purposes, constitutes achievement at normal value of firm’s elements, unless they flow together into a P.E. in Italy. The same applies if, afterwards, such elements are distracted by P.E’s estate. In any case capital gains pertaining to P.E.s located abroad are deemed to be achieved at normal value (159)(160).

Two regimes emerge from art. 166 T.U.I.R.: the first covers firm’s elements not flown to a P.E. located in Italy or flown but distracted. These elements must be ascertained in relation to company’s budget and regarded inclusive of immaterial goods and starting-up value (161). The second applies to capital gains pertaining to P.E.s located abroad and possessed by an undertaking that moves its residence, and it is explained by the circumstance that such incomes would not be taxable in Italy, due to a lack of personal attachment, once residence was moved.

Various obstacles may arise to a transfer of residence abroad by the whole tax system. For example, persons subject to C.I.T. in Italy can lose their residence only by moving abroad legal seat and place of effective management and main business, since each of these three criteria is alternatively suitable to perfect in Italy residence for C.I.T. purposes. Moreover, it is sometimes requested to taxpayer to demonstrate (and to win

158 Circular 17th March 2005 11/E allows financings collected by bonds, since company law provisions by Italian civil code secure in that case a balance between capital and debt.
159 Please look at foot-note n. 40 for normal value
160 Funds waiting to be taxed (included the ones taxable in case of distribution) and registered in budget before residence is changed are subject to taxation when not restored in accountable estate of the mentioned P.E.
over a deemed residence in Italy) obtainment and keeping of residence abroad, especially in tax havens (162).
Anyway, jurisprudence now allow Italian enterprises to move their residence abroad, without losing their “nationality” by an international private law view, since art. 166 T.U.I.R. sets an autonomous discipline for change of abode, without any reference to winding up (163).

2.2.3 CFC rules

In respect of CFC rules, incomes gained by these companies, located in tax havens, are taxed transparently and directly in the hands of resident holdings, irrespective of the effective distribution of dividends or other incomes.
Pursuant to art. 167 par. 1 T.U.I.R., if an Italian resident directly or indirectly (also through fiduciary companies or by a nominee) controls an enterprise, a company or a body, resident in a tax haven, incomes gained by this last are taxed in the hand of the Italian resident and proportionally to the shares possessed, beginning from the end of foreign person’s commercial period. This applies as well to participations in non resident persons when incomes comes from their P.E.s located in tax havens. This rule covers Italian resident’s direct or indirect participation, not lower than 20 per cent, to profits gained by an enterprise, a company or a body residing or located in a tax haven; this percentage is decreased to 10 per cent if the company works in the Stock-Exchange. The rule does not cover participations in non resident persons not residing in tax haven when incomes are earned through P.E.s established in such countries.
In effect to these provisions, criteria to determine taxation are changed, both in relation to time and to assessment. Two States, Italy and the tax haven country, claim a concurrent right to tax on profits, but these are ascertained in Italy in light of Italian

161 C. GARBARINO, Manuale di tassazione internazionale, cit., pag. 258
162 G. MELIS, Profili sistematici del “trasferimento” della residenza fiscale delle società, in Dir.Prat. Trib. Int.le., 204, I, pag. 16
163 Trib. Verona, 5th November 1996, in Le Società, 1997; an Italian limited company moved to United Kingdom, where its mother company had residence: the Cort held that anglo-saxon incorporation principle does not necessarily bring an automatic loss of nationality for the newly incorporated company, because such company has not to comply to formalities peculiar of civil law systems and continues to operate under its country’s law.
C.I.T rules. So when dividends are effectively paid by the CFC, they are not assailable by the Italian Tax Administration, if profits have already been transparently taxed, according to Italian CFC rules and irrespective of any distribution.

Art. 167, par. 4 considers as tax havens States and territories listed by a decree of Ministry of Finance, in reason of a taxation slightly lower than the Italian one or lack of adequate exchange of information or equivalent criteria.

Decree 21st November 2001 sets a definite list of tax havens for CFC purposes; every kind of enterprise, company or body residing or located in these countries or territories is deemed to fall under CFC rules scope (but - further - taxpayer is allowed to demonstrate the opposite). This list is completed by another two: the first numbers countries but also derogations for kinds of entities and corporate structures in each country; the second, on the contrary, indicates to which kind of persons CFC rules apply in a precise list of countries (164).

With regard to the relevant notion of control, art. 167, par. 4 refers to art. 2359 of Italian civil code. In case of direct control, both “by law” (possess of majority in shareholders’ meeting) and “de facto” (possess of sufficient votes to dominantly influence the shareholders’ meeting), CFC incomes are pro quota taxed in the hands of the Italian resident direct holder. In case of indirect control (votes of controlled companies, fiduciary companies and nominees are taken in account), both by law and de facto, if the resident holding performs such control through other residents, CFC incomes are taxed pro quota to them; on the other side, if control is exercised through non residents, CFC incomes are pro quota (and by transparency) attributed to the resident. In case of

164 Pursuant to art. 1, the following States and territories are regarded as privileged fiscal regimes: Alderney (Channel Islands), Andorra, Anguilla, Dutch Antillas, Aruba, Bahamas, Barbados, Barbuda, Belize, Bermuda, Brunei, Cyprus, Philippines, Gibraltar, Gibuti (ex Afar e Issas), Grenada, Guatemala, Guernsey (Cannel Islands), Herm (Channel Islands), Hong Kong, Isle of Man, Cayman Islands, Cook Islands, Marshall Islands, Turks e Caicos Islands, British Virgin Islands, U.S. Virgin Islands, Jersey (Channel Islands), Kiribati (former Gilbert Islands), Lebanon, Liberia, Liechtenstein, Macao, Maldives, Malaysia, Montserrat, Nauru, Niue, New Caledonia, Oman, French Polinesia, Saint Kitts e Nevis, Salomon, Samoa, Saint Lucia, Saint Vincent e Grenadine, St. Helen, Sark (Channel Islands), Seychelles, Singapore, Tonga, Tuvalu (former Ellice Islands), Vanuatu.

Pursuant to art. 2 the following are included in art. 1: a) Bahrein, with exclusion of companies carrying on exploration, extraction and refining of oil; b) United Arab Emirates, with exclusion of companies subject to tax and concerning oil and petroleum chemistry c) Monaco, with exclusion of those companies that produce at least 25 per cent of all proceeds outside the Principality.

Art. 3 lists kind of companies to which the regime applies within certain countries, e.g. Switzerland with reference to companies not subject to cantonal nor municipal taxation, as holding companies, auxiliary companies and domicile companies.
“external” control (dominant influence by means of contracts or agreements), CFC incomes are attributed to the resident shareholder in relation to its participation to profits (165).

According to art. 167, par. 6 CFC incomes are separately taxed at the average rate applied on the whole income earned by the resident. Such rate can never be lower than 27 per cent. CFC incomes are so only partially consolidated, in order to avoid suspicious mix with the own gains get by the resident holding.

Art. 167, par. 5 points out two alternative derogations to CFC regime: taxpayer is allowed to demonstrate that CFC pursues an effective industrial or commercial activity which is its main one in the tax haven State or Territory or that participation in CFC is not aimed to allocate incomes in tax havens.

The taxpayer is in both cases requested to ask Tax Administration a preventive ruling, pursuant to art. 11 State Act 27th July 2000, n. 212 so called “Taxpayer’s Statute”. The taxpayer, or a person requested by law to fulfil on his/her behalf tax obligation, must address to Tax Administration central legal department proper documentary evidence. Tax Administration must formally reply within 120 days, and, if no answer is given in such meanwhile, it is deemed to agree with taxpayer’s point. The response is relative only to the single problem highlighted by the taxpayer and covers solely the situation described, in law and in fact.

The first proof must be shown pursuant to the Italian civil code’s notion of commercial and industrial activity (art. 2195) and by demonstrating that the CFC operates through a proper organization. The activity must also be “main”, so it must outgrow by quantity any other carried on in the tax haven (166).

The second proof is to show that that CFC incomes has been consistently taxed abroad, due either to foreign tax-rate or to the structure of the foreign tax; this derogation is aimed to remove from CFC rules scope participations that are coherent, above

165 A plain and systematic explanation of art. 2359 of Italian civil code is given by ASSOCIAZIONE DISIANO PREITE, Il diritto delle Società, Bologna, 2004, pag. 103-06

166 Circular 12th February 2002, n. 18/E lists, e.g. documentation on CFC’s incorporation deed (in relation to nature of CFC’s activity) commercial period, organization (in respect to effective pursuit of the main activity).
reasonable doubt, to entrepreneurial organization of the resident enterprise, and not merely aimed to save on fiscal obligations (167).

Finally, pursuant to art. 168, par. 1 T.U.I.R., CFC rules apply as well to resident persons that dispose, directly or indirectly and even through a fiduciary company or a nominee, of at least 20 per cent in proceeds of an enterprise, company or body, resident or situated in a State or territory with privileged tax regime. Such percentage is reduced to 10 per cent in case of Stock-Exchange companies.

This regime (so called, “linked CFCs”) is residual, since it applies only when it is impossible to show (168) a de facto control alongside to participation in proceeds. Moreover, it does not cover participations in persons not situated in tax haven countries if these last earn incomes from P.E.s under privileged tax regimes.

According to art. 168, par. 2, T.U.I.R., it is considered, in order to ascertain linked CFC’s incomes, the bigger value between:

a) profits ascertained in the CFC’s budget before taxes are paid, even if the company is not obliged by its domestic law to draw up a budget.

b) an income inductively determined according to cost plus coefficients suited for categories of goods in the net estate.

2.2.4 Tax haven rules

Art. 110, paragraphs 10-12 set tax haven rules. According to par. 10, expenses and negative elements arising from transactions between resident enterprises and undertakings fiscally domiciled in non-EU States or territories with “privileged fiscal regimes” (i.e. tax havens) are not tax deductible. However, art. 110, par. 10 T.U.I.R. does not operate if Italy and a “black list” country enclose in their Convention a provision similar to art. 24, par. 4 OECD and such rule is implemented by means of State legislation (so called lex specialis argument). It should be noted that Italy usually demands to insert in art. 24, par. 6 OECD a safeguard clause, stating that non

167 The same circular suggests inter alia, as profitable proofs, accountable and fiscal documentation showing that CFC incomes are gained in non-black listed countries for not less than 75 per cent of the whole.

168 C. GARBARINO, Manuale di Tassazione Internazionale, cit., pag. 1049
discrimination principle must not limit domestic rules aimed to prevent fiscal evasion and elusion.

A “resident enterprise” for tax haven rule purposes is, broadly, everybody produces business incomes. Assumed that a P.E. located in Italy assesses its own taxable base and duly pays, as persons ordinarily listed as enterprises (art. 55 T.U.I.R) do, and that “residence” should, for the purposes in question, be linked to the entrepreneurial activity effectively carried, a P.E. might well be a resident enterprise (169).

Non resident enterprises are ascertained by their fiscal residence, a criterion which extends the scope of persons taxable by Italian Tax Administration’s to P.E. owned by Italian companies in a tax haven country.

Art. 110, par. 10 sets criteria to the Ministry’s Decree entitled to namely identify tax haven countries and territories. The main criterion is a level of taxation slightly lower than the Italian, both due to tax-rates and to structure of the tax, as long the sum effectively paid by taxpayer results inferior to what should have been paid in Italy. Alternative and secondary criteria are lack of adequate exchange of information (that coincides with no DTC entertained with the country in question) and equivalent criteria, in relation to the peculiar features of each country. EU members ca not be black-listed, for plain non-discrimination reasons, even though this compliance with EU Law might well turn out in a discrimination between resident enterprises that operate within EU States effectively, but non in law, tax havens (for example, in the Netherlands, in Luxembourg, in Ireland, in Gibraltar, in Madeira) and enterprises that transact in other far away countries, regarded “fiscally privileged regimes” both effectively and in law (170).

The black list is provided with by Ministry of Finance’s Decree 23rd January 2002, and works as the CFC one. Art. 1 lists tax haven countries, while art. 2 tax haven countries as well as activities to which the discipline is not applicable if carried on there; art. 3, on the contrary, numbers activities that fall under these rules, if they established in countries not otherwise deemed to be tax havens.

In respect of operations under the discipline, “expenses” are any flow of wealth outgoing from the enterprise, and “negative elements” are widely interpreted too, and

169 C. GARBARINO, Manuale di Tassazione Internazionale, cit., pag. 1374
170 C. GARBARINO, Manuale di Tassazione Internazionale, cit., pag. 1379
referred to any kind of transaction with an enterprise fiscally domiciled in a tax haven). Art. 110, par. 12 hides to tax haven rule operation to which CFC rules apply. No rule, instead, discipline relations with transfer pricing provisions. It is argued that, if an operation felt under both disciplines, Tax Administration would be entitled to prefer one regime to another (171), of course by alleging reasons of that.

Art. 110, par. 11 points out two derogations to the regime. Taxpayer can alternatively show that the foreign enterprise carries on a main and effective commercial activity or that the transactions entertained correspond to and effective economic interest and have been diligently brought to perfection. Moreover, this provision obliges Tax Administration to notify to the taxpayer a warning, in order to enable him/her to bring, within 90 days, one (or both) of the above mentioned proofs, before issuing an assessment warning. Tax Administration must, moreover, allege reasons, in the assessment warning, for not considering suitable the proofs given, if that would be the case.

Deduction of expenses and negative elements is, anyway and when authorized, conditioned by separate statement of such amounts in incomes’ declaration.

In respect to the first derogation, the taxpayer must demonstrate, in light of the Italian notion (art. 55 T.U.I.R.), commercial nature of foreign enterprise’s activity; then must show that it is the main activity (evidences requested are to be adjusted case by case) and its effectiveness, by an organizational point of view (172). In respect to the seconds, two proofs must be secured: one hand, that the transaction corresponds to an effective economic interest for the resident enterprise, by showing, e.g, a substantial equality between the price paid to the foreign company and the normal value, or the peculiar nature of the transaction; on the other that the transaction has been duly performed and completed, by bringing customs documentations, bills and evidence of (official) financial flows.

2.3 Relief from international double taxation

171 C. GARBARINO, Manuale di tassazione internazionale, cit. pag. 1383
Italy applies world wide taxation principle and so, in relation to source principle situations, international juridical double taxation threat arise. Art. 165 T.U.I.R. grants a foreign tax credit on incomes gained abroad, and so implements “fiscal international neutrality” as a general principle of tax law codification (State Act of delegation to government 7th April 2003, n. 80).

Such credit is granted when foreign incomes, conclusively taxed abroad, concur to whole income’s ascertainment; deduction of a tax duly paid abroad from net income Italian tax, for both physical persons and corporations, is allowed only within a quota corresponding to proportion between foreign income and the whole income, once accounted deductible losses from previous tax periods; if more incomes flow several foreign States, these must be separately stated for each country.

Art. 165 T.U.I.R. is within provisions common to all tax subjects. Physical persons non-entrepreneurs are taxed, on foreign incomes also, in relation to single income categories and according to cash basis; physical entrepreneurs include their foreign incomes in their business income, which is in Italy, when gained through a P.E. subject to taxation on accrual basis; exceeding tax credits relative to business incomes can be carried backward or forward; persons subject to C.I.T. are always deemed to gain business profits, and art. 165 T.U.I.R. applies to them either if income is earned through a P.E., or defined foreign sourced by art. 23 T.U.I.R. or if a Convention with the source States implies compulsory granting of a tax credit (art. 23B OECD); partnerships are in principle transparently taxed and so tax credit is attributed to partners (173), even though art. 165 T.U.I.R. does not expressly state it.

Pursuant to art. 165 par. 2 T.U.I.R., incomes are regarded as produced abroad according to the same criteria set by art. 23 T.U.I.R. in relation to the ones sourced in Italy. Par. 3 states a so called per country limitation principle, and so, e.g. no compensation is allowed if the taxpayer is subject to a tax lower than the creditable amount in State A and to a higher one in State B.

Foreign income must have been conclusively taxed: circular 8th February 1980, n. 3/7/360 demands that tax is not refundable at all, so tax paid in account or provisionally

172 Circular 12th February 2002 n. 18 lists as pertinent proofs the incorporation deed, an analysis of the foreign company’s organization in relation to its main commercial activity, accountable and fiscal documentation.
or in a compensation suitable to be refunded or awaiting that a challenge is settled are not tax creditable.

Resolution 31st March 1999, n. 59/E sheds light in relation to art. 165 par. 8 and considers that request of FTC in incomes’ declaration is an essential procedural requirement, not in contrast with DT Conventions.

When conclusive payment falls before that declaration of the tax period relative to foreign income is delivered, deduction must be accounted there (par. 4); when the payment is completed afterwards, tax credit is deductible in the period in which it is accounted in declaration (par. 7).

Par. 5 encloses a derogation for P.E.s and non resident subsidiaries in cross-border consolidation: deduction can be accounted even if conclusive payment takes place takes place afterwards (but within delivering of declaration for next tax period); the relevant foreign taxes must be stated in incomes’ declaration.

Par. 6 enables to carry on the exceeding credits for eight commercial periods backwards and, if necessary, forward, in order to secure in a large and profitable meanwhile the effectiveness of such credit without affecting residence State’s finances with the burden of reimbursements. This provision apply only for business incomes gained within the same foreign State. Per-country limitation does not apply, anyway, in case of cross border consolidation.

The relationship between Art. 165 discipline and art. 23 OECD is disciplined according to art. 169 T.U.I.R. principle: domestic law prevails only when more favourable to the taxpayer, and when its application is feasible (174).

2.4 Miscellaneous

2.4.1. Notion of Permanent Establishment

The new Italian notion of P.E., set by 2003 reforms, corresponds in the opinion of the Act delegating government, to “criteria of DTC”. This implies a general reference to the

173 C. GARBARINO, *Manuale di tassazione internazionale*, cit. pag. 105
174 C. GARBARINO, *Manuale di tassazione internazionale*, cit., pag. 126
network of Treaties signed by Italy (175), but also suggests a wide reference by Tax administration to OECD Commentary, in order to secure a uniform interpretation of P.E. notion (176).

Art. 162 par. 1 T.U.I.R. definition almost recalls art. 5 par. 1 OECD, by pointing out a fixed place of business, an enterprise, and the use of the first by the second in the aim of its activity. Reference by Tax Administration to OECD Commentary seems therefore more than ever necessary, when asked to clarify “fixed place”, “enterprise” and “activity” notions.

Par. 2 lists situations suitable to constitute a sign of material P.E. (requirements by par. 1 will have always to be met): a place of management, a branch, an office, a workshop, a laboratory, a mine, an oil or gas well, a quarry, any other place of digging out of natural resources, in places also beyond territorial waters if the state can there lawfully (both by international and domestic law views) exercise rights in relation to sea grounds, to its subsoil and its natural resources.

Par. 3 provision slightly differs from OECD one, since a building site or construction or installation project or relative supervisory activities constitutes a P.E. only if it lasts more than three months (OCED Model requires twelve).

Par. 4 reads the same as art. 5 par. 4 OECD and state juris et de jure presumptions. Moreover, availability of computers and auxiliary machinery for collection and delivery of data aimed to sale of goods and services is not itself a P.E. (par. 5).

Personal P.E is disciplined by par. 6, stating that the resident or non resident person that, in the territory of the State, habitually concludes in behalf of the enterprise contracts non involving purchase of goods constitutes a P.E. of that enterprise. The range of this provision is wider than art. 5 par. 5 OECD, that excludes activities mentioned in art. 5 par. 4 OECD.

Pursuant to art. 162 par. 7, the so called “independent” agent constitutes a P.E. only when he/she is acting beyond the ordinary course of his/her business.

Par. 8 points out a brand new provision for sea activities: an enterprise is not deemed to have a P.E. by the mere performance of activities in the territory of the State through a

175 L. PERRONE, La stabile organizzazione, in Rass. Trib., 2004, n. 3, pag. 794
ship’s agent (L. 4 Aprile 1977, n.135) or maritime agent (State Act 12th March 1968, n. 478) enabled to commercial or operative management of enterprise’s ships, also continuously. The activity habitually carried on by such person is auxiliary or preparatory to a ship-owner’s business activity, and so they can never constitute a P.E. for the last one (177).

Par. 9 is analogous to art. 5 par. 7 OECD and endorses the principle that a controlled company is not itself a P.E. of the parent company.

The Italian notion of P.E. covers both personal and corporate income taxes, but applies only to activities regarded as “business” ones in Italy (art. 55 T.U.I.R. - look at page 18 of this paper).

In case of contrast between the domestic notion of P.E and provisions by Conventions, these last prevail (lex specialis argument), unless the domestic one results more favourable to the taxpayer (art. 169 T.U.I.R), since, it has been noted, conventional rules’ “mission” is to limit tax claim of the State, and not, on the contrary, to add new pretensions to those established in State’s legislations (178).

2.4.2. Ruling system

Art. 8 of State Act 24th November 2003, n. 326 has given an international ruling tool to resident enterprises (individual ones, bodies, partnerships, companies) alternatively falling under transfer pricing rules (art. 110 par. 7 T.U.I.R.) or participated by non residents or participating in non resident bodies or obliged to pay to or entitled to receive by non residents dividends, interests or royalties. An act by the Director of Agenzia delle Entrate (23rd July 2004) has implemented this tool.

The application must be delivered to the competent office in relation to fiscal domicile (one office is established in Milan for northern Italy and another in Rome for central and southern Italy) enclosing documentation to show fulfilment of mentioned subjective requirements and the object of the ruling.

177 G.M. COMMITTERI and G.F. SCIFONI, La stabile organizzazione nell’ordinamento tributario internazionale, cit., pag. 637
In relation to transfer pricing, art. 3 of Director’s act application must contain a detailed description of goods and services in question, identification of non resident companies, criteria to assess arm’s length value of infra-group transactions in question and reasons to consider them lawful; according to art. 8 a ruling procedure on transfer pricing matters is concluded by an agreement setting criteria to assess arm’s length value of transaction considered by the ruling.

In general, Tax Administration and the taxpayer subscribe, at the end of the procedure, a binding agreement lasting three tax periods. Art. 9 Director’s act enables Tax Administration to verify compliance to the agreement and that ascertained conditions go on, both in law and de facto. The enterprise has to provide Tax Administration with information either at regular times or on demand, and to agree with Tax Administration entries in the place where activities are carried on by its inspectors, in order to collect documentation and relevant data. In case these or other obligation or terms of the agreement are not complied with by the enterprise, Tax Administration delivers it a request to allege reasons within 3 days from notification; in case these reasons are not explained or are regarded as unfit, the agreement is put to nothing by the time of its infringement.

The agreement can be modified, in relation to new circumstances in law and de facto, both by Tax Administration’s initiative (when a change is assessed) and taxpayer’s. New circumstances, pursuant to art. 11 Director’s act, must be unexpected, effective, suitable to engrave decisively on agreement’s validity. Modifications must be agreed within 180 days by the initiative, under penalty of its solution from the very date in which change of circumstances has occurred.

The agreement is renewable by application of the enterprise at least 90 days before its expiration. Tax Administration endeavours an investigation and gives its response at least 15 days before the expiration, alleging reasons for not renewing the agreement if that would be the case.

Assumed that an international ruling (leaving domestic legal systems out) should at the same time guarantee to States that taxable items are not unlawfully taken away from imposition and relieve double taxation for taxpayers, this ruling does not reach the first goal, since Italian Tax Administration has merely to send a copy of the agreement to fiscal authorities of those countries where foreign enterprises in question reside or are
permanent established (art. 8 Director’s act) (179). In relation to the second goal, the possibility to submit the application both preventively and while the transaction is in course, discussion that inspires the whole procedure (despite the often “towering” position of Tax Administration, which is still today a “die-hard” heritage of Italian tax law and administrative law in general) and its negotiability (though it will probably rely much on the effective “power” of the taxpayer, in relation also to chances of competition between legal systems) seem to consider it reached, at least in part (180).

II DOUBLE TAX TREATIES

1. GENERAL QUESTION

Italy has up to now concluded seventy-eight tax DTCs, that apply to eighty-seven countries (181). The last added one, once exchange of ratification ahs been perfected on 15th January 2007, is the Convention concluded with the government of Arab Republic of Syria, signed in Damascus on 23rd November 2000 and ratified by Italy with Sate Act 28th April 2004, n. 130.

2. PERSONAL SCOPE AND TREATY ENTITLEMENT

2.1 Partnerships

In relation to partnerships, it should be ascertained whether they can be regarded as “persons” under art. 1 OECD Model Convention (to which Conventions entered in by Italy usually comply) and, if so, whether they can be considered as “resident” persons

179 P. ADONNINO, Considerazioni in tema di ruling internazionale, in Riv. Dir. Trib., 2004, IV, pag. 60
180 It should be noted that Advanced price Agreements are not, up to now, available in Italy, but it is argued that ruling procedure in relation to transfer pricing issues is similar to an unilateral APA. Look at C. GARBARINO, Manuale di tassazione internazionale, cit., pag. 1016 for more details.
181 The convention signed with former Soviet Union applies now to Armenia, Azerbaijan, Belarus, Moldavia, Kirghizistan, Tagikistan and Turkmenistan. The one entered in with Jugoslavia respectively to Bosnia Herzegovina, Croatia , Slovenia, Serbia and Montenegro. Look at
On one hand, art. 3 par. 1 letter a) OECD includes individuals, companies and any other body of persons in the notion of “person”, and letter b defines “company” as any body corporate or any entity that is treated as a body corporate for tax purposes. Par. 1 of OECD Commentary on art. 3 regards partnerships as companies, in case they are independent taxable units, or bodies of persons if transparently taxed; so in both situations a partnership has to be considered a person.

On the other hand, i.e. in respect to residence of partnerships, par. 5 of OECD Commentary on art. 1, together with par. 8.4 on art. 4, links residence for conventional purposes to taxation in the State where the partnership is situated; if it is taxed there “as a company or … in the same way” it will be a resident, and entitled to treaty benefits; if it is instead transparently taxed, it will not be regarded resident nor entitled, but partners, with respect to their share of the income of the partnership, may rely on the Convention between residence State and Source State. Par. 6.4 of Commentary on art. 1 points out that terms “paid” and “derived”, referred by OCED Model Convention to several items of taxations, must be widely interpreted, if the partnership is not a taxable unit, in order to let partners be entitled to Conventions’ benefit in relation to their shares on income, despite such items (e.g. dividends and interests) are directly paid to the partnership. A narrow interpretation would come out as a double taxation, since neither the transparent partnership (which is not a resident) nor the partners (who do not directly receive the payments) would be entitled to treaty benefits.

2.2 Groups of Companies

Groups of companies under a group taxation system can not be regarded as persons as long as no legal personality is granted to the group itself and the regime is essentially a tool to ascertain the whole group’s taxable base, which is a benefit and a simplification, both for the parent companies, together with the several subsidiaries, and for Tax Administration. In such a situation, formal tax obligations (e.g. incomes’ declaration and payment of accounts) may be allocated differently than they would in the ordinary

http://www.finanze.it/export/sites/default/finanze/dipartimentopolitichefiscali/osservatoriointernazionale/convenzioni/index.htm for relevant information and the Conventions.

182 E. DELLA VALLE, La soggettività delle partnerships nel modello OCSE di convenzione contro le doppie imposizioni sul reddito: la prospettiva italiana, cit., pag. 759
regime, but effective obligations continue to lie on the single bodies, e.g. through a water-fall mechanism of compensations and refunds. So treaty provisions may be invoked only by that body which entertains, case by case, relationships with persons abroad.

2.3 Limitation on benefits

“Limitation on benefits” clauses are advanced instruments conceived against treaty shopping abuses by U.S. Tax authorities through the last decades of negotiations. It applies at conventional level the “substance over from” principle, built by Supreme Court’s jurisprudence. Very briefly, such clause limits entitlement to treaty provisions by reason of subjective and objective features (kind of activity and of income) in question. A general rule (“a resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article”), five categories of persons and several tests are enclosed in art. 22 U.S. Model Convention. It has bee pointed put that the presence of such clause in Conventions signed by EU Countries can constitute, for these last, a breach of UE freedoms of establishment and movement. The ultimate step in LOB evolution is art. 26 of the Convention between U.S. and the Netherlands (183).

Since no Italian treaty policy in respect of LOB clauses is founded up to now, attention should be paid to LOB provision in U.S.-Italy Convention of 1984, brought by art. 2 of enclosed protocol, aimed to “clarifying and supplementing the Convention for the avoidance of double taxation with respect to taxes on income and the prevention of fraud or fiscal evasion” and signed simultaneously to the Convention. This provision reads:

A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to benefits provided in Articles 7 (Business profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital gains) or 22 (Other income) unless:

(a) more than 50% of the beneficial ownership of such person (or in the case of a company, more than 50% of the number of shares of each class of the company's shares) is owned, directly or indirectly, by any combination of one or more of:
(i) individuals who are residents of the United States;
(ii) citizens of the United States;
(iii) individuals who are residents of Italy;
(iv) companies as described in subparagraph (b); or
(v) the Contracting States; or
(b) it is a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange.
2. Paragraph 1 shall not apply unless the competent authority of the other Contracting State determines that either the establishment, acquisition or maintenance of such person or the conduct of its operations had as a principal purpose obtaining benefits under the Convention.
3. For the purpose of subparagraph (1)(b), the term "a recognized stock exchange" means:
(a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934.
(b) any stock exchange constituted and organized according to Italian laws; and
(c) any other stock exchange agreed upon by the competent authorities of the Contracting States.

It may be interesting to note that the new Convention proposed by the U.S. to Italy, and signed in 1999, but not yet ratified, encloses, in its protocol, a limitation on benefits provision which is, according to the letter on submittal, more comprehensive than the one in force.

2.4 Subject-to-tax clause

According to par. 15 of OCED Commentary on art. 1, the clause in question provides that treaty benefits in the State of source are granted only if income in question is
subject to tax in the State of residence. Par. 16 finds it suitable for States with a well
developed economic structure and a complex tax law, but suggests to insert bona fide
provisions in the aim of flexibility. Par. 17, moreover, argues that conduit problems
might be more satisfactory dealt by such clause by enclosing cases of improper use. A
subject-to-tax provision is enclosed in art. 18 paragraphs 1 and 2 of Convention
between Italy and Georgia in 2000: pensions and other remunerations paid to a resident
of a contracting State due to employment gone to end are taxable only in that state, but
this provision does not apply if the beneficiary is not subject to tax for that incomes in
the State of residence and pursuant to its legislation. In such case, incomes in questions
are taxed in the source State.

The Report by Third Permanent Commission, appointed on Foreign and EC Affairs, at
Italian Camera dei Deputati in relation State Act 11th July 2003, n. 205 ratifying the
Convention declares that such provision is a subject to tax one, by bringing this English
terminology in the Italian wording. Anyway, it should be noted that the rule in question
is not particularly advanced nor complex, due to its limited scope and the absence of
those bona fide and specific anti-avoidance and anti-abuse provision suggested by
OCED Commentary.

3. SELECTED DISTRIBUTIVE RULES

3.1 International group taxation: distribution rule for income attributable to the parent
company

The whole income attributable to a group is subject in the hands of the parent company
to C.I.T in Italy; foreign tax credit is granted for taxes paid by non resident subsidiaries
in their countries of residence in order to relieve double taxation on foreign incomes,
otherwise taxed both in the hands of the resident parent company and where non
resident subsidiaries reside. So taxes conclusively paid abroad are deductible from the
sum of parent company’s and non resident subsidiaries’ taxable bases, alongside with
tax credits pertaining to the holding company and withholding taxes. Tax credit is
granted separately for each subsidiary, in derogation to per country limitation rule,
unless these non resident subsidiaries are part of a group that, according to foreign
legislation, admits a complete consolidation of taxable base. In such case, non resident subsidiaries are regarded as a single company. Moreover, in relation to business profits gained abroad through a non resident subsidiary, deduction can be accounted even if conclusive payment falls afterwards the tax period in question (but before declaration for next tax period has to be delivered).

3.2 Infringements of DTC and application of different distribution rules

Different distribution rules from those set in DTCs are brought by CFC regimes, but a unilateral mechanism to relieve double taxation is brought in. Once assumed, as a matter of fact, transparent taxation, foreign tax credit method avoids double taxation on incomes gained by the CFC, when these are taxed both in Italy (State of residence of the parent company) and abroad (in CFC’s State of residence).

Taxes conclusively paid abroad are deductible from the transparently assessed tax, but since taxes paid by the CFC, and not by the Italian resident company, are in question, the first are the deductible ones. Moreover, the “quota of Italian tax” up to which foreign tax is deductible, should be ascertained in proportion to the sole foreign income (both at numerator and at denominator), because taxation of CFC income takes place separately from the own income of the resident company. In derogation to per country limitation rule, deduction occurs separately for each CFC, also when the Italian parent company controls several CFCs residents or situated in the same tax haven country.

The discipline applies as well to CFC’s incomes gained through P.E. in a tax haven and includes the possibility to account deductions in the tax period in which they concur to income despite foreign tax are conclusively paid afterwards, before delivery of next period’s declaration.

3.3 Incomes from immovable property

Incomes from immovable property located in Italy are subject both to domestic and to conventional rules, if a tax treaty is enacted between Italy, as the source State, and a foreign country. These rules are formal as well as substantive.

Domestic formal rule answers this question in order to locate non residents’ incomes: is
Italy the source State according to a “real” criterion? This rule, set by art. 23 par. 1 letter a T.U.I.R., states that in relation to non residents’ taxation, incomes from immovable properties situated in Italy are considered as produced in Italy (so called *locus rei sitae* criterion). In the meanwhile, conventional formal rule is art. 6 of relevant Convention, which assures a concurrent right to tax transnational incomes from immovable properties both to the Source State and the State of residence of the owner.

Domestic substantive rules are those about tax treatment of incomes from immovable properties, while conventional ones make reference to these last, but also include “property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources” and “income derived from the direct use, letting, or use in any other from of immovable property”.

Art. 6 par. 4 of relevant convention usually states a limited force of attraction principle in relation to destination of immovable property: par. 1 and par. 3 apply as well to incomes arising from immovable properties at owned by an enterprise or employed in practicing of a profession, and so source State concurs also when business or self-employment incomes are in questions and, moreover, when the property is owned by a P.E (184).

Force of attraction displayed by commercial activities changes the definition of incomes from immovable properties, that switch to business incomes category.

Pursuant to such a complex domestic and conventional status, incomes from immovable property owned by a simple partnership or a physical person are taxable under art. 6, while those owned by a general or limited partnership, by a company or by a P.E. fall under art. 7. Capital gains will always be taxed under art. 13, provided that requirements set by such provision are met, especially in respect of par. 4 OECD Model Convention (*e.g. conventions with China and with Ghana, “gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State”*, which less sharp and more favourable to the source State than MC
provision. Convention with Ukraine is in the same line, as gains derived by a resident of a Contracting State from the alienation of shares, other than shares quoted on an approved Stock Exchange, deriving their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in this last one).

3.4 Rules for determining arm’s length prices in respect to transactions between associated enterprises

The Italian roots of this paper suggest to focus on so called Philip Morris Cases, in which the Italian Supreme Court (Corte di Cassazione) has created an innovative jurisprudential notion of P.E. by direct reference to OCED Model Convention and Commentary and to DTCs, as implemented by State Acts, as no legal definition of P.E. existed in Italy at that time. Moreover, such cases are interesting as well for the analysis of a wide (and, in the opinion of some authors, confused 185) documental proofs offered by Tax Administration in order to show that Italian company named “I.”, only 2 per cent of which was own by P.M. Europe (incorporated in the U.S.) directly, was indeed a P.E. in Italy of the whole P.M. group and its companies, which would ground several infringements of Italian Tax Law by such companies, acted through their P.E., “occulted” in an Italian company with a precise intention to elude Italian tax obligations (186).

The Court gives a new characterization of P.E. within a multinational group. Such P.E. was defined multiple, since the group on its back must be considered unitarily in order to identify such P.E., despite the group had no legal personality itself. More companies of P.M. group, within a precise and one-headed strategy, made in fact use of company I. to pursue their own incomes and, according to the Court, this corresponds to art. 5 par. 2 letter a) of Model Convention. A multiple P.E. so carries on, within a group strategy, a function to coordinate and to facilitate performance of activity of several group members in a given region or territory. For the purposes of identification of such P.E., a mere formal check up of control requirements is not enough, because of art. 5

184 GARBARINO, Manuale di tassazione internazionale, cit., pag.463
185 B. ACILLI, Il caso Philip Morris, in Dir. Prat. Trib., 2004, I, pag. 73
186 It should be noted that Italian tax trial only admits documental proofs, and not evidence.
par. 7 OECD MC provision.

A P.E. of this kind might well be a crucial center of management of complex entrepreneurial activities, “occulted” in a domestic corporate body. The court considers signs of this concealment:

a) the circumstance that a de facto P.E. is incorporated a body of different nature, but also that style and business purposes of the firm are set differently than the usual ones within the group (that was the case of company I.);

b) pursuit of activity over ordinary business: company I.’s main business, according to its deed of incorporation, regarded cigarettes filters, and effectively such activities consisted in 70% of company I. efforts. However, the Court took greatly in account supervision activities with respect to execution of contracts for supplying and delivery of tobaccos concluded between foreign PM members and State Monopolies, since this activity consisted in the remaining 30% of company I.’s efforts. Such percentage is deemed to be remarkable and economically relevant;

c) subjection to directives by the group and by foreign group members

In respect to auxiliary nature of the activity (art. 5 par. 4 letter e OECD), the Court held that this was not the case of company I, because of the huge deployment of resources and efforts by company I. itself in relation to its “exorbitant” activity to monitor fulfillment of contracts signed by P.M. foreign companies and State Monopolies, in behalf of the first ones. Furthermore, such supervision was considered necessary and non-fungible, for foreign entities, to produce their incomes in Italy, irrespective of the lack of a formal mandate and that the mentioned contracts did not expressly state the powers effectively carried on by company I. The Court recalled on this point par. 25 of OCED Commentary on art. 5 par. 4, and included I.’s supervision in its scope. Decisive, therefore, has been regarded the circumstance, under the view of “personal” P.E., that company I.’s representatives held offices in other P.M. group members and that took part in negotiations of the mentioned contracts by such foreign companies and State Monopolies. The Court refers to art. 5 par. 5 OCED and considers a fiscal elusion practice, as well as a sign of concealment, to separate signature of contracts by their stipulation.

Conclusively, the Court adopts an evident substance over from approach when
assessing requirements of a P.E., both from in its material and personal from, and building the notions of multiplicity and concealment, regarding such methodology in line with OECD Commentary. Attention is therefore paid to activities effectively performed by company I. in relation to fulfillment of contracts between P.M. foreign companies and State Monopolies, and very little care is shown to separate legal personalities in question, nor precise links are entertained between infringements, fiscal behaviour and proofs one hand and single legal entities – which has been heavily criticized. All the elements are examined only in relation to company I. on one side and the whole P.M. Group and, its members entered in negotiation with State Monopolies, on the other.

It has been pointed out that no general rule about substance over form exists in Italian Tax Law, which contrast with such a wide and extensive use of that principle deployed by the Court. In U.S. instead, the principle results from Supreme Court’s jurisprudence, which is of course the source of law, and, moreover, it operates only after every single formal, fictitious and elusive operation has been ascertained in all its constitutive elements and attributed to a precise person, while Corte di Cassazione has expressly jumped to the substance without putting in light such elements, both objectively and subjectively (187).

Court’s reasoning is criticized also because of a contradiction between the asserted management function of the multiple P.E., in relation to the activities carried on through it by several foreign companies, and its subordination to directives by such entities and due to a confusion between the concepts of P.E. on one hand and of branch or subsidiary on the other, in respect of the dispute around incorporation, style of the firm and its main business. A notion of multiplicity or a definition of concealment seem not to be included in OECD Model Convention and in its Commentary (188) and so it would have maybe been more appropriate to examine the whole matter under transfer pricing rules, assumed that employment of company I. resources was not counterbalanced by foreign companies’ payments, as shown by Tax Administration and surprisingly not reported in Cassazione’s sentences (189).

187 B. ACILLI, Il caso Philip Morris, cit., pag. 107
188 B. ACILLI, Il caso Philip Morris, cit., pag. 115
189 B. ACILLI, Il caso Philip Morris, cit., pag. 117
3.5 Dividends, interests and royalties

In presence of a Convention, a complex juridical status, arising both from conventional and domestic provisions, arises in order to dividends, interests, and royalties. The conventional formal roles, brought by paragraphs 1 one of relevant articles, entitle the source State to tax that items and so refer to domestic law criteria. It must be noted, however, that many conventions entered in by Italy are not in line with art. 12, par. 1 OCED, granting an exclusive right to tax to the State of residence of the beneficial owner in relation to royalties; relevant treaty provisions are, instead, in line with the approach, taken by MC in respect to dividends and interest, to limit the withholding tax levied by the source State.

Insofar conventional provisions do not state differently, Dividends, interests and royalties (this last ones by juris et de jure presumption, and as payments for use of intellectual works, industrial patents, trademarks, procedures, formulas and information with respect to experience acquainted in economic, commercial or scientific fields) are sourced in Italy, when paid by the State, by residents in Italy or by P.E. of non resident persons; interests and other proceeds arising by deposits and bank or postal accounts are not regarded as produced in Italy.

Interests usually coincide with proceeds arising from loans and deposits as well as from bonds and similar securities. Dividends are, instead, ordinarily relative to investments in an organized structure, participated by the investor through shares and similar instruments, due to the increasing confusion between features of securities at variable income and at fixed income and due the prevalence, especially for small investors, of investment concerns over control and management of an enterprise, but only to the extent in which payment is completely conditioned by economic performance of the company or to results of a given affair (190). Conventional provisions, including taxable items in interest’s and dividend’s notion, almost comply with OECD MC, except for default reference to domestic law of the source State that is extended to interests also.

Beneficial ownership notion exists in domestic law only for exchange of information purposes, while, at conventional level, treaties entered in by Italy are in line with OECD
Model Convention. With-holding are always levied on a gross basis, domestically between 12.5 and 27 per cent rate, unless beneficial ownership percentages (usually at 10%) operate, with some remarkable exceptions, e.g. Convention with Denmark, granting zero rate in case of the dividends if the beneficial owner is a company, other than a partnership, which holds and has held directly at least 25 per cent of the capital of the source States’ company paying the dividends for a twelve month period prior to the date the dividends are declared and 15 per cent in all other cases, and the one with Ukraine that is similarly conceived.

A remark on so called hybrid instruments: when these do not imply an effective participation to entrepreneurial risk, as shares by definition do, their regime should comply with the on of interests, pursuant to art. 11 par. 3 OCED MC (followed by the greater part of conventions signed by Italy) and to par. 25 of OCD Commentary on art. 10, which reasons that article 10 deals not only with dividends as such but also with interest on loans, insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the enterprise’s business, which should be assessed case by case by criteria suggested by the same paragraph (191) (192).

3.6 Distributive rules for exit taxes

In relation to exit taxes, it has been argued that article 13 par. 1 OCED should be examined in order to ascertain whether these taxes comply or not with conventional systems (193).

In relation to assets situated in the State from which residence is moved and not

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190 A. FANTOZZI, Corso di diritto tributario, Torino, 2004, pag. 401-02
192 The loan very heavily outweighs any other contribution to the enterprise's capital (or was taken out to replace a substantial proportion of capital which has been lost) and is substantially unmatched by redeemable assets; the creditor will share in any profits of the company; repayment of the loan is subordinated to claims of other creditors or to the payment of dividends; the level or payment of interest would depend on the profits of the company; the loan contract contains no fixed provisions for repayment by a definite date.
193 G. MELIS, Profili sistematici del trasferimento della residenza fiscale delle società, cit., pag. 43-48
flown to a P.E. there, taxation takes place before change of residence, and so no claims can be raised up by the new State of residence; besides art. 13 OECD does not suit to cover nor impedes taxation of assets of a foreign P.E., since the article refers to alienation, while exit taxes are levied at the exit from worldwide taxation regime, independently from effective pursuit of a capital gain: the cases in points are different in nature, as exit taxes prevent undue loss of taxable items when residence is moved, while art. 13 only distributes such items once residence is ascertained and the alienation is effectively concluded.

After alienation has been completed and residence moved, the new residence State will levy taxes on assets of a P.E. in its territory or not flown in a P.E. in the former State of residence and or owned by P.E. in a third State. The State where residence is moved is entitled to tax capital gains emerged before such change only if the single convention so provides, due to silence of OCED Model in this respect; but, in this case and again, no Model Convention’s provision expressly grants the taxpayer a credit for correlative exit taxes already paid in the former State of residence.

4. METHODS TO AVOID DOUBLE TAXATION

Art. 169 T.U.I.R. states prevalence of provisions by the “consolidated act” itself on DTCs provisions if the first ones are more favourable to the taxpayer. The relevance of such principle has been pointed out in relation to different tax topics, but might be interesting to know that doctrine on T.U.I.R. states that such provision carries no innovation to the legal system, and therefore it is to ministerial notes on single points, covered both by DTCs and domestic law, that reference has to be made (194). For more details on this respect, please look at par. 1. 2.3.

A conventional method to relieve double taxation is the matching credit provision (195); when a capital import country gives up its right to levy withholding taxes on dividends,

194 M. LEO, Le imposte sui redditi nel testo unico, Milano, 2006, pag. 2161-65
195 C. CARLO, Il matching credit il nuovo regime di tassazione dei dividendi di fonte estera, in Il Fisco, 2004, n. 48
interests or royalties paid by resident persons to non resident ones, such provision is enclosed in Treaties with countries that grant a credit for taxes duly paid abroad, since these countries would not normally grant that credit if no with-holding tax is set; as a consequence they would benefit from the sacrifice of the capital import country, and not the investors (who pay in the residence state those taxes they have been exempted from in the second mentioned State).

A matching credit provision impedes this wrong imputation and obliges the residence State of the receiver to grant a credit in respect of the exemption secured by the source State, as it would be if a tax had been effectively paid there.

Italy entertains over thirty conventions enclosing matching credit provisions; they vary in relation to bilateral or non-bilateral application, number of incomes covered, rate of matching credit to be granted and time limitations.

5. MISCELLANEOUS PROVISIONS

Directive 77/799/CEE points out methods for exchange of information, mutual assistance, effective enforcement of fiscal national laws in relation to direct taxes, accise, insurance premiums, and, by means of Regulation 1798/2003, VAT. The aim of such administrative cooperation is the correct assessment of taxes on income, on estates and in relation to V.A.T.

Exchange of information takes place on demand, spontaneously or in automatic, and simultaneous inspections, bi- or multi-lateral consultation or exchange of experiences (especially with regard to inter-company transfer pricing issues) may be attached to it.

Art. 2 describes assistance on demand: the competent authority of a member State is entitled to ask the foreign counterpart for information concerning a specific case in inquiry; this last Tax Administration must act as it normally would on its own or on demand by an other authority of its member State (pursuant to Directive 2004/56/CE).

Automatic exchange of information is carried on regularly, and in relation to specific cases too, but is based on previous arrangements within a consultation procedure.

Spontaneous exchange is performed by initiative a State when:
a) it has grounded reasons to presume an abnormal reduction or exemption in another member State
b) a taxpayer enjoys in a member State a reduction or an exemption that should bring an increase or a subjection to tax in the State taking initiative
c) taxpayers of different member States entertain business relations that reduce taxation
d) fictitious transfers of proceeds within a group may determine a reduction of taxation
e) foreign Tax Administration holds useful information in order to assess correctly taxes on income, estate or V.A.

Information anyway exchanged is treated, for the purposes of secrecy, not less diligently as it is under domestic law; moreover, when legislation or administrative practice oblige to stricter limitations, these must as well be complied with by the State which receives information. A tax Administration is entitled to deny information with respect to industrial, commercial and professional know-how, on grounds of public order and if the counterpart is not allowed to grant information similar to those requested, pursuant to its domestic law.

It should be highlighted that Italy entertains Conventions for exchange of information with non-EU Countries also, as Australia, Norway, Trinidad and Tobago, Tunisia and United States.

III. EUROPEAN COMMUNITY LAW

1. PRIMARY EUROPEAN COMMUNITY LAW

It is now time to investigate tax regimes applicable to multinationals in light of EU Law, with special regards to protection of fundamental freedoms.

The Italian group taxation regime, as outlined above, is twofold: the regime is national or cross-border in relation to the residence of subsidiaries, and tax consequences as well as obligations slightly differ between these two variants. This might be regarded as an infringement of the freedom of establishment for Italian parent companies, that can be
dissuaded by investing in foreign companies because of the non-deductibility of their losses from group’s taxable base in domestic consolidation and of the stricter requirements stated for cross-border consolidation, which allows such deductibility. A violation could be complained by foreign holdings also, since they have only “indirect” access to national consolidation and no one in cross-border one.

While the two regimes have in common formal features (e.g. irrevocability of choice), characterization of control (e.g. reference both to shares and profits, to direct and indirect control and to de-multiplication; Italian residence of the parent company) and elements for ascertainment of group’s income (e.g. coincidence of parent’s and subsidiaries’ commercial periods and exclusion from consolidation of losses that are previous to choice), they slightly differ for others (196).

In relation to choice, this lasts five years and is taken by the parent company in cross-border consolidation, while, in domestic one, it has a three year validity and is jointly exercised by the holding and the subsidiaries.

With respect to control, under cross-border regime only foreign subsidiaries are admitted, and – due to “all in, all out principle” – the resident holding must be the highest in rank; moreover de-multiplication operates both for the purposes of control and of assignment of subsidiaries’ income to group’s taxable base, and control must last at the end of the holding’s commercial period. On the contrary, domestic consolidation includes solely resident subsidiaries, a foreign holding can option for the regime through a P.E. and choose which subsidiaries consolidate and which not (so called cherry-picking) and de-multiplication takes place only in relation to control, which is ascertained only at the beginning of each commercial period, once the choice is taken.

In regard to assessment of group’s income, this is harder for the parent company in cross-border consolidation, due to attached obligations, such as budgets’ review for subsidiaries, request of a ruling to tax Administration in order to certify that all requirements for consolidation are met, re-assessment of income attributable to each foreign subsidiary pursuant to domestic CIT rules; relevant differences also are non-applicability of thin-cap domestic rules to interests paid by foreign subsidiaries, and

non-suitability of losses previous to choice, and therefore not included in the regime, to compensate with such companies’ taxable incomes. A justification that might well be annexed by the State, in case of trial in front of the ECJ, both for the benefits and the lighter regime of domestic consolidation, is coherence within the whole tax system, in relation to residence and subjection to worldwide taxation of resident companies, with special regard to deductibility of their losses, and not of those relative to non-resident bodies. Under a proportionality point of view, it is possible that non-inclusion of derogation to such non-deductibility to be censored: losses suffered by a foreign subsidiary should be deductible at least when the enterprise is about to be winded-up or when losses can not be carried, neither backwards or forward, in the residence State. The existence of a cross-border consolidation regime might constitute a justification for restrictions of domestic one in relation to foreign subsidiaries, but the first regime itself can be questioned, due of its greatest degree of inflexibility, in light of proportionality issues.

1.1. Influence of ECJ case law and revision of domestic law

Before that thin-cap reform passed in Italy, the relevant bill was modified in order to drive out the derogation in case that payments fell in the shareholder’s taxable base, for the purposes of his personal taxes and the attached obligation to declare that income. ECJ rulings in Lankhorst-Hourts Gmbh case suggested to state non-deductibility of interests paid both to residents and non-residents. The former version was suited only to prevent elusive arbitrages with non resident enterprises, aimed to reduce the company’s taxable base by deductibility of interests paid to shareholders, subject to a more favourable tax regime. The enacted one, instead, is a direct fiscal limit to thin capitalization 197.

197 C. GARBARINO, *Manuale di Tassazione Internazionale*, cit., pag. 876
Multinationals can rely on direct effect of directives as long as requirements for such effects are met, in relation to the complex ECJ jurisprudence on this controversial point. Legal foundation for such effect, which is probably not in line with Treaty wording nor with the intentions of their contracting parts, is found in the estoppel argument: no one should benefit from his own wrongdoing, so States can not be advantaged due to their failure to implement directives.

The doctrine of direct effect, and its acceptance by national courts, has allowed the Commission to focus only on the most important cases of remiss by member States in enacting the measure by assignment is made on courts to ensure a day by day compliance with the directives and to manage pleadings by individuals (198).

It may be questioned whether a real difference between regulations and directly effective directives still exists; a difference is that the second ones are capable of direct effect only when time for implementation has expired, while the right of member States to choose means by which achieve the objective and the exceptionality of direct effect for directives are not decisive, insofar directives can be sharply detailed if their objective so requests in the opinion of EU bodies and direct effect can be deemed for groups of directives rather than be assessed case by case.

The main difference lies in that directives are only suitable to grant rights to individuals by imposing obligations to the States (vertical direct effect), as estoppel argument can not apply to individuals. The non suitability to horizontal direct effect, anyways, gives way to problems, especially in relation to equal situations that differ only in that they are entertained with privates or with public bodies, and limits the scope of the doctrine.

The ECJ has tried to short-circuit this impediments by alleging a wide concept of “State” (each public body that performs a service pursuant to a State measure, under its control and by use of special powers), supporting national courts in interpretation of national legislation pursuant to directives (so called indirect effect, which probably takes place only in relation to subsequent legislation) and governmental liability for non-implementation of directives that confer rights to individuals, that suffer a loss because of the failure to implement.
On this last respect, Francovich case has found a general principle in the Treaty, according to which Member States are liable to compensate individuals for losses caused to them as a result of a violation of Community law, for which Member States are responsible, as effectiveness of Community law would be affected and protection of rights weakened if such rule did not exist (199).

Such remedy can be activated only to non implemented directives that confer, by means of specific provisions, rights on individuals, when there is a causal link between such violation of Community law and the loss in question, suffered by the applicant.

On 2nd February 2005 State Act n. 11 has been passed in order to set new “general provisions for Italy’s participation to EU’s law making procedure and for fulfilment of communautaire obligations” (so called “Legge Comunitaria”).

Obligations, pursuant to art. 1, arise subsequently to each EU act that obliges the Republic to its implementation, ECJ rulings stating a clash between domestic acts or regulations with EU law provisions and decisions within police and judiciary cooperation in criminal matters. For these purposes, a committee is established within Prime Ministers’ offices for European affairs.

Implementation of directives belongs to the State and to the Regions each in the subjects of its own competence according to the Constitution (art. 8 par. 1); every year, before 31st January, a bill must be submitted to the Parliament by the Prime Minister or the Minister for EU affairs on “provisions for fulfilment of obligations arising from Italy’s membership to EC”; the report attached must give a detailed analysis for level of compliance of domestic law to EU law.

The “Legge Comunitaria” to be adopted must modify or quash domestic provisions not in line with EU law, implement EU acts, delegate the government to implement directives by means of ministerial regulations, state principles for implementation by Regions in fields of their competence, take steps in the exercise of “substitutive powers”, according to guarantees set by the Constitutions, when they fail to comply with EU law, and enact international treaties signed within foreign relationships of EU (art.9).

199 T. HARTLEY, The foundations of European Community Law, cit., pag. 235
The Prime Minister or the Minister for EU affairs can submit to the Cabinet urgent measures to implement acts or rulings when term for implementation expires before next Legge Comunitaria enters into force (art.10)
A special procedure is set of decisions towards the Republic, in case they result particularly important for national interests or sue to their onerous fulfilment, both for a challenge by the Government and for assistance to the competent authority in implementing such decision.

3. State Aid

Articles 87-89 of the Treaty are aimed to safeguard genuine competition from public support to enterprises, both in the common market and in domestic one, as long as such support can make harder foreign firms’ activities or unfairly facilitate exports (200). The Commission, that is entitled to apply these rules pursues an European industrial policy.

The relevant notion of State Aid is stated by art. 87: it includes every kind of valuable benefit, directly or indirectly attributed to an enterprise by means of a public intervention; the measure is ascertained in relation to the effects that it is suitable to determine, and must be in favour of certain enterprises or of certain productions. The Aid can be set by law, by an administrative measure and even by a private law act, as long as this last is under a public provision.

In relation to the source of the Aid, this must attribute resources that are, broadly speaking, at disposal of public authorities to enterprises; such attribution must be, moreover, a decision of the State.

It is requested that the effective beneficiary of the Aid is an enterprise, i.e. any public or private body performing an economic activity in goods’ and services’ market, so entities like Universities and research institutions are excluded; the measure taken by the State must select some enterprises or productions, while measures aimed to improve the whole economic system do not fall under the scope of State Aid.

The measure is deemed to distort trades and competition, affect the position of non-beneficiary enterprises and prevent a better use of public resources; anyway it will be necessary to ascertain case by case the proportion between the aid and the investments,
the beneficiary’s market share, the relevant market. A State aid by definition can not affect goods or services not open to competition.

In relation to *de minimis* provisions, regulation n. 69/2001 has set a threshold of 100,000 € granted within a three years period, under which Aids are not to be notified to the Commission.

Within the large case law of State aid, particularly interesting in relation to Italy is the one of State Aids by means of fiscal measures, due to the novelty of such provisions in our domestic law (201).

Tax credits granted to truck drivers by ministerial decrees in the early ‘90s have been regarded State Aids both by the Commission (decisions 93/4967CEE and 97/270/CEand by the ECJ, that assessed a failure to comply by Italy in 29th January 1998 and rejected a challenge in 19th May 1999. This case is peculiar since Italian legislator has avoided expiration of terms to rectify beneficiaries’ income declarations by regarding the above mentioned credit of private law nature, under law decree 20th March 2002 n. 36 (converted in State Act 17th May 2002, n. 96).

Decision 11th December 2001, n. C54/A/2000 EC defined State Aid provisions in relation to the Italian bank system; this decision has been challenged by the Italian Government. It has been observed that the so called standstill obligation arises directly from the decision, in force of the Treaty, and so both a note released by the Ministry of Finance and a law decree are redundant in question. In relation to Bank Foundations, the Commission excluded their enterprise nature, since management of estate with the purpose to contribute to social aimed non-profit bodies s not an economic activity under art. 87, par. 1 EC. On the contrary, any Aid by these Foundations (which are of public nature) to enterprises must be notified to the Commission.

Decision 5th June 2002, n. C27/99 declared State Aid a three year exemption (1997-99) for CIT in favour of joint.-stock companies, mainly owned by public bodies, entitled to carry on municipal public services; the decision has been challenged in front of CFI by such municipalized enterprises. The main issue in question is whether an Aid granted in a market not open to competition must or must not be regarded as an existing Aid once

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such market is liberalized. In light of art. 1, letter b) point v of regulation 659/1999 such aid is new, but CFI case law (sentence Alzetta 15th June 2000) displays a milder interpretation.

4. GENERAL QUESTIONS

Italy is not regarded as an attractive country, both for foreign capitals and holding companies, due to its bureaucracy and labour legislation (according to entrepreneurs’ confederations). Social partners closer to labour reply that “liberalisation” of employment contracts, enacted by the controversial D. Lgs 10th September 2003, n. 276, has slavishly followed entrepreneur’s demands for an extreme flexibility of employment contracts without bringing to any improvement to competitiveness of the Italian system as a whole, since a country like ours can not be expected to compete on the field of cheapness of labour (which would be very dangerous from a social point of view and contrary to the Lisbon strategy) but on the one of excellence and quality of productions and of workers (which requires reforms of different nature, such as modernisation of educational system).

On an international tax law perspective, it would be desirable to equalize treatment of cross-border groups to the one of domestic groups and to ensure a more diligent compliance to EU law provisions, and to freedoms of establishment and movement of capitals, with special respect to taxation of outgoing proceeds.

Broadly and conclusively, it is crucial to promote at all level competition and free access to market and to make of independent authorities effective protectors of such competition, even if this might mean a reduction of so called “private monopolies” (in relation to that private companies that now carry on those activities, such as management of highways, telecommunications, broadastings, that have been State monopolies for decades and then privatized) and effectively open Italian market to foreign actors, which is usually welcomed when talking but heavily contrasted in practise.
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EUCOTAX Wintercourse 2007
Tilburg

Università LUISS – “Guido Carli” – Roma

Facoltà di Giurisprudenza

Cattedra di Diritto Tributario

RELATIONSHIPS AND POSSIBILITIES OF CONFLICTS BETWEEN WTO LAW, EC LAW AND INTERNATIONAL TAXATION

Roberto Formisani
Matr. 069123
I. INTRODUCTION

In the end of the XX Century, after one hundred years which saw the increasing interconnections and interrelations of the economies of the world’s Countries (a process which has been called in the earlier part of the past century “mondialisation” and nowadays named “globalisation”), the necessity of an international regulation of such a phenomenon, which took almost 50 years, resulted in the constitution of the World Trade Organisation (“WTO”), which is in charge to enforce the huge corpus iuris of the Agreements superseding the world trade. Since the beginning of the multilateral negotiations of the Uruguay Round, many scholars around the world started to discuss the possibilities of conflicts between those agreements and the treaties concluded by the States in order to avoid the double taxation phenomenon (Double Tax Conventions or, more commonly, Tax Treaties). Along with this, it is not possible to give to the reader a full approach to the quarrel without bearing in mind the influence of European Community law with regard to those issues. This paper modestly will try to describe very shortly the current context, with some ideas of the Author.

2. A BRIEF HISTORICAL OVERVIEW OF INTERNATIONAL TRADE LAW

After the most protectionist period in the cross-border trade relations (the 30’s) and the World War II tragedy; the idea of pursuing the richness of States through a progressive liberalisation of global trade became; above all, abolishing tariffs, the typical mean of protectionism, became the leitmotiv in the politic and academic debate.

In 1947, 22 States concluded the General Agreement on Tariffs and Trade (hereinafter “GATT”) and the treaty was left open for signatures. The main difference in approaching the subject-matter of a world trade regulation was the adoption of a multilateral instrument, surpassing the traditional bilateral way of negotiating in this field. An international organisation superseding to the observance of the treaty was intended to be established by the Havana Charter (1948), but it never came into effect.

In order to further the liberalisation, several “rounds” of negotiations were undertaken by the growing GATT community. The strategy pursued by the countries involved was not to amend the Agreement, but to conclude separate agreements on the discussed
matters\textsuperscript{203}. For the scope of this paper, we remind above all the Tokyo Round, during which the first organic regulation of subsidies (“The Subsidies Code”) was adopted. The turning point was the Uruguay Round, which lead to the signature of the Treaty (The Marrakesh Agreement) establishing, finally, an international organisation in charge of enforcing and applying all the agreements undertaken with it (the so-called “WTO umbrella”). Moreover, many fields of the subject before left without any regulation were covered by special-agreements provisions, so creating a very impressive normative body.

3. GENERAL ASPECTS OF THE INTERNATIONAL TAXATION

First of all, it is better to remark that the relationship between the direct taxation (which can be deemed to be one of the most relevant “trade-related” subject) and world trade law is very unclear. This is a difficult issue to deal with; given that the taxation, even direct, after the progressive abolition of tariffs and the traditional trade-barriers, can be easily used in a distorting and protectionist way\textsuperscript{204}. Such an obscurity happened because of several reasons (including a very little interest in the topic by the academic literature), but in my opinion the main one is the fear of the Contracting States to the multilateral trade law system to lose sovereignty in a so vital ground for a country\textsuperscript{205}. Provisions better formulated in these matter would mean a better coordination in a close-linked issue. Tax treaties and international trade law have the same aim: to improve the cross-border transactions between States and persons from different countries.

International taxation means the regulation of avoidance of double taxation. We have to bear in mind that States tax income on two different basis:

-“Residence”: the income of all the residents in a country are subject to taxation
-“Source”: the income originated in a country are subject to taxation.

\textsuperscript{202} H. Van HOUTTE, \textit{The law of international trade}, London ,2002, p. 75
\textsuperscript{203} H. Van HOUTTE, \textit{The law of international trade}, cit., p. 76
\textsuperscript{205} This view seems to be shared by A. QURESHI \textit{Trade related aspects of international taxation} , cit., p.161
In a more global world, an increasing number of income arise from international economic activities; so, it becomes very probable that an income, in the hands of the same taxpayer involved in such activities, may be taxed by, in the same time, his residence state (because of the first criterion) and the source state (because of the second criterion). This fact has always been perceived as unfair and as a heavy burden on the international economical relations. This is the commonly called “Juridical double taxation”. The traditional way through which States tried to solve the problem was by concluding treaties (known as Double Taxation Treaties, hereinafter “DTTs”) in order to allocate taxation rights (so as to let just one state to tax a single income and a single taxpayer), avoid any risk of no taxation (because of the lack of a taxing jurisdiction over a type of income), and generally to reduce taxes on income involved in cross-border activities. The international organisations drafted many Model Conventions (historically, we would like to remember the Draft Model issued by the League of Nations), the two most relevant are the OECD Model Tax Convention on Income and on Capital206 and the UN Model Tax Convention207. The aforementioned Conventions take into account two different methods for double taxation relief:

-“Credit Method”208: The amount of the source state tax is considered by the residence state into the income tax total amount, so reducing this amount by the total payable tax to the residence state

-“Exemption Method”209: The residence state does not consider any foreign income in the taxable base for its taxation purposes.

Those concepts will be very important for the remaining part of the paper.

4. THE RELATIONSHIP BETWEEN WTO LAW AND EC LAW. THE “DIRECT EFFECT” ISSUE

Under the general theory of public international law, the provisions of a treaty are deemed to have a “direct effect” when they grant rights and obligations to private

206 The latest edition was issued in 2003, it is available for consultations on the website of the OECD: www.oecd.org
207 The latest edition is available at the website: http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002084.pdf, together with the commentary
208 See art. 23 B OECD Model
persons\textsuperscript{210}. Under the art.300.7 EC treaty, the agreements concluded by the Community are binding for the Community itself and the Member States\textsuperscript{211}. Therefore, in the EC law, direct effect leads to the possibility of challenge the validity of a Community act, because the ECJ held that those agreements has a supremacy over the Community law, and the latter have to be compatible with the former\textsuperscript{212}.

Before the conclusion of the Marrakesh Agreement, even if the GATT 1947 was not concluded by the Community, the ECJ held\textsuperscript{213} that the Community, because of the willing of the Member States to let the organisation to be bound by the GATT provisions and of the exclusive competence of the Community over the commercial subject-matter, has displaced the Member States as a party to the Agreement. In the same judgment, the ECJ stressed that no direct effect can be accorded to the GATT provisions, taking into account many reasons: the many exceptions, the possibility of taking particular measures in exceptional situations and a dispute resolution system based on conciliation. In other words, the “great flexibility” of the General Agreement. The so settled jurisprudence of the ECJ was not overruled by the entry into force of WTO Agreement and the many modifications in the multilateral trade law system.

The leading case in this field is the judgment \textit{Portugal v. Council}\textsuperscript{214}: the Portugal challenged two commercial agreements concluded by the Council on the behalf of the Community with India and Pakistan; maintaining that those arrangements were breaching the GATT, the Agreement on Textile and the Agreement on Licensing

\textsuperscript{209}See art. 23 A OECD Model
\textsuperscript{210}Some Authors; see H. Van HOUTTE \textit{The Law of International Trade}, cit., p. 3, call this particular situation “Self-executing provisions”. Another important distinction is made by G. ZONNEKEYN \textit{The status of the WTO law in the EC legal order} in \textit{Journal of World Trade}, 2000, 3, p. 120; between “invocability” (the right, for private persons, to ask a court to review the legality of an Community act under the provision of an international agreement) and “Direct Effect”(the granting of rights and duties for individuals under the agreement’s provisions). According to the Author, the first right is caused by the presence of the second situation.
\textsuperscript{211}The power to conclude treaties by the Community is granted in particular in the tariff and trade matter (art.133 EC treaty). We would like to remember that the commercial matter is an exclusive area of competence of the Community, with regard to its relations with the Member States. That is the reason why the Community itself concluded the WTO Agreement, and it is called an “originary member” of the Organisation, as resulting by the Art. 11(1), WTO Agreement.
\textsuperscript{212}Case-law quoted by P. MENGOLLO \textit{I diritti e gli interessi delle imprese, il diritto dell’OMC e le prerogative delle istituzioni della Comunità: Verso una dottrina comunitaria delle political questions?} in \textit{Contratto e Impresa Europa}, 2/2006, p. 152
\textsuperscript{213}International Fruit Co., Judgment rendered on 12/12/1972, Cases from 21 to 24/72
\textsuperscript{214}Judgement rendered on 23/11/1999, C-149/96
Procedures. The Council, backed by the France and the Commission, argued the absence of direct effect of the WTO provisions, quoting the aforementioned ECJ caselaw.

In his Opinion, the Advocate General Saggio stressed the many differences between the GATT 1947 and the WTO regimes, for instance the great number of provisions embodying unconditional and precise commitments and the new dispute settlement system, more similar to an international court and less “political”. He argued that the direct effect feature is not necessary to challenge the legality of a Community act under the international agreements concluded under the Art. 300 para. 7 EC treaty. With regard to the Preamble of Council Decision 94/800\textsuperscript{215} (which clearly states the denial of direct effect), the A.G. asserted that, under international law, no such a declaration can be considered to have an impact on the effectiveness of the agreement. The presence of a direct effect must be evaluated only on the basis of the agreements themselves.

In the Judgement, the main statement by the Court was that the ECJ is incompetent to render a judgement because, given that the WTO dispute settlement body leaves many room to political negotiation in case of a breach, otherwise, there would be an interference of the Court in powers granted to others bodies of the Community, which are directly involved in the WTO dispute settlement mechanism. Another ground for the denial was that many other trading partners of the Community in the WTO do not grant such a direct effect\textsuperscript{216}. If, the court argued, the direct effect was granted, while the other main trading partners do not grant that, there would be an imbalance in the Agreement execution\textsuperscript{217}. In the end, the ECJ quoted the Preamble of the Council Decision 94/800 to support its conclusions. We have to remark that the ECJ in two cases singled out two exceptions to the general rule:

\textsuperscript{215} The Community act which implemented in the EC law the Uruguay Round Agreements.

\textsuperscript{216} For instance; see the main trading partner of the Community, the USA. The section 102 (c) (1) (a) of the Uruguay round Implementation Act states: “No persons other than the United States...shall have any cause of action or defence under any of the Uruguay Round Agreements by virtue of the Congressional approval of such an agreement”

\textsuperscript{217} In my opinion, this argumentation may seem an overruling of what the ECJ held in the Judgement Kupferberg (26/10/1982, C-104/81), in which the ECJ stated that the direct effect in Community Law of an international agreement cannot be granted taking into account the judicial decision of the other contracting parties. But here we have two political, not judicial statements (The preamble for the EC, even an Act for the US).
- *Fediol* case\(^{218}\): The ECJ is empowered to review the legality of an act in the light of the WTO law if the act at stake expressly refers to the WTO law

- *Nakajima* case\(^{219}\): The same power is granted when the act is a fulfilment of the WTO law.

There also another leading-case that has been considered as an exception by some scholars\(^{220}\): the *Hermés* case\(^{221}\). Here the ECJ upheld that the national legislation of a Member State; implementing the EC law, may be reviewed by the judicial bodies of the Community also in the light of the WTO law, if the Community, taking such a measure, was fulfilling an obligation under the WTO law itself.

The ECJ decision was criticised by many scholars\(^{222}\). They argued that many changes in the regime after the entry into force of the WTO agreement, such as the ones borne in mind by the A.G. Saggio in the quoted opinion, were sufficient grounds for recognising the direct effect. Anyway, I share the conclusions of the ECJ, above all, for one reason: there are still grounds for negotiations in the current dispute settlement system\(^{223}\); given that the consultations are a political matter, it would be an infringement of the separation of powers principle \(^{224}\), because the ECJ would be allowed to review a political decision, taking into account that the political decisions are of competence of the political bodies of the Community (i.e. the Council).

### 5. The Most Favoured Nation ("MFN") Obligation in GATT and GATS and its Interrelations with Tax Treaties

The main principle embodied in the WTO Umbrella, in order to fight protectionism and the other practices against a free world trade, is non discrimination. The non

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\(^{218}\) Judgement rendered on 22/6/1989, C-70/89

\(^{219}\) Judgement rendered on 7/5/1991, C-69/89

\(^{220}\) B. BONAFE’ *Principio di reciprocità ed effetti diretti degli accordi internazionali della C.E.: In margine alla sentenza Portogallo c. Consiglio in Diritto dell’Unione Europea*, 2000, 3,p. 615

\(^{221}\) Judgment rendered on 16/6/1998, C-53/96

\(^{222}\) See, for instance, G. ZONNEKEYN *The status of the WTO law in the EC legal order*, cit., p.112

\(^{223}\) See the procedure established by the art.4 Dispute Settlement Understanding (“DSU”)

\(^{224}\) We have to remember that Art.6 of the Maastricht treaty (as modified by the Amsterdam treaty) provides that the European Union (and so the Community) are based on the values of freedom, democracy, rule of law; legal principles shared by all the Members States. It is impossible not to consider the “separation of powers” principle in the number of such principles.
discrimination may be split225, by the standpoint of a contracting State, in two different profiles:

-“External” non discrimination: A obligation to put all Countries at the same level regarding the concessions of preferential treatments (in order not to have any preferential trade relationship)

-“Internal” non discrimination: A obligation to avoid any treatment which is purposive to (or simply may have as an indirect effect to) put the traders, nationals of other Countries, in a worse position than the position of the nationals of the Country at stake in its internal market.

Relating to the former profile, we may find the Most Favoured Nation (MFN) clause; considering the latter the National Treatment (NT) clause. This last provision will be discussed in the next paragraph.

In the GATT, The MFN clause is contained in Art. I:

“With respect to custom duties and charges of any kind imposed on or in connection with importation or exportations (...) any advantage, favour, privilege or immunity granted by any Contracting Party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originated in or destined for the territories of all the Contracting Parties”

Most part of the scholars are bent on excluding direct taxation from the GATT scope of application226, because the charges mentioned in the article seems to relate only to the ones imposed on goods (i.e. all the indirect taxes such as VAT). Probably, an interpretation of the provision in way so broad to include, for instance, direct taxes on the income generated by the sale of goods could be too misleading from the letter of the

225 Some scholars (H. VAN DER HURK and J. KORVING The D. Case against Netherlands and the ECJ’s decision- is there still a future for MFN treatment? in IBFD Bulletin, August/September 2006, p.366) have distinguished a “vertical” discrimination (a worse treatment, in compare to a National, for a non resident by a State) and an “Horizontal” discrimination (two different treatment accorded to two Nationals from two different States, in comparison to the treatment of National’s State providing the treatment)

226 Just to remember one above all, G. CAPPADONA Wto, Gatt, tax treaties and international taxation: The effects of their interactions and the possibilities of conflict in Diritto e pratica tributaria internazionale, 2004, 2, p. 475. Another argument is provided by the definition of “direct taxes” in the ASCM (Agreement on Subsidies and Countervailing Measures, an agreement annexed to GATT) provided by footnote 58 of the Annex I, which states: “The term “direct taxes” shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property”. The kinds of taxes involved do not seem to regard the goods’ importation/exportation process, to which the GATT Art. I refers.
provision. The main problems in the GATT field with respect to direct taxation has been in the subject-matter of subsidies (and the most important WTO case-law on this issue, the panel on the US Foreign Sales Corporation227, are complaints on breaches of the ASCM). The only issue discussed in the above mentioned panel related to non discrimination was the allegation of a breach of the NT obligation. Probably, even if such a measure could be challenged under other multilateral instruments, the distortions that may be caused by direct taxation in the field of the sale of goods leads us to bear in mind the necessity of an explicit provision covering this problem.

For sure, the direct taxation measures; both national and international, are covered by the MFN provision in the GATS. Art. II provides:

“With respect to any measures covered by this agreement, each member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country”

As we can clearly figure out in compare with the GATT MFN provision quoted above; the GATS provision has a much broader scope of application. No one can doubt that direct taxation measures can affect the supply of service activities228 (i.e. about the possibilities of granting particular preferential regimes to the Permanent Establishment, even in the field of the bureaucratic proceedings relating to the collection of direct taxes)229. Another proof is given by Art. XXVIII, which enshrines a definition for the purpose of the Agreement of the notion of “Direct Taxes”. Probably, even if we cannot assume that the political decision of enacting a so broad scope of application for the provision was purposive to include the fiscal issue in the Umbrella (the mean seems not to be so commensurate to the aim assumed), the provision at stake represents the will of the Member States to let the Multilateral Trade Agreements cover also fields deemed to be part of the traditional conception of State’s sovereignty (taxes are the most clear

227 WT/DS108/R
228 A. QURESHI trade-related aspects of international taxation, cit.; p. 168 states correctly that the GATS applicability to the direct taxation is based on the mention of the “service suppliers”
229 According to Art. XXVIII GATS “Service of an other member State” comprehend also “a service (...) supplied (...) trough the commercial presence or trough the presence of natural persons by a service supplier of an other Member”.

example) in order to improve multilateral system and the world trade. But an important exception is provided:

“A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions”.

The exception, based on the existence of a “negative list” (the measures inconsistent with MFN clause are expressly indicated in the list), is probably given by the particular sensibility of the matter involved (and probably its connection with direct taxation subject). The negotiators decided to let free the States to choose which sector needed to be protected, because of its importance for the internal economy (for instance, many exceptions has been notified with regard to banking and financial services). This provision seems to avoid the clashes possibility.

Moreover, the MFN clause is fashioned for working only in a multilateral context: its application in the naturally bilateral field of DTTs becomes very hard to imagine. For example, let’s assume to have a tax treaty in which the contracting States A and B want to include an MFN provision. If they want to extend the concessions granted by A to B under the treaty to the third State C, it would happen only with the formalities provided by the art.36 of the Vienna Convention on the law of the treaties: but an acceptation, even if implicit, makes the mechanism conditional. On the other hand, in order to extend the concessions granted to the State A in multilateral treaty providing for an MFN clause to a State B, we can just assume a clause that, recalling the State A’s MFN obligation, obliges this Country to extend such concessions to B. In the standpoint of A the mechanism is the same, but no MFN obligation arise for C. Perhaps, only a duty to grant similar favours to A, but not to all the States party to the multilateral arrangements. In the end, we may argue that no relation on this ground may be found between the Agreements and the DTTs.

But there is still room for conflicts. Assuming the two States party to the WTO, the reciprocal favours (so not-extendable to other Countries) that usually are stipulated in the DTTs may be saw as an infringement of the MFN? Many scholars have taken in

230 The treaties are res inter alios acta, the effects of the subjective positions arising from the agreement cannot be extended to third States directly, without its assent (art.34 Vienna Convention on the law of the treaties)
consideration Art. XIV GATS, which provides some exceptions to the treaty obligations, but only if
Such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable between Countries where like conditions prevail, or a disguised restriction on trade in services”.
In particular, paragraph (d) states that a Member can undertake:
“[a measure] inconsistent with art. II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreements or arrangements by which the Member is bound”.

The expression of the agreement is very clear in carving out DTTs. The only ground on which the tax treaties may be challenged is the violation of the general provision of non discrimination in applying the measures embodied in the chapeau of the article\(^\text{231}\). Probably the solution of the potential conflicts is given by the presence, in almost all the tax treaties, of a non discrimination provision\(^\text{232}\). But what about the “arbitrary and unjustifiable discrimination”? The leading-case in this field was the “Shrimps-Turtle” decision\(^\text{233}\), which pertained the application of the similar provision enclosed in Art. XX GATT (the most important difference in the chapeau is that, in the GATT one, “same conditions” are the benchmark for appreciating the existence of a discrimination, while in the GATS one, they read “like conditions”). The panel argued that the measures have to be applied in good faith, so as not to damage the status of the other Member State\(^\text{234}\). This can creates some problems, because the reciprocal base on which the bilateral may be view at any time by another WTO Member State as an arbitrary discrimination, overall bearing in mind that, even if two very relevant models exist, the provisions in the DTTs vary from tax treaty to tax treaty, providing for different relief from double taxation methods, different withholding tax rates on interests and dividend

\(^{231}\) As G. CAPPADONA Wto, Gatt, tax treaties and international taxation: The effects of their interactions and the possibilities of conflicts, cit.; p. 493, in my opinion correctly, argues.
\(^{232}\) See, for example, art.24 OECD model Convention
\(^{233}\) WT/DS58/R
and so on. Differences that are commonly deemed to be the consequences of the
different relationships (commercials, historicals…) amongst the States. The problem
needs to be solved by the jurisprudence. Another settled case-law\textsuperscript{235} defined “arbitrary”
measures not establishing clearly rules of competition and “unjustifiable” a difference in
treatment provided without any justified reason. The case-law above mentioned, going
further, stated also that the measures have to be necessary (it means necessary to
achieve the purpose of the rule) and proportionate (it has to balance the rule’s purpose
and the restriction on world trade so caused). In my opinion, the only problem is that
this jurisprudence, even if rightly formulated, is related to another legal text applied to a
completely different groups of measures involved (in the \textit{shrimps-turtles} case, for
instance, an exemption from the general import limitation of shrimps by the US).
Therefore, it does not seem to me to be the best ground on which deriving conclusions
on the direct taxation matter.

Shifting our standpoint from the WTO to EC law, one of the most debated issue was the
asserted existence of an MFN provision in Community law and its effects on the tax
treaty network amongst EC Member States.
The MFN treatment is not, at the current time, part of the customary international law
(so as to bind the Community), and no MFN provision has been stipulated in the EC
Treaty, not even in other agreements under the European law. As remarked in many
judgements by the ECJ, Community law has supremacy over the national law of the
Member States\textsuperscript{236} and we assume that the implementation of a tax treaty, making the
provision part of national law, may be judged on the ground of the compatibility with
the Community fundamental freedoms\textsuperscript{237}. Even in the Community, concerns of the
Member States regarding the loss of sovereignty in the fiscal matter has brought to a
compromise embodied in Art.293 EC Treaty:

\textsuperscript{234} This interpretation may be deemed to be applicable to all the WTO umbrella, and not only to the
GATT, because is the application of the general rule (art. 26 VCLT) that the treaties have to be executed
(interpreted and applied) in good faith.
\textsuperscript{235} Quoted by G. CAPPADONA, \textit{National report Italy} in \textit{WTO and direct taxation}, Vienna, p. 432 and
following
\textsuperscript{236} The landmark decision was the \textit{Costa} judgement; rendered on 15/7/1964, C-6/64
\textsuperscript{237} D. DURRSSCHIMDT, \textit{Tax treaties and MFN treatment, particularly within the European Union} in
\textit{IBFD Bulletin}, May 2006, p. 266
“Member State shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: (...) 

-The abolition of double taxation within the Community(....)"

In other words, it seems to me that the Community, because of the sensitive field interested and a probable lack of awareness at the time of the stipulation the Treaty about the double taxation issue, decided not to follow a clear provision (i.e. enacting a sole method for all the Member States in relieving from double taxation) but it left the decision to the States; trough the traditional method of concluding treaties, granting them the most absolute freedom in solving the problem. It means that the Community has no direct power in the field of income and wealth taxation. The only way to challenge a national taxation provision before the ECJ is the breaching of a fundamental provisions of the Community legal order. In all the case-law, tax provisions (in particular, DTTs) has been judged with respect to a supposed infringement of the fundamental economical freedoms of the Community238. The principle that is derivable from this case-law is that the Member States, even in their exclusive competence, has to legislate in a way fulfilling the EC law239. In the tax matter, the States may establish different regimes between resident and non-resident because of the fundamental features of the national tax systems; but not in order to discriminate, ergo not when there are similar circumstances between resident and non resident. Anyway, only in the “D.” case240 the ECJ was asked to decide whether or not the EC law grants to the citizens the possibility to get access to the more favourable provisions of a DTC signed by another Member State with other Member States, and not the ones signed by the citizen’s State, because of the right to enjoy the Community fundamental freedoms. In other words, an MFN treatment: An obligation for the States, under the Community law, to extend the more favourable provisions of a bilateral tax treaty to the rest of the Community.

In the case it was discussed the position of a German resident ,D., who own an holiday home in the Netherlands, about the 10% of his total wealth. Because of this, he was

238 Free movement of goods (EC treaty, part III, title I); free movement of persons, services and capital (Part III, title III). The most relevant judgements related to the conflicts of DCTs provisions and the Community law have never covered the MFN issue, they always applied other profiles of non discrimination principle (i.e. in the Saint-Gobain judgement the National Treatment)

239 As underlined by the Advocate General in his Opinion delivered in the “D.” case

240 Judgement rendered on 5/7/2005, C-376/03
subject to the Dutch wealth tax. This tax provided for an exemption if a non resident taxpayer owns at least 90% of his total wealth in the Netherlands. His application before the Dutch tax authority was rejected, and subsequently he applied a Dutch tax court, that brought the question before the ECJ for a preliminary ruling. He complained a breach of the freedom of movement of capitals; he argued that 100% of his taxable wealth was located in the Netherlands, because Germany does not levy any wealth tax. He brought another claim before the ECJ: to be entitled to get access to the Belgium-Netherlands tax treaty, which provides for an allowance regarding the wealth tax without any particular requirement.

In his Opinion the Advocate General Poiares Maduro argued that D. was in comparable situation to the Dutch taxpayers, basing his conclusions on the Schumacker case. In the aforementioned case, a Belgian (state of residence) worker was equalised to a German taxpayer (state of source) because he earned there more than 90% of his total taxable income. D., as we said before, got the 100% of his taxable wealth in the Netherlands. Regarding to the second question, he asserted that a difference in treatment between comparable taxpayers by a Member State’s tax system; although the regime is provided by a tax treaty, can constitute an infringement of the EC law general principles. Even if the States are sovereign in taxation, under the settled ECJ case-law, they cannot exercise their jurisdiction in way so as to breach Community law.

In the Judgement, the Court ruled that, regarding to the first question, the Member States may grant a tax advantage provided that at least the 90% of the taxable base is located in the State of the source. The Court rejected the A-G position, stressing that the most relevant part of D.’s income was situated in the residence State. His first question was so dismissed. With respect to the second question, the ECJ referred to the aforementioned Art.293, underlining that no fiscal harmonization has been enacted. Then, it stated that, though the situation of two taxpayers from different States (i.e. A and B, members of the Community) can be comparable (and so no different tax treatment may be applied, because it would indirectly lead to a breach of the fundamental freedoms’ enjoyment), the allocation of tax rights between the Contracting States (A and C; both Community members and a resident of B claiming for access to the DTT) of a tax treaty creates a differentiation so as to make the positions divergent.
The very recent decision by the ECJ revitalised an everlasting debate amongst the scholars, discerned between “believers” and “non believers”\textsuperscript{242}.

It seems, in my opinion, very hard to uphold the existence of an MFN clause in the EC law. It is true that the ECJ held in several times (in subject-matter other than taxation) that in exercising the freedoms granted under the Treaty of Rome the citizens has the right to get access to the bilateral agreements between two other Member States\textsuperscript{243}; but in this topic the right is related to the fundamental principles of the EC law (Non discrimination, freedoms of movements, etc…), whilst in direct taxation\textsuperscript{244} no similar rights (i.e. a right to bear a similar level of taxation, similar tax allowances, etc…) are not provided in the EC treaty. Moreover, in the treaty just a non discrimination provision is enacted, and no MFN clause is established \textsuperscript{245}. According to current dominant opinions amongst the international lawyers, an MFN clause has to be expressly stipulated in the treaty\textsuperscript{246}. As some scholars remarked, the problem lies on the possibility to interpret the fundamental freedoms provisions (together with the non discrimination one) in a so wide way to include in the prohibition of discriminating, by a Member State’s legislation, two non-resident in a comparable situation\textsuperscript{247}. The same Author goes further, stating that both the fundamental freedoms and the general non discrimination clause contains an MFN obligation\textsuperscript{248}. In my opinion, these broad interpretation is very hard to upheld, since the freedoms themselves are limited by some exceptions\textsuperscript{249}. Another ground for questioning the logical rightness of the judgement, in the opinion of the Author, was the Court’s assertion that the difference in treatment

\begin{footnotesize}
\textsuperscript{241} Judgement rendered on 14/2/1995, C-279/93

\textsuperscript{242} For a very impressive bibliography related to the debate T. O’SHEA The ECJ, the D. case, double tax conventions and most favoured nations: compatibility and reciprocity in EC Tax review, 4/2005, p. 190, fn. 3

\textsuperscript{243} See, for example; the Matteucci judgement, rendered on 27/9/1988, C-235/87; mentioned by T.O’SHEA The ECJ, the D. case, double tax conventions and most favoured nations: compatibility and reciprocity, cit., p 195.

\textsuperscript{244} Indirect taxation, VAT above all, has been harmonised in the Community, probably because of the politician’s awareness of the potential distortive effects on the Common Market

\textsuperscript{245} See art.12 EC Treaty, which forbids discrimination on the ground of nationality


\textsuperscript{247} D. DURRSCHMIDT Tax treaties and Most-Favoured-Nation treatment, particularly within the European Union, cit., p. 208-209

\textsuperscript{248} D. DURRSCHMIDT, Tax treaties and Most-Favoured-Nation treatment, particularly within the European Union, cit., p. 209

\textsuperscript{249} See art.39 EC Treaty, with regard to free movement of workers
\end{footnotesize}
between persons who can get access to the treaty because of his inclusion in the DTTs’ scope of application and people who cannot is justifiable, because the situation are not comparable given the different legal status. Going further the Author correctly states that different legal status may create discrimination (for instance, two Member States’ legal order in the Community, one complying with the right to enjoy the fundamental freedoms, the other one failing in doing it); but here the subject-matter (direct taxation) is not covered by EC law binding provision, the mean of tax conventions to solve the problem is designated by the Treaty itself (even if we have to remember that DTTs, expression of the State’s fiscal sovereignty, has to be enacted in a way complying with Community law). Those treaties are res inter alios acta, unless particular circumstances, nationals of third states cannot claim access to the treaty provisions\textsuperscript{250}. Given that, it becomes hard to imagine, in my opinion, a “comparable situation”. The differences in treatment are the same that can commonly be found in the legal status of two citizen coming from different States, another situation that is very difficult to compare. The only consideration I may modestly do is that, given the aforementioned observations, a clash; due to the lack of an MFN treatment under the treaty, exists between the aim and means provided. In other words, providing expressly an MFN clause would surely makes the Common Market works better, improving the spaces of freedom for Union’s citizens. With respect to our more limited scope; bearing in mind that direct taxation may be use (as it happens in the world trade) like a protectionist cudgel and that the divergences in treatment caused by the DTTs within the Community may be a great determent in the European cross-border economical relations; the best way would the stipulation of a multilateral tax treaty within the Community, replacing the current DTTs amongst the Member States.

6. The National Treatment (“NT”) Obligation: the Other “Cohabitation” Problems

The NT duty in the WTO law is connected strictly with the “internal” profile of the non discrimination principle. In the GATT the principle is enclosed in art. III:

“1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale,

\textsuperscript{250} See the art.34 Vienna Convention on the law of the treaties
purchase, transportation, distribution or use of products, and internal quantitative
regulations requiring the mixture, processing or use of products in specified amounts or
proportions, should not be applied to imported or domestic products so as to afford
protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of
any other contracting party shall not be subject, directly or indirectly, to internal taxes or
other internal charges of any kind in excess of those applied, directly or indirectly, to
like domestic products. Moreover, no contracting party shall otherwise apply internal
taxes or other internal charges to imported or domestic products in a manner contrary to
the principles set forth in paragraph 1.

3. With respect to any existing internal tax which is inconsistent with the provisions of
paragraph 2, but which is specifically authorized under a trade agreement, in force on
April 10, 1947, in which the import duty on the taxed product is bound against increase,
the contracting party imposing the tax shall be free to postpone the application of the
provisions of paragraph 2 to such tax until such time as it can obtain release from the
obligations of such trade agreement in order to permit the increase of such duty to the
extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of
any other contracting party shall be accorded treatment no less favourable than that
accorded to like products of national origin in respect of all laws, regulations and
requirements affecting their internal sale, offering for sale, purchase, transportation,
distribution or use. The provisions of this paragraph shall not prevent the application of
differential internal transportation charges which are based exclusively on the economic
operation of the means of transport and not on the nationality of the product.”251

We already stressed in the foregoing that GATT has been deemed not to deal with direct
taxation. We have to remark anyway that, in the FSC panel decision, it has been argued
expressly that “Nothing in the plain language of the provision specifically excludes
requirements conditioning access to income tax measures from the scope of application
of Art. III (…)”. The mentioned assertion looks like being an important opening to the
theory of GATT applicability in direct taxes; but, in my opinion, this statement needs to
be evaluated in the light of further jurisprudence by the WTO bodies.
In the GATS, the art. XVII is the one which deals with the same principle:

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.”

The interpretation of a so broad provision is helped by the agreement with some definitions:

-“Measures” is defined by Art. XXVIII(a) as “any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form”

-“Service of another Member”(art. XXVIII(f)): “a service which is supplied, (i) from or in the territory of that other Member, or in the case of maritime transport, by a vessel registered under the laws of that other Member, or by a person of that other Member which supplies the service through the operation of a vessel and/or its use in whole or in part; or (ii) in the case of the supply of a service through commercial presence or through the presence of natural persons, by a service supplier of that other Member”

-“Service Supplier”( art. XXVIII(g)): “any person that supply a service”

Another important issue is the definition of “likeness”. A WTO panel decision252 gives an objective definition of the notion (in the sense that no subjective criterion was exploited), arguing that likeness must be evaluated when there are like nature and characteristics of the service supplied. The panel, going further, stated that, if suppliers are supplying like services, they must be considered “like” suppliers. Some scholars rightly argued that, because of this equation, there could be no discrimination on the ground of residence (for tax purposes), but only amongst different service supplying253.

The provisions hitherto mentioned seem to have a very similar scope of application and aim in comparison with the non discrimination clause usually embodied in the DTTs. Here we report the one adopted in the OECD Model:

251 The other paragraph of the article not related to taxation has been omitted
252 The EC-Bananas case, WT/DS27/R
“1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which Nationals of the State in the same circumstances, in particular with respect to residence, are or may be subjected.”

One of the sentences in the Article at issue states:

“This provision shall, notwithstanding the provision of Article 1 (which deals with subject to whom the convention applies), also apply to persons who are not resident of one or both the Contracting States”

The rule means that nationals (a wider category than residents) of the States parties to the treaty have not to be discriminated.

The paragraph 6 of the provision at issue is very interesting, because it creates the first possibility of overlapping between tax treaties and GATT (unless subsidies):

“The provision of this Article shall, (…), apply to taxes of every kind and description”

The rule, thereafter, applies also to indirect taxation, the only field in tax law where the GATT provisions are involved. In my opinion, no clash could happen between the provisions at stake, because the obligation enshrined is the same, and it is related to the same kind of taxes. I think that the same conclusions can be derived with respect to GATS.

One of the most relevant conflicts between national tax systems and the NT clause may arise with regard to the so-called CFC (“Controlled Foreign Companies”) legislation, adopted by almost all the Western countries with the aim to contend the unfair “tax competition” with so-called tax havens.

Many alerts about that were published above all after the issuing of the OECD paper called “Harmful tax competition: An emerging global issue”. In the paper, the OECD advised the Member State to take some “defensive measures” against tax havens.

253 G. CAPPADONA Wto, Gatt, tax treaties and international taxation: The effects of their interactions and the possibilities of conflicts, cit., p.481
254 As remarked, quoting other scholars, by L. FRIEDLANDER The role of non discrimination clause in bilateral income tax treaties after GATT 1994 in British Tax Review, 2002, 2, p. 78
256 “Tax havens” are defined by the paper as tax jurisdiction -imposing no or only nominal taxes
“uncooperative”257. Some of recommended measures by the OECD (such as “Disallowing any deduction, exemption, credit and other allowances in relation to all substantial payment made by persons located in countries (...) involved in harmful tax practices(...)” or “the use of legislative provisions allowing the taxation of residents on amount corresponding to income that benefits from harmful tax practices”) are integrant part of the CFC legislation in many Western countries258. The alerts above mentioned are about the compatibility of such provisions with both MFN and National Treatment principles. Some Authors argued even that the measures may breach GATT; but; bearing in mind that, in my opinion, only GATS deals with direct taxation, I disagree on this point259.

First of all, we must remember that measures included in the List provided by the Annex to GATS art. II are lawfully inconsistent with GATS MFN. The lawfulness, therefore, depends on what has been carved-out by the Member States. If nothing has been included, there could a violation of the MFN clause. Anyway, the art. XIV GATS laid down a general exception, allowing States to enact measures:

“inconsistent with Article XVII (the National Treatment obligation), provided that the difference in treatment is aimed at ensuring the equitable or effective(6) imposition or collection of direct taxes in respect of services or service suppliers of other Members”

The Footnote 6 so goes on:

“Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

- lacking an effective exchange of information
- lacking of transparency
- dealing with activities that are not substantial

257 Those are the 35 tax havens, identified in another OECD paper issued in the 2000, which have not signed any memoranda of understanding in the period from the paper’s issuing to 31st July 2001

258 For example, one of the main feature of the Italian CFC regime is the disallowance of deduction for costs and expenses incurred with tax havens, which are listed in a decree issued by the Ministry of Finance

259 I. HOFBAUER To what extent does the OECD Harmful tax competition project violate the MFN obligation under WTO law? in IBFD Bulletin, September 2004, p.401. The Author argues that direct taxation may be considered as a taxation on goods because the enterpeneurs has the power to shift tax burden on the consumers by increasing good’s prices. It seems more an economical than a legal reason, and I said above that, as the largest part of the scholars, I do not agree with such an interpretation of GATT provisions.
(i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
(ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
(iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
(iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
(v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
(vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.”

The direct aim of many CFC provisions seem, at first glance, to fall above all within the definition of paragraph (vi); albeit it would necessary also an inquiry on the teleological dimension of the CFC legislation, in order to determine if such provisions are fully consistent with WTO law.

Also this provision is subject to the duty not to be discriminatory embodied in the chapeau, as we saw above. In my opinion, measures adopted not to prejudice some specific countries; but all the countries playing incorrectly, in order to avoid any tax fraud (a sure legitimate aim) cannot be deemed to be discriminatory. For sure, a discrimination may be found in the behaviour of the OECD, which classified the harmful practices held by some of its Member States (for instance, Switzerland) as “potentially” harmful and the ones held by non-OECD States as surely harmful. Bearing in mind that there are no substantial divergence in the borne activities, if such a formulation was followed by a OECD State, it would constitute grounds for consultation under the DSB260.

Another interesting rule for the scope of this paper is the art. XX(3):
“A Member may not invoke Article XVII, either under this Article or Article XXIII, with respect to a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation. In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, it shall be open to either Member to bring this matter before the Council for Trade in Services. (11) The Council shall refer the matter to arbitration. The decision of the arbitrator shall be final and binding on the Members.

(footnote original) 11 With respect to agreements on the avoidance of double taxation which exist on the date of entry into force of the WTO Agreement, such a matter may be brought before the Council for Trade in Services only with the consent of both parties to such an agreement.”

Even if there is no jurisprudence or administrative interpretation by a WTO body on this Article261, the rule clearly aims to avoid any risk of conflicts on the litigation’s settlement between the Mutual Agreement Procedure, provided by the OECD Model, and the WTO Dispute Settlement System. In the Commentary to the Model262, the OECD argued that such a provision may bring problems because of: first, the difference in treatment between DTTs concluded before and after the entry into force of the GATS, and second, the interpretation caused by the expression “fall within the scope of application” (in the OECD opinion, it is not clarified whether the measures involved have to be related to taxes taken in account by all or some treaty’s provisions). The OECD advised, in order to solve the potential problem, to insert in the DTTs a provision stating that all the controversies about the treaty’s scope of application, even if concluded after the GATS entry into force, shall be brought before the Council on Trade in Services.

The risks of overlapping, clashes and conflicts between the two different dispute settlement procedures263 has been stressed by many scholars. Firstly, we have to

261 As reported by the WTO website, www.wto.org
262 As they read in the Commentary to the Art.25, paragraphs 44.1- 44.7
263 R. GREEN Antilegalistic approaches to resolving disputes between governments: A comparison of the international trade and tax regimes in Yale Journal of International law, 23, 1998, p.82 distinguished between an “antilegalistic” resolution method (the tax treaties’ one), based on soft law and relying on intergovernmental negotiations, and a “legalistic” method (the WTO one), based on rules and settled by a third party who applies such rules.
remember that the national tax laws, if discriminatory, may be ground for consultation, because of the violation the NT clause. But the dispute may be solved also exploiting the mutual agreement procedure. Given that, as we saw above, no direct effect has been recognized to WTO provisions, the DSB in fiscal matter will be used directly by States\textsuperscript{264}, whilst the Mutual Agreement Procedure will be put into action by private persons\textsuperscript{265}. The only issue is that, by a legal point of view, an overlapping between the procedures mentioned still stand.

Secondly, with regard to a possible conflict amid the settlement procedures about a potentially discriminatory provision in tax treaty, the above mentioned GATS Article excludes any possibility of exercising a jurisdiction by the WTO DSB. The arbitration provided is established only to ascertain whether or not the DSB may have power to solve the dispute, assessed that the dispute is not related to a DTTs. Hence, the only way to settle the dispute in the tax treaty context is the Mutual Agreement Procedure. Green\textsuperscript{266}, for instance, giving his opinion on the eventual clash of “jurisdictions”, seems to back strongly the submission of the income tax disputes under the WTO DSB, but in a \textit{de lege ferenda} prospective. It seems to me that the solution of clash eventuality in these matter has been well resolved both by the WTO and the OECD.

\textbf{7. SUBSIDIES AND STATE AIDS UNDER THE WTO REGIME AND THE EC LAW}

In WTO law, the potential subsidizing effect of direct taxation has been recognised since the conclusion of GATT in 1947. Subsidies are one of the most practised protectionist measures adopted by the countries: We can find two different kinds of subsidies:

- related to the Country’s export: the State, by mean of any kind of measure, provides an economic help (concessions of loans, tax deferral, etc…) to the exporters, so as to

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\textsuperscript{264} In my opinion, it would happen when a great number of persons involved in cross-border activities, so important to be able to behave as a lobby, will induce (using their political power) politicians to brought such a complain before the WTO DSB.

\textsuperscript{265} Even groups of persons, but without such a political power.

\textsuperscript{266} R. GREEN \textit{Antilegalistic approaches to resolving disputes between governments: a comparison of the international tax and trade regime}, cit., p. 79-139. The Author’s conclusions may be derived from the article as a whole. He, taking into account argumentations by the law and economics studies applied to
strengthen their position in the world trade and consequently improve internal economy. This leads to a wrenching in global competition -related to the Country’s import: national enterprises are subsidized in order to get a stronger position in the internal market and stop the foreign importer’s access to the national economy. These measures are aimed to, in the end, improve employment, enterprises’ earnings (because of the less competition borne), and also tax revenues for the public bodies267.

Under GATT, subsidies is for sure the subject-matter that may constitute grounds for challenging national direct taxation measures.

In the GATT, the first provision dealing with subsidies is Art. XVI. In particular paragraph 4 lays down the so-called “principle of origin”: “Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.”

But clarifications in a so obscure subject became so urgent to led the negotiators during the Tokyo Round to adopt a side agreement about subsidies: the “Subsidies Code”. The main lack of the Code was the absence of any definition of what could be considered as a subsidy. The Code provided only for a list of measures. Given the foregoing, it was replaced, at the time of entry into force of the WTO Agreements, by the Agreement on Subsidies and Countervailing Measures (hereinafter, the ASCM). Art. 1 of the ASCM provides for a definition of subsidy. With regard to taxation, Art. 1.1.a.1.ii states that it is considered as a subsidy:

“(a) government revenue that is otherwise due is foregone or not collected (1).

(footnote original) 1 In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement,
the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.”

According to Art. 1.1.b, another element is required, namely that:

“A benefit is (...) thereby conferred”

One of the most important features of the ASCM are the different treatment amongst different kinds of subsidies, in the light of their impact on the world trade. This method was called by the Scholars the “Traffic Light Approach”268. According to such a norm, the subsiding measures must be divided into three groups:

-“Prohibited Subsidies” (so-called “red-light” subsidies): such measures constitute immediately grounds for the procedures established by the ASCM

-“Actionable Subsidies” (“amber-light” subsidies): those subsidies may lead to a legal action only if certain conditions are met.

-“Non-Actionable Subsidies” (“green-light” subsidies): those aids are permitted under the meeting of certain requirements.

With regard to the first category, Art.3 identifies as prohibited:

“Subsidies contingent, in law or in fact(4), whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

*(footnote original)* 4 This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.”

In particular; Annex I to the ASCM, which provides an illustrative list of export subsidies, expressly mentions:

“The full or partial exemption remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises.”

and

“The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.”
If such a measure is adopted by a WTO Member State, the complaining State does not need any proof of the existence of an injury or a prejudice\textsuperscript{269}.

The actionability of a subsidy relies on two features: specificity\textsuperscript{270} and the adverse effect to the other WTO Member States.

Specificity must be determined under certain criteria provided by the Art. 2:

“(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions\textsuperscript{2} governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to.

2 Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific.”.

Whilst the first two subparagraphs defines the so-called \textit{de jure} specificity, the last one describes the \textit{de facto} specificity\textsuperscript{271}. Moreover Art 2.2 states:

“A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific”

\textsuperscript{268}H. Van HOUTTE, \textit{The Law of international trade, cit.}, p. 125

\textsuperscript{269} R. LUJA \textit{WTO Agreements versus the EC fiscal aid regime: impact on direct taxation in Intertax}, 1999, 27, 6-7, p. 208

\textsuperscript{270} According to the Art. 1.2 ASCM: “A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II (prohibited subsidies) or shall be subject to the provisions of Part III(actionable subsidies) or V(non actionable subsidies) only if such a subsidy is specific in accordance with the provisions of Article 2.”

\textsuperscript{271} According to Art. 2, the specificity in fact has to be appreciated under certain criteria, such as “use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.” The above mentioned definition is quoted by V. Di COMITE \textit{La nozione di sovvenzione nell’OMC alla luce dell’interpretazione offerta dai Panels e dall’Organo d’appello in Diritto del commercio internazionale}, 2005, 2, p. 277
This provision is related to the granting of a subsidy by infra-governmental public bodies (i.e. a region).

With respect to the other requirement, it is laid down by the Art. 5:

“ No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

a) injury to the domestic industry of another Member
b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular th\textsuperscript{272}e benefits of concessions bound under Article II of GATT 1994;
c) serious prejudice to the interests of another Member.”

The first condition has to be proved by the complaining State; for instance, showing the subsidy effect on the importation of the subsidized good, the variations of the good price in the internal market and, consequently, the impact on the revenues of the domestic producers of this good\textsuperscript{273}.

For the second one, we remind the Art. XXIII GATT and the jurisprudence on this.

About the third one, the “serious prejudice” shall be deemed, according to Art. 6.3, to exist in presence of such effects:

a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.”

\textsuperscript{272} The footnotes to the Article provides that the expressions “serious prejudice” and “nullification and impairment”, having the same sense of the same expressions used in the GATT, must be assessed in the same way

\textsuperscript{273} R. LUJA \textit{WTO Agreements versus the EC fiscal aid regime: impact on direct taxation}, cit., p. 208
In the subject-matter of direct taxation, such subsidies are supposed to exist in presence of, for example, tax credits for new activities or remissions of any debt to enterprises. In the end; the green-light subsidies are all the non-specific subsidies. The category is nowadays expired. They were related to the activities enlisted in Art.8 (i.e. assistance for research, for disadvantaged regions, etc).

The only ground for a legal action against a non actionable measure was the causing of a serious adverse effect on the industrial economy of another Member State, that would be difficult to repair.

Doubts of compatibility between the traditional methods against double taxation enclosed in the DTTs and the WTO subsidies regulation has been arose by Scholars. They argued above all that the exemption method contrasts with the principle of origin enclosed in Art. XVI.4, because it produces a reduction of the total tax burden for enterprises involved in cross-border activities in comparison to the ones operating only in the domestic market. We have to remember that paragraph (e) of the Annex I of the ASCM includes, amongst the illustrative list of export subsidies, “The full or partial exemption remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises.”

Further, the Footnote affirms: “Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.”

Even if the list is not a numerus clausus, but just an illustration of the typical ways to grant export subsidies, the Footnote carves out the aforementioned methods by being considered a subsidy. In my opinion, the FSC panel has rightly held that the DTTs rules may fall within the ASCM scope of application, but it seems to me a clear exception. This opinion is upheld by the ETI case’s Appellate Body decision, even if this position was taken incidentally by the Body. It was just reasoning about the burden of

274 R. LUJA WTO Agreements versus the EC fiscal aid regime: impact on direct taxation, cit., p. 209
275 As stated by the Art. 8.1
276 G. CAPPADONA Wto, Gatt, tax treaties and international taxation: the effects of their interactions and the possibilities of conflict, cit., p. 504 and following
277 WT/DS108/AB/RW
the proof with reference to the US exception that the ETI was a measure against double taxation falling, by virtue of this, under the Footnote provision.

With regard to the potential infringement of principle of origin rule, we have to remember that breaching such a provision leads by itself to a subsidy, which can be deemed to be prohibited because it is related to exporting activities\textsuperscript{278}. What about the benefit requirement? In my opinion, even if not necessarily there will be a lowering of the sale prices, the exporters are putted in a better position in the world trade competition. The only problem is that all these conclusions may have room only if such a lowering of sale prices, caused by a reduction of the tax burden by way of an exemption, happens\textsuperscript{279}. Therefore, the situation must be evaluated with a case-by-case approach.

As we saw above, the leading-case in the WTO case-law related to direct taxation was the FSC (Foreign Sales Corporation) dispute between the United States and the European Community. In truth, the dispute regarded different fiscal regimes enacted in the US, as from 1971, aimed to improve the US export around the world. In 1976 the Community challenged the DISC (Domestic International Sales Corporation) legislation\textsuperscript{280}, which established a preferential fiscal regime (an exemption on the due interests for the deferred profit taxation) for subsidiaries of domestic corporation involved in export sales activities. The Panel held that the following measures constituted a pecuniary benefit prohibited under Art. XVI GATT:

- The allowance of a deduction of export promotion activities in shipping and air transport
- The assignment of a 10% of the export promotion expenses to the DISC
- The lacking of a transfer pricing discipline not based on the arm’s-length principle\textsuperscript{281}

\textsuperscript{278} See Art. 1 ASCM; which, after the definitions in the paragraph 1.a.1, use the conjunction “or” to refer to the principle of origin rule in paragraph a.2:

\textsuperscript{279} See G. CAPPADONA \textit{WTO, GATT, tax treaties and international taxation: the effects of their interactions and the possibilities of conflict}, cit., p. 515. In other words, when we may find a situation of the prices as delineated by the provision.

\textsuperscript{280} GATT Council, 23S/82

\textsuperscript{281} The “Transfer Pricing” is a particular ensemble of provisions; adopted by a State, in order to discipline the sale activities between companies member of the same group, aiming to avoid tax fraud because of the artificial lower price (than the market one) stipulated by the companies involved. A principle internationally recognised in dealing with such an issue is the “Arm’s-length principle”, by which the companies must deal with each other as if they were independent enterprises. In the statement, the GATT Council clearly affirmed the necessity to apply such a principle to transfer pricing rules.
The US challenged the territorial approach exploited by three European countries (Belgium, France, Netherlands), arguing that the benefits granted by the DISC legislation was very similar to the ones granted by a territorial approach in taxing foreign income. Regarding to this last question, the three panels established stressed that allowing income, derived from an economical process originated in the country and completed outside not to be taxed constituted a revenue foregone. In some way the GATT Council legitimated the territorial taxation system\(^\text{282}\), arguing that “an economic process located outside the territorial limits of the exporting Country need not to be subject to taxation”\(^\text{283}\).

Nothing happened for a long period of time, until the US adopted the famous FSC legislation. Such provisions established an exemption to imposition on a certain amount of “foreign trade income\(^\text{284}\)” generated by the FSC. Moreover, the parent company was allowed to deduct the whole dividends received by the FSC. The main difference was that the DISC was a tax deferral, whilst the FSC was a tax exemption\(^\text{285}\). In the panel, it was argued a definition very important to understand the exact meaning of the expression “revenue….otherwise due” enclosed in the Art. 1 ASCM, namely that “a panel,(…), must examine the situation that would exist but for the measure in question”\(^\text{286}\). Remaining in this issue, the Appellate Body corrected the too much formalistic panel’s approach, stating that “ it would(…) not be difficult to circumvent such a test by designing a regime under which no general rule that apply formally to the revenues in question absent the contested measure”. It seems to me that, in the light of

Nowadays, Footnote 59 to the Annex I of the ASCM prescribes: “The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length.”. Therefore, the adoption of this method becomes binding under the WTO system.

\(^{282}\) As remarked by Prof. Stephan, quoted by R. LOPEZ-MATA *Income taxation, international competitiveness and the WTO rules on subsidies: lessons to the US and to the world from the FSC dispute in Tax Lawyer*, 2000/2001, 3, p. 594

\(^{283}\) GATT Council’s statement quoted by R. LOPEZ-MATA *Income taxation, international competitiveness and the WTO rules on subsidies: lessons to the US and to the world from the FSC dispute*, cit., p. 594

\(^{284}\) It was defined in the statute as the income derived from the export-related operations carried out by the FSC, including disposition or lease of “export properties” (goods manufactured in the US with a minimum of 50% US contents value)

\(^{285}\) R. LOPEZ-MATA *Income taxation, international competitiveness and the WTO rules on subsidies: lessons to the US and to the world from the FSC dispute*, cit., p.598

\(^{286}\) The so-called “but for” test
what the Appellate Body held about the “but for” test, it can be considered as an investigation related to the existence of a general-special relation between tax rules: the fiscal subsidizing rule as a *lex specialis*, compared to a general body of rules. Indeed, this seems backed by the existence of the specificity’s requirement: in other words, what I mean is that ascertaining the speciality of the supposed subsidizing rule may be associated to the assessment of the specificity requirement. Anyway, it is correct by the DSS bodies not to use this test as the only (because of the risks remarked by the Appellate Body) way to investigate in the subject-matter; but it could be considered a starting point.

The US based the defence above all over the GATT Council statement aforementioned and over the Footnote 59 to paragraph (e) of the Annex I of the ASCM, which provides: “the Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member”

The US argued that, bearing in mind these provisions, the States has the right not to tax foreign economic processes even if it could be contingent upon exportation. Further they argued that the WTO, given the footnote, was not the appropriate forum to resolve disputes related to taxation. The Panel rejected the US argumentations, with regard to the former one, because the facts at issue were different in compare to the DISC case, in respect to the latter one, because such an interpretation was deemed to be an inappropriate restriction of the right to access, by a WTO Member State, to the DSS. A scholar 287 has argued that the problem, for the US, is having enacted a legislation (the aforementioned “Subpart F Treatment”) which disadvantages the exporters; and departing from this legislation by adopting measures providing for an export-contingent exemption is always a breach of the ASCM obligations.

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287 R. LOPEZ-MATA *Income taxation, international competitiveness and the WTO rules on subsidies: lessons to the US and to the world from the FSC dispute*, cit., p.602
The panel affirmed that the FSC was a prohibited subsidy because the tax benefits were contingent upon exportation\(^{288}\). The Appellate Body confirmed the Panel’s findings; stressing that

- The exclusion as foreign income, regardless of any concrete analysis, provided by the FSC discipline was an exemption from the general rules (that oblige to ascertain, in comparable export, the effective connection of the income)
- The 100% deduction provided for the FSC parent company’s shareholders was an exemption, in compare to the taxation applied to a comparable position of a shareholder of another corporation
- The FSC legislation was a depart from the so-called “Subpart F treatment”\(^{289}\), given that those dividends were not considered as “constructive dividends”; rule that could be applicable in a comparable situation of another parent corporation.

Along with the repeal of the FSC discipline, US Congress adopted in 2000 a new legislation called Extraterritorial Income Act (hereinafter ETI). As well as the preceding norms, the aim was to enact a body of rules consistent with the ASCM and, at the same time, improving the US exporters position in the world trade competition. The method here followed is rather a tax exclusion than a tax exemption, because the taxpayer’s taxable base is reduced by the exclusion of the “qualifying foreign trade income”\(^{290}\). In order to avoid the contingency upon exportation, it was stated that the qualifying foreign trade property do not need to be manufactured in the US. Someone\(^{291}\) argued, in my opinion correctly; that, since the goods so manufactured are essentially fashioned for exportations, the admission to the regime seems to be in fact contingent upon exportation. I would just remember what the Footnote 4 to the Art. 3.1.a states:

\(^{288}\) According to the Art. 3.1.a ASCM
\(^{289}\) Namely the US CFC rules, embodied in the Subpart F of the US Internal Revenue Code (IRC)
\(^{290}\) Given the definition of “extraterritorial income” as the income attributable to the foreign trading gross receipts; the “foreign trading gross receipts” are the ones derived from the sale or exchange of “qualifying foreign trade property”, or from these properties’ lease outside the US. The last expression is referred to properties:
- “held primarily for sale, lease or rental, in the ordinary course of business, for direct use, consumption or disposition outside the United States”
- which more than the 50% of their market value is attributable to foreign content
\(^{291}\) R. LOPEZ-MATA Income taxation, international competitiveness and the WTO rules on subsidies: lessons to the US and to the world from the FSC dispute, cit., p.604
“This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings”.

The last two cases related to this controversy were settled very recently. The ETI Legislation was found inconsistent with the WTO rules\(^{292} \), because contingent in law upon exportation: the exclusion was granted under the condition of the introduction of the goods in the external market. In particular, the Panel stated and the Appellate Body upheld that the ETI cannot be considered as a double taxation relief method (as argued by the US), because it excluded both foreign and domestic income and that the foreign income has no link with a foreign country. Therefore, it cannot be considered as a foreign-located income.

In the end, the US repealed with the “American Jobs Creation Act” (2004) the ETI regime, but the Act delayed the application of such a regime by mean of a transitional rule. The Panel and later the Appellate Body “convicted” the US for not having implemented the recommendations in the former panels in a reasonable time, so breaching the Art. 4.7 ASCM.

In the EC, we can find almost the same problems that we found in the WTO system. In both the systems, indeed, it was necessary to enact a legislation against subsidies or any kind of contributions by States, in order to preserve a real competition in European Common Market, or in the world trade on the road for liberalisation. Since the conclusion of the Treaty of Rome, provisions with this aim were adopted in the EC law. Art. 87 para. 1 EC Treaty states:

> “Save as otherwise provided in this Treaty, an aid granted by a Member State of through State resources in any form whatsoever which distorts or threatens to distort 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 Common Market”

The paragraph 2 provides a list of measures which are \textit{de jure} deemed not to have a negative impact on the Common Market, whilst the paragraph 3 enumerates a number of measures the lawfulness of which has to be assessed by the Commission.

It seems to me to find something very similar to the WTO “Traffic-Light Approach”.

Moreover, Art. 96 EC Treaty provides that:
“(Paragraph 1) Where the Commission finds that the differences between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the Common Market and that the resultant distortion needs to be eliminated, it shall consult the Member State concerned

(Paragraph 2) If such consultation does not result in an agreement eliminating the distortion in question, the Council shall, on a proposal from the Commission, acting by a qualified majority, issue the necessary directives. The Commission and the Council may take any other appropriate measures provided for in this Treaty”

This provision has been interpreted by the Commission in a notice issued in November 1998. It has stressed that several points, which are very close to the WTO regulation, for instance, that:

- the aid must grant a benefit
- it must be specific or selective (i.e. the aid is limited to certain geographical areas of the granting State)
- it has been excluded that a general measure can be deemed to be a subsidy.

Even the exceptions provided to the general rule looks like very similar to the non-actionable subsidies enlisted in the Art. 8.2 ASCM. An important difference is given by the presence, in the EC law, of a de minimis rule\(^\text{293}\); providing that, under a certain maximum threshold fixed by the Commission, the prohibited aids may be legitimate.

It is clear, anyway, that the Commission is competent over the infringement of such rules by EC Member States, which may bring an action before the ECJ, therefore the WTO DSB is not competent. It has competence over the breaching of the WTO Agreements, and if damaged is an EC Member State it cannot act by itself; but it will be the Commission which will represent the State. This happens because of the exclusive competence over the commercial subject-matter of the Community. Given that, no risk of overlapping jurisdictions seems to appear.

\(^{292}\) WT/DS108/R, recourse to Art. 21.5 DSU

\(^{293}\) Which has been prescribed by the Commission’s Regulation 1998/2006.
8. CONCLUSIONS

In this paper we have analysed the interactions and the potential conflicts amongst the WTO law (overall the most important Agreements, namely the GATT, the GATS and the ASCM), the EC law and the tax treaties rules, taking into consideration the most exploited model of tax convention, the OECD one. First of all, we discussed the current context of the debate regarding the assumed direct effect of the WTO regime in the EC law, holding that the ECJ position in the issue is, in my opinion, correct. Later, the main topic was explored by the standpoint of the relevant arguments. Firstly, the compatibility of the Most Favoured Nation clause with tax treaties. We excluded the possibility of conflicts with the GATT generally, because GATT is related to the taxation on goods, whilst the tax treaties are involved with direct taxation. With regard to the GATS one, the possibility of conflicts, even with respect to a possible overlapping of jurisdiction, was excluded by the general exception provided in the Art. XIV (even if further clarifications need to be given in respect of the chapeau of the Article) and by the Art. XXIII. In the end, we discussed the asserted existence of an MFN clause in the EC law in the light of the ECJ “D.” judgement. About the National Treatment obligation, we assumed that the general non discrimination provision embodied in the tax treaties consistent with the OECD, binding the States parties to the DTTs to a substantially similar behaviour, excludes other potential conflicts. Moreover we apposed the compatibility with such an obligation of the OECD proposals about the fight of the so-called “harmful tax competition practices”. In the latter point we discussed the subsidies regulation in the WTO regime and the EC State aids, in particular with regard to the DISC-FSC-ETI dispute before the WTO DSB between the United States and the European Community.
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1. NON-PROFIT ORGANIZATIONS AND CHARITIES: OVERVIEW
1.1 Development of “third sector” and legal context

In the last decade, the so called “third sector”, has undergone a substantial development, and not only from the quantitative point of view. Under the qualification of “third sector”, often used as a synonym of non profit, we include some subjects which operate according to principles and mechanisms which neither belong to the State nor to the market. With the term third sector, in the field of non profit organizations we classify associations, voluntary bodies, social cooperation and non governmental organizations (ONG) characterised by their activity in the social field.

It is true that the numerous intermediate organizations today in existence no longer restrict themselves to interventions of sole assistance and help, they instead carry out true commercial activities, interacting within the commercial network of our country. Not only this, even those institutions whose institutional activity remains within the bounds of the non-commercial, as originally intended by the delegate legislator, have for the greater part changed the sources of funds with which to confront their bestowals: they too, in fact, draw often the necessary finances for their institutional ends from the exercise of objectively commercial activities.294

The tributary legislator could not therefore remain insensitive to this new economic reality (and resource) for the Country. The first intervention in the direction indicated above has been made with the issue of the D.Lgs. N° 266/1991 (“D.Lgs.” stands for legislative decree), concerning voluntary organisations.

Non profit organizations of social concern (ONLUS “organizzazione non lucrative di utilità sociale”) are now regulated for tax purposes by D.Lgs. 04.12.1997 N°460. This law integrates other existing laws covering the Italian taxation system: Article 108 D.P.R. 22.12.1986 N° 917295 (in Italy TUIR, “testo unico delle imposte sul reddito”, that is consolidated text on income taxes) and article 6 D.P.R. 29.09.1973 N° 601.

1.2 Main features of ONLUS

According to article 10 D.Lgs. N° 460/97, automatically regarded as ONLUS are voluntary work organizations, non governmental organizations, social cooperatives and consortia exclusively made up of social cooperatives; all subjects characterised by the absence of a systematic and programmed pursuit of subjective gain.

In order to be recognised as ONLUS, the statutes or constitutive deeds of the institutions concerned must envisage the carrying out of certain activities determined by law with social solidarity contents, the prohibition to distribute, even indirectly, managerial profits and remainders, the obligation to hand over the organization’s assets, in case of its dissolution for any cause, to other non profit organisations of social utility or with public utility aims.

Finally, a unified discipline is required in the associational relationships in order to insure an effectively democratic character.

These organizations can also carry out other activities, accessory to the institutional ones, but, since now, it is important to underline that they must respect the observance of the limit of 66% of the income deriving from accessory activities with respect to the global budget of the institution.

A favourable taxation system is applied on condition that services are rendered to subjects qualified for some activities, for other activities social solidarity is intended to pursued by the nature of the beneficiaries.

Finally, the ONLUS must provide information on the start of its activity to the competent Regional Directorate of Income, likewise it must notify a loss of the prerequisites which qualify it; a registry of ONLUSs is kept within the Ministry of Finances. The fulfilment of these formal obligations is a fundamental condition in order to enjoy the fiscal relief.

1.3 ONLUS in TUIR system

ONLUSs are subject to corporate income tax and they are considered a particular kind of non-commercial institutions based on membership.

295 D.P.R. stands for “decreto del presidente della Repubblica”, Head of State decree.
It is useful to mention the debate generated around the nature of institutions which may aspire at the qualification of ONLUS, since it assumes a specific relevance in the economy of the present work.

According to part of the doctrine, the qualification of ONLUS would be possible when the institution is already *ex ante* classifiable in the category of non commercial institutions. This because the social solidarity aims, which constitute the true identification parameter of such organizations, would turn out incompatible with a management of a business nature, imposing, on the contrary, the adoption of a management essentially charitable.

Such conclusion doesn’t seem convincing.

The legislator, when he has theorised the ONLUS category, has intended to give relevance to the subjective profile of the intermediate organizations, regardless of the activity carried out, and he has seen in the absence of a lucrative aim and in the pursuit of socially useful ends, the fit causes for justifying the assignation of institutions inspired to these principles to a particularly advantageous fiscal regime.

This is not all, since the typology of activities contemplated by Article 10 of D.Lgs. N° 460/1997, that the organizations must carry out in order to be eligible for enrolment in the ONLUS Registry, are without doubt to be regarded as commercial.

It has been pointed out on this score that ONLUS constitute a different category and, in a certain way, competitive with non commercial institutions, being the first characterised by requisites which are very different from those contemplated for the second.

Therefore, whereas the discipline concerning non commercial institutions should need to be applicable the non existence of a principal commercial activity, on the contrary, the discipline concerning ONLUS, exactly implies the existence of a principal commercial activity: which in the presence of precise and typical objective and subjective requirements of the organization, would be “de-commercialized”, and consequently not taxable by virtue of the non lucrative aims of the same institution.296

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2. THE CORPORATE INCOME TAX IN TUIR SYSTEM

2.1 Introduction

In this chapter, the Italian taxation system on juridical persons will be briefly analyzed, particularly rules concerned with non-commercial institutions, institutions based on membership and ONLUS.

The reference legal text is TUIR, which in Articles 73 and following contains the discipline on the corporate income tax (in Italy IRES “imposta sul reddito delle società”).

2.2 Passive subjects

Precondition of the corporate income tax is the possession of monetary or by nature income.
Subject to the corporate income tax are:
a) the joint-stock companies and the partnerships limited by shares, the limited liability companies, the cooperative societies and the mutual aid societies whose residence is inside the State territory;
b) the public and private entities other than the companies and the trusts whose residence is inside the State territory and whose main or sole activity is the business activity (commercial institutions);
c) the public and private entities other than the companies and the trusts whose residence is inside the State territory and whose main or sole activity is not the business activity (non-commercial institutions);
d) the companies and entities of every kind, including the trusts, with or without personality, whose residence is not inside the State territory (non-resident institutions)

Among the institutions above mentioned(letter b) and c)) are included, besides the juridical persons, the non-acknowledged associations, the consortia and all other organizations not belonging to other passive subjects towards which the ground for taxation exists in autonomy.
So, near to the four original category, another group of passive subjects has been individuated, the ONLUS, which may consist in associations, foundations, private entities with or without legal standing and also social cooperatives (therefore also passive subjects according to letter a), whose memorandum or constitutive deeds contains special rules (chapter 3).

2.3 Criteria for establishing the nature of commercial/non-commercial institutions

So far as concerns the distinction between commercial institutions and non-commercial institutions we may note that Article 87, 4th comma, TUIR, states that the identification of the exclusive or principal object of an institution must be carried out, as a rule, according to the contents of the relevant deed of constitution or of the statute, so long as these possess valid formal requisites (public deed or private authenticated indenture); only in the second instance, when a deed of constitution or a statute lack the necessary requisites, the object of the institution may be recognised on the ground of the activity it exercises (Article 87, comma 4 bis)\(^{297}\). According to the prevailing jurisprudence, the contrast between the declaration of intent, even though properly formalised, and the actual nature of the activity carried out conforms with the latter\(^{298}\). This has furthermore induced the legislator to recognize that “independently of statutory rules, the institution loses its qualification as a non-commercial institution if its prevalent activity is commercial for the entire duration of the fiscal year, even after the application of a series of quantitative criteria\(^{299}\) apt to concretely assess the prevalence of commercial activities as opposed to the institutional (Article 111 bis TUIR).

\(^{297}\) L. CASTALDI, Gli enti non commerciali nelle imposte sui redditi, Torino, 1999, p. 266.
\(^{299}\) According to art. 149 these the quantitative criteria for establishing whether an institution loses its qualification as non-commercial or not:

- a) prevalence of commercial activities in the real estate sector, net of redemption, as opposed to other activities.
- b) prevalence of incomes deriving from commercial activities with respect to normal value of sales or work relative to institutional activities;
- c) prevalence of income deriving from commercial activities as opposed to institutional incomes, the latter being intended as contributions, subsidies, liberalities, association fees;
- d) prevalence of deficits inherent to commercial activities, as compared to the remainder of the expenses.
So far as concerns the discovery of the principal object, the rule specifies that what matters it is the essential activity that enables the fulfilment of the primary aims as required by the law or by the constitution deed.

The central point for qualifying such institutions is therefore the reference to the commercial or non-commercial nature of the activity which is essential to the fulfilment of the institutional aims.\(^{300}\) So far as concerns the connotation of commercial activity, it seems logical to refer to the criteria for attributing the connotation of commercial as established by Article 51, 1\(^{\text{st}}\) and 2\(^{\text{nd}}\) comma, TUIR.\(^{301}\)

2.4 Criteria for establishing residence

The fourth category of passive subjects, constituted by non-resident institutions and companies, is obviously identifiable by virtue of the criterion of territorial location as from the residency. On this point we may note that the law established three alternative criteria of residency: regarded as resident are institutions or companies which for the greater part of the fiscal year have their legal offices, the administrative offices or, finally, the principal object of its activity in the territory of the State (Article 7, 3\(^{\text{rd}}\) comma, TUIR).

The legal location does not pose the problem of eligibility, since this is deduced from the deeds which discipline the organization of the association. The administrative


\(^{301}\) The text of art. 55, c. 1 and 2, TUIR states that:

1. "All funds deriving from commercial enterprise business are regarded as income from enterprise. We regard as commercial enterprise business, the habitual professional exercise, albeit non-exclusive, of the activities contemplated by Article 2195 c.c., and of activities named in Article 32 TUIR such as animal breeding, activities concerning the production, handling, conservation, transformation, commercialisation and enhancement where they exceed specific limits as set in the same article.

2. Are furthermore regarded as enterprise income:

a) funds deriving from the exercise of organised activities as by enterprise, directed to the supply of services which do not fall under Article 2195 c.c.;

b) income deriving from the activity of exploitation of mines and quarries…;

c) income from land, when it pertains to particular companies, or to permanent organizations of non resident persons exercising entrepreneurial activities”.

Activities listed in Article 2195 c.c. as follows:

1) industrial activities for the production of goods and services;

2) intermediate activities in the circulation of goods;

3) land, air, sea transport activities;

4) banking and insurance;

5) auxiliary activities to the above-
location is instead identifiable in relation to the site where the programmes and management relative to the economic activity are located.

This is a de facto criterion.

Another de facto criterion is constituted by the principal object.\(^{302}\)

2.5 Taxable income of non-commercial institutions

The total income of non-commercial institutions as indicated by letter c, section 1, paragraph 73 TUIR is formed by the land income, by the capital gains, by the business income and other incomes wherever produced and whatever destination they have, excluding those not subject to taxation and those subject to withholding tax or to substitutive tax\(^{303}\). In relation to the same institutions, the supply of services not enlisted in paragraph 2195 of the civil code\(^{304}\) (industrial activities whose aim is the production of goods and services, intermediary activities in the movement of goods and auxiliary activities) if they are supplied in compliance with the institutional aims of the entity without any specific organization and if the payment of the consideration does not exceed the directly imputable costs are not considered business activities.

The total income is determined by the summing up of the incomes of each category which contribute to its making.\(^{305}\)

Once the total income had been established, tax deductible are:

1) fees and other burdens bearing on income generating assets;
2) sums paid to employees called to fulfil tasks in electoral offices.
3) contributions, donations and offers benefiting non governmental organizations, up to a value of no more than 2% of the total declared income;

Having thus established the rate applicable to the income, from the total the following are deductible from the gross tax:

1) passive interests and corresponding accessory burdens;
2) expenses supported by subjects obliged to maintenance;


\(^{304}\) See note 5.

\(^{305}\) A. FANTOZZI, *Corso di diritto tributario*, cit., p. 450.
3) liberal donations of monies in favour of the State and of other territorial or non-territorial institutions, ONLUS, social promotion associations, scholastic institutions.
In this way the amount of the net tax is obtained.

2.6 Non-commercial institutions based on membership: ecclesiastical and political organizations.

A particular discipline applies for establishing the income of non-commercial institutions based on membership, with the purpose of taking into account their possibility of carrying out activities (non principal) of concern to its associates. In particular, we confront the problem of ascertaining whether the activity carried out by such institutions based on membership may be qualified as commercial when it is not aimed at the open market, but restricted to its associates.306 The basic rule contemplates the fact that the associates membership fees and contributions paid by members in order to acquire and maintain the position of associate, do not contribute to the overall income (article 148, 1° comma, TUIR ex D.Lgs. 344/2003); furthermore, such rule grants the irrelevant nature as income of such contributions by virtue of their essentially patrimonial nature, and thus ascribable to membership contributions. In line with such provision, it is specified in the same rule that activities carried out for the benefit of associates, if in line with the institutional goals of the same, are in no case regarded as commercial, even when included among those contemplated in article 2195 c.c.

It is also accepted that additional and complementary services rendered to associated upon their specific request and against the payment of sums under whatever description (charge, contribution, complementary fee) are regarded as commercial; thus such sums paid by an associate contribute to the taxable income of the association. It is opportune to remind here that this rule must relate to the provision according to which the nature of commercial activity is excluded wherever such activity consists of a service different from those envisaged in article 2195 c.c. and the money involved does not exceeds the costs of a straight charge (article 148,2° comma TUIR ex D.Lgs. 344/2003)
As a derogation, it is envisaged that specific and additional services are not regarded as commercial even when rendered on payment of specific charges if rendered in “direct satisfaction” of the institutional aims by some kinds of associations. A further derogation establishes that in order to define specific services a commercial nature of the same is recognised in all cases, regardless of any other consideration concerning its relationship with the aims of the association (article 148, comma 4, TUIR ex D.Lgs. 344/2003).

As for political and religious organizations, they are included in this category, they are non commercial institutions based on membership.

Particularly, in no case political movements and parties, trades unions organisations, employers associations, and trade associations are regarded as ONLUS.

As for ecclesiastical organizations, those whose charitable aims are acknowledged by the Ministry of Internal Affairs, are regarded as ONLUS only as concerns the exercise of activities contemplated in order to be qualified as ONLUS, except for the prohibition to undertake different activities from those necessary for the qualification as ONLUS.307

Ecclesiastical organizations also enjoy fiscal benefit with regard to tax on real estate.

The original legislation of ICI (Municipal Tax on Buildings), established by D.Lgs. 504/92 contemplates an exemption for a series of properties as follows:

a) buildings and outbuildings (i.e. oratories) destined to religious practices;

b) buildings belonging to the Holy See;

c) buildings used by public or private institutions which are not chiefly or exclusively devoted to commercial activities (non commercial institution as from Article 73 TUIR), destined exclusively to activities concerning social, educational, recreational, cultural, sport, worship and religion.

Therefore in order to enjoy fiscal exemption, two condition are required:

1) that the buildings are utilised by non commercial institutions;

2) that the buildings are destined to the above activities.

306 A. FANTOZZI, Il diritto tributario, cit., p. 889.

307 A. FANTOZZI, Corso di diritto tributario, cit., p. 452.
Article 7 of D.L. 203/2005 specifies that the extension is applicable only to activities that are not solely commercial. Since neither ONLUS nor religious institutions are exclusively devoted to business, they should continue to benefit from the exemptions. Exemption from ICI for this category seems to be compatible with EU legislation which forbids State subsidies, since it does not affect Member States neither it impairs fair competition or threatens to do so.\(^{308}\)

Finally it is important to remind that to ecclesiastical institutions recognized as juridical entities for civil purposes, and to amateur sport associations, dispositions concerning the loss of qualification of non-commercial institution do not apply. (Article 149, c.4 TUIR).

### 2.7 ONLUS in TUIR system

A specific discipline for determining the taxable income is contemplated for ONLUS; firstly, for such subjects, the carrying out of institutional activities during the pursuit of goals exclusively concerned with social welfare, is not regarded as commercial activity; in the second place the profits deriving from the exercise of activities directly connected (this means accessory and complementary to institutional activities) do not produce taxable income (article 150 TUIR ex D.Lgs. 344/2003).

The generalised “decommercialization” of all institutional activities carried out by ONLUS identifies the character of the same institution, in that it excludes it from the category of commercial institutions; in this we can envisage a significant difference from the derogative facilitation rule envisaged for associative institutions which essentially operates on the basis of an objective qualification of its activities. Furthermore such rule declares the irrelevancy of the income derived from the activities of ONLUS, since it precludes them for fitting in any of the categories producing income.\(^{309}\)

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\(^{309}\) A. FANTOZZI, *Corso di diritto tributario*, cit., p. 453.
3. Legal form and provisions of ONLUS deed

According to art. 10 D.Lgs. 460/97, under the denomination of non profit organizations of social interest (ONLUS organizzazione non lucrativa di utilità sociale) we intend all associations, committees, foundations, cooperative societies and other private institutions with or without legal standing. The statutes or constitutive deeds of these institutions, drafted in the form of public deeds or private agreement authenticated or registered, must expressly envisage:

a) the carrying out of specific enlisted activities, that are social and health assistance; medical assistance; charity; education; training; amateur sport; conservation, promotion and improvement of artistic and historical assets including libraries and heritage; conservation and improvement of nature and environment, with the exclusion of the current work of recycling of urban, special or dangerous waste; furthering of the arts and culture; safeguarding civil rights; scientific research of special public interest, directly carried out by foundations or assigned by them to universities, research institutes and to other foundations which carry it out directly;

b) the sole pursuit of activities with social solidarity contents;

c) the prohibition to undertake different activities from those mentioned in paragraph a) unless directly related to them;

d) the prohibition to distribute, even indirectly, managerial profits and remainders, funds, reserves or capital for the duration of the organization, unless destination or distribution are imposed by law or are done in favour of other ONLUS which by law, statute or regulation are part of the same structural unit;

e) the obligation to employ profits or management residue for the realization of institutional activities and of other activities connected with these;

f) the obligation to hand over the organization’s assets, in case of its dissolution for any cause, to other non profit organizations of social utility or with public utility aims;

g) the obligation to draft a budget or annual account;
h) unified discipline for associational relations and associational rules, aimed at granting the effective existence of the same relation, expressly excluding temporary participation to associated life and preventing associates and participants of major age the right to vote for the approval and alterations of the statute and of the rules and for the appointment of the directors of the same association;

i) the use in the denomination and in any distinctive sign or communication aimed to the public, of the statement “non profit organization of public utility” or of the acronym ONLUS.

3.2 The pursuit of social solidarity goals

Two conditions are provided for in order to establish whether social solidarity goals are pursued or not.

Firstly, it is understood that aims of social solidarity are pursued when the cession of goods and services relative to statutory activities in the fields of health assistance, education and training, amateur sport, promotion of arts and culture and safeguard of civil rights are not intended for the benefit of members, associates or participants or of members of administrative and control bodies but aimed at benefiting:

a) disadvantaged persons on account of physical, psychic, economical, social or family conditions;

b) members of foreign groups, restricted to humanitarian aid.

Secondly, social solidarity goals are intended to be pursued even when among the beneficiaries of statutory activities of the organization there are own members, associates or participants, or members of administrative and control bodies, should they find themselves in disadvantaged positions.

Moreover, besides the two conditions above mentioned, we regard in any case as inherent to social solidarity aims institutional statutory activities carried out in the sectors such as social assistance health assistance, charity, conservation, promotion and enhancement of artists and historical assets.

We regard as directly connected with the institutional ones statutory activities of health assistance, education, training, amateur sport, promotion of arts and culture and safeguard of civil rights, carried out in absence of the conditions above mentioned,
together with activities which are natural accessories to those statutory and institutional being an integral part of the same. The carrying out of connected activities is admitted on condition that in each exercise they fall within the context of each of the sectors which constitute the object of ONLUS’ activities, and that the same are not prevalent in relation to the institutional ones and that the relative profits do not surpass 66% of the total expenses of the organisation.

3.3 Examples of indirect distribution of profits

We envisage in all cases as indirect distribution of management profits or remainders:

a) the sale of goods and services to members, associates or participants, to founders, to members of administrative and control bodies, to those who for any reason operate for the organization or are parties to it, to subjects who liberally donate to the organization, to their families up to third degree and second degree relatives, and to societies directly or indirectly connected or controlled by them, or made on more favourable conditions than quality would suggest; except for activities carried out in the field of conservation, promotion and improvement of artistic and historical assets including libraries and heritage and in the field of conservation and improvement of nature and environment, the advantages given to members, associates or participants and to subjects who liberally donate, and to their families, having a merely honorary significance and little value;

b) the purchase of goods or services at prices which, without economic reasons, are higher than their actual value;

c) the payment to members of the administration and control bodies of individual annual fees above certain levels fixed by legislative decrees;

d) the payment to different subjects from banks and authorised financial brokers, of passive interests, deriving from loans of any kind, above 4% of the official percentage of interests;

e) the payment of salaries and stipends to employed workers which rise by 20% above those contemplated by collective worker’s contracts for the same qualification.
3.4 Special rules regarding foundations, ecclesiastical and political organizations

As for foundations, there is no limit with regard to the sectors in which their activities are to be carried out.

As for institutions recognised by religious confessions with which the State has stipulated pacts agreements or understandings, they are not obliged to unified discipline for associational relations and associational rules, aimed at granting the effective existence of democratic relationships and to use, in the denomination and in any distinctive sign or communication aimed to the public, the statement “non profit organization of public utility” or the acronym ONLUS.

Moreover, ecclesiastical organizations belonging to religious confessions with which the State has stipulated pacts, agreements or understandings and social help associations, whose charitable aims are acknowledged by the Ministry of Internal Affairs, are regarded as ONLUS only as concerns the exercise of activities enlisted in order to be qualified as ONLUS; except for the prohibition to undertake different activities from those mentioned in art. 10 c.1, par. a) D.Lgs. 460/97 (see par. 3.1) unless directly related to them, to the same organizations and associations apply the provisions even the facilitative ones, on condition that for such activities a different set of account books are kept.

In no case regarded as ONLUS are public institutions, commercial companies which are not cooperatives, conferring institutions, political movements and parties, trades unions organizations, employers associations, and trade associations.

In all cases are regarded as ONLUS all voluntary help organizations inscribed in the books instituted by the autonomous regional and provincial administrations of Trento and Bolzano, along with non governmental organisations recognised as fit, social cooperatives and consortia which are 100% constituted by social cooperatives.

3.5 ONLUS registry and the obligation to keep books

Article 11 of D.Lgs. N° 460/1997 prescribes that the ONLUS must provide information on the start of its activity to the competent Regional Directorate of Income, likewise it must notify a loss of the prerequisites which qualify it.
The sole registry of ONLUSs is kept within the Ministry of Finances. Subjects who undertake the activities contemplated in article 10 D.Lgs. 460/97, must give notice within thirty days to the regional tax office of the Ministry of Finances, within whose jurisdiction they reside, in conformity to the provisions issued with special decree by the Ministry of Finances. The above said notice is handed in within thirty days from the date of enforcement of the present decree by the subjects who on the above said date are already involved in the activities contemplated by article 10 D.Lgs. 460/97. To the same tax office must also be notified every subsequent alteration which involves the disqualification from the status of ONLUS. The notification of these communications is the necessary condition for entitlement to the facilitations contemplated for ONLUS. ONLUS must fulfil the obligations of bookkeeping concerning both the overall activity carried out and its commercial activity directly related to its institutional goals of social solidarity.

Organizations must compile proper account books chronologically and systematically conceived and must within four months from the closure of their exercise, compile a special document illustrating their patrimonial, economical and financial situation.

3.6 Control of formal and substantial nature on ONLUS

Controls of ONLUS are the task, on one hand, of the Agency for the ONLUS, by virtue of its entitlement to request the inspection of documents and acquire information, whereas the powers of audit are in the hands of Tax offices and Finance Police. The Revenue has established controls of a formal and of a substantial nature to which ONLUS may be subject, and also specify the sanctions applicable in case of default of the law.310

The inquisitive function of the Agency for the ONLUS consists in its entitlement to carry out series of actions aimed at uncovering violations of the legislative rules and regulations on the part of institutions subject to its control. Its work ends with the sole

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discovery of violations, since the power to apply the corresponding sanctions rests with the Revenue and other competent offices.

Deeper fiscal control are carried out by exercising the power of access, of inspection and verification, applicable in order to ascertain the actual taxable capacity of the passive fiscal subject, and to repress tax evasion and other violations.

As for the powers of fiscal control of Tax Offices, the verification of the formal requisites contemplated by the law plays a fundamental and preliminary role with respect to all other controls, not only because the lack of adherence to even one only of the formal conditions necessary for assigning the qualification of ONLUS, would signify the impossibility of enjoyment of the tax advantages reserved to this category of subjects, but also in consideration of the mechanism for the attribution of the qualification of ONLUS, which in substance consists in a sort of self qualification on the part of the institution, without a pre emptive exam of the questions by an office of the Financial administration.

Within this sector the main inspections are aimed at ascertaining:
- the entitlement of the legal subject in question to acquire the qualification of ONLUS;
- the adjustment of statutory rules to legal requirements;
- activity sector or sectors and the possibility of enjoying tax relief;
- pursuit of social solidarity ends according to legal requirements;
- fulfilment of the obligation to notify the ONLUS Registry;
- the correct use of the acronym ONLUS

The substantial checking up of the activity actually carried out by the ONLUS represents the central point of the audit, even when for the formal check up no irregularity emerges.

Within this sector of enquiry verifications must be carried out by operational Offices coordinated by regional Managerial offices and will be chiefly directed to ascertaining:
- the actual accomplishment of institutional activities, according to statutory requirements;
- the carrying out of any accessory activities;
- the actual role of accessory of any accessory activities with respect to institutional activities;
- the non predominance of accessory activities with respect to institutional activities;
- the observance of the limit of 66% of the income deriving from accessory activities with respect to the entire budget of the institution,
- the absence of other activities;
- the actual employment of managerial leftovers for institutional goals;
- the absence of any, direct or indirect, redistribution of profits.

In case such controls discover the lack of the necessary grounds for the assumption of the qualification of ONLUS, the competent regional Revenue Directorate must notify to the institution in question, with properly motivated argument, of the negative outcome of the audit and its consequent debarment from the ONLUS Registry, which obviously also implies the impossibility to enjoy the relative tax relief benefits. However, before such measure is taken, the Revenue Directorate must listen to the opinion of Agency for ONLUS, even though this may not be binding.

The problem which emerges at this point concerns the consequences of the debarment from the ONLUS Registry. In the past, in fact, the Financial Administration maintained that the loss of qualification is equivalent, from the partrimonial point of view, to the dissolution of the institution, with consequent obligation of devolution of any residual patrimony to another ONLUS or to public utility ends. In Notice N° 14/E of 2003, instead it is said that any undue tax savings will be recovered, with the application of the sanctions contemplated in the decree ONLUS and in individual tax laws.

On the other hand, it appears evident how the problems of verification for the eligibility to the status of ONLUS derive from procedure of attribution contemplated, which as already specified, consists in substance of a kind of self declaration, with no provisions for systematic controls.311

3.7 Assessment of taxable income

As for the assessment of income of ONLUS, rules on the determining of non commercial institutions’ income must be considered.

In fact, according to art. 26 D.Lgs. 460/97, when compatible, rules on non-commercial institutions apply to ONLUS.

So, the total income is formed by the land income, by the capital gains, by the business income and other incomes wherever produced and whatever destination they have, excluding those not subject to taxation and those subject to withholding tax or to substitutive tax. In relation to the same institutions, are not considered business activities the supply of services not enlisted in paragraph 2195 of the civil code (industrial activities whose aim is the production of goods and services, intermediary activities in the movement of goods and auxiliary activities) if they are supplied in compliance with the institutional aims of the corporation without any specific organization and if the payment of the consideration does not exceed the directly imputable costs.

The total income is determined by the summing up of the incomes of each category which contribute to its making.

However, we must consider two fundamental rules about ONLUS which constitute facilitation rules. They are contained in art. 150 TUIR.

ONLUS are tax exempt in their income deriving from commercial activities directly connected with institutional activities but also for commercial activities carried out chiefly and exclusively in direct connection with the pursuit of institutional goals in social work, in such a way as to be regarded as non commercial activity.

3.8 VAT taxation and stamp duty exemption

Since VAT applies to the compulsion, the absence of a subjective lucrative goal constitutes irrelevant circumstance.

The sale of assets and the rendition of services carried out in the course of operation of a non profit institution are fully taxable. This constitutes an antinomy.

In fact, ONLUS are not subjected to the obligation to certify income with receipts of fiscal bill, for what concerns operations connected with its institutional activities. However the other obligations concerning invoicing, record, liquidation, declaration are provided for. This provision can be interpreted only according to the sense that institutional activities enjoy only a formal simplification.
In matters of stamp duty all deeds, documents, contracts are exempted along with copiers even when declared conform, extracts, certifications, declarations, statements created or required by the ONLUS.

A similar exemption applies for government concessions.

According to article 3, D.Lgs. 346/1990 extends to ONLUS the exemption from inheritance and gifts tax provided for non-territorial entities with assistential, educational, scientific research, training goals.\textsuperscript{312}

3.9 Facilitation rules for transfer of assets and carrying out of services to the benefit of ONLUS

The fiscal legislator is furthermore concerned with facilitating all operations both concerning the transfer of assets and the carrying out of services and finances, by both entrepreneurial and not entrepreneurial subjects to the benefit of ONLUS.

According to article 13-bis, comma 1, letter i-bis) TUIR liberal donations in benefit of ONLUS are income tax deductible by 19%, and at any rate for no more than two thousand euro. It is neccessary to remind that according to art. 13, comma 5, D.Lgs. 460/97, the exclusion from taxable income of liberal donations to non governmental organisations is granted on condition that for the above donations the donor does not benefit from tax deductions, as from article 13-bis, comma 1, letter i-bis) TUIR of the same provision.

According to article 65, letter C quinques and C sexies TUIR are deductible from the income of a business as levies of social utility, all liberal donations in money not above four millions or at two per cent of the declared income of the enterprise, and the expenses supported by the same enterprise relative to the hiring of employees employed for an indeterminate time, utilised for rendition of services in favour of ONLUS within the limits of 5 per one thousand of the total of the expenses for services by means of employed labour, as declared in the statement.

According to article 13, comma 2 and 3 D.Lgs. 460/1997 are not destined to goals outside the activity of the enterprise all foods and pharmaceuticals to which production or exchange is directed the activity of the enterprise, when given for free to the ONLUS,
along with assets to whose production or exchange is aimed the activity of the enterprise, different from the first where still given for free: to the end of the restriction of letter C sexsies of article 65 of TUIR we regard as free gift the endowment of such assets only when their value corresponds to a specific cost supported for their acquisition or production which altogether does not surpass the one thousand euro figure.

In such cases the legislator charges the assigning institution with the burden of a pre-emptive communication to the sole competent territorial office and of a specific registration and on the responsibility of the organization a declaration of commitment to employ such assets for activities pertaining to social solidarity.

Article 3 DPR 633/72 does not regard as services rendered subject to VAT all operations concerning advertising carried out for the benefit of the institutional activities of the ONLUS.

According to article 10 D.P.R. 633/72, if in favour of the ONLUS some operations (free gift of goods excluding those whose production or trade does not fall within the proper activity of the enterprise if the cost does not rise above 25 euro and of assets for which a deduction has not been applied at the moment of purchase or import) whereas others, if carried out by the ONLUS (transport of the sick or wounded with properly equipped vehicles, hospitalisation and medical care included, the administration of pharmaceuticals, clinics and food, education of children and youth, teaching of all kinds even for training, updating, professional re qualification and re conversion including lodgings, food, books and stationery, social health care, home help or clinical assistance in a community and similar in favour of the elderly and of disabled adults, drug dependants, AIDS victims, handicapped, minors even if involved in situations such as antisocial behaviour and deviation) are tax exempted.

Article 1 of the attached tariff to D.Lgs. 131/1986 contemplates that for deeds of transaction on payment of real estate and for other transactions or transfer of real rights of benefit on real estate in favour of ONLUS the registration tax amount will be fixed, but on condition that in the deeds the intention of utilising directly the assets should be stated and that they are purchased for the purpose of carrying out institutional activities and that their utilisation should take place within two years from the date of purchase.

In fact the legislator has found an innovative instrument for financing ONLUS in the certificate of solidarity whose emission constitutes for the seller a tax deductible cost from the income of enterprise of the seller in the measure of the difference between the rate effectively applied and the rate of reference determined by inter ministerial decree on condition that the seller grants an exclusive destination of the funds collected and/or put aside even with separate management. As for Regional tax on productive activity (IRAP, “imposta regionale sulle attività produttive”), ONLUS are not regarded by the legislator as passive IRAP subject.313

4. NON-COMMERCIAL NON-RESIDENT INSTITUTIONS AND NON-PROFIT ORGANIZATIONS ACTIVE TRANSNATIONALLY.

4.1 Taxable income of non-commercial non-resident institutions

As above said, the fourth category of passive subjects to IRES is constituted by non resident institutions and companies. Institutions and companies which for the greater part of the fiscal year have their legal offices, the administrative offices or, finally, the principal object of its activity in the territory of the State are regarded as resident(Article 7, 3rd comma, TUIR).

As for non commercial, non resident institutions, the global earnings of such a typology of institution, is only composed by the profits generated within the territory of the State, determined according to the source taxation of income principle and to the provisions contemplated by Title 1 TUIR relative to the categories within which individual earnings are ascribed, “with the exclusion of tax exempted ones and those subject to taxation at source or substitutive taxation”.314

In order to establish which income is produced in the territory of the State, we must refer to what is contemplated in Article 23 TUIR.

For the application of tax to non residents we regard as produced within the territory of the State:

a) income from real estate located within the State;

313 V. FICARI, ONLUS, cit., p. 6
314 A. FANTOZZI, Corso di diritto tributario, cit., p. 453.
b) capital gain paid by the State, by subjects resident within the State or by permanent organizations existing in the territory owned by non resident subjects, with the exclusion of interests and other income deriving from bank deposits and bank or postal current accounts;

c) enterprise income deriving from activities carried out in the territory of the State by stable organizations;

d) different income deriving from activities within the territory of the State and from assets located within the same territory, and increases deriving from the handing over of burdensome stocks and shares of resident companies.\footnote{315}{G. PROVAGGI, \textit{L'assoggettabilità ad IRES degli enti «non-profit»}, in \textit{Corr. Trib.}, 2003, p. 3130.}

Moreover, it seems that incomes deriving from self-employment contributes to the making of the total income.\footnote{316}{BAGGIO, FIORESE, \textit{Società ed enti non residenti}, in \textit{Giur. sist. dir. trib.}, 1996, p. 326.}

As for any other matter concerning the taxation of non-commercial, non-resident institutions, we must consider the respective rules concerning non commercial resident institutions.

4.2 Non-profit institutions and charities resident in Italy and active transnationally

In a world pervaded by globalisation, state borders appear to be breaking up under the pressure of interests which national economic systems no longer satisfy. These are interests tied not only to the running of commercial and entrepreneurial activities, thus pertaining to multinational firms, but also to the interests of civil society (scientific, philanthropic, technical, social, political) and which may find satisfaction only through cooperation among bodies subject to different state departments. Often, in this context, Italian ONLUS feel the need to expand their activity abroad (a need felt with particular urgency, for example, in the field of human right protection).\footnote{317}{A. DEL VECCHIO, \textit{Giurisdizione internazionale e globalizzazione}, Milano, 2003, p. 104.}

How does the Italian legislator regulate this new situation?

In an abstract way, there is no difference between the treatment of an ONLUS active nationally and an ONLUS active also transnationally. If the entity is resident in Italy, it will be taxed according to the worldwide income taxation principle and if the entity is...
correctly identified in ONLUS registry and so owns all the requirements provided for by Italian law, it will enjoy fiscal facilitation rules also with regard to abroad activities. The problem of double taxation has been solved by introducing a method of avoiding double taxation, especially the credit method, which allows to consider foreign taxation and to deduct foreign tax paid from domestic tax which is due.

As for the receipts of funds from a foreign country, it does not constitute relevant taxable income also at an internal level and so it is irrelevant also at an international level.

As for the gifts from foreign country, we should consider the general rule provided for by article 13-bis TUIR: liberal donations in benefit of ONLUS are income tax deductible by 19%, and at any rate for no more than two thousand euro. As for gifts tax if the donor is non resident of the State, the tax must be restricted to assets and rights existing in Italy and a tax exemption will be enjoyed by the beneficiary ONLUS which however is charged by the burden to show, within 5 years from the donation, that it has employed whatever it has received (or what it has gained by the sale of what it has received) for the purpose of health care, study, scientific research, education, training or other public utility goals, according to the general rule.\textsuperscript{318}

It is neccessary to remind that according to art. 13, comma 5, D.Lgs. 460/97, the exclusion from taxable income of liberal donations to non governmental organizations is granted on condition that for the above donations the donor does not benefit from tax deductions.

4.3 Non-profit non resident institutions and charities active in Italy.

As for this kind of entities, the total income will be determined according to source income taxation principle and we must consider the general rule applying to non-commercial non resident institutions.

As for the supply of funds from Italy, they will not be taxed if the foreign institutions is identified as no-profit institution or as non-commercial institution based on membership.

\textsuperscript{318} V. FICARI, \textit{ONLUS}, cit., p. 8.
As for gifts made from Italy, for the donor in order to enjoy the fiscal deduction above mentioned and for the institutions in order to enjoy the gifts tax exemption provided for ONLUS and other kind of institutions, there is the need of enrolment in ONLUS registry or the need to check the presence of Italian requirements.

It is nececcary to remind that according to art. 13, comma 5, D. Lgs. 460/97, the exclusion from taxable income of liberal donations to non governmental organizations is granted on condition that for the above donations the donor does not benefit from tax deductions.

It is important to remind that, near to this condition, as for concerns foreign public institutions and foundations and associations constituted abroad, exemptions will generally be applied according to reciprocal agreements.

5. Stauffer Case and Compatibility with Community Law

5.1 The four freedoms

Art. 14 of the EC Treaty provides for an “Internal Market” which “shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty.”

The free movement of goods between Member States can be deemed the core of the Common Market. It does not only comprises the Customs Union but it is also based on a ban on quantitative restrictions and measures having equivalent effect, as well as on a ban on fiscal discrimination with regard to imports and exports between Member States.

The free movement of persons followed upon that of goods. The Treaty was committed to allowing for unfettered choices to be made on an economic basis throughout one single integrated market and it was deemed essential that persons should be left free to participate in this process. A fundamental distinction is to be made between workers, i.e. employed people, and self-employed people. The employment markets work out very differently for one category and the other. With regard to the second category, the right of establishment is guaranteed by art. 43 of EC Treaty: “freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms….., under the
conditions laid down for its own nationals by the law of the country where such establishment is effected…”. Beneficiaries of this right of establishment are companies and firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community.

The free movement of services plays a residual role.

As for the free movement of capital and payments, all restrictions on the movement of capital and on payments between Member States and between Member States and third countries shall be prohibited. Similarly to the regime for goods but contrary to what applies for the right of establishment and the free movement of services, those freedoms benefit not only nationals of Member States but everyone.

5.2 Stauffer case: legal context, facts and preliminary ruling

Case C-386/04 regards the reference for a preliminary ruling under art. 234 EC Treaty from Bundesfinanzhof (Federal Finance Court of Germany), which is concerned with the interpretation of certain provision relating to the free movement of persons, services, capital and payments, especially Article 73b of the EC Treaty (now Article 56 EC). The reference arose in proceedings between the “Centro di Musicologia Walter Stauffer”, a foundation established under Italian law, and the Finanzamt München für Körperschaften (Munich Corporation Tax Office) (‘the Finanzamt’), concerning the liability of certain income to corporation tax for the 1997 tax year.

With regard to the legal context of the case, we must distinguish between Community discipline and national legislation.

As for the Community discipline, it is important to say that investments in real estate on national territory by non-residents constitute a category of capital movements.

As for the national legislation, the normative discipline regarding corporation tax states that corporations, associations of persons and bodies of assets neither managed nor established in Germany, on their domestic income shall be subject to limited liability to corporation tax; entities which, under their statutes, act of foundation or other constitution and under their de facto management, pursue exclusively and directly charitable, benevolent or other religious objects shall be exempt from corporation tax.
The exemption shall be excluded if commercial activities are undertaken and shall not apply to persons with limited tax liability. Rental income, where the immovable property, conglomerations of property or rights are located in Germany, shall be domestic income for the purposes of limited income tax liability.

The foundation, which is recognised as having charitable status under Italian law, carries out activities in the field of education and training in Italy and Switzerland and is the owner of commercial premises in Munich. The Finanzamt assessed the income the foundation received from rental of that commercial property to corporation tax for the 1997 tax year. The services ancillary to the rental of that commercial property are provided by a German property management agent. The foundation satisfies also the conditions laid down by German law in order to be qualified as having charitable status and the letting of the property did not constitute a commercial business. So in a way of principle, it should be exempted from corporation tax. However, since the foundation’s seat and management are in Italy, the rental income it receives in Germany is subject to limited tax liability. Accordingly the tax exemption does not apply to taxable persons with limited tax liability and the foundation was assessed to corporation tax on the rental income it received in Germany from the letting of the commercial property.

After the judgements of various courts, the Bundesfinanzhof (Federal Finance Court) decided to stay the proceedings and to ask the Court for a preliminary ruling. By its question, the Bundesfinanzhof asks whether the provisions of the EC Treaty relating to the right of establishment, the free movement of services and capital preclude a Member State, which exempts from corporation tax rental income received in its territory by charitable foundations with, in principle, unlimited liability to tax if they are established in that Member State, from refusing to grant the same exemption to a charitable foundation governed by private law in respect of similar income on the basis that, as it is established in another Member State, it has only limited liability to tax in its territory.

The foundation cannot rely on the provisions concerning the right of establishment because the foundation does not have a permanent presence in the host Member State. On the other hand, the foundation can rely on provisions concerning the movement of capital, because free movement of capital covers both the ownership and administration of such property and it is not therefore necessary to consider whether the foundation acts as a provider of services.
Does the application of domestic legislation produce a restrictive effect on charitable foundations established in other Member States? In order to answer this question, we should consider that the ban on restrictions on free movement of capital (art.73b), takes effect without prejudice to the right available to Member States to distinguish between taxpayers who are not in the same situation with regard to their place of residence or the place where their capital is invested. However those restrictive measures cannot constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments. The difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest, such as the need to safeguard the coherence of the tax system or effective fiscal supervision.

However in this particular case, ECJ states that:

1) on the one hand, it is not a requirement under Community law for Member States automatically to confer on foreign foundations recognized as having charitable status in their Member State of origin the same status in their own territory, but, on the other hand, in the case of a foundation such as Stauffen Foundation which, recognized as having charitable status in one Member State, also satisfies the requirements imposed for that purpose by the law of another Member State, the authorities of that Member State cannot deny that foundation the right to equal treatment solely on the ground that it is not established in its territory.

2) among the arguments on reasons of general interest, the Finanzamt maintains that the tax legislation is justified, firstly, by the difficulty of ascertaining whether, and to what extent, a charitable foundation which is established abroad actually fulfils the objects laid down in its statutes in accordance with national law and, secondly, by the need to monitor the effective management of that foundation. According to ECJ, these are disadvantages of a purely administrative nature which are not sufficient to justify a refusal of equal treatment. The tax authorities are free to require a charitable foundation claiming exemption from tax to provide relevant supporting evidence to enable those authorities to carry out the necessary checks and there is mutual assistance between the different tax authorithies of Member States.

Also arguments based on the cohesion of the national tax system, the need to protect the basis of tax revenue, general assumption of criminal activity are not accepted.
Accordingly, Article 73b of the EC Treaty, in conjunction with Article 73d of the EC Treaty, must be interpreted as precluding a Member State which exempts from corporation tax rental income received in its territory by charitable foundations which are established in that Member State, from refusing to grant the same exemption in respect of similar income to a charitable foundation established under private law solely on the ground that it is established in another Member State.

5.3 Compatibility of Italian system with Community law

Is the Italian taxation system concerning non-profit organizations compatible with Community law provisions? Is it discriminatory towards non-profits organizations constituted in other Member States? In order to check the compatibility of our tax law with EC law, we can say that there are not special rules for non-resident and non-profit institutions. Non-profit institutions may have their registered office abroad. However non-profit institutions must give notice and identify themselves to the regional tax office of the Ministry of Finances. So non-profit organizations instituted according to the law of a foreign country may carry out their activities in Italy but in order to enjoy fiscal benefit they must be registered in ONLUS registry and the need to be registered in Italy, in an abstract and concrete way, may be discriminatory and may constitute an hindrance for intra-community activities. This need of registration appears incompatible with European system especially with regard to certain statements contained in Stauffer’s judgements. In this case the Court challenges the arguments of the Finanzamt, according to which the conditions under which Member States confer charitable status on a foundation, which entails the grant of tax benefits and other privileges, varies from one Member State to the other, according to each State’s conception of public utility and ‘charitable purposes’. It follows that a foundation which meets the requirement imposed by Italian law may not be in a comparable situation to a foundation which meets the requirements imposed by German law since it is highly likely that the requirements applicable in each Member State concerning the conferring of charitable status are different and this difference implies that an unequal treatment between domestic and foreign institutions may be acceptable. The Court rejects those arguments. Whilst it is not a requirement under Community law for Member States
automatically to confer on foreign foundations recognized as having charitable status in their Member State of origin the same status in their own territory (Member States have a discretion in this regard that they must exercise in accordance with Community law and in those circumstances, they are free to determine what the interests of the general public they wish to promote are by granting benefits to associations and foundations which pursue objects linked to such interests in a disinterested manner) nevertheless, the fact remains that where a foundation recognised as having charitable status in one Member State also satisfies the requirements imposed for that purpose by the law of another Member State and where its object is to promote the very same interests of the general public, which is a matter for the national authorities of that other State, including its courts, to determine, the authorities of that Member State cannot deny that foundation the right to equal treatment solely on the ground that it is not established in its territory. It seems that this binding sentence implies that a national judge, facing with the request by a foreign non-profit entities of enjoying fiscal benefit provided for by Italian legislator in favour of non-profit institutions, should consider the substantial nature of the entities, regardless the lack of enrolment in ONLUS registry.

As for concerns the receipts of funds from foreign income, this is not an hindrance to Community integration because membership fees and contributions paid by members are irrelevant for fiscal purpose also at an internal level.

As for concerns gifts in favour of ONLUS\textsuperscript{319}, if the donor is non resident of the State, the tax must be restricted to assets and rights existing in the State and he will enjoy the fiscal benefit only if his national State recognizes a fiscal deduction in this case. If the donor is resident within the State the tax is due on all assets and rights transferred even if situated abroad. If the donee entity is foreign, according to our national law, in order to enjoy fiscal benefit, the donor must inform the financial administration and the foreign non-profit organizations must identify itself and satisfy Italian requirements. This control, on the one hand, if considered as a control of a substantial nature and not as a merely formal need of enrolment, appears reasonable but it may constitute an hindrance for the receipts of gifts from other Member States.

\textsuperscript{319} See charter 6, paragraph 3.
5.4 Can an European Foundation be a solution?

In this context the creation of a registry at European level for non-profit Institutions may be a reasonable solution. Nowadays the uniformity of market access conditions is a fundamental goal and through the building of an European foundation, of a sole registry, this result could be finally achieved.

6 Inheritance and Gifts Tax

6.1 Normative evolution and legal context

D.L. 262/2006 as converted by L. 286/2006 has reintroduced the inheritance and gifts tax (suppressed in 2001), bringing back the legal structure of the text concerning successions and donations (D.Lgs. 31st October 1990, N° 346), except for what has been differently arranged by the new laws.

The most relevant innovative aspect consists of the taxation on not only free transfers of assets mortis causa or due to donation or to liberal act, but also on other free transfers and on the constitution of bonds of destination.

It is useful to mention the normative development of the discipline regarding taxation on free transfer “inter vivos” and “mortis causa”.

The tax concerned, firstly disciplined by D.P.R. 637/72, has been the object of a legislative amendment, aimed at creating a systematic discipline and brought about with D.Lgs. 346/90. This new discipline was strictly linked with the discipline of other taxes, like registration tax.

It is important to underline that, whilst the D.P.R. N° 637/1972 acted upon the gratuitous transfer of assets and rights, the reform that followed (D.Lgs. N° 346/1990) restricted the applicability of this tax to transfers by means of “donation or other liberal act between living parties”, thus restricting its applicability to liberal and gratuitous acts.

The same discipline, already subjected to substantial changes by virtue of L. 342/2000, has been de facto shelved as a consequence of the total suppression of the inheritance
tax and of the partial suppression of the tax on donation and on other liberal acts, provided by article 13 of L. N° 383/2001.

The legislator of 2006, according to a preliminary interpretation, therefore, had to bring back a series of rules which, in substance, had only temporarily been “forgotten”. The action of the tax now reintroduced is therefore based upon a series of substance and procedure rules, still based on D.Lgs N° 346/1990, to which the novelties introduced by the financial law are added (Law 296/2006), regarding applicable tax rates and franchises.

So, the treatment of this subject the present work will be organized by dealing with provisions of D.P.R. 637/72 and D.Lgs. 346/1990 and then by dealing with novelties brought about by the recent legislation.

6.2 The object of tax and passive subjects

The inheritance tax falls under the heading of indirect taxation. The context of this tax is the transfer of wealth by succession “mortis causa”. Inheritance tax applies to the increase in assets which the beneficiary enjoys and which once belonged to the “de cuius”.

Article 2 of D.Lgs. 346/1990 specifies that the tax also concerns assets outside the national territory.

The article, specifies, at comma 8, that even in case of the deceased’s bankruptcy, the tax applies to the activities which come to the inheritors after the bankruptcy closure. This confirms that the object of the tax is the patrimonial gain enjoyed by the inheritor.

The inheritance and gifts tax is applied to transfers of assets and rights depending on succession and for reasons of death, and to the transfer of assets or rights between the living.

The tributary law anticipates the moment of taxation by making it coincide with the call to the inheritance. The taxation rules demand certain fulfilments and among them the payment of the tribute, independently of its acceptance.

Article 28, comma 2 D.Lgs. 346/1990 of the above mentioned decree contemplates that the called to the inheritance and their legal representatives, the temporary named attorneys or temporary holders of the assets of the deceased, the administrators of the
legacy, the curators of the legacy and the executors of the will, as well as all those called to the inheritance who have not yet accepted it, and all the others who are obliged to declare the succession, to answer for the tax within the limits of the value given to the assets as assigned to each one, these are all expected to present a declaration.

The other presupposition concerning the tax is the deed for the gratuitous transfer of assets between the living, this is to say any deed lacking financial dues.

The object of this tax is the deed of gratuitous transfer in the widest sense.

The passive subjects of inheritance and gifts tax are the heirs, legatees and donees. To these categories those called to the legacy, the administrators and curators upon whom rests the responsibility to provide to the payment of the tribute if and for the amount of the inherited assets, are to be added.\textsuperscript{320}

6.3 Determination of tax

If the “\textit{de cujus}” or donor is a resident, then his assets abroad constitute patrimony subject to taxation.

If he is non resident, the tax is only due for his assets in Italy.

The amount of chargeable tax derives from the difference between the active mass of all assets, and the debts carried by it.

The tax affects the net patrimonial increase.

Article 10 D.Lgs. 346/90 rules that also assets and rights subject to tax which have been transferred to third parties as burdens during the last 6 months in the life of the deceased concur to the formation of the chargeable tax.

The parameter for establishing the measure of the tax is the exchange value of the transferred assets, defined by the law as selling value on the opening date of the succession.

The revenue has power to verify the declared value, and the deed of rectification must be registered within two years from the liquidation of the principal tax.

The law subordinates the deduction of the passive from the active inherited, to its pre-existence on the date of opening of the succession. The maximum term for the

documentary demonstration of the inherited debts is of three years from the date of opening of the succession procedure.

The series of tax rates is twofold. The first group concerns the global patrimony going for succession and the second the single items of the inheritance.

Article 7 D.Lgs. 346/1990 rules that towards the spouse and the direct descendants, the tax is established by applying only the rates applicable to the global value of the legacy; in all other cases the two rates apply jointly.

Article 8 D.Lgs. 346 /1990 rules that a tax equal to the actual one applied to all donations made by the deceased to heirs and legatees must apply to the global value of the legacy.

6.4 Procedure for the enforcement of the tax demand

The declaration of succession is the first deed that informs the revenue on the existence of a presupposed tax applicable.

Its effect is that of causing an examination of taxable elements by the revenue.

The term for the denunciation is six months from the opening of the succession procedure; article 31 D.Lgs 346/1990 regulates cases in which the devolution occurs after the opening of the succession: in such case the term starts from the date in which the different event has occurred: for example in case of acceptance with benefit of the inventory.

The revenue has the power of checking on the statements and of initiative for ascertaining unknown taxable items.

According to articles 33 and 34 D.Lgs. 346/1990 the revenue can: a) liquidate the tax relative to declared values by correcting material errors; b) rectify the same values in order to balance them against their pecuniary consistency; c) ascertain the existence of assets and rights omitted by the taxpayer.

With this rule we define the obligation of the taxpayer by establishing a sum of money. The liquidation must be notified to the signatory of the declaration.
The taxpayer must pay the amount within 99 days from the date of the notice showing the amount.  

The law recognises the right of the revenue to cash in part of the due tax (1/3) even during the course of a legal case concerning the legitimacy of the taxation.  
The legislation demands a series of obligations and prohibitions from third parties in order to indirectly insure the fulfilment of the fiscal obligations.

6.5 Gifts tax

The gifts tax is disciplined by D.P.R. 26/10/72 N° 637, which includes two articles: 55 and 56.  

Article 55 of D.P.R. 26/10/72 N° 637 declares applicable to the gifts tax the rules relative to the inheritance tax, among other the ones concerning the basic tax rate, chattels, verification of major value, etc.  
The first comma of article 56 D.P.R. 637/72 rules that the deeds of donation are subject to fixed term registration, according to the provisions concerning registration tax applied to public documents. The reference to the rules on registration tax applies also to the payment and cashing of the tax.  
The tax on donations is established on the basis of the whole net value of the assets and rights which form the object of the provisions, by applying the tax rates determined by law, divided among the donnees in proportion with the assets and rights attributed to each. If the donnee is not a spouse or kin in direct line, the tax is increased by an amount and by the value of the assets distributed to each of the beneficiaries.  
The object of this tax is the free transfer of a right. If the donor is non resident of the State, the tax must be restricted to assets and rights existing in the State. If the donor is resident within the State the tax is due on all assets and rights transferred even if situated abroad.  

Article 3 D.P.R. 637/72 contemplates an exemption of the tax for the transfer of assets to the State, to regions, to provinces, to communes and to public institutions, to foundations and legally acknowledged associations and non profit public hospitals,

which are solely devoted to health care, study, scientific research, education, training or other public utility ends.

Public institutions, foundations or recognised associations, different from the listed above, enjoy also fiscal advantages, but transfers in their favour are tax exempted only when aimed at the same activities. In these cases the beneficiary must show, within 5 years from the donation, that it has employed whatever it has received (or what it has gained by the sale of what it has received) for the purpose of furthering the above said aims as indicated by the donor: in default of such evidence, the exemption will be invalidated and tax will become due with the addition of legal interests. Finally, so far as concerns foreign public institutions and for foundations and associations constituted abroad, exemptions will be applied according to reciprocal agreements. 322

6.6 Novelties introduced by D.L.262/2006 and by financial law for 2007

Novelties are concerned with objective, subjective and territorial requirements for taxation.

The most relevant novelty emerges exactly in consideration of the expansion of the objective requirements for taxation. With D.L. N°262/2006 the cases in which the tax is due has been significantly extended; the regulations appear to include not only mortis causa transfers, donations and other gifts between the living, but also every other free gift as well as acts that do not necessarily involve transfers, but acts of only a “binding nature”, such as the constitution of a patrimonial fund or bond of destination on specific registered chattels, real estate, or shares.

Therefore the object of inheritance and gifts tax is not only every free transfer, according to the system already provided for by D.P.R. 637/72 but also other cases which do not implies transfer.

This aspect confirms that the requirement for taxation is not the mere transfer but the patrimonial increase, enjoyed by the beneficiary, according to the prevailing jurisprudence.323

As for the subjective requirements for taxation, we must distinguish between the qualification as donor or as the person who disposes of his own property and the situation of beneficiaries.

As for concerns the first aspect, in deeds between living it is not necessarily a physical person.

As for concerns the second aspect, a progressive rate of taxation is provided for with the rewarding of the nearest degrees of kindred, along with an ever wider franchise.

Going on to the territorial scope of the tax, this will apply according to worldwide taxation principle concerning bodies residents in Italy, independently from the residence of the beneficiaries of wealth accumulation/transfer, while it follows a source taxation principle for other subjects which see tax demands from the Revenue restricted to the sole assets existing in the national territory.

The gift, in order to produce its juridical effects, is to be drafted in the form of public deeds and to be registered.

Therefore, next to the tax on donation or succession also the registration tax is due.

Rules concerning the territorial criteria for establishing the application of registration tax are different from those concerning inheritance and gifts tax.

The registration tax, by virtue of its nature of deed tax, is generally due every time a deed is presented or utilised, independently of the residence of the subjects or the location of the assets object of the deed.

However Article 55, comma 1-bis, D. Lgs. 346/1990 expressly states that deeds concerning direct or indirect donations, made abroad and having beneficiaries resident in Italy are subjects to a fixed term registration.

From the joint effect of regulations concerning territoriality, thus derives, on the one hand, the application of inheritance and gifts tax when the giving cause is resident, or when the deeds have as their object assets located in Italy independently of the residence of the person who disposes of his property or of the beneficiaries at the moment of the transfer. On the other hand, registration tax applies to gifts, other free transfer between living and destination bond in favour of beneficiaries resident in Italy.

Among the novelties introduced by the Financial law, we must consider the different rates and exemptions, to be utilised in settlement of the tax:
- the rate of 4 per cent on the attributed comprehensive net value exceeding the franchise of 1,000,000,00 Euro in case the beneficiary is a spouse or direct relation;
- the rate of 6 per cent in case of relations within the fourth degree, or kin in direct or lateral line, with the exception of a franchise for each beneficiary, within the degree of brother or sister equal to Euro 100,000,00 on comprehensive net value;
- the rate of 8 per cent, without any franchise, in case of transfers to subjects different from the previous;
- in all cases independently from the degree of relation of the beneficiary, it is introduced a special franchise of 1,5 million Euro for a seriously disabled beneficiary.324

7. DISCIPLINE OF TRUST

7.1 Civil discipline and constitutive elements of trust

The last legislative input, before the financial law for 2007, into the discipline of trust is L. N° 364 of October 16, 1989, with which we notify without reservations the Hague Convention of 1/07/1985 for the acknowledgment of the institution of trust. According to Article 2 of the Hague Convention, with the term “trust” we intend the juridical relations established by a person, the SETTLOR with a deed between the living or “mortis causa” when the assets are placed under the control of a TRUSTEE in the interest of a beneficiary or for specific ends.325

There are three subjects in the institute of trust: the SETTLOR, the TRUSTEE and in case one or more beneficiaries.

The constitutive elements of a trust are:
1) the assets of a trust constitute a distinct entity and are not part of the trustee’s and settlor’s estate (i.e. patrimonial segregation);

2) the assets of the trust are held in the name of the trustee or of another person on behalf of the trustee;
3) the trustee is invested with the power and the burden of the obligation for which he must answer, to administer, manage or dispose, of the assets according to the rules of the trust and the specific rules imposed by the law.
According to the rules of the Convention the trust is regulated by the law chosen by the settler.
When the chosen law does not provide for the establishment of trust or for the trust as such, the choice will be invalid and the national law which the trust has the closest relationships with, will be applicable: in order to establish the existence of this link, we should consider trust’s seat of administration, assets’ situation, trustee’s residence or seat of affairs, objectives and places where such activities will be carried out.
Moreover, art. 13 of the Convention states that States are not obliged to acknowledge a trust whose essential elements (which are meant to be the assets placed under the control of the trustee and the beneficiaries of trust) are more closely connected with States not providing for the institute of trust or the category of trust.
Article 13 of the Convention contemplates that the acknowledgment of a trust has a number of fundamental effects:
1) personal creditors cannot seize the assets of the trust;
2) the assets of the trust are separate from the trustee’s estate in case of his insolvency;
3) the assets of the trust do not enter into the matrimonial field and into the succession concerning the assets of the trustee.
The actual scope of ratification law has generated a wide debate, based on the fact that Italian legislator has not introduced internal amendments, necessary for an actual receipt of trust’s institute. So, according to a part of jurisprudence and case-law, the Hague Convention has not introduced trust’s institute in substantial law within single States, such as Italy, which have not an internal legislation on trust. The Hague Convention would not acknowledge internal trust, that is, according to prevailing trends, a trust instituted in Italy according to the law of another States by Italian residents and concerning assets or activities located in Italy.
However, according to the prevailing jurisprudential opinion, a different interpretation of Hague Convention stands for the admissibility of internal trust: States which have not a specific legislation of trust can acknowledge the institution of trust. We consider as possible the choice of a foreign law as law applicable to trust even if the regulated situation does not present any element that has nothing to do with Italian system.326

7.2 Trust’s juridical subjectivity and fiscal discipline

As for the fiscal discipline concerning a trust, what was the fiscal discipline regulating trust before entry into force of L. 296/2006?

Article 19 of the Hague Convention leaves untouched the autonomy of each country so far as concerns fiscal aspects, however, the Italian legislator has never issued any fiscal provision concerning the trust before Law No 296/2006.

The lack of domestic regulations of civilistic nature created a “normative gap”; in this context a case-by-case analysis of the various kind of trust was carried out by the usual procedure and the case-law.

As for the dispute on trust’s juridical subjectivity, the latest dominant ministerial opinion regards the trust as a taxable passive subject.

According to the prevailing guidance, in the institute of trust it should be possible to find the essential elements as indicated by Italian regulations (art. 73, comma 2, TUIR) which regard as passive taxable subjects to corporate income tax “all other organisations not belonging to other passive subjects towards which the ground for taxation exists in autonomy.”

As for the dispute on trust’s juridical subjectivity, the latest dominant ministerial opinion regards the trust as a taxable passive subject.

First of all, trust should constitute an “organization” in fiscal terms since it is endowed with patrimonial separation, with its own purpose and autonomous administration.

In the second place, trust does not belong to other passive subjects: the settlor gives up his rights in favour of third persons; the trustee, by virtue of bonds existing on assets

326 R. PARISOTTO, A. CERVONE, Trattamento fiscale del trust alla luce della Finanziaria per il 2007, cit., p. 945.
conferred in trust, can’t enjoy these assets and gain any advantage or patrimonial increase from those; the beneficiaries have not right to directly collect profits related to trust.

In way of principle, we must distinguish between incomes deriving from the managerial work of trustee and incomes in case distributed to final beneficiaries, by virtue of settlor’s statements. In other words we must separate the position of the trust as autonomous passive subject liable to answer of the fiscal obligation with the assets assigned to it by the settlor, from that of the fiscal beneficiaries where they are recipients of profits deriving from the same managerial activity.

The natural problem of double taxation can be easily solved by considering as tax deductible incomes distributed to beneficiaries; such deduction is to be regarded as a negative element of business income when the trust has as main or prevailing object the carrying out of a commercial activity or as deductible burden when the trust is a non commercial institution.

Taxation on beneficiaries depends on the nature of the economic attribution they enjoy:
1) we would have no direct taxation when the economic attribution implies the transfer of the ownership of assets before belonging to trust. In this case, such transfer represents the moment at which the definitive attribution of ownership is realized and the requirements for the indirect taxation on gifts are complied with.
2) rules on capital gains taxation should be applied when the distribution of wealth deriving from the managerial activity of trustee is the object of the economic attribution. At any rate, we must stress that the passive subjectivity of the trust is a generalization, whose validity needs to be examined in each case since it must derives from a concrete state of affairs.

The problem of IRES taxation of the trust must be also examined from the point of fiscal residence.

In relation to this problem, the possibility to find in the trust those elements which identify as passive subjects to corporate income tax “also other organizations not belonging to other passive subjects towards which the ground for taxation exists in autonomy” is to be determinated only with regard to resident trust and not with regard to non resident trust, which should be regulated, as for this aspect, by articles 151 and 152 TUIR (assessment of income of commercial non resident institutions) or articles
153 and 154 TUIR (assessment of income of non commercial non resident institutions), whether the trust has as main object the carrying out of a commercial activity or not. 327
The criteria for establishing whether a trust is resident in the territory of the State are the same which must be adopted for any other passive subjects to IRES.
Regarded as resident in the territory of the State as concerns IRES are the institutions which for the greater part of the taxable period have their legal address, or the seat of their administration, or their principal object in the territory of the State (art. 73, c.3 TUIR).
On the one hand the criterion of the legal seat is not applicable to trust, on the other hand the seat of administration is considered as the place where key-decisions are taken. According to OCSE Commentary, it is generally the residence of trustee.
We can say that, before the innovations introduced by financial law for 2007, trust was considered as passive subject to corporate income tax, except for the need to check, from time to time, the essential elements of patrimonial segregation from settlor’s assets.328

7.3 New aspects of the financial law for 2007

Article 1, commas 74-76 of Law 296 of 27/12/2006 (financial law for 2007) has introduced some important innovations within the fiscal discipline of the trust.
1) Article 73 of TUIR states that subjects to business income tax are: public and private institutions which are not companies, and also trusts residents in the territory of the State which has as their exclusive or chief object the exercise of commercial activities; trusts which do not have as their exclusive or principal object the exercise of commercial activities; companies and institutions of any kind, including trusts, with or without juridical status, non resident in the territory of the State.

327 R. PARISOTTO, A. CERVONE, Trattamento fiscale del trust alla luce della Finanziaria per il 2007, cit., p. 945.
328 R. PARISOTTO, A. CERVONE, Trattamento fiscale del trust alla luce della Finanziaria per il 2007, cit., p. 945.
2) To Article 44, comma 1 of the TUIR the letter *g-sexies* is added and are regarded as capital gains the gains attributed to the beneficiary of the trust even when non residents.

3) Article 13 of D.P.R. 29.9.73 N° 600 is modified. For the purpose of fiscal control are obliged to keep books: public and private institutions different from companies, subject to the tax on juridical persons, and trusts which have as their exclusive or principal object the exercise of commercial activities; also trusts which do not have as their exclusive or principal object the exercise of commercial activities.

4) The financial law does not contemplate any criteria to ascertain the fiscal residency of the trust to which, therefore, general rules regarding any other passive subject to IRES are applied. The financial law, however, introduces two new presumptions of Italian residency for the trust. Regarded as resident in Italy are, unless proved wrong, trusts instituted in different countries from those of D.M. 4 September 1996\(^{329}\) (“White List countries”\(^{330}\)) where at least one of the disposers and at least one of the beneficiaries are fiscally resident in the territory of the State. Regarded in any case as resident in Italy are trusts instituted in a different country from the “White List” ones, when after their constitution a resident subject in the territory of the State makes a donation in favour of the trust which involves the transfer of property of real estate or the constitution or transfer of real estate rights, along with destination bond on the same assets.

According the main condition in order to establish the fiscal regime of trust is whether the beneficiaries are determinated (non-discretionary trust) or not. a to the provision of financial law for 2007. In fact, assuming that trust is an autonomous passive subject who is obliged to compile and keep books and that, in order to establish the fiscal residence, we must take into account the new presumptions, the legislator states that

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\(^{329}\) D. M. Stands for ministerial decree.

\(^{330}\) The countries as indicated by D. M. 4 september 1996, which an exchange of information is possible with, are: Algeria, Argentina, Australia, Austria, Belgium, Belorussia, Brazil, Bulgaria, Canada, China, South Korea, Ivory Coast, Croatia, Denmark, Ecuador, Egypt, United Arab Emirates, Russian Federation, Philippines, Finland, France, Germany, Japan, Greece, India, Indonesia, Ireland, Israel, Jugoslavia, Kazakhstan, Kuwait, Lithuania, Luxemburg, Macedonia, Malta, Morocco, Mauritius, Mexico, Norway, New Zealand, Netherlands, Pakistan, Poland, Portugal, United Kingdom, Czech Republic, Slovak Republic, Romania, Singapore, Slovenia, Spain, Sri Lanka, United States, South Africa, Sweden, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Hungary, Venezuela, Vietnam, Zambia.
when beneficiaries are determined, profits achieved by trust are attributed in any case to them according to their participating share as determined in trust deed or other documents or, failing these, on he basis of equal shares.331

7.4 Taxation on destination bond: an opinion of Financial Administration

The gifts tax is applied to the institution of any destination bond (for example planning bonds, patrimonial funds, acceptation of legacy with the benefit of the inventory) or only when with the institution of a bond a subject defined as “beneficiary” of the free transfer enjoys a stable patrimonial increase?

Inheritance and gifts tax applies only to the constitution of a bond which imply the contemporaneous transfer of assets to a subject other than the disposer, even if temporary.

Such tax is not applicable to the constitution of destination bonds based on legal measures (benefit of inventory) or administrative provisions (urban planning bonds).

The tax on successions and donations is not even applicable to the institution of destination bonds on assets with remain at the disposal of the donor (for example, the constitution of assets destined for a specific deal from a capital company, …

For the latter type of bond constitution a fixed registry tax is due..

With reference to the purpose bond, we observe that the lack of final beneficiaries of the assets constituting the trust, does not fall under the tax on successions and donations, consequently such tax is only due for the sole constitution of the bond on transfer basis, this is to say by means of attributing the assets from the donor to the trustee.

If the trust has been instituted in favour of named or unnamed final beneficiaries, we observe that – except for the application of the tax at the time of the institution of the bond on transfer basis- the successive transfer of assets in favour of the final beneficiaries is itself subject to autonomous imposition of tax, identifiable in reference to the concrete case and according to the emerging juridical situation. In fact, at the

331 R. PARISOTTO, A. CERVONE, Trattamento fiscale del trust alla luce della Finanziaria per il 2007, cit., p. 945.
moment of the dismissal of the trust, the trustee usually makes a free donation in favour of the final beneficiaries, which is subject to the tax on successions and gifts. It should be stressed that this interpretation of trust regulations, until now, is only an opinion of Fiscal Administration.

8. FAMILY TRUSTS

8.1 Typical structure of Family Trust

The Italian legislator, with the new Law 14.02.2006 N° 55 has brought in important innovations in matter of succession by introducing the so-called “Family Trust”. This constitutes a departure from the general principle contemplated by Article 458 c.c. which contemplated the prohibition of successor’s pact. The family pact is (in extreme synthesis) a contract to which participate an entrepreneur (or a shareholder), one or more of his descendents, and “the spouse” of such entrepreneur and “all those who would make legitimate heirs if at the moment the issue of succession for the assets of the entrepreneur (or shareholder) should open. With such contract, the entrepreneur transfers (without charge) his enterprise (or his shares) to one or more of his descendents, who must liquidate to the other participants (in money or nature) their legitimate rights which would go to them on the bases of individual quotes contemplated in Article 536 and following of the Civil Code. What has been received by the parties must be assigned to their respective legitimate quotas, excluding reduction or collation.

8.2 Theories on family trust and taxation

The very first comments to this reform have seen the prevalence of an “atomistic” reconstruction of this institute, to which a mixed cause has been attributed. Next to a cause of liberalism (concerning the transfer of a firm or the entrepreneur’s shares to his heir), a resolutory cause should have been envisaged (which would concern the liquidation of the due legitimate rights to the other participants).
A novel and interesting doctrinarian contribution, however, has recently demonstrated how the finding of a unitary cause for the new institute, is not at all impossible. It has been found, in fact, within the institute, a *sole cause of liberalism* which should bring together all transfers of assets contained in a pact.

In other words such liquidation – even though materially carried out by the allotting party of the firm – should at any rate be assigned to the disposing entrepreneur. The positive aspect of the above mentioned thesis appears immediately clear. It, in fact, enables to carry the entire family trust within the field of the *donation tax*, to which should be subjected both the transfer of the firm from the entrepreneur to the beneficiaries, and all the liquidations made in favour of other legitimates appeared.

The same derogation introduced by Article 458 of the Civil Code points clearly out that the new contract must be simply regarded a *succession pact* and more precisely a *disposer succession pact*.

In consideration of the aims of an institute expressly aimed anticipating (at least in part) the effects and relations of a future succession, within the *family trust* we can concretely apply the succession tax. The *family trust* will alternatively discount the mortgage tax on real estate pertaining to the firm or the tax connected with the assets transferred to the legitimates, according to which of the taxes provide the highest revenue.333

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EUCOTAX Wintercourse 2007
Tilburg

Università LUISS – “Guido Carli” – Roma

Facoltà di giurisprudenza
Cattedra di Diritto Tributario

ANTI-AVOIDANCE MEASURES IN DOUBLE TAX CONVENTIONS – LOB

Andrea Melchiorri
Matr. 073363
1.1 Concept of improper use or abuse of DTCs

1.1.1 General

OECD tax treaty model doesn’t provide for an explicit definition of improper use or abuse of the treaty itself, nevertheless some specific provisions against those kind of operations are present (e.g. concept of beneficial ownership in Art. 10, 11 and 12). Consequently it is necessary to analyze the Commentary to the treaty model even if, according to Vienna Convention on the Law of Treaties, this instrument should only be used as a confirmation of an interpretation and not as a way to interpret the treaty itself. Commentary to Article 1 of the model contains a specific section related with the improper use of Convention that has been amplified in the model revision in 1992. Article 1 of the model convention is titled “persons covered” and it is concerned with the identification of the subjects who have the right to benefit from the convention. It is important to underline that, even if the section about the improper use of the convention is present in the commentary to Article 1, in turn related with the subjective area of application of the convention, the abuse of DTC (Double Tax Convention) phenomenon is not only related to subjects invoking a convention that they have not the right to benefit from.

Subjective abuse implies treaty shopping and triangular cases but on the other hand doesn’t cover rule shopping. Following this reasoning we must agree with those scholars334 who consider incomplete the definition given by the UN Committee report in 1988335. Indeed the latter covers treaty shopping operations but excludes rule shopping ones. In this sense, the choice to position the paragraphs about the abuse of

335 Paragraph 8 of the report gives the following definition of abuse of the treaty: “the use of tax treaties by persons the treaties where not designed to benefit, in order to derive benefits the treaty where not designed to give them”.
conventions in the commentary to Article 1, seems not to appreciate the entirety of the phenomenon.

A solution to this problem is given by those scholars\textsuperscript{336} who look to the \textit{ratio} of the convention discipline. In other words it would be necessary to identify the purpose that contracting States attributed to the treaty they agreed.

Obviously the main purpose coincides with the one contained in the first sentence of paragraph 7 of the Commentary to OECD model convention: the elimination of the international double taxation. Nevertheless this is not the only treaty objective, but the convention aims also to fight tax avoidance and evasion as expressly affirmed by the second sentence of the same paragraph.

Consequently further aims are included in single conventions. For example this purpose is expressed in the title of the majority of the conventions stipulated by Italy with other States. In this way States’ objectives are clarified: the negotiation of a DTC is not limited to solve positive conflicts between their tax sovereignty but also negative ones (i.e. tax avoidance and evasion).

Examining the Commentary, even after the revision in 1992, there is no explicit definition of the abuse of international conventions, but only a list of anti-abuse measures not transferred in the body of the model.\textsuperscript{337} Moreover the Commentary tries to define the relations between conventional anti-abuse rules and nationals ones.\textsuperscript{338}

In the end it seems that no concept of possible DTCs abuse is provided by the OECD model while on the other side the one given by the UN model is incomplete or at least out-of-date.

\footnote{Among the others V. UCKMAR, \textit{I trattati internazionali in materia tributaria} in A. AMATUCCI, \textit{Trattato di diritto tributario}, Padova, 1994, p. 755.}
\footnote{For a deeper examination see chapter 3.}
\footnote{It seems that the Commentary stimulates the application of the national rules also for the areas disciplined by international conventions, in particular in paragraph 7.1, 9.2 and 22.1. Anyway the Commentary approach risks to facilitate violations of the \textit{pacta sunt servanda} principle through what is called treaty override (the internal discipline prevails on the conventional one thanks to \textit{lex posterior} principle that would derogate the \textit{lex superior} one), despite of the cautions that the same Commentary recommends for treaty override itself (the application of the internal discipline should not jeopardize the conventional one otherwise a new treaty must be stipulated). For a concrete example of the phenomenon see P. PISTONE, \textit{L’abuso delle convenzioni internazionali in materia fiscale}, cit., p. 655.}
An analysis of US model convention is useful and interesting. United States have a great experience\textsuperscript{339} in the use of DTCs also to fight tax avoidance and evasion and probably the main difference between their model and the OECD one is given by the provision of a specific anti-abuse clause against treaty shopping. In particular in the Technical Explanations to the Model it is foreseen that American fiscal agents must verify the intentionality of the abuse\textsuperscript{340}, while on the other hand Article 22 paragraph 3 of the 1996 Model protects situations where "substantial operations" are carried out. This particular case helps us in the research of the concept of DTCs abuse: where verification of an abuse of a provision is concerned, it is necessary to look at the purpose of the provision itself.\textsuperscript{341} When the behaviour of the taxpayer doesn’t match with the ratio of the conventions, resulting interpretatively, there is an abuse of the treaty or on the question when the subjects are not entitled to benefit from the treaty (treaty shopping) or when manipulation of provisions is concerned (rule shopping). In other words there is an abuse of DTC when a taxpayer, in order to reduce his tax burden, carries into effect operations to obtain fiscal benefits which has not the right to enjoy by reason of his substantial situation. In this way treaty routing can be protected. Even if in this case there is a choice concerning the State were the activity can be carried out more conveniently, in terms of global tax burden, we have not an abuse but only the perfectly legal right to reduce the tax burden at international level. This result can be achieved when the taxpayer is able to show that there is a substantial situation that justifies the subject behaviour (so-called activity clause).

1.1.2 Consequences of treaty shopping for Source and Residence States

In order to analyse the consequences of treaty shopping, it is necessary to consider that the essential feature of this phenomenon is the switching of the State from which

\textsuperscript{339} This policy brought for example USA to express a reserve contained in paragraph 29 of the Commentary to Article 1: "The United States reserves the right to limit the benefits of the Conventions to certain persons". This reserve has been withdrawn.

\textsuperscript{340} It is not necessary the explicit proof of the subjective element but Article 22 of the USA model provides for specific tests.

\textsuperscript{341} In this case States’ agreement about the allocation of taxation rights on a multinational source of income.
income is obtained (i.e. Source State). This result is achieved through a modification of the identity of the taxpayer to whom the income is allocated. The mechanism aim is to gain access to a DTC which reduces or eliminates the tax levied in the Source State. To obtain the switching of the State, the new entity must reside in another State, which has entered into a better convention with the Source State, so as to obtain the desired tax reduction.

Just from the few lines above it clearly results that the immediate damage from Treaty shopping is suffered by the Source State, in fact without the application of the DTC, it would have levied taxes on the income without any limitation. Moreover a secondary effect is produced. When a DTC is negotiated the existing volume of capital, flowing between the contracting States, is a relevant matter: briefly it can be said that a State negotiating position is inversely proportional to its investment volume in the other State, especially when the treaty aims to reduce the taxation at source. If a DTC is particularly advantageous for resident taxpayers, treaty shopping structures will increase the capital flows modifying substantially the circumstances at the base of the negotiation of the DTC itself (*rebus sic stantibus*). As a consequence there will be a higher loss in the non-resident tax revenue due to the changing of the economic situation.

More complicated is the situation from the Resident State perspective. The central concept to understand the case at issue is the DTC reciprocity. As clarified by Félix Alberto Vega Borrego342 “the non-resident tax revenue losses suffered by a State are compensated by the higher resident tax revenue collected”. When treaty shopping is concerned it is possible that there is no convention between the Resident State and the State of origin of the taxpayer who “treaty shops”. In this case there is an indirect loss because the loss of non-resident tax revenue is not compensated by higher resident tax revenue and the Resident State should apply unilateral expensive methods to avoid double taxation. Moreover the State suffers also a weakening of its negotiating position towards the State of residence of the “treaty shopper” seeing that the latter is already able to indirectly obtain a reduction at source.

1.2 Treaty Shopping

The main feature of treaty shopping is the creation of an interposed subject that gives place to a trilateral relationship: payer of the income, interposed (i.e. recipient of the income) and interposing subject (i.e. beneficial owner). Through this mechanism the interposing subject is able to benefit from the DTC between the Residence State of the interposed subject and the Source State, which can be more convenient than the DTC between its own Residence State and the Source State. The interposed subject is often referred to as the “conduit company” because it doesn’t have a personal substantial interest in the receipt of the income but simply constitutes a filter for the interposing subject.

An example of conduit company is when a subject resident out of EU interposes an holding company in a Member State that grants exemption for foreign income. Moreover, through the same holding company, the non European subject controls a subsidiary incorporated in a different Member State. Directive 90/435/EEC grants tax exemption for dividends from the subsidiary to the parent company which is the interposed holding company. Finally the latter sends the dividends to the subject resident out of EU.

Stepping stone strategies are more complex and elaborated: indeed not only one but two or more interposed companies are concerned. Increasing the number of interposed companies it is possible to exploit more than one DTC or to gain the access to a particular DTC. For instance this is the case of a company resident in State X which wants to make an investment through a subsidiary in State Y, and there is no DTC between X and Y or this is not very profitable. In the meantime State X has a more advantageous DTC with State Z which does not have any convention with State Y. But there exists a good treaty between State Z and W that in turn has an advantageous

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343 The expression treaty shopping derives from forum shopping, an American civil procedural law phenomenon indicating the research of the most convenient jurisdiction for the trial.

344 It is also possible that no DTC has been concluded between the interposing subject Residence State and the Source State.

345 Interesting for the case at issue is the anti-abuse provision in Art 27-bis paragraph 5 of the D.P.R. September 29th 1973, n. 600 that excludes the exemption if the non EU subject is able to prove that the conduit company was not created with the only or exclusive purpose to enjoy the benefit (see chapter 5.1).
convention with State Y. In this way taxpayer of State X can reduce the tax burden for his investment in State Y.

Another typology of treaty shopping are the holding structures:\textsuperscript{346}

I. Same country holding company: some DTCs grant a better tax regime for minority shareholders resident in the other contracting State. In this case a company resident in country X, which wants to invest through a subsidiary in country Y, could control the latter through a minority participation via a holding company expressly incorporated in country X. Similar is the case of a national legislation which grants a better regime for dividends paid by a resident company to another resident company. The mechanism is similar but in this case the holding company is incorporated in the same foreign company State in order to obtain the benefit.

II. The quintet structure: some DTCs can contain clauses which suspends the access to the benefits whenever a resident company pays dividends to a non resident subject holding more than a certain rate (e.g. 25\%) of its shares. In this case the investing company could incorporate a subsidiary in the other country and control it through several intermediate control companies each one with a participation lower than 25\% (i.e. 5 holding companies with a participation of 20\%).

Anyway, it is always important to distinguish between the abusive structures of treaty shopping and the legal ones of treaty routing, the difference must be appreciated through a case by case analysis.\textsuperscript{347}

1.2.1 A particular type of conduit company: rent-a-star companies

A particular tax avoidance operation concerns remunerations for artistic or sporting performances, which are not paid directly to the artist or the sportsman but to a different subject: the rent-a-star company. The choice of the State where to incorporate the company will obliviously be influenced by tax planning reasons and will pay attention to the DTCs network of the State in which the company will be created. Moreover, in

\textsuperscript{346} P. VALENTE, Convenzioni internazionali contro le doppie imposizioni, Milano, 1999, p. 43.

\textsuperscript{347} See supra chapter 1.1.1.
this way, the income will not be taxed in the Source State\textsuperscript{348}, neither in the hands of the artist or the sportsman nor as a business profit because the company has not a permanent establishment (PE).

First of all we will examine the Italian measures and then those provided by the DTCs.

As a general rule, a withholding tax is foreseen for non resident subjects rendering independent personal services in Italy\textsuperscript{349}. Artists and sportsmen performances can surely be included in this income bracket and then taxed in this way.

On the other hand if those performances are attributable to a non-resident company a special rule is provided by Art 23, paragraph 2, letter d) of CITA: remunerations paid by undertakings, companies or non resident entities for artistic or professional performances executed on their behalf in Italy are considered to have been generated in Italian territory, and then taxable through a withholding tax.

Part of the scholars\textsuperscript{350} requires for the applicability of the provision that the incomes derive from an activity that is objectively artistic or professional and then a definition is necessary. The latter seems not easily obtainable from Art 53 of CITA\textsuperscript{351}. Some doctrine\textsuperscript{352} looks at the copyright law and defines it as an activity from artists, actors or performers: that technical-artistic performance whose object is the recitation or representation of literary works, dramas, operas, choreographies or films, or the performance of a musical composition. This definition detects precisely the activities involved and in the meantime it is also compatible with the guidelines provided by the OECD commentary to Art 17 of the model convention.

Article 20 paragraph 2 lett. d) doesn’t transform the income but according to the Ministerial report on the draft of CITA constitutes a derogation to the taxation of the

\textsuperscript{348} Otherwise usually a withholding tax is levied.

\textsuperscript{349} See Art 23 paragraph 1 letter d) of D.P.R. December 22nd 1986, n. 917 (CITA).


\textsuperscript{351} Some scholars proceed with a comparison between the actual provision and its precedent versions: the central element would be the way homogeneous acts are repeated both under the aspect of their content and the way they are executed. In this way C. GARBARINO, Sulla tassazione dei redditi di lavoro autonomo percepiti da soggetti non residenti e sull’obbligo della ritenuta, in Dir. Prat. Trib., 1988, II, 1236 e ss.

Following this reasoning the provision would be applicable every time the activity at issue is objectively referable to the performance of arts or professions, independently, not only from the juridical nature of the non–resident person, but also from the concrete way the performance is executed (it being irrelevant that it is referable to an undertaking activity).

Anyway it must be remembered that this strong measure is not applicable whenever it is contrary with the provisions of DTCs negotiated by Italy. According to lex specialis principle, income brackets foreseen by treaties will prevail on the different ones provided by the national legislation.

The majority of the DTCs in force nowadays in Italy, contain a provision similar or identical to Article 17 of the model convention titled “artists and sportsmen”. Paragraph 2 protects Source State taxation rights in case of a rent-a-star company. On the subject paragraph 11.1 of the commentary to the model convention clarifies that the provision is still applicable whenever the artist or the sportsman and the company are not resident in the same contracting State. Indeed, “notwithstanding the provisions of Article 7” Source State can levy the income of the rent-a-star company, in force of the DTC. On the other hand if the company is resident in a third State, which has concluded no DTC with the source State, the latter can still levy a tax if it is foreseen by its national legislation. For Italy the possibility is granted by, the already discussed, Art. 20 CITA.

1.3 Exit Taxes

353 For the different positions see A. PAROLINI, Riflessioni critiche sulla tassazione dei compensi percepiti da non residenti per prestazioni artistiche o professionali, in Riv. Dir. Trib., 2001, fasc. 1, p. 12.
354 For an analysis of the effects of some of the previous ones see A. PAROLINI, Riflessioni critiche sulla tassazione dei compensi percepiti da non residenti per prestazioni artistiche o professionali, cit., p. 6.
355 For the reader comfort the text of Art. 17 of OECD model convention has been copied here:

“1. Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

2. Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised.”
Exit taxes are those provisions whose aim is to avoid that the transfer of fiscal residence by a subject subtracts from taxation the latent appreciation of the assets substantially resulting in a reduction or avoidance of capital gains taxation. Exit taxes have also an anti tax avoidance aim. Indeed a taxpayer could transfer his residence in an another State with the sole purpose of selling his assets and taking advantage of the allocation of taxation rights fixed by the negotiating States in the DTC. In this case the new residence State will be chosen basing on the lower taxes levied on capital gains and it must be noticed that some States grant even the exemption. Moreover, according to the DTC allocation of taxation rights, the State of origin can not levy taxes356.

The Italian exit tax provision is contained in Article 166 of CITA357. The provision excludes taxation of the latent capital gains on company assets, when those goods are transferred to a permanent establishment in the State of origin. Otherwise, as a general rule, when a subject undertaking a business enterprise moves his residence abroad, assets must be estimated at their normal value358.

However some problems emerge in determining the taxable base. This question particularly concerns intangible assets such as the goodwill. Indeed different States opt for different solutions. Nevertheless it must be noticed that real seat doctrine States, such as Germany, exclude the goodwill from the taxable base as a logical consequence of the application of the liquidation regime. In Italy the majority of the scholars exclude it359, seeing that the decree of the Ministry of Finance360, which should have determined the active element considered by the provision, hasn’t been put into effect as yet.

We will finish with some considerations about the compatibility of exit taxes as an instrument to fight tax avoidance with EU freedom of establishment. Even if European

356 Indeed according to paragraph 5 of Art. 13 of the OECD model convention: “Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.”
358 As defined by Article 9 paragraph 3 CITA: price averagely applied for goods and services of the same kind or similar in a free market condition and at the same commercialization level, in the place and at the time when those goods or services have been purchased.
360 Ex Article 30 paragraph 2 law decree February 23th 1995, n. 41.
Court of Justice (ECJ) abstractly admitted “that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty”, there is no concrete application yet. This is specifically due to a consideration of exit taxes as a measure breaking proportionality principle. According to this principle, as it has been shaped by ECJ case law, actions which whilst justified in general terms, have negative effects on others, should be kept to the inevitable minimum. First of all the payment of exit taxes doesn’t consider the real purposes of the transfer and doesn’t provide for a case by case analysis, consequently damaging also operations with no tax avoidance intentions. For instance it is possible that the State of destination foresees for a reasonable capital gains taxation but also that the change of residence was intentioned by an effective will to stay in the other State, and the length of permanence should also be considered. Probably it would be better to reverse the procedure, granting to the tax administration the power to prove case by case the existence of tax avoidance intentions.

1.4 Triangular cases

What characterizes triangular cases is that they involve three States taxation rights for an income concerning only two subjects. As well as treaty shopping they can constitute situation of subjective abuse of conventions, but there is not an interposed subject, but a permanent establishment which has not a different and autonomous juridical personality. In a triangular case an head office controls through a permanent establishment a subject situated in a third country.

In the Saint-Gobain case (C-307/97) a French head office had a permanent establishment (PE) in Germany through which held a direct participation in a US company. In 1988 the permanent establishment was excluded from benefiting from

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361 ECJ, 15/05/1997, C-250/95, Futura Participations and Singer / Administration des contributions, paragraph 31 in www.curia.eu.
362 In the case at issue the freedom of establishment.
364 Cf. P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 670
365 And other indirect participations in Switzerland, Austria and Italy
the DTC between Germany and USA because it was considered not to be a German resident subject. It must be clarified that from the court case emerged that Saint-Gobain was undertaking a substantial activity through the PE and that treaties abuse is not a certain consequence of the application of a DTC to subjects different from the residents of one of the two negotiating States, but would require the exclusive intention of minimizing the global tax burden. So, at least in EU, the risk of abuse must be evaluated case by case and not with abstract rules that would penalize activities undertaken through a PE rather than through a subsidiary.

The DTC between France and Italy is very interesting on this subject where it is foreseen that a PE is allowed to invoke the DTC between the State where it is located and the Source State and at the same time does not exclude the application of the convention between the latter and the State of residence of the head office.

1.5 Rule Shopping

Rule shopping is different from treaty shopping because it doesn’t involve the creation or substitution of entities but concerns the attempt to modify the nature of the income and consequently the tax payable. Usually the purpose is to exploit the application of DTC articles that attribute exclusive taxation rights to Resident State instead of articles

366 As results from paragraph 63 of Sain-Gobain: “Consequently, the answer to be given to the Finanzgericht must be that Articles 52 and 58 of the Treaty preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions [...]”.

367 Art 25 paragraph 2: “(a) The taxation on a permanent establishment which an enterprise of a State has in the other State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a State to grant to residents of the other State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

(b) Where a permanent establishment situated in a State receives dividends, interest or royalties arising in the other State and pertaining to property or rights effectively connected with its activities, such income may be taxed in the State in which it arises in accordance with the respective provisions of paragraph 2(b) of Article 10, paragraph 2 of Article 11 and paragraph 2 of Article 12. The State in which the permanent establishment is situated shall eliminate double taxation in accordance with the conditions provided in paragraph 1(a) or paragraph 2 of Article 24, disregarding the last clause. This provision shall apply wherever the enterprise of which the permanent establishment is a part has its place of management.”
that provide for a division of those rights. In this way it is possible to avoid Source State withholding taxes.

The most important rule shopping cases concern dividends\textsuperscript{368}: taxpayers attempt to substitute the dividends conventional clause with the one on interests (thin capitalization) or capital gains (dividend washing\textsuperscript{369}).

So in thin capitalization operations the objective is to turn dividends into interests\textsuperscript{370}. This result can be achieved using loan capital to finance the company instead of risk capital. Then the loan capital remuneration can be calculated on the basis of market price according to arm’s length principle or on the basis of the company business profit. In both cases there is no tax neutrality between loan capital and risk capital, but when the arm’s length principle is applied it is quite difficult to stop the abusive rule shopping behaviour. Indeed, it is simply inconceivable to generally forbid companies access to the credit market and then it becomes necessary to foresee parameters or factual elements that are indicative of the sole thin capitalization operations\textsuperscript{371}. On the other hand when the remuneration changes on the basis of company profits, a sort of profit-sharing element is identifiable allowing for a classification of those loans as hybrid financial instruments.

On this question Article 11 paragraph 6\textsuperscript{372} of OECD model is extremely interesting, which doesn’t modify the qualification of the income as interest, but limits the application of the Article regime as far as it is in accordance with the conditions

\textsuperscript{368} It is important to keep in mind Article 10 of OECD model about dividend taxation which limits Source State taxation rights at: “a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends; b) 15 per cent of the gross amount of the dividends in all other cases.”

\textsuperscript{369} Or dividend stripping.

\textsuperscript{370} The general rule in Article 11 of OECD model provides for a maximum withholding tax of 10% on the gross amount: “However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.” Moreover, several DTCs grant even complete exemption.


\textsuperscript{372} Article 11 paragraph 6 of OECD model convention: “Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which 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.”
following by the application of arm’s length principle. It is important to notice that, in the meantime, Article 10 paragraph 3 excludes the qualification of dividends as income originated by a debt-claim. However, paragraph 25 of the Commentary to Article 10 allows the application of the dividend regime, provided by the national legislation, for that part of the income that exceeds the amount calculated according to arm’s length principle.

A different purpose characterizes dividend washing operations which consists in the sale of a participation with accrued, but not yet distributed, dividends so that the latter are transformed in capital gains. As the dividends related to the participation are defined both in the *an* and in the *quantum*, the taxpayer can consider them in the evaluation of the sale price. In this way the shareholder is able to immediately convert into cash the accrued dividends in the shape of capital gains. Clearly, also in this case there is no tax neutrality and indeed Article 13 paragraph 4 attributes exclusive taxation rights to Residence State when capital gains on shares are concerned.

Moreover it is interesting to note that dividend washing can be characterized by treaty shopping aspects whenever shares are sold to a subject benefiting from more advantageous conventional tax regime to which the seller wouldn’t have the right to benefit from. The effects in terms of tax base erosion can be better appreciated if it is imagined the situation of a participation controlled through an investment company located in a State with tax exemption regime for capital gains but in the meantime supplied with a good conventional net.

### 2 LOB (LIMITATIONS ON BENEFITS) PROVISIONS IN DTCs

There are not many LOB clauses in DTCs negotiated by Italy. This type of clause comes from the US aggressive policy against international tax avoidance and it is

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373 Article 10 paragrap 3 OECD model: “The term “dividends” as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident”.


375 OECD recommends anyway to proceed previously with a case by case concrete analysis which shows a prominence of the profit-sharing element on the loan remuneration.
certainly an effective instrument against tax conventions abuse. An increasing interest of OECD in this field must be underlined, who prefers, however, to proceed to a preventive analysis of the substantial features of these clauses before introducing them in the model convention377.

According to the American Law Institute, US conventions have three different approaches to treaties abuse:

1. Special measures approach: it excludes specific categories of subjects from benefiting from the convention.
2. Principal purpose approach: it excludes the application of the convention whenever the control relationship between two companies has principally a tax avoidance purpose.
3. Comprehensive approach: it is now the most diffused and it limits the application of the conventions according to subjective and objective conditions referring to the undertaken activity and the type of international income.

This approach is received in Art 22 of the US Model Convention that is structured in five paragraphs:378

I. general rule which grants treaty benefits only in the strict limits provided by the Article;
II. list of five type of resident subjects that have access to the benefits379 and the so called ownership-base erosion test which requires that persons other than an individual are controlled at least for the 50% of their participations by subjects who can benefit from

376 This is justified by the fact that some States exempt capital gains.
377 In paragraph 120 of OECD report on “Harmful tax competition. An emerging global issue” is written that: “The Committee intends to continue its work in this area (ndr. LOB) with a view to modify the Model Tax Convention or the Commentary so as to include such provisions that countries will be able to incorporate in their tax treaties”.
378 Cf. P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 692.
379 Paragraph 2 of US Model Convention: “A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is: a) an individual; b) a qualified governmental entity; c) a company, if: i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or: ii) at least 50 percent of each class of shares in the company is owned directly or indirectly by companies entitled to benefits under clause i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to benefits of the Convention under this paragraph; d) described in subparagraph 1(b)(i) of Article 4 (Residence); (ndr. “A legal person […] established and maintained in that State […] exclusively for a religious, charitable, educational, scientific, or other similar purpose”) e) described in subparagraph 1(b)(ii) of Article 4 (ndr. “A legal person […] established and maintained in that State […]to provide pensions or other similar benefits to employees pursuant to a plan”), provided that more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State”.
the convention and that the income produced by the same participations is received at least for the 50% by the same subjects;

III. this provision is an activity clause that protects activities producing predominantly business income. Indeed “the business of making or managing investments will not be considered an active trade or business unless the activity is banking, insurance or securities activity conducted by a bank, insurance company or registered securities dealer”. Moreover, lett. c) contains some criterions for the evaluation of the activity;

IV. this second safeguard provision has a discretionary nature and grants to tax authorities the possibility to allow the application of the convention to residents of a Contracting State not otherwise entitled to benefits;

V. definition of “recognized stock exchanges”.

The LOB clause provided by the DTC between USA and Italy seems to be different from the standard one included in the US Model Convention. Indeed a person (other than an individual) resident of a contracting State is not entitled to benefit from the convention unless:

“(a) more than 50% of the beneficial ownership of such person (or in the case of a company, more than 50% of the number of shares of each class of the company's shares) is owned, directly or indirectly, by any combination of one or more of:

(i) individuals who are residents of the United States;
(ii) citizens of the United States;
(iii) individuals who are residents of Italy;
(iv) companies as described in subparagraph (b); or
(v) the Contracting States; or

(b) it is a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange.”

This provision is a property clause which, moreover, should be fulfilled by “qualified” residents. In more details the status of “qualified” resident, precondition for benefiting from the convention, is attributed to companies only if they comply with a stock exchange provision and are quoted “on a recognized stock exchange”380.

380 The definition of “recognized stock exchange” is provided by paragraph 3 of Art. 2 of the Protocol of the DTC between USA and Italy.
However, according to paragraph 2 “Paragraph 1 shall not apply unless the competent authority of the other Contracting State determines that either the establishment, acquisition or maintenance of such person or the conduct of its operations had as a principal purpose obtaining benefits under the Convention”. So the application of the LOB clause is conditioned by a previous general bona fide test. This detail seems to be particularly relevant when the compatibility of the LOB clause with EC law is at issue, as will explained later-on\textsuperscript{381}.

The strength of the LOB clause included in the DTC negotiated with USA is its applicability to a wide range of provisions: “Articles 7 (Business profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital gains) or 22 (Other income)”\textsuperscript{382}. However, more limited anti-abuse measures can be found in other DTCs stipulated by Italy.

First of all it must be noted that all the examined conventions\textsuperscript{383} present, in accordance with the OECD model convention, the beneficial owner clause in the articles concerning dividends, interests and royalties (usually 10, 11 and 12). This clause will be examined in chapter 3.1.

Here anti-abuse clauses provided in the articles concerning dividends of the DTCs with France and United Kingdom will be considered.

Article 10 paragraph 8 of the DTC concluded with France conditions the application of the conventional benefits on dividends to a property clause. Indeed it is necessary that more than the 50% of the capital of the resident company is owned by resident persons. However, the taxpayer can still benefit from Art. 10 if it complies with the provided \textit{bona fide} clause\textsuperscript{384}.

Different dividends taxation regimes are provided by Art. 10 of the DTC between Italy and United Kingdom foresees. First of all paragraph 3 letter b) of the convention

\textsuperscript{381} See paragraph 4.
\textsuperscript{382} Art. 2 paragraph 1 of the protocol to the convention between Italy and the USA.
\textsuperscript{383} DTCs concluded by Italy with: USA, Sweden, Belgium, Spain, Germany, Netherlands, France, United Kingdom, Austria and Hungary.
\textsuperscript{384} Article 10 paragraph 8: “Where the beneficial owner of the dividends is a company resident in a State, and more than half of its capital is owned by one or more persons who are not resident in that State, the provisions of paragraphs 3 and 4 shall apply only on condition that such company furnishes the competent authority of the other State, if so requested by that competent authority, information permitting the authority to determine if the company has acquired the holding in good faith for business reasons or
entitles, an Italian resident who receives dividends from a company resident in the
United Kingdom, to a “tax credit in respect thereof to which an individual resident in
the United Kingdom would have been entitled had he received those dividends, and to
the payment of any excess of that tax credit over his liability to United Kingdom tax”. However, in order to benefit from the former provision, it is necessary that the Italian
resident is the beneficial owner of the dividends and that “the recipient of the dividend
and of the tax credit is [...] subject to Italian tax in respect thereof”. The latter
condition is contained in letter d) of the same paragraph and is a subject-to tax clause.
On the other hand a different regime is foreseen, by lett. c), whenever “the beneficial
owner of the dividend is, or is associated with, a company which, either alone or
together with one or more associated companies385, controls, directly or indirectly,
10% or more of the voting power in the company paying the dividend”. According to
the subparagraph, “in these circumstances a company which is a resident of Italy and
receives dividends from a company which is a resident of the United Kingdom shall [...] be entitled to a tax credit equal to one half of the tax credit to which an individual
resident in the United Kingdom would have been entitled had he received those
dividends, and to the payment of any excess of that tax credit over its liability to tax in
the United Kingdom”. However, also this reduced benefit is subordinate to the
beneficial owner and subject-to tax clauses.
An inverted provision is contained in paragraph 4, this time concerning dividends paid
by an Italian resident company.
Paragraph 5 conditions the tax credit to a general bona fide clause: “The provisions of
neither sub-paragraph (b) nor (c) of paragraph 3 and neither sub-paragraph (a) nor (b)
of paragraph 4 of this Article shall apply unless 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

385 According to the same sub-paragraph c: “two companies shall be deemed to be associated if one
controls, directly or indirectly, more than 50% of the voting power in the other company, or a third
company controls more than 50% of the voting power in both of them”.
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.”

Last but not least paragraph 9 provides that: "If the beneficial owner of a dividend, being a resident of a Contracting State, owns 10% or more of the class of shares in respect of which the dividend is paid then the provisions of paragraph 2, 3 or, as the case may be, 4 of this Article shall not apply to the dividend to the extent that:

(a) it can have been paid only out of profits which the company paying the dividend earned or other income which it received in a period ending twelve months or more before the relevant date; and

(b) the shares in respect of which the dividend was paid have not been held for twelve months continuously ending on the date the dividend was declared. For the purposes of this paragraph the term "relevant date" means the date on which the beneficial owner of the dividends became the owner of 10% or more of the class of shares in question. Provided that this paragraph shall not apply if the beneficial owner of the dividend shows that the shares were acquired for bona fide commercial reasons and not primarily for the purposes of securing the benefit of this Article.” This provision seems to deal with dividend washing and it is applicable whenever the receiver owns a “qualified” participation. In this case, in order to benefit from the tax credit it is necessary to comply with a minimum holding period and the dividends themselves must be originated by “qualified” profits. However, the taxpayer can avoid the limitation of the benefits proving its substantial bona fide.

Other anti-abuse provisions are contained in Article 11, dealing with interests. Paragraph 9 stipulates that the operation which originates the interests has not an abusive aim, substantial bona fide is required. Moreover, the first part of paragraph

386 Article 11 paragraph 9: “The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons.”
10 provides for a subject-to tax clause, while the second part contains a minimum holding period clause against operations similar to dividend washing ones. Another important LOB clause is included in Art. 23 of the DTC concluded between Italy and Switzerland. Some remarks on this provisions are necessary even if Switzerland does not participate to this edition of Eucotax Wintercourse.

Art. 23 deals with convention’s benefits on dividends, interests and royalties. The latter are not granted to legal entities “resident of a Contracting State, and in which persons who are not residents of that State have, directly or indirectly, a substantial interest in the form of a participation, or otherwise”, unless they fulfil several conditions.

a. “the interest-bearing debts to persons who are not residents of the first-mentioned State are not higher than six times the equity capital and reserves”. This condition is a rule against thin capitalization abuses, as it can be noted from the debt/equity ratio.

b. “the interest paid on loans contracted with such persons is not paid at a higher rate than the normal interest rate”. Also this provision is aimed to contrast rule shopping operations. Indeed, this condition includes also those interests which, even if not exceeding the, previously examined, debt/equity ratio, on the other hand, exceed “the normal interest rate”. The latter, in Italy, is “the legal rate of interest plus three percentage points”.

c. “not more than 50 percent of the relevant income from sources in the other Contracting State is used to satisfy claims (interest, royalties, development, advertising, initial and travel expenses, depreciation on any kind of business asset including intangible assets, processes, etc.) by persons not resident in the first-mentioned State”. The former is a base erosion requirement which can raise problems of incompatibility with EC law as will be discussed in chapter 4.

d. “expenses connected with the relevant income derived from sources in the other Contracting State are met exclusively from such income”.

387 Article 11 paragraph 9: “The reliefs from tax provided for in paragraph 2, 3 or 4, as the case may be, of this Article shall not apply if the beneficial owner of the interest is exempt from tax on such income in the Contracting State of which he is a resident and such recipient sells or makes a contract to sell the holding from which such interest is derived within three months of the date such recipient acquired such holding”.

388 On the other hand in Switzerland is “the average interest rate on debentures issued by the Swiss Confederation plus two percentage points”.
the corporation distributes at least 25 percent of the relevant income derived from sources in the other Contracting State.”

It is interesting to note that the former list of conditions is open. Indeed, according to paragraph 1 letter e of Art. 23, “Additional measures already taken, or to be taken by one of the Contracting States, against abuse of the use of tax relief relating to tax withheld at source in the other Contracting State, shall not be prejudiced hereby.”

Moreover, when the same entities receive interests and royalties from Italy, a further condition needs to be fulfilled: these interests and royalties must be “subject, in the canton in which such legal entity has its seat, to the cantonal tax on income in the same or similar way as is provided in relation to the Federal Defence Tax”.

Finally a property and base erosion clause is provided for family foundation resident in Switzerland.

Rules concerning the application of this provision are contained in paragraph 3: “The supervision, investigation and corroboration necessitated by the application of paragraphs 1 and 2 shall be carried out by the competent authorities of the Contracting State in which the recipient of the relevant income is resident. If the competent authority of the other Contracting State, from which the income originates, has reasonable grounds to cast doubt on the declarations made by the recipient of such income in his efforts to obtain a tax reduction, and the information contained in those declarations is confirmed by the competent authorities of the first State, then it shall communicate those grounds to the competent authority of the first State; this authority shall then undertake a new investigation and inform the competent authority of the other State of the conclusions reached. In case of disagreement between the competent authorities of the two States, Article 26 shall apply. No reduction will be given until agreement is reached.” The main problem of this procedure is the time it needs. Indeed, the sole Art 26 (i.e. mutual agreement procedure), can take years to be accomplished. Such a situation can give rise to questions about the fairness of this procedure, if in the end, the taxpayer is legally allowed to benefit from the convention, seeing that, in the meantime, the reduction was suspended.

389 Art 23 paragraph 2: “[…] A family foundation resident in Switzerland may not claim the benefit of the reductions of tax imposed by Italy on dividends, interest and royalties if the founder, or the majority of the beneficiaries, are not residents of Switzerland, and more than one third of the relevant income is not, or will not be, paid to residents of Switzerland.”
To conclude, it doesn’t seem possible to talk about an Italian LOB provisions policy in DTCs because the latter are rare and, most of all, not systematic. So Italian legal system deals with abuses more at national level. This choice is anyway consistent with the commentary to Article 1 of the OECD model.

3 OECD POSITION AGAINST TREATY SHOPPING

OECD model convention doesn’t include clauses against tax conventions abuse because the necessary agreement was missing. However, OECD commentary suggests five different approaches, allowing single States the freedom to adopt, provision by provision, the approach they prefer. All the different approaches substantially limit the possibility to benefit from the Convention.

I. Look through approach: it limits the application of the convention benefits to companies that are owned or controlled, directly or indirectly, by persons who are not resident of a contracting State. However, the same Commentary underlines the excessive restrictiveness of this approach because it doesn’t proceed with an examination of the activities undertaken by the same subjects, in this way neglecting the substantial standpoint. Moreover, this measure is not effective whenever the interposed companies are not controlled by non resident persons.

II. Channel approach: it is particularly focused on tax avoidance operations concerning conduit companies. This approach excludes from benefiting from the convention companies of a contracting State where subjects, not residing in the same contracting State, have a substantial interest or even control of the company. A particularly important condition for the exclusion from the benefits is that “more than the 50% of the received income is used to satisfy claims by such persons” (i.e. the non resident subjects). This approach is effective also against stepping stone strategies.

III. Subject-to tax approach: limits conventional benefits in the source State for those income brackets which are levied with a preferential regime in the residence State. This

390 See especially paragraph 7.1 of the Commentary to Art. 1.
391 Cf P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 685 e ss. and P. VALENTE, Convenzioni internazionali contro le doppie imposizioni, Milano, 1999, p.45 e ss.
rule is aimed to prevent substantial double “non taxation” cases. However, the commentary suggests not extending this approach as a general rule but to limit it to conduit companies cases. It must be stressed that the clause at issue is not effective when stepping stone strategies are concerned and also when the conduit company, even if not benefiting from a preferential regime, is located in State providing for a general low taxation.

IV. Bona fide approach: OECD commentary suggests introducing some limitation to the examined approaches in order “to ensure that treaty benefits will be granted in bona fide cases” and whenever no treaty abuse is concerned. The commentary makes a list of five different clauses:

- General bona fide provision: conventional benefits are granted if the income is originated by operations “motivated by sound business reasons and thus do not have as primary purpose the obtaining of any benefits”.
- Activity provision: grants conventional benefits to sources of revenue other than passive incomes.
- Amount of tax provision: conventional benefits are granted by the source State if the “reduction of tax claimed is not greater than the tax actually imposed by the contracting State of which the company is a resident”. This provision, more than an anti-abuse clause, seems to be a limit to the resident State possibility of lowering its tax rates.
- Stock exchange provision: assumes the effectiveness of the conduit company to be guaranteed by market rules.
- Alternative relief provision: residents of a third country can benefit from the convention if the source State negotiated a not less favourable convention with the third State at issue.

V. Exclusion approach: excludes the application of the convention for certain specific types of companies benefiting from a preferential tax regime in their residence State. Indeed this approach is similar to the subject to-tax one but it focuses on the recipient subject rather than on the income. For example Luxemburg holding companies are often excluded from benefiting from the conventions[^392], but anyway it is possible to

[^392]: In DTC between Luxemburg and Italy see Art 1 of the protocol.
constitute a Société de Partecipation Financière (so.par.fi.). Indeed even if the latter is highly taxed, it allows the access to Luxemburg conventions network.

As underlined by a scholar\textsuperscript{393}, the main problem with those anti-abuse provisions is the lack of a well defined concept of abuse of DTCs.

3.1 Beneficial Owner

The not totally obvious concept of beneficial owner has always been and still is subject for discussion. The beneficial owner clause, dealing with treaty shopping and subjective interposition operations, is contained in Art. 10, 11 and 12 of OECD model respectively concerning dividends, interests and royalties.

The concept of beneficial owner has its roots in common law systems where case law stressed the substantial and economic side of the operation, from time to time at issue, rather than the formal-legal one. Such a concept, so much connected with the difference between common law and equity which, in its turn, split the ownership right in its legal and economic sides, is hardly adaptable to civil law systems\textsuperscript{394}.

The clause at issue was first introduced in the model convention of 1977. At the time the Commentary only specified on the subject that the limitation of source State taxation rights was not applicable whenever interposed agent or a nominee were concerned (i.e. between the payer and the beneficial owner). Conduit companies were included only later by the OECD report on “Double taxation convention and the use of conduit companies”. In the report it is stressed that a company, even if is the formal owner of the income, it is not the beneficial owner whenever it has such limited powers to be considered as a trustee or an administrator on behalf of another subject. Moreover, the report specifies that in order to be identified as the beneficial owner, it is not sufficient that the company main activity is holding participations or activities. In paragraph 61 of OECD report on “The application of the OECD model tax convention to partnership” of 1999 it is further specified that the beneficial owner is the subject to whom the income is referable to, according to the national legislation of the contracting State. In 2003 new

\textsuperscript{393} Cf P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 688.

\textsuperscript{394} For a brief but clear analysis of the problem see P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 697.
important paragraphs have been added to the Commentary. The latter stresses that the concept of beneficial owner is not used in the Convention with a technical and restrictive meaning, but rather it results from the context and the Convention purposes, especially international double taxation elimination and tax evasion and avoidance prevention. Then the Commentary only gives the example of an income received by an agent or a nominee, however, under the light of OECD report on “Double taxation convention and the use of conduit companies”, it can be generally stated that any subject who is an intermediary on behalf of a third subject being the real beneficiary of the income is not a beneficial owner. Paragraph 12.2 of the commentary to Art. 10 clarified that conventional benefits are still applicable whenever the interposed subject and the beneficial owner are resident of the other contracting State. However, the Commentary, even with the new added paragraphs, is not able to fully solve the interpretative doubts on the beneficial owner concept395.

Even if some scholars claim for the applicability of Art 3 paragraph 2 of OECD model396, the majority asserts the existence of an international autonomous concept of beneficial owner397 several possible definitions398 have been found. One theory looks at the definition give by the common law systems and identifies, according to the equity case law, the beneficial owner in the “person whose ownership attributes outweigh that of any other person”399. A similar approach stresses the substance over the form, identifying the beneficial owner in the person “who is free to decide (1) whether or not the capital or other assets should be used or made available for use by other or (2) on

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396 “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”
397 Arguing that not all the States discipline this concept and that also in common law systems there is not a complete and precise definition that can be automatically absorbed by the conventions; however, USA has a strong practice in the use of his national concept. P. PISTONE in L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 698, considers the international autonomous concept as a “tax policy objective”.
398 Cf A. BALLANCIN, La nozione di “beneficiario effettivo” nelle convenzioni internazionali e nell’ordinamento tributario italiano, cit., p. 219.
how the yields therefrom should be used or (3) both"400. In some legal systems (principally USA) the substantial approach is so strong that the beneficial owner clause is considered to be an expression of the substance over form principle. This approach seems to be confirmed by the Commentary401, when it states that a conduit company is not the beneficial owner whenever, even being the formal owner of the income, it has such limited powers to be considered as a trustee or an administrator on behalf of different subject.

Another theory identifies the beneficial owner in the person to whom the income is referable, according to national legislation of the contracting State. This position is based on the commentary of Art 10, 11, 12 of US model convention, according to which: “the “beneficial owner” of a payment of interest is understood generally to refer to any person resident in a Contracting State to whom that State attributes the payment for purposes of its tax”. This theory is held by the OECD report on “The application of the OECD model tax convention to partnership”402.

Basing on the sole commentary provisions two kinds of subjects certainly could not be beneficial owners:

1. agents and nominees who are not qualified as income’s owner according to the residence State tax legislation;
2. any conduit subject who in practice has such limited powers that substantially is a nominee or an administrator on behalf of a third subject.

So, according to the Commentary, the person who the income is attributed to, according to its own residence State tax legislation, not necessarily is the beneficial owner. The inquiry on the exercisable powers is particularly complex in companies which are part of a group. Indeed the concentration of all the shares in the hand of the parent company does not automatically exclude the status of beneficial owner for the controlled company. On the other hand, some doubts arise when the most important decisions of the controlled company, require approval from the controlling company. To conclude the inquiry tends to become an assessment of the existence of some discretionary

400 In this way K. VOGEL, On double taxation conventions, Londra-l’Aia-Boston, 1997, p.562.
401 Paragraph 8.1 of the commentary to Art. 11.
402 See paragraph 61: when a partnership, taxed on a transparency basis, receives royalties, the partners “[…] should be considered to be the beneficial owners of such income as these are the persons liable to tax on such income […]”. 
powers, in the hands of the conduit company, through an analysis of the activities undertaken and of the assumed risks: if the income flows are coherent with the activities undertaken and the risks assumed by the recipient subject then the latter is the beneficial owner.

In the majority of DTCs negotiated by Italy, the limitation of the source State taxation requires that the recipient, resident of the other contracting State, is the beneficial owner, according to the formula provided by the model convention of 1977. After the model revision in 1995 is now certain that the benefit is also granted whenever an interposed subject is involved but the beneficial owner resides in the same State (i.e. the other contracting State).

The definition of beneficial owner contained in the DTC between Italy and Germany is very interesting: “The recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if he is entitled to the right upon which the payments are based and the income derived there from is attributable to him under the tax laws of both States.” This definition’s merit is to provide for a clear solution binding both States. A similar concept has been adopted by the few Italian Ministry of Finance acts on the subject. In Ministry of Finance Circular December 23rd 1996, n. 306/E, concerning the regime of Legislative Decree April 1st 1996, n. 239 (dealing with interests and other forms of income from bond and similar titles) the beneficial owner is identified in the subject to whom the income is referable, according to Italian tax laws, moreover it is specified that the condition is not fulfilled if there is an interposed subject such as an agent or a nominee. The same position is confirmed in the resolution of the Ministry of Finance May 6th 1996, n. 104/E.

This subject is dealt also by Art 26-quarter of President of the Italian Republic Decree September 29th 1973, n. 600 (from now on D.P.R. 600/1973) introduced by directive 2003/49/EC. Paragraph 4 lett. c) substantially received the directive definition which distinguishes between companies and PEs. Identifying beneficial owner as:

403 DTCs with Australia, Belgium and USA contain a different clause requiring that the beneficial owner of the income is resident of the other contracting State.
404 See chapter 5.2.
1. “A company of a Member State [...] if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person.”

2. “A permanent establishment [...]:
(a) if the debt-claim, right or use of information in respect of which interest or royalty payments arise is effectively connected with that permanent establishment; and
(b) if the interest or royalty payments represent income in respect of which that permanent establishment is subject in the Member State in which it is situated to one of the taxes mentioned in Article 3(a)(iii) [...]."

The definition in number 1 seems to be identical to the already examined OECD Commentary provision. As regards number 2, the effective connection provided in lett. a) is a consequence of the lack of autonomous legal personality of the PE while lett. b) is similar to the definition of the Ministry of Finance Circular. On this provision the Ministry of Finance Circular November 2nd 2005, n. 47/E, affirms that a company is beneficial owner of interests or royalties when it obtains an economic benefit from the operation at issue, has the ownership and can dispose of the received income. The new element of obtaining a personal benefit from granting the loan or the licence seems to be an evolution of the concept. However, till now, from the few elements present in the Italian legal system, it seems that the adopted theory is the one that identifies the beneficial owner in the subject to whom the income is attributed according to Residence State tax legislation independently from the effective payment. Indeed this solution does not include those conduit subjects whose contribution to the production of the income is so weak that they can be considered as interposed subjects operating on behalf of a beneficial owner.

To conclude, the best solution seems to be to proceed to the elaboration of a definitive and precise definition of beneficial ownership at OECD level for the purposes of DTCs.

405 Art. 1 paragraph 3.
406 Art. 1 paragraph 5.
408 Cf A. BALLANCIN, La nozione di “beneficiario effettivo” nelle convenzioni internazionali e nell’ordinamento tributario italiano, cit., p. 227 e ss.
Although the EC Treaty doesn’t confer any competence to EC Institutions about direct taxation matters, and the ECJ has never decided, till now, about the incompatibility of LOB clauses in DTCs; the question of the incompatibility of these clauses with EC law can be argued according to ECJ case law.

First of all, it must be stressed that, even if both the internal and external competence about direct taxation is in the hand of Member States, in several occasions ECJ stated that these national powers must be exercised in accordance with EC law. This rule is not only a consequence of the principle of primacy of EC law but it also results from Art 10 EC Treaty, disposing that Member States “shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty.”

The main problem of LOB provisions is their compatibility with the principle of non-discrimination on grounds of nationality, and its interrelations with three fundamental freedoms (i.e. freedom of establishment, free movement of capital and freedom to provide services). As regards the extension of the non-discrimination principle it is useful to keep in mind paragraph 23 of Baars, C-251/98, according to which: “As to Article 6 (ndr. now 12) of the Treaty, it follows from the case-law of the Court of Justice that that Article, which lays down a general prohibition of all discrimination on grounds of nationality, applies independently only to situations governed by Community law for which the Treaty lays down no specific non-discrimination rules.”

After these due premises it is possible to proceed with an analysis of the single LOB clauses and, firstly, they will be singularly and abstractly examined, then a concept of abuse for EC law will be defined.

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409 For instance in Saint-Gobain C-307/97: “although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law” but also paragraph 19 of ICI C-264/96: “Although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community law (see Case C-279/93 Schumacker [1995] ECR I-225, paragraph 21; Case C-80/94 Wielocks [1995] ECR I-2493, paragraph 16; Case C-107/94 Asscher [1996] ECR I-3089, paragraph 36; and Case C-250/95 Futura Participations and Singer [1997] ECR I-2471, paragraph 19)”

410 Art 12 EC Treaty: “Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.”

411 Respectively Art 43-48; 56-60 and 49-55 of EC treaty.

412 Stock exchange clause, property and base erosion clause, activity clause and the general bona fide clause.
I. Stock exchange provision requires “the shares of a company residing in contracting State to be listed in a stock exchange recognized by the DTC or by the competent authority of the States that concluded the treaty”414. In this way a company, in order to benefit from the treaty, suffers a limitation in the choice of the markets where its shares will be traded. Moreover, the “qualified” stock exchanges are usually located in one of the contracting State. Consequently this clause is a hindrance to the freedom of movement of capital because not all the Member States stock exchanges are “qualified”. Briefly this clause, which conditions the application of treaty benefits, is a deterrent to the possibility of the free movement of capital inside EU.

II. The property and base erosion clause will be split in two single clauses: ownership requirement and base erosion requirement. The ownership requirement “limits the application of the DTC to entities which are majority owned by persons that reside in the same State as the company”415. So in order to benefit from the treaty a company must be owned, for more than 50%, by taxpayers residing a Contracting State. Shareholders are usually also required to be “qualified” resident and so they must be individuals, public bodies, entities that comply with the stock exchange clause. The former conditions can be a hindrance to the freedom of secondary establishment416. Indeed, a subsidiary, incorporated in a Member State, other than the parent residence State, will not benefit from the DTCs concluded by its residence State whenever this LOB clause is provided for (i.e. subsidiary’s ownerships are resident of a third State different from the negotiating ones). Whenever this third State is a EU Member State there is a breach of the freedom of the establishment in terms of discrimination on grounds of shareholders’ residence. In the Open Skies case (C-466/98) an Air Services Agreement between US and UK, allowing “the United States of America, inter alia, to revoke, suspend or limit the operating authorisations or technical permissions of an airline designated by the United Kingdom but of which a substantial part of the ownership and effective control is not vested in that Member State or its nationals.”

413 Cf. F. A. VEGA BORREGO, Limitation on Benefits Clauses in Double Taxation Conventions, cit., p. 242 and P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 661.
415 Cf. F. A. VEGA BORREGO, Limitation on Benefits Clauses in Double Taxation Conventions, cit., p. 244.
was at issue\textsuperscript{417}. “\textit{It follows that Community airlines may always be excluded from the benefit of the [...] Agreement, while that benefit is assured to United Kingdom airlines. Consequently, Community airlines suffer discrimination which prevents them from benefiting from the treatment which the host Member State, namely the United Kingdom, accords to its own nationals}”\textsuperscript{418} and “\textit{consequently, by concluding and applying that agreement, the United Kingdom has failed to fulfil its obligations under Article 52 (ndr now Art 43) of the Treaty.}”\textsuperscript{419} This judgement seems to confirm that LOB clauses excluding from benefiting from the convention those entities which, even if residing in a contracting State, are controlled, over a certain percentage, by citizens of another Member State seems to be in contrast with Art 43 of EC Treaty. On the other hand, the base erosion requirement “\textit{limits transactions between a taxpayer and persons residing in third States, that give rise to an expense deductible from its tax base}”\textsuperscript{420}. It is usually required that transactions with residents in third States, give rise to a deductible expense lower than 50%. In this case a breach of freedom of establishment can be found: indeed a Member State taxpayer is dissuaded from incorporating a subsidiary in another Member State using this LOB in his DTCs because the consequent and “physiological” high number of operations with the taxpayer residence State will give rise to an excess of deductible expenses excluding the application of the benefits. Moreover, this clause is also a breach of the freedom to provide services as long as taxpayers will refrain from providing services to customers residing in States different from the contracting ones.

III. The activity clause “\textit{requires that a trade or business is conducted in the State of residence, which is connected or incidental to the income obtained in the State of source}”\textsuperscript{421}. So it is necessary that an activity of a business nature is conducted in the Residence State.

\textsuperscript{416} Which consists in the freedom of constituting a PE or a subsidiary in another Member State.
\textsuperscript{417} Paragraph 47.
\textsuperscript{418} Paragraph 50.
\textsuperscript{419} Paragraph 52.
\textsuperscript{420} Cf. F. A. VEGA BORREGO, \textit{Limitation on Benefits Clauses in Double Taxation Conventions}, cit., p. 245
\textsuperscript{421} Cf. F. A. VEGA BORREGO, \textit{Limitation on Benefits Clauses in Double Taxation Conventions}, cit., p. 247
From the standpoint of the activity location, Art 48 EC Treaty is crucial: “Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States”. From the former Article it follows that it is not necessary that the company is incorporated in each State where any single element (i.e. registered office, central administration, principal place of business) is located. Moreover, none of these criteria must necessarily be located in the same State where the company has been incorporated. These remarks are very important if it is considered that only the central administration and the principal place of business have a factual link with the EC territory while, on the other hand, the registered office criterion has rather a formal nature. On the subject the following ECJ judgements are fundamental: Segers C-79/85; Centros C-212/97 and Überseering C-208/00. In these cases the ECJ has provided for a general interpretation of Art 48 of the EC Treaty, dealing with companies incorporated according to a Member State company law carrying on the whole of their trade or business or having their effective head office in another Member State. The essence of these sentences is expressed by paragraph 16 of Segers: “Article 58 (ndr. now 48) requires only that the companies be formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the community. Provided that those requirements are satisfied, the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial.” As a result if, on the one hand, the concept of establishment implies that, in order to be protected by EC law, a nexus of factual nature is necessary, the latter must not compulsorily be located in the same State where the company has been incorporated it being sufficient that the latter is a EC Member State. In this sense, the activity clause, considering only the business activity carried on in the State of residence, may be in contrast with the freedom of establishment. Finally, the activity clause, as verification “that the income generated at source was obtained in the course of the trade or business conducted by the entity in the State of residence”\textsuperscript{422} is, in

\begin{footnotesize} 
\textsuperscript{422} Cf. F. A. VEGA BORREGO, Limitation on Benefits Clauses in Double Taxation Conventions, cit., p. 254. The author considers also some EC directives (85/611/EEC and 95/26/EC) requiring company head office and place of management to be located in the incorporation State but justifies this further condition on the base of the speciality principle (the entities concerned are financial institutions and
\end{footnotesize}
principle, compatible with EC law. However, the clause could be considered contrary to EC law as it doesn’t consider activities carried on in other Member States.

IV. The general good faith clause disposes that “the competent authorities should grant the benefits of the DTC when the taxpayer proves that one of the main objectives of the incorporation, acquisition and maintenance of the person in the State of residence and the performance of its operations from this State is not to enjoy the benefits of the treaty”. This clause could solve some of the problems about the compatibility of LOB clauses with EC law if used as an instrument for the national competent authorities to guarantee benefits to taxpayers protected by EC freedoms. However, the problem is still not solved, when the source State is not a Member State (such as US) seeing that the relevant competent authorities will not apply EC law. Moreover, also this clause risks to be contrary to EC law according to what ECJ held in paragraph 57 of Schumacker (C-279/93): “[…], it does not suffice to meet the requirements of Article 48 of the Treaty for a foreign worker to have to rely on equitable measures adopted by the tax administration on a case-by-case basis.” In other words, it is not sufficient to provide for a mechanism allowing taxpayers to claim for the reconsideration of the discriminatory consequences of a certain regime to protect a rule contrary to EC freedoms.

From the previous analysis LOB clauses are a priori contrary to EC law but these remarks do not mean that they are always incompatible with it. This is due to compensation between different EC law objectives and according to paragraph 51 of X e Y II (C-436/00): “it is clear from the case-law of the Court of Justice that the need to safeguard the cohesion of a tax system (see Case C-204/90 Bachmann [1992] ECR I-249 and Case C-300/90 Commission v Belgium [1992] ECR I-305), the prevention of tax evasion (see ICI, cited above, paragraph 26, and Metallgesellschaft and Others, paragraph 57) and the effectiveness of fiscal supervision (see, inter alia, Futura Participations and Singer, cited above, paragraph 31, and Case C-254/97 Baxter and Others [1999] ECR I-4809, paragraph 18) constitute overriding requirements of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty (see, in particular, as regards such justifications in insurance companies and they need State control). Moreover, it identifies another incompatibility cause in the absolute exclusion of certain activities: entities providing investment services and active holding
the context of restrictions concerning a difference in income tax treatment, Case C-55/98 Vestergaard [1999] ECR I-7641, paragraph 23).” However, even if it is potentially possible to override EC law, the ECJ imposed strict limits retrieved from EC law general principle. First of all, it is necessary to assess the existence of a consistent risk of abuse (so a case by case analysis and an overall examination of the operation are necessary), then the measure must be applied in a non-discriminatory way and must be justified by imperative reasons of public interest. The possible restriction must also only be as wide as strictly necessary for the attainment of the other protected value according to the proportionality principle. Moreover, in Vestergaard case (C-55/98) the ECJ held that also presumptions, simply reversing the burden of proof, are incompatible with the fundamental freedoms if the right exercise becomes more difficult without any real anti-abuse reason. In the light of these criterions LOB clauses seems to be disproportionate as long as they presume the existence of abuses also when the latter are not concerned, such as in the case of companies exercising EC freedoms. To conclude, LOB clauses would be compatible with EC law, even if situations protected by EC law are at issue, whenever an individual examination of the company’s action fraudulence is carried on.

It is interesting to analyse here the DTC between USA and Italy LOB clause. The latter provides for a property clause which must be fulfilled by “qualified” residents. Moreover, also a stock exchange provision is included because companies, in order to be “qualified” residents, must be quoted “on a recognized stock exchange”. However, for the purposes of this chapter it is much more interesting paragraph 2: “Paragraph 1 shall not apply unless the competent authority of the other Contracting State determines that either the establishment, acquisition or maintenance of such person or the conduct of its operations had as a principal purpose obtaining benefits under the Convention”. Indeed, such a provision seems to solve EC law incompatibility problems seeing that it must be applied before the LOB clause restriction, providing for a previous individual analysis. Moreover, there is no hindrance to the exercise of fundamental freedoms because it is not necessary for the taxpayer claim as in the majority of bona fide clauses.

companies.

423 See especially: Leur-Bloem C-28/95; ICI C-264/96; Centros C-212/97 and Lankhorst C-324/00.

424 Cf. P. PISTONE, L’abuso delle convenzioni internazionali in materia fiscale, cit., p. 663.
To conclude, the best solution to solve LOB clauses incompatibility problems seems to be the elaboration of an EC Model Tax Convention respecting all EC law exigencies and constituting a good negotiation base for Member States.

5 ANTI-ABUSE PROVISIONS IN EC DIRECTIVES

5.1 Directive 90/435/EEC

“In order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the establishment and effective functioning of the common market” 425, the Council of the European Communities enacted the directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. The fundamental principles of this directive are: a Member State must grant tax credit or exemption to the resident parent company receiving dividends from a subsidiary 426 located in another Member State; a Member State must be free from withholding tax dividends paid by a resident subsidiary to its parent located in another Member State.

First of all a little anti-abuse provision is the participation minimum “holding period”. According to Art 3 paragraph 2 of the directive: “Member States shall have the option of [...] not applying this Directive to companies of that Member State which do not maintain for an uninterrupted period of at least two years holdings qualifying them as parent companies or to those of their companies in which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years.” Art 27-bis, paragraph 1, lett d) of D.P.R 600/1973, according to the former provision, provided for a minimum “holding period” of one uninterrupted year. A similar clause is present also in the directive 2003/49/EC 427 and it is aimed to avoid short-term operations on participations directed to the obtainment of the benefits.

425 First consideranda of directive 90/435/EEC.
426 The same regime must be applicable when between parent and subsidiary is interposed a PE as now clarified by directive 2003/123/EC. However, the same result would be obtained applying the non-discrimination principle affirmed by ECJ in Saint-Gobain (see chapter 1.4).
427 See the following chapter.
Article 1 paragraph 2 of the directive is more general: “This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse”. As a consequence, according to Art. 27-bis, paragraph 5 of D.P.R. 600/1973, the application of the discipline is excluded for companies which, even fulfilling the foreseen subjective and objective conditions, are directly or indirectly controlled by extra-EU subjects. However, those companies can still benefit from the directive if they are able to prove that they have not been incorporated with the sole or main purpose to benefit from the regime at issue. This provision is aimed to contrast abusive treaty shopping operations and correctly proceeds with a case by case analysis based on a bona fide clause.

Directive 90/435/EEC has been modified by directive 2003/123/EC\(^{428}\) which Italy is going to adopt. Last year the Council of ministers approved a draft of legislative decree containing modifications for Art. 27-bis D.P.R. 600/1973\(^{429}\). Relatively to paragraph 5, a harsher provision has been planned: parent companies that fulfil the subjective and objective conditions required but are directly or indirectly controlled by extra-EU subjects will have to prove that they don’t hold the participation with the only or main purpose to benefit from the directive.

5.2 Directive 2003/49/EC

Directive 2003/49/EC is aimed to solve problems of double taxation between associated companies resident in two Member States: exclusive taxation rights on intra-communitarian interests and royalties are attributed to the residence State while an exemption must be granted by the source State\(^{430}\). Moreover, this Directive introduces the important anti-abuse concept of beneficial ownership, that is examined in chapter 3.1.

Here attention will be focused on the Italian provision adopting the directive: Art 26-quater of D.P.R. 600/1973.


\(^{429}\)See for a deeper examination of the modifications: M. PIAZZA, Per le società “madri e figlie” soglia ridotta, in Il sole 24 ore of 22-07-2006.

\(^{430}\)Clearly this regime asks for subjective and objective requirements.
First of all, it must be noted that, as well as Art 27-\textit{bis} paragraph 1 lett d), Art 26-\textit{quater} paragraph 2, letter e) provides for a minimum uninterrupted participation holding period of one year\textsuperscript{431}.

Moreover, similarly to Art. 1 paragraph 2 of Directive 90/435/EEC, Art. 5 of directive 2003/49/EC, significantly titled “Fraud and Abuse”, allows Member States to introduce provisions against fraud and abuse\textsuperscript{432}. This provision gives the grounds for the introduction of the limitation of the exemption of paragraph 5 of Art. 26-\textit{quater}: whenever the interests or royalties payer is directly or indirectly controlled by the beneficial owner or both of them are directly or indirectly controlled by a third subject, the exemption is limited up to the interests or royalties amount calculated according to arm’s length principle. This rule excludes from the exemption benefit, those operations which, although exceeding the arm’s length condition, on the other hand does not exceed the debt/equity ratio necessary for the applicability of the thin capitalization regime\textsuperscript{433}.

To conclude letter f-\textit{ter}) was added to paragraph 3 of Art 37-\textit{bis} of DPR 600/1973. This provision allows tax administration to ignore tax benefits provided by Art 26-\textit{quater} whenever interests and royalties are paid to persons other than individuals, directly or indirectly controlled by one or more non EU resident subjects. Indeed in those cases the beneficial owners of the payments are outside EU but they use interposed subjects to obtain the exemption benefit\textsuperscript{434}.

\textit{6 ITALIAN NATIONAL ANTI-ABUSE PROVISIONS}\textbf{\footnotesize{\textsuperscript{431} Similarly to Directive 90/435/EEC (see footnote 93) also this directive allowed the extension of the holding period up to two years; Art 1 paragraph 10: “A Member State shall have the option of not applying this Directive to a company of another Member State or to a permanent establishment of a company of another Member State in circumstances where the conditions set out in Article 3(b) have not been maintained for an uninterrupted period of at least two years.”}}
\textbf{\footnotesize{\textsuperscript{432} Article 5 of directive 2003/49/EC: “1. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. 2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive.”}}
\textbf{\footnotesize{\textsuperscript{433}See chapter 6.3.}}
6.1 Introduction

In the following chapters the main Italian anti-abuse provisions will be examined. This choice is motivated by the possibility that these provisions are applied to international operations. Indeed, foreign companies can be subjected to Italian taxation regime whenever they carry on activities, in this country, through a PE.

6.2 Dividend Washing

Previously we examined the objective of a dividend washing operation, now the mechanism will be examined in detail through an *excursus* of the main sentences of Italian Supreme Court that will underline also the case law and legislative evolutions on the subject.

Before the CIT reform of 2003 capital gains were taxable (and losses arising from participations disposal were deductible) and dividends tax regime in order to avoid internal double taxation, provided for a credit method. This system was in force at the time the facts at the base of the cases happened and specific anti-tax avoidance measures hadn’t yet been foreseen. The latter was introduced in Article 14 paragraph 6-bis of CITA by Law Decree September 9th 1992, n. 372 which practically denied the credit to the purchasing company losing its most important benefit.

In case 3979/2000 an investment fund sold to a company shares, with accrued but not yet distributed dividends. Then the company received the dividends and proceeded

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435 See chapter 1.5.
436 Supreme Court, Tax division, judgement n. 3979 of January 26th 2000; Supreme Court, Tax division, judgement n. 20398 of April 29th 2005; Supreme Court, Tax division, judgement n. 22932 of October 25th 2005.
437 Legislative Decree December 12th 2003 entered into force on 01/01/2004
438 Dividends are a distribution of the company profit to partners. If dividends taxation doesn’t take into account the already levied company income tax, the same source of income would be taxed twice at two different economic levels.
439 Substantially tax paid by the company for the income in form of profit were credited to the partner receiving the dividend. For further information see R. LUPI, *Diritto Tributario: parte speciale (i sistemi dei singoli tributi)*, Milano, 2005, pg. 49.
441 Società per azioni.
to sell back the shares to the investment fund for a lower price. Both of them had tax benefits due to the different tax regime provided for investment fund and companies. Indeed the fund immediately obtained the dividend value in the form of capital gain, avoiding in this way the withholding tax provided. On the other hand the company included the dividends in its taxable base for corporate income tax but could reduce it according to the method of the tax credit. Moreover, the company could deduct the loss due to the lower second sale price of the shares.

In the first two stages of the proceeding it was held that dividends should follow the tax regime that would have been applicable to the investment fund in force of Article 37 paragraph 3 of Presidential Decree September 29th 1973, n. 600 (D.P.R. 600/1973). In more details the company was considered to be only a mere interposed subject for the perception of the dividends and consequently the provision mentioned could have authorized tax inspectors to ignore the interposition and to assess the income directly in the hand of the investment fund. The Supreme Court quashed the former judgements, refusing the qualification of the provision as a general anti-abuse rule and affirming its nature as a provision for the assessment of those evasion cases where a subject, fulfilling the conditions for taxation, fictitiously attributed it to a different subject. Then Art. 37 paragraph 3 could not be applied in order to ignore fiscal consequences of concrete and effective contracts. Indeed the Supreme Court stressed that a specific anti-elusive provision would be necessary in order to ignore fiscal consequences of a valid and effective legal ownership.

A similar use of Art. 37 paragraph 3 is suggested by another Secit resolution. In more details the resolution analysed the case of Italian shares given in usufruct by a foreign subject to an Italian taxpayer. In this way the resident taxpayer received the dividends benefiting of the tax credit and deducting the usufruct price, on the other hand

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442 The reduction of shares value is a consequence of the now occurred payment of dividends.
443 Commissione tributaria e Commissione tributaria regionale.
444 This theory was originally elaborated by Secit (a public body whose main task is to produce tax and economic policy studies and fiscal analysis based on information and data gathered from all areas of the Tax Administration) in resolution n. 49/1993.
445 See supra where it is explained that a provision limiting the benefits of dividend washing operation entered into force only subsequently.
446 See footnote n. 110; Cf. resolution n. 137/1993.
447 With no permanent establishment.
the foreign investor converts into cash an amount calculated on the base of the future foreseeable dividends avoiding, in the meantime, the provided withholding tax\textsuperscript{448}. According to Secit also in these cases it would be possible for tax inspectors to ignore the fiscal effects of the operation in force of Article 37 paragraph 3 D.P.R. 600/1973\textsuperscript{449}. In the light of the examined Supreme Court judgement, Art. 37 is not applicable also to these usufruct operations being the Italian resident the legal “possessor” of the dividends and not a mere interposed subject.

Subsequently a completely different approach and solution to the problem has been adopted by the Court in 2005 in judgements n. 20398 and 22932\textsuperscript{450}. The former concerns a double sale between an investment fund and a company similarly to the already examined judgement 3979/2000. On the other hand the latter is a case of shares usufruct between a non-resident and a resident subject. In both cases the Supreme Court declared the contracts null and void\textsuperscript{451}, and consequently no fiscal effect is produced, due to a lack of cause. Cause is one of the essential elements of the contract as provided by Article 1325 number 2 of Civil Code and \textit{ex} Art 1418 when one of the essential elements is absent the contract is void.

The real problem is the definition of this element. Agreeing with one scholar\textsuperscript{452} the concept of the Court is different from the “objective” one that considers it as the abstract economic and social function of the contract. Indeed, from this point of view, the validity, of such a fundamental contract as the sale is, is simply beyond dispute. On the other hand the Supreme Court looks at the fundamental practical intention pursued by the two parties to a contract (concrete cause theory). Using this different criterion the contracts at issue are void because no reason, other than the reduction of the global tax

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\textsuperscript{448} Art. 27 paragraph 3 D.P.R: 600/1973.
\textsuperscript{449} It must be stressed that the validity and effectiveness at civil law level had never been questioned.
burden, can be noticed\(^{453}\). In both cases, then, the problem moved from a matter of interposition to a question of contractual validity.

It is interesting to note that in paragraph 3.3 of case n. 20398/2005 the Supreme Court expressly refers to ECJ case law\(^ {454}\) where it was held that individuals cannot abuse EC law. The Italian Court particularly refers to case C-110/99 where “this principle” was applied to abusive operations finalized to the restitution of custom duties. However, the Supreme Court is conscious that the ECJ never recognized the existence of a general anti-abuse clause in the tax area. The Italian Court anyway specified that if such a clause existed, it would influence the entire tax system including also those taxes that are the exclusive competence of Member States.

The Italian Court also quoted case C-28/95 A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2, where the ECJ, referring to Art. 11 lett. a) of Directive 90/434/CEE\(^ {455}\), in paragraph 41 held that “However, in order to determine whether the planned operation has such an objective\(^ {456}\), the competent national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. According to established case-law, such an examination must be open to judicial review [...]

The Supreme Court concluded that even if a rule actually doesn’t exist against the so-called abuse of law, a “tendential principle” can be delineated and, waiting for the EC case law evolution, interpreters must look at national legal system for instruments to fight the phenomenon.

\(^{453}\)D. STEVANATO, Le “ragioni economiche” nel dividend washing e l’indagine sulla “causa concreta” del negozio: spunti per un approfondimento. Comment to judgement 20398/2005, cit. The author criticizes this theory that seems to assimilate the cause to personal interests pursued by the parties relevant exclusively under the conditions of Article 1343 and 1344 of the Civil Code. So he is substantially afraid for the certainty of legal relationship. For a deeper analysis BIANCA, Diritto civile, Milano, 2000, p. 452.

\(^{454}\)More precisely: October 11th 1977, C-125/76, Cremer; May 2nd 1996, C-206/94, Palletta; March 3rd 1993, C-8/92, General Milk Products; May 12th 1998, C-367/96, Kefalas; September 30th 2003, C-167/01, Diamantis. However, it must stressed that those cases are not concerned with tax law.

\(^{455}\)Article 11: “A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares: (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that one of the operations referred to in Article 1 is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives; [...]”.

\(^{456}\)See Art. 11 lett a) quoted in footnote n. 122.
From 2004 Italy passed from the credit method to the exemption one. With the participation exemption regime both capital gains and losses arising from participation disposal don’t produce any fiscal consequence. Nevertheless it must be noted that participation exemption is not a general regime but it is necessary to fulfil the conditions foreseen by Art 87 CITA and the residual cases regime taxes capital gain and allows the deduction of losses arising from disposal.

For our purposes the provisions of Art. 109 paragraphs 3- and 3-ter of CITA is particularly interesting. The latter introduced an anti-abuse clause which forbids, when the participation exemption regime is not applicable, the deduction of the losses arising from disposal of shares and similar financial instruments up to the amount of the dividends received. The deduction limit is applied whenever shares: have been purchased in the 36 months before their sale, satisfy the conditions of letters c) and d) Art 87 CITA and produced dividends in the precedent 36 months before their sale.

It must be briefly noted how there are two different theories about the application of the provision:

I) The first one, based on a literary interpretation, requires that the provision be applied whenever the enlisted conditions are fulfilled. The theoretical base is that the close sales of participation always produce a loss due to the payment of the dividends.

II) The second one, based on a deeper analysis of the ratio of the provision, provide for a further condition: the shares seller already enjoyed the participation exemption. According to this theory a more specific benefit must be fought: the production of deductible losses from a participation whose capital gain was not taxed.

This condition, indeed absent from the provision, is deductible from the fact that the participation must have the features provided by Art 87 lett. c) and d), and, most of all,

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457 More precisely the exemption is limited up to the 91% of the capital gain, reduced to 84% in 2007. The shift to the exemption regime, as expressly affirmed in L. 80/2003, was justified by competitiveness exigencies but was also coherent with the new exemption regime for dividends as underlined by the government report to Legislative Decree December 12th 2003, n. 344.

458 The most important are the participation detention for at least 18 months (lett. a), the company issuing stock and shares should be resident in a different State from those included in the black-list enacted with Ministry of Finance decree of November 21th 2001 (lett. c) and carry on a commercial activity according to Art 55 of CITA (lett. d).

459 Introduced by Art 5-quinquies of Law Decree September 30th 2005, n.203.

460 See footnote n. 124.

through a historical interpretation, which it underlines, how in the credit system no limits to the losses deduction were provided. This theory argues that the deduction was not limited because this tax revenue loss was compensated by the taxation of the capital gain in the hand of the first buyer\textsuperscript{462}.

To conclude it is important to talk about a different form of tax-avoidance exploiting the more advantageous tax regime foreseen for dividends paid to resident than the one foreseen for non-resident subjects. It must be immediately stated that the already examined anti-tax avoidance provisions are not able to block those operations and they are concerned only with abuses of the capital gain regime. For instance a non resident subject, in order to avoid the withholding tax on dividends, can sell his participations to a resident company which will receive the dividends without any withholding tax and benefiting from the exemption regime. We have already mentioned Article 14 paragraph 6-\textit{bis} of CITA, which limited the tax credit for the company, now the problem is to evaluate whether or not this provision is applicable in the exemption system with the proper modifications\textsuperscript{463}.

\subsection{The participation exemption regime: a brief analysis of the conditions provided by letters c) and d) of Article 87 CITA}

In the previous chapter the importance of letters c) and d) of Article 87 CITA should be noted. Moreover these conditions have also an anti-abuse function relative to the participation exemption regime.

However, a brief comment to letter a)\textsuperscript{464} of the same Article is necessary. This provision requires for a minimum holding period\textsuperscript{465} of 18 months before the sale and has a clear anti-tax avoidance aim because it avoids participation transfers motivated by the sole purpose of benefiting from the participation exemption. As underlined by some

\begin{footnotesize}
\begin{enumerate}
\item[462] This theory is the one supported by the Assonime Circular quoted in footnote n. 127.
\item[463] The credit would be substituted by the exemption.
\item[465] A similar provision is also present in directive 90/435/CEE; see chapter 2.1.4.1
\end{enumerate}
\end{footnotesize}
if the capital gain results from a short-term investment, then the exemption would be a groundless fiscal benefit. Indeed only the capital gains, resulting from a participation held for a substantial length of time, has a link with the company profits and would require measures against the economic double taxation.

Letter c) stipulates that the company issuing stock and shares should be resident in a different State from those included in the black-list enacted with Ministry of Finance decree of November 21st 2001 (i.e. so-called tax havens). The residence in those other States must be kept uninterruptedly for 3 years before the sale of the relative participation. If the company has been in existence for less than 3 years, the residence in a “white list” country must be maintained for more than half the length of time of the period between the incorporation act and the receiving of the capital gain.

However, the taxpayer can still benefit from tax exemption as long as he can show that the result of localizing incomes in those States had not being pursued from the start of the operation. The former condition is consistent with the anti-tax avoidance ratio of the discipline: in tax havens the profit would not be taxed and so it would no longer be necessary to avoid economic double taxation.

Finally letter d) which stipulates that the company issuing stock and shares carries on a commercial activity according to Art 55 of CITA. The second sentence of this letter foresees an “absolute presumption” with an anti-elusive aim: there is no commercial activity (and then no participation exemption) whenever the patrimony of the participated company is predominantly formed of immovable properties other than those which are object of the production and sale activity of the company, its plants and the buildings directly used in the undertaking activity. The idea is to identify real


\[467\] Otherwise the capital gain is the result of the market fluctuation.


\[469\] As clarified by Tax Administration Circular n. 36/E/2004.

\[470\] Through the procedure provided by paragraph 5, lett. b), Art 167 CITA.

\[471\] Principally the activities foreseen by Art 2195 Civil Code: production and sale of goods or services; commercial distribution; transports: banking and assurance; auxiliary activities to the precedent ones.

\[472\] This type of presumption does not admit contrary proofs.

\[473\] Such as a building company whose patrimony, probably, will be predominantly formed by immovable properties even if they are undertaking a real commercial activity.
estate companies created with the sole aim of benefiting from the different tax regime for companies. This provision wants to fight this phenomenon, making it less attractive, but in the meantime, from the standpoint of the economic double taxation, it seems unreasonable. It is also required that the commercial activity must be uninterruptedly undertaken for a minimum period of 3 years. The condition is anyway considered fulfilled for companies whose shares are negotiated in regulated markets.

To conclude, according to paragraph 5, if the company issuing stock and shares is a holding company, the conditions of letters c) and d) must be satisfied by the majority of the companies controlled by the latter.

6.3 Thin capitalization

Assuming the tax avoidance aiming of thin capitalization, this chapter will be focused on the Italian regime measures against the phenomenon. First of all the fiscal consequences of the transformation of dividends into interests: negative interests (remuneration for the loan received) are deductible by the company while dividends are not; on the other hand the moneylender benefits from a better taxation on interests (than on dividends) usually due to the application of substitute taxes. The tax benefit is greater where rule shopping is concerned as described in chapter 1.5.

To fight these abusive operations, when debts are excessively higher than the equity net worth, Article 98 CITA provides for:

1. Partners postponement in the reimbursement of the loan, after the payment of external creditors

474 On the subject it is interesting to notice that this absolute presumption, not allowing for a contrary proof, could be unconstitutional unless the participation exemption is considered, not as a general regime, but rather as a facilitation.

475 The fulfilling companies must represent the majority of the holding company patrimony value.

476 See chapter 1.5.

477 For a comparison between the legal regimes provided by several States see A. PISTONE, *La tassazione degli utili distribuiti e la thin capitalization: profili internazionali e comparati*, Padova, 1994, p. 313 e ss.

478 Thin capitalization is also an instrument for the abuse of civil law for a brief analysis cf. A. CONTRINO, *La normativa fiscale di contrasto della “thin capitalization”*, cit., p. 1237.
2. Loans from partners or “correlated parties”, exceeding a certain debt/equity ratio, produce non deductible interests by the company.

3. Paid interests qualified as dividends in the same amount.

The discipline provided by Article 98 is applicable only on entrepreneurs whose turnover exceeds 5.164.569 € or the lower amount provided by “sector surveys”\(^ {479}\), because only those subjects can, due to this turnover, deliberately\(^ {480}\) choose between debt and equity\(^ {481}\). Moreover, the loan is only granted by “qualified” partners or their “correlated parties” are relevant. Indeed only those who are subject hold a control participation and consequently have a sufficient decisional power to opt for loan instead of risk capital. So there is no limitation on the company call on the credit market if the creditors have no relations\(^ {482}\) with “qualified partners” and their “correlated parties”. It is also important to keep in mind that the thin capitalization rule produces its effects only on that part of the loan granted by those subjects which is both “pathological” and “abnormal”:

1. there is a presumption of “pathology” and then of tax avoidance whenever the debt/equity ratio fixed by the legislator is exceeded. Under that limit tax planning produces a legal reduction of the tax burden.

2. Such a loan must also be considered “abnormal”, meaning that a normal external lender would not grant it. So the company would have to prove that an external creditor would have granted the same loan at the same conditions if it wishes to avoid the application of the thin capitalization regime. Indeed the loan granted by the partners would be a real alternative to that granted by external creditors and would not be motivated by tax avoidance.

As a general rule, Article 98 disposes that the non deductible quota of the interests paid by the company is the part exceeding the 4/1 ratio between the amount of loaned money granted by “qualified partners” and their “correlated parties”, and their quota of equity.

\(^{479}\)In Italian “studi di settore”, which are enacted through a Ministry of Finance decree. Those are a Tax Administration instrument to assess presumptively the medium and little entrepreneurs revenue. See G. FALSITTA, Manuale di diritto tributario (parte generale), Padova, 2005, p. 309.

\(^{480}\)They are not forced by entrepreneurial exigencies and so their choice can be completely motivated by tax avoidance reasons.

\(^{481}\)An exception to this rule is disposed by paragraph 7 of Art 98 disposing that holding companies are always subjected to thin capitalization regime.
net worth (debt/equity ratio). Nevertheless there are two relevant types of debt/equity ratio:

I. Cumulative debt/equity ratio: which is calculated aggregating the amount of all the loans granted by “qualified partners” and their “correlated parties” (numerator), and their aggregate quota of equity net worth (denominator). Only if this ratio exceeds 4/1 it is possible to proceed with the individual debt/equity ratio. In this way it is possible that the regime is avoided, through a compensation mechanism, when only some (and clearly not all) lender partners exceed the individual ratio.

II. Individual debt/equity ratio: determine the amount of exceeding interests that are not deductible by the company. It is necessary to specify that only the part of this amount directly granted, and not simply guaranteed, by the “qualified partners” and their “correlated parties”, are qualified as dividends.

From a subjective point of view there are two alternative conditions to obtain the status of “qualified partner”:

1. when he exercises a direct or indirect control of the company according to Art. 2359 of the Civil Code.

2. when his participations, including also those held by his “correlated parties”, represent at least the 25% of the company capital.

According to paragraph 3 letter b) of Article 98 “correlated parties” are: companies that are controlled by “qualified partners” according to Art 2359 C.C. Moreover if these are physical persons, then also their relatives are “correlated parties” according to Art. 5, paragraph 5 of CITA.

482 Art. 98 concerns not only loans from “qualified partners” and their “correlated parties” but also guaranteed by the same subjects.
483 Clearly no compensation is possible here.
484 It is sufficient to fulfil just one.
485 Art 2359 C.C. forsees three cases:
1) “legal control”: the partner holds at least of the 50% + 1 of the votes in the ordinary shareholders’ meeting
2) “factual internal control”: the partner holds a sufficient number of votes to exercise a dominant influence in the ordinary shareholders’ meeting. For example because the participation is spread or other partners are often absent from meeting.
3) “factual external control”: the partner, independently by his participation, is able to control the company thanks to stipulated contracts that put the company in a situation of economic dependence.
486 Then the spouse, relatives up to the third degree and relative in law up to the second degree.
Consequently the thin capitalization regime is applicable to resident companies and commercial corporate bodies, non commercial corporate bodies (limited to their commercial activity) and non resident companies and corporate bodies (limited to the activity carried on through a permanent establishment).

For the application of the Italian discipline it is irrelevant that the lender partner is resident or non-resident\(^{487}\). It must be admitted that originally the legislator’s intention was to mainly (but not only) penalise non-resident partners\(^{488}\), but the situation changed after the ECJ case Lankhorst-Hohorst (C-324/00)\(^{489}\). In this case the Court held that the German thin capitalization regime was discriminatory and incompatible with EC law\(^{490}\) because it was applicable only to “repayments in respect of loan capital which a company limited by shares subject to unlimited taxation has obtained from a shareholder not entitled to corporation tax credit” and “as regards the taxation of interest paid by subsidiary companies to their parent companies in return for loan capital, such a restriction introduces a difference in treatment between resident subsidiary companies according to whether or not their parent company has its seat in Germany.” Indeed “such a difference in treatment between resident subsidiary companies according to the seat of their parent company constitutes an obstacle to the freedom of establishment which is, in principle, prohibited by Article 43 EC. The tax measure in question in the main proceedings makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure.”

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\(^{487}\)Several States (e.g. France, Spain, Portugal, Denmark and United Kingdom) simply excludes the application to resident partner or exempt them when some conditions are fulfilled.

\(^{488}\)See in particular Art 4 paragraph 1, letter g) of L. 80/2003.


\(^{490}\) As clearly expressed by the ECJ in paragraph 26: “It should be remembered that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law and, in particular, avoid any discrimination on grounds of nationality (Case C-80/94 Wielockx [1995] ECR I-2493, paragraph 16, Case C-107/94 Asscher [1996] ECR I-3089, paragraph 36, Royal Bank of Scotland, cited above, paragraph 19, Baars, cited above, paragraph 17, and Joined Cases C-397/98 and C-410/98 Metalgesellschaft and Others [2001] ECR I-1727, paragraph 37).”
Final considerations on the fiscal effects of the thin capitalization rule for non-resident taxpayers. First of all the discipline provided by the national legislation: withholding tax on dividends is higher than on interests\textsuperscript{491}.

The case of a taxpayer resident in EU is particularly interesting. Indeed if it fulfils both the subjective and objective conditions of Art 27-bis D.P.R. 600/1973, adopting the directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States which grants for the exemption from the withholding tax. Consequently the lender could ask for the reimbursement of the levied withholding taxes on interests. An interesting interrelation can be noticed with the Directive 2003/49/EC on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, adopted in Italy with Legislative Decree May 30\textsuperscript{th} 2005, n. 143. This directive is not directly applicable to the deemed dividends due to thin capitalization regime\textsuperscript{492}, but it prevents the lender from asking for reimbursement seeing that when directive 2003/49/EC (exemption of interests and royalties) is applicable also applicable is directive 90/435/EEC (exemption of dividends).

Finally the case of a taxpayer resident in a State which negotiated a DTC with Italy usually providing for lower withholding taxes. The problem is the choice between the regulations governing interests (usually Art 11) or dividends (usually Art 10). This problem is due to the residual clause about the definition of dividends usually provided by Art 10 paragraph 3 including “other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident”: when the thin capitalization rule is applied the underlying source of the income still remains a loan\textsuperscript{493}. The traditional doctrine denied

\textsuperscript{491}D.P.R 600/1973 provides for a withholding tax of 12.50% for interests (Art. 26, paragraph 5) and a withholding tax of 27% for dividends (Art 27, paragraph 3) with a maximum reimbursement of 12% under certain conditions.

\textsuperscript{492}Article 4 of Directive 2003/49/EC: “\textit{1. The source State shall not be obliged to ensure the benefits of this Directive in the following cases: (a) payments which are treated as a distribution of profits or as a repayment of capital under the law of the source State; [...]”\textsuperscript{.}}

\textsuperscript{493}This issue doesn’t emerge in DTCs concluded with France and Germany where the residual clause (respectively Art 10, paragraph 9, lett. a) and Art. 10, paragraph 6, lett. b) expressly refers to the qualification of the internal legal system including the transformation realized by Art 98 CITA.
the application of Art. 10 to thin capitalization cases⁴⁹⁴, but this trend has changed in conformity with paragraph 25 of the Commentary to Art. 10 paragraph 3 that expressly refers to deemed dividends. Substantially the applicable rate would be the one provided for dividends, implying that the reference to the national legislation provided by Art. 10 paragraph 3 affects also the nature of the underlying source of the income as can be also deducted by paragraph 15, lett. d) of the Commentary to Art 10 paragraph 2.

7 CONCLUSIONS

In this chapter few suggestions on possible improvements of the current anti-tax avoidance measures will be given. First of all the OECD model convention doesn’t provide for sufficient anti-abuse measures. Probably good results would be achieved if more anti-abuse provisions were included directly in the OECD model convention and not simply suggested in the commentary. However, this approach requires a wide agreement and a deep analysis of the OECD Member States exigencies. Moreover these States can be bound by other international organisation rules or principles (e.g. European Union). Nevertheless, the creation of a stronger common base on anti-abuse provision would produce, in the long-term, the best results assuming the influence that the OECD model convention has on the DTCs negotiation.

Moreover, the most important anti-abuse clause present in the current OECD model convention, i.e. the beneficial owner clause, is still not well defined. So, defining the real nature and range of effectiveness of this clause, is a priority. The best solution would be to create a new and independent (from the common law one) concept so that, the latter, would be also more compatible with civil law legal systems. Such a definition could be provided by the commentary.

Another interesting hypothesis could be the creation of a European model convention. In the short-term, such a convention would help Member States to elaborate anti-abuse

⁴⁹⁴Art 10 was considered applicable only when the lender participates to the riskiness of the financed undertaking and has the right to receive both the profits and the revenue from the liquidation of the latter. Cf. K. VOGEL, On double taxation convention, London, 1997, p. 650-652, 656-657 and 734-736.
provisions consistent with EC law. From a different standpoint, this approach is also a way to strengthen and harmonize the common market.

To conclude, the needs of the increasing globalization economy requires efforts for the creation of legal regimes wider than national ones: in order to contrast with the maximum efficiency an international phenomenon, as DTCs abuse is, the best solution is promoting international cooperation.
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