LUISS Guido Carli
LIBERA UNIVERSITA' INTERNAZIONALE DEGLI STUDI SOCIALI

Dipartimento di Scienze giuridiche

CERADI – Centro di ricerca per il diritto d'impresa

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"The Limits to Tax Planning, Minimizing Taxes and Corporate Social Responsibility"

Emilio Galdieri
Letizia Gianni
Vito Giuseppe Liotine
Roberta Piccinni
Paola Maria Plantamura
Rossella Sabia

Coordinamento della ricerca: Alessio Persiani e Federico Rasi

Direzione della ricerca: Giuseppe Melis ed Eugenio Ruggiero

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

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

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

Ha formato oggetto dell'ultima edizione del *Wintercourse* – tenutosi presso l'Università di Barcellona dal 14 al 23 aprile 2009 – il tema della "*L'elusione fiscale fra limiti normativi e conseguenze sanzionatorie"* , così articolato:

1. L'elusione fiscale fra disposizioni normative e soluzioni dottrinali;
2. Norme antielusive a carattere specifico (cc.dd. *Anti-base erosion rules*)
3. Il *treaty shoppin*
4. Norme anti differimento: la disciplina in tema di *Controlled Foreign Companies*;
5. L'attuazione delle norme antielusive della direttive comunitaria (la Direttiva Madre – Figlia; la direttiva Fusioni; la direttiva Interessi e *Royalties*; la Direttiva *Savings*);
6. Gli obblighi di *disclosure* e la questione della brevettabilità degli schemi di pianificazione fiscale.

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I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti, nell'ordine, dagli studenti Emilio Galdieri; Letizia Gianni; Rossella Sabia; Paola Maria Plantamura; Roberta Piccinni e Vito Giuseppe Liotine.

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ELENCO DEI CONTRIBUTI

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Università LUISS – "Guido Carli" – Roma
Facoltà di Giurisprudenza
Cattedra di Diritto Tributario

General anti-avoidance rules & doctrines

Emilio Galdieri
094153

PART I
GENERAL CIVIL LAW CONCEPTS
AND THEIR POSSIBLE USE IN TAX LAW

CHAPTER 1 - FORM AND SUBSTANCE OUTSIDE TAX LAW

1.1 INTRODUCTION

For many years in the past, tax avoidance cases in Italy have been contrasted only with the use of specific measures, inserted in those sectors that seemed more vulnerable time to time. To the tentative of formulating a general anti-avoidance rule, it had been opposed the principle of the right to arrange affairs and the need to preserve the certainty of law.

But the real concern was that, if it would attributed to the tax administration the power to evaluate the effective correspondence between the form of the transaction and the economic result truly pursued by the parties, the remedy would had been worse than the problem[1]. In fact, the tax administration is not an impartial third party and such power could had been easily misused in the absence of detailed norms regulating it.

Therefore, the identification of tax avoidance cases was left to legislator, sometimes even after long bureaucratic procedures.

However, another difficulty met in the introduction of a general anti-avoidance rule had been the great variety of forms that the phenomenon of tax avoidance can take, especially in relation to the corresponding fragmentation of the single requirements on which the tax system is articulated.

For this reason, some scholars suggested to bring all that variety of forms of tax avoidance under a common roof, which should had been the doctrine of the *abuse of law*[2], as developed in private law. In other countries, it had proved to be a really valuable instrument to limit the pathological or degenerated exercise of the law, used not to obtain the result imagined and protected by the legal system but something else.

Attempts were made to give to such principle a clear collocation in the Italian civil code[3], but at the end it did not find its place in the final version of the code: the worries of jeopardizing the certainty of law, setting a too generic limit to the free exercise of rights, prevailed.

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[1] L. ANTONINI, *Equivalenza di fattispecie tributarie ed elusione di imposta*, in *Riv. dir. fin.*, 1966, I, pp. 167 – 174.

[2] For an analysis on this see P. RESCIGNO, *L'abuso del diritto*, in *Riv. dir. civ.*, 1966, I, p. 205.

[3] See, for example, art. 7 of the Civil Code project of 1942: "Nessuno può esercitare il proprio diritto in contrasto con lo scopo per cui il diritto medesimo gli è stato riconosciuto" (translation: nobody can exercise his/her own right in a way contrasting with the scope for which that right itself has been granted to him/her).

However, over the years it was studied the possibility of using other concepts of civil law as anti-avoidance methods. Two of the most important attempts had been the *fraus legis*[4] and the *functional interpretation of contracts*, both of which are contemplated in the Italian civil code (from now on: "c.c.") of 1942. Therefore, it would be wise to begin our research from there.

1.2 FRAUS LEGIS

Art. 1344 c.c., titled "Fraus legis (of contracts)", clearly states[5] that, when a contract is used as an *instrument to avoid* the application of an *imperative norm*, its cause must be considered *illicit*. And when the cause is illicit, the contract is void (art. 1418 c.c.)[6]. It could not be otherwise, since the cause is one of the fundamental requirements of a contract (art. 1325 c.c.).
But what is the meaning of "cause"? This is not an easy question, since the theories about its nature varied a lot during the last centuries. According to a modern vision, the cause is the function performed by the contract itself from a sociological *and economic point of view. This is not only an objective perspective, but also an approach very concerned with society and the role played in it by the right to arrange affairs. In other words, the cause would be the abstract and typical economic scope of the contract.*
The Italian legislator has been influenced by this objective and abstract interpretation of the meaning of "cause", when preparing the Italian civil code of 1942. In art. 1325 c.c., the word "cause" is used almost like a synonymous of "contractual type". Unfortunately, this way the cause of the contract ends up to be confused with the contract itself.
Another possible and more recent interpretation of the meaning of "cause" could prevent such confusion. In fact, according to a subjective (or concrete) approach, the cause is the *individual* economic function of the contract. Therefore, while the objective theory looks at the impact of the contract for the society, the subjective theory underlines the concrete economic scope pursued by the parties (the individuals). This way, the cause of a contract is intended as the purpose of the transaction, which can be inferred by the tangible interests that come into play in the specific case. But as said above, the main theory is the objective one[7].

The study of art. 1344 c.c. has given rise to many questions regarding the structural elements of the contract abusing the law. Basically, there are two main approaches that have been taken: an objective one and a subjective one.

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4 In Italian: *contratto in frode alla legge*.

5 Art. 1344 c.c.: "Contratto in frode alla legge – Si reputa altresì illecita la causa quando il contratto costituisce il mezzo per eludere l'applicazione di una norma imperativa".

6 Art. 1418 c.c.: "Cause di nullità del contratto – Il contratto è nullo quando è contrario a norme imperative […]. Producono nullità del contratto […] l'illiceità della causa […]" (translation: Void contract – The contract is void when it is contrary to imperative norms […]. A contract is void for […] the illicitness of its cause […]).

7 F. GAZZONI, *Manuale di diritto privato*, Napoli, 2007, p. 788.

According to the objective theory, the problem when dealing with a case of fraus legis is to quantify how much imperative a norm is and to find out whether a typical contract has actually been used in an illicit way[8]. For the subjective theory, instead, the major concern is to asses the fraudulent intentions of the parties of the contract, willing to pursuit a result close or equivalent to the one forbidden. Therefore, the contract should be void on the basis of the concrete scope of the parties, even if they had not been actually able to pursue it . But one of the criticism moved against this approach, is that the norms that limit the parties in their right to arrange affairs are not only imperative but also exceptional. And to exceptional norm is not possible to apply analogy.

Anyway, as said in the introduction, the fraus legis concept has been studied also by tax law scholars in the attempt of using it in tax law too, especially as a general remedy in tax avoidance cases[9].

However, in spite of the good intentions regarding an extensive reading of the normative disposition contained in art. 1344 c.c. and the persuasion of the existence of an unwritten anti-avoidance principle, the arguments against the application of the fraus legis concept in tax avoidance cases are many.

First of all, there is not any such imperative norm that can force the taxpayer to make his/her transactions in a particular form when the legal system offers him/her various licit alternatives to choose from[10]. But it should be noted that, while in the past it was not interpreted in this way, recent judiciary developments seem to read art. 53 of the Italian Constitution, which establish the "ability to pay principle" in its first paragraph, as an imperative norm that puts a limit to the exercise of private autonomy when the purpose is to obtain a lower tax burden without any valid economic reasons[11].

Secondly, the civil law remedy to fraus legis is the nullity of the contract. But this kind of sanction results quite excessive and insufficient at the same time in confront of the objectives of tax law[12]. It is excessive because it brings to the elimination of the contract, while it would be much better to simply make it unenforceable to the tax administration. This way, the civil law validity of the contract would be safe but, at the same time, the tax administration would have the power to re-characterize it only for tax purposes. And it is insufficient because it does not make the Italian revenue authority able to take back the amount of tax yield stolen through the use of tax avoidance contractual constructions.

In fact, an instrument of tax re-characterization of contracts would be much more useful for the revenue authority than the nullity of civil law. Even more so, if it is considered the fact that the tax revenue dynamic is deeply related to the dynamic of transactions. It is the freedom of doing

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[8] P. M. TABELLINI, *Libertà negoziale ed elusione di imposta*, Padova, 1995, p. 49.

[9] U. MORELLO, *Il problema della frode alla legge nel dir. trib.*, in *Dir. prat. trib.*, 1991, p. 8.

[10] For the difference between tax avoidance and lawful tax savings see Part II, Chapter 1.

[11] These new judiciary developments are examined in Part II, Chapter 3.

[12] Already in 1923, Hensel was saying that: "the scope of the attempts to stop tax avoidance is not the nullity of the contract, but the revenue from the tax avoided". A. HENSEL, *Zur Dogmatik des Begriffes "steuerumgehng"*, in *Bonner Festgabe für Zitelman*, 1923, p. 119.

transactions through the use of contracts that supplies the revenue of the most important taxes. Therefore, it would appear as a contradiction to be willing to resolve the problem of tax avoidance with the nullity of contracts.

Moreover, it is important to stress the negative impact that the nullity of the contracts, used to avoid taxes, would have on the certainty of law. In fact, the effects of the transactions made with those contracts may well involve also other economic agents, that would irremediably suffer a loss (in terms of money, time, etc.) from the nullity of the contracts even if they were not aware of any tax avoidance scheme. The fear of such unpredictable losses would bring, soon or later, to a reduction in the overall number of transactions made in Italy, with tremendous consequences for the national economy.

In conclusion, it should be in the own interest of the revenue authority to preserve the existence of contracts (and the transactions behind them) made by the parties. But it should be noted since the beginning that the legal attitude toward these considerations has been changing in the last recent years. Therefore, it is not to be completely excluded the possibility of a new judicial and scholar attitude concerning the applicability of the fraus legis concept to tax law, in the near future.

But before dealing in more detail with the developments of the position taken by the Italian judicial system on the nullity of contracts, it would be better to briefly analyze also another private law concept that has been tried to be used in tax law: the functional interpretation of contracts.

1.3 Functional interpretation of contracts and registry tax

Interpreting a contract consists in a complex hermeneutic activity, with the scope of finding out the juridical relevant meaning that has to be linked with the words used in the contract[13]. This activity is regulated by various rules of its own that can be found in the civil code from art. 1362 to art. 1371.

These rules can be divided into two groups:

- the first one (arts. 1362 – 1365 c.c.) is composed by rules of *subjective interpretation*, directed to search the parties point of view;
- the second one (arts. 1367 – 1371 c.c.) is composed by rules of *objective interpretation*, used when the rules of the first group are not sufficient for the interpreter to give the contract a juridical relevant meaning.

It stands by itself art. 1366 c.c. which works almost like a bridge between the two groups. In fact, it simply states that a contract *inter vivos* should be interpreted *in bona fide* (the so called *reliance principle*) [14]. According to it, when interpreting a contract, it should be taken into consideration not only the meaning given to certain words by one of the parties, but also the meaning perceived by the other party of the contract. The *ratio* behind this principle is to avoid possible frauds at the loss of the one of the parties.

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[13] F. ZICCARDI, *Interpretazione del negozio giuridico*, in *Enc. Giur. Treccani*, 1989, vol. XVII, p. 1.

The starting point of the interpreter is the text of the contract, but his/her analysis should not be limited to the literal meaning of its words (art. 1362 c.c.). Through an overall examination of the contract and interpreting its clauses one with the other (art. 1363 c.c.), the interpreter should try to understand what was the scope pursued by the parties, i.e.: their common intention; the meaning that they both gave to the agreement.

In order to establish what was the common intention of the parties, also their behavior should be evaluated, both before the conclusion of the contract (in this case is very important to considerate the negotiations that preceded the conclusion of the contract) and thereafter (what the parties did to honor their agreement), as suggested by art. 1362 c.c..

However, such criteria were thought in a private law context, which is quite different from tax law (a branch of public law). Therefore, while their *potential* applicability to tax law is commonly agreed on, some problems may arise in their *concrete* application. Just to do an example, in a tax law trial it is not allowed to use as a proof any kind of testimony, so it would become much harder to understand the common intention of the parties *ex* art. 1362 c.c..

Anyway, in the first half of the last century, there were made several attempts to overcome the strictness and formal approach of the civil law criteria of contract interpretation. An outstanding example of such attempts is represented by the so called *Scuola di Pavia* and its founder, Benvenuto Griziotti (professor at the University of Pavia). For Griziotti and his followers, tax law needed a much more flexible attitude concerning the interpretation of contracts. In fact, considering that the main social and economic function of taxes is to fulfil the public financial needs, and that tax revenue comes from the economic facts constituted by the taxpayers, Griziotti thought that the interpretation of contracts should had been based on their real economic substance. This was the essential point of the theory of the *functional interpretation of contracts*. To sum up again, a tax statute links a certain economic fact to a certain amount of tax. Therefore, the important aspect here would be the coming into existence of that economic fact. It follows that, when interpreting a contract, the focus should be on whether the economic facts actually come into existence or not. The interpreter should try to understand the real economic *function* of the contract in question; in other words, its economic substance. On the contrary, its juridical characterization would become less important, in consideration of the tax mechanism described above.

In elaborating its functional interpretation of contracts, Griziotti was surely inspired also by famous jurists of other countries, such as Hensel, Becker, and Blumenstein[15], but found nevertheless a normative proof of the goodness of his theory even inside the Italian legal system of his times. It was art. 8 of Royal Decree n. 3269 of 30 December 1923 (nowadays art. 20 of Presidential Decree n. 131, 26 April 1986), about the registry tax.

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[14] A. TORRENTE – P. SCHLESINGER, *Manuale di diritto privato*, Milano, 2007, p. 539.

[15] G. MELIS, *Sull'"interpretazione antielusiva" in Benvenuto Griziotti e sul rapporto con la scuola tedesca del primo dopoguerra: alcune riflessioni*, in *Riv. dir. trib.*, 2008, p. 413.

According to the first paragraph of this article, in its original wording, “taxes are applied on the basis of the intrinsic nature and effects of the acts or transfers, even if their title or apparent form does not correspond with that nature or those effects”. For Griziotti[16] and the School of Pavia, with “effects” the legislator meant “economic effects”, and the principle of the *economic substance* was to be considered valid for all kind of taxes in general, not just the registry tax. Such approach would had been able to solve the problem of tax avoidance from its roots because it would had given to the tax administration to search for the economic results really pursued by the parties, overcoming the possible tax avoidance schemes organized by the dishonest taxpayers.

However, the theory of the functional interpretation of contracts met the skepticism of most scholars[17] of that time. Their view was a more traditional one: the tax administration should not had had the power of looking for the economic substance of a transaction, and should had limited its investigations only to the juridical effects of a contract. Therefore, if the characterization given to a contract by the parties did not correspond to its juridical effects, the tax administration could had re-characterized the contract with is appropriate name. But on the contrary, if the characterization corresponded indeed to its juridical effects, then the tax administration should not had gone further, verifying that there was such correspondence also with the economic effects of the transaction in question.

This conservative position became the dominant one and was soon supported also by the Court of Cassation[18] and by the legislator. It is particularly significant that in the early years of seventies, the wording of art. 8 of Royal Decree n. 3269 (nowadays art. 20 of Presidential Decree n. 131, 26 April 1986) was changed: the word “transfers” disappeared and to “effects” was added the adjective “juridical”. This way, any possible reference to the economic substance of a transaction was gone. And with it, any applicability of the theory of the functional interpretation of contracts, as a mean to contrast tax avoidance.

1.4 The opinion of the Court of Cassation

The difficulties to use private law concepts in tackling tax avoidance schemes are many as seen above. While art. 1344 c.c. was thought in a civil law context and its scopes are inevitably different from those of tax law, even the adoption of new methods of interpretations different form those of the civil code does not seem to have found the approval neither of the scholars nor the judicial authorities.

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[16] B. GRIZIOTTI, *Il principio della realtà economica negli articoli 8 e 68 della legge di registro*, in *Riv. dir. fin. sc. fin.*, 1939, p. 202.

[17] Among the others A. UCKMAR, *Principi per l’applicazione delle tasse di registro*, in Dir. prat. trib., 1937, p. 338; A. BERLIRI, *Negozi giuridici o negozi economici quale base di applicazione dell’imposta di registro?*, in *Riv. dir. fin.*, 1941, p. 161; E. RASTELLO, *Il tributo di registro*, Roma, 1955, p. 283.

[18] Cass., 9 January 1978, n. 75; Cass., 7 March 1978, n. 1123; Cass., 1 December 1978, n. 5693.

In the past, the Court of Cassation (Italian highest court) had stated more than once[19] that the tax system must had found remedies to tax avoidance and the abuse of law inside itself. In fact, it was argued, the nullity of the contract would have not be the best solution to tax avoidance and, beside that, it must have been noted that contracts are not the only civil law instruments used to avoid taxes. The reasoning behind such position was the concern that the nullity of contracts would have been at the same time a serious treat to the certainty of law and not very effective in contrasting tax avoidance schemes (as seen above in § 2).

Instead, while the functional interpretation of contracts would have been very useful indeed in tackling tax avoidance, the Court of Cassation preferred to align itself with the more traditional line of though, which considers as the only criteria for interpreting a contract those provided by the civil code from art. 1362 to art. 1371. Also in this case, the logic behind such position was the safeguard of the certainty of law: if the economic effects of a transaction should prevail on the juridical ones, it was argued, then the entire legal system could potentially be jeopardized .

In more recent times, while the skepticism toward the functional interpretation of contracts has not diminished, the Court of Cassation has showed instead a renewed interest for the nullity of contracts as a possible remedy against tax avoidance. In fact, it stated in several judgements of the last few years[20] that one or more interconnected contracts, when used by the parties with no other economic scope than to avoid taxes, should be affected by nullity. It is a very curious and unexpected change of position, received with caution by most scholars. However, such judicial developments will be dealt more in detail later on (Part II, Chapter 3).

It should be pointed out that also the norms on the interpretation of contracts are subject themselves to interpretation. And the Court of Cassation has showed two general positions:

- on one hand[21], the literal meaning of the words is fundamental, therefore, if the expressions used in the contract have a clear and unequivocal meaning, it should not be possible for the interpreter to search for the common intention of the parties;
- on the other hand[22], a judge can never renounce to the search for the common intention of the parties, therefore the literal meaning of the words used by the parties is only the first instrument to find out their common intention.

However, it must be clear that in the Italian legal system it is the form to prevail over the substance, and not the contrary. Even when it is said that the literal meaning is only the first criterion to interpret a contract, the interpreter cannot really investigate over the economic substance of a transaction. In fact, the other criteria are only complementary to the literal meaning and are always based on formal facts,

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[19] Cass., 15 November 1974, n. 3620; Cass., 24 October 1981, n. 5571.

[20] Cass., 21 October 2005, n. 20398; Cass., 14 November 2005, n. 22932.

[21] Cass., 20 March 1996, n. 2372; Cass., 6 October 1995, n. 10521; Cass., 28 June 1986, n. 4309.

[22] Cass., 18 August 1986, n. 5073; Cass, 20 January 1984, n. 511; Cass., 25 February 1982, n. 1198.

such as the behavior of the parties before the transaction and their formal purposes (which do not necessarily coincide with their substantial ones).

As said above, the major concern of the Italian legislator is the certainty of law, which makes possible for a legal system to work properly. It is such an important principle that all other rules and norms are thought in a way that does not compromise it. While this approach proves to be very useful from a private law point of view, allowing the citizens to engage in economic transactions with the proper knowledge of their future effects, not the same can be said from a tax law point of view.

In fact, in tax law a *substance over form* approach would probably be much better overall, providing the tax administration with the right tools to contrast any kind of unfair behaviors of the taxpayer, including tax avoidance. But unfortunately it is not easy at all to balance such contrasting needs: the certainty of law on one hand, and the inquiry over the economic substance of transactions on the other. As it will be explained later on (Part II, Chapter 2), a solution to such dilemma has been found in the use of a quasi-general anti-avoidance norm, which, while preserving the certainty of law, gives to the tax administration the power to investigate (to a certain extent and only if some criteria are met) the economic substance of a transaction.

CHAPTER 2 – TRANSACTIONS WITH WRONG CHARACTERIZATION

2.1 TRANSACTIONS WITH WRONG CHARACTERIZATION

In the past, the tax administration made use more than once of a so called *anti-avoidance interpretation* of contracts, in the attempt of putting a stop to increasingly alarming tax avoidance cases[23].
This kind of interpretation was based on the research of the *real* economic results pursued by the parties, even when the words used in the contract were quite clear and there should not had been space for any interpretation at all (as the old Latin aphorism says, "*in claris non fit interpretatio*").
Not following the civil code rules on interpretation, there were not any norms left to regulate this new interpretative method. Therefore, the tax administration began soon to apply the most inventive approaches[24] case by case. But this way, also those contracts not meant to avoid taxes were putted in question.
The attitude shown by the tax administration in handling such situations represented a serious treat to the certainty of law. In fact, one thing is to examine a transaction and verify if the parties have unintentionally mis-characterised the transaction in question or parts of it; another to simply ignore the literal meaning of the contract(s), in search of a pretended economic result different from the one that appears from the transaction form. While it is perfectly licit to re-characterize a transaction on the basis of the actual content of the contract(s), not the same can be said concerning what would be a creative interpretation of it (them).
In the first case, the tax administration simply applies a different tax burden according to the different type of contract(s) in question, that may have been wrongly characterized by the parties but whose actual intentions are clear from the wording of the contract. It is almost a mechanic operation: to a certain type of contract is linked a certain amount of taxes, determined previously by a statute.
In the second case, instead, the tax administration would go too far in using its tax asserting powers and would "*piercing the veil*" of the transaction(s), jeopardizing the certainty of law. Moreover, it should be noted that since those powers can be granted only by a national or regional statute, and that more often than not there are very precise and strict limits to their possible exercise, the tax administration is bound to follow the disposition of the statutes. Not doing that, would mean to break the law and the principle of legality, in the form of an abuse of power[25].
Anyway, the Court of Cassation finally putted an end to this ambiguous situation. It stated that the interpretation (of a contract) not based on the civil code rules is illegal. The tax administration can not characterize a contract without considering the will clearly manifested by the parties. The interpretative

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[23] For example cases of lease back, dividend washing, and dividend stripping. For further information: P. M. TABELLINI, *Libertà negoziale ed elusione di imposta*, cit., p. 411.

[24] P. M. TABELLINI, *L'elusione della norma tributaria*, Milano, 2007, p. 74.

[25] G. MELIS, *L'interpretazione nel diritto tributario*, Padova, 2003, pp. 259 – 288.

criteria found in the civil code from art. 1362 to art. 1371 have to be respected also in a tax law perspective[26].

Therefore, in the Italian legal system the form of a transaction prevails on its economic substance and, save for certain exceptions, taxation mostly derives from the legal forms chosen by taxpayers. The reason behind that is a reflex of that very principle cited above: the certainty of law. In fact, thanks to this formalistic approach, it results much easier to have a high predictability of the tax consequences of a given transaction(s).

Making the form prevailing over the substance is a precise juridical, judicial, and (probably even more) political choice. At the crossroads between thwarting tax avoidance attempts or sacrificing the certainty of law, the Italian legislator has always found himself on this last track. Obviously, such position may be subject to numerous critics and it may well be that other Parliaments would have (or already have) done differently.

Few years later, the Court gave also an indication about linked contracts, which are commonly used to try to avoid taxes. In order to be able to say that several contracts are linked together toward the pursuit a single scope, it is important that two requirements are met: an objective one and a subjective one. The first is based on the causal interconnection of the contracts, meant to regulate economic interests of the parties toward a more global and united economic major interest. The last is based on the common practical intention of the parties, not willing to obtain only the typical effects of each single contract, but interested in the coordination of those contracts and in the realization of another ultimate goal, autonomous from a causal point of view[27].

Therefore, in order to verify whether a series of transactions are an attempt to avoid taxes, the tax administration should not limit its investigation to one single contract of that series, but should examine the whole scheme in its entirety. Only this way it will be possible not to jump to wrong conclusions. In fact, it may be that a contract of the causal series of transactions is perfectly regular taken by itself, but would become a tax avoidance instruments in the context of a more complex scheme.

In conclusion, as seen until now, it is not easy to balance these two main interests of the legal system: the certainty of law on one hand; the necessity to contrast tax avoidance on the other. The solution to such problem must try to take into consideration both of them, and steps forward may have been taken in relatively recent years, with the introduction of an anti-avoidance norm with quite a broad sphere of applicability. But this will be discussed more in detail later on (Part II, Chapter 2).

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[26] Cass., 28 July 2000, n. 9944; Cass., 3 September 2001, n. 11351.

[27] Cass., 16 March 2006, n. 5851.

CHAPTER 3 – SIMULATION IN CIVIL LAW AND IN TAX LAW

3.1 CIVIL LAW AND SHAM

Arts. 1414 and following of the civil code are dedicated to the figure of *sham* (or *simulation*). However, the legislator did not give any precise definition of it, leaving the task to the elaboration of scholars.

A contract is considered "simulated" when the parties pretend apparently to want the legal effects deriving by that contract but in fact they do not. The only reason they make that contract is to be able to claim those formal legal effect against third parties.

Therefore, what characterizes a simulation is the internal and secret agreement among the parties that the official contract they stipulated is a mere fiction, not able to produce the legal effects it formally pretends to do. This way, the legal situation that should take place because of the contract will never come into existence.

For what concerns the legal situation behind the simulation, there are two possible cases:

- if the simulation is *absolute*, there is no legal reality between the parties and therefore the previous legal situation remains unchanged;
- if the simulation is *relative*, another transaction, different from that stated in the simulated contract, takes place; this last transaction is called *dissimulation.*

The true legal relation between the parties can be difficult to prove, considering that the parties are normally interested in concealing it. However, the civil code gives some guidelines on how to handle such a situation in art. 1417 c.c., which has to be read in coordination with the general dispositions on proof set by arts. 2722 c.c. and following.

Third parties have a wide range of means of proof, from actual documents (that are obviously rare and hard to find) to witnesses and presumptions. The last ones are the most used by third parties, who will present several factual elements to the judge, from which he/she will be able to presume that the contract in question is a simulation

3.2 TAX LAW AND SHAM

In tax law there is no special tax concept of simulation, and one relies only on the civil law concept.

In the second paragraph of art. 1415 c.c., the legislator stated that the third parties who had been damaged by the simulation can ask the judge to declare the nullity of the simulated contract, making the actual reality prevail over the fake one stated on the contract.

On the basis of the first paragraph of art. 1415 c.c., it has to be considered third party everyone who did not take part in the contract, not even through representatives. Therefore, also the tax administration could easily fit in this category[28].

However, the applicability of simulation to tax avoidance cases is unlikable. In fact, from a legal point of view, there is no doubt that sham is quite different from tax avoidance. Simulation is characterized by a difference between what is the legal reality wanted and that declared. Therefore, it can be considered more a question of tax evasion than of tax avoidance, since in the last there is not a different intention from that declared, but a different scope from the typical one linked to the contract made.

In other words, tax avoidance is not sham because there is not any kind of simulation at all. In tax avoidance, the parties want precisely what they have declared in the contract (or linked contracts). There is neither a dissimulated transaction to be covered, nor a previous legal situation that has to remain unchanged. When it is mentioned the contraposition between the legal form and the economic substance of a transaction in tax avoidance attempts, it is not meant in anyway the presence of a real transaction and a simulated one. In fact, there is no doubt that the parties really wanted to make the transaction in the legal form they have chosen. What it is putted into question is whether taxation should be based exclusively on that legal form, giving relevance to the juridical situation, or if also the economic substance can be considered as a criterion for taxation.

The bottom line is that the conceptual difference between simulation and tax avoidance makes the first not useful for tax anti-avoidance purposes. The best it could do is to make the tax avoidance contract void, but, as seen above, nullity should not be the major goal of the tax administration.

[28] G. FALSITTA, *Manuale di diritto tributario. Parte generale*, Padova, 2003, p. 187.

CHAPTER 4 – INTERPRETATION IN CIVIL LAW AND IN TAX LAW

4.1 CIVIL LAW AND ANALOGY

The hermeneutic instrument of analogy is contemplated by art. 12 of the "Dispositions on the law in general"[29], which come right before the beginning of the civil code.

Analogy can be used when there is a legislative gap in the legal system. In the case it is not possible to resolve a dispute through a specific norm, the interpreter can deduce a non-written norm (suitable to solve the dispute) from:

- norms that regulate similar cases;
- the general principles of the Italian legal system.

4.2 TAX LAW AND ANALOGY

Historically, the use of analogy in tax law cases has never been accepted neither by scholars nor by judges. The reasons behind this are many, but the most common arguments against analogy in tax law are mainly two[30].

An old one was the comparison between tax law and criminal law. Taxes were seen as a limitation or a penalty to individual freedom, much like to the sanctions in criminal law. And since in criminal law the use of analogy is forbidden[31], it was assumed that the same should had been applied to tax law.

Another argument is the reference to art. 23 of the Italian Constitution, in which it is ratified the principle of the reserve of statute in tax matters. According to art. 23 "no personal or patrimonial service can be imposed if not on the basis of a statute"[32]. Since taxes are a form of patrimonial service, it is assumed that without a specific statute a tax cannot be levied. Therefore, analogy is not possible in tax law.

However, having said that, it must be pointed out that there is a difference between substantial norms and procedural norms. The first establish the content of the tax in terms of its applicability and the criteria to quantify its amount; the second, instead, indicate the various formal obligations of

[29] Art. 12: "Nell'applicare la legge non si può ad essa attribuire altro senso che quello fatto palese dal significato proprio delle parole secondo la connessione di esse, e dalla intenzione del legislatore. - Se una controversia non può essere decisa con una precisa disposizione, si ha riguardo alle disposizioni che regolano casi simili o materie analoghe; se il caso rimane ancora dubbio, si decide secondo i principi generali dell'ordinamento giuridico dello Stato.

[30] G. MELIS, *L'interpretazione nel diritto tributario*, cit., pp. 381 – 406.

[31] Art. 14 of the Dispositions on the law in general: "Le leggi penali e quelle che fanno eccezione a regole generali o ad altre leggi non si applicano oltre i casi e i tempi in esse considerati".

[32] Art. 23 Cost.: "Nessuna prestazione personale o patrimoniale può essere imposta se non in base alla legge".

taxpayers, the investigative powers of the tax administration, the legal proves, and the steps of the trial[33]. For these last kind of norms, there is not any problem in the application of analogy, given the same *ratio legis* between the regulated case and the unregulated one.

Regarding the substantial norms, another distinction should be made. In fact, analogy is still applicable[34] also to these kind of norms when they deal only with secondary aspects of a tax already imposed by another substantial norm. As the Italian Constitutional Court has pointed out numerous times[35], the reserve of statute provided by art. 23 of the Italian Constitution is not *absolute* (like in criminal law) but *relative*. This means that it is not necessary for a tax statute to regulate even in the smallest details the various aspects of a tax, as long as the legislator clearly defines the essential elements of a tax, in order to prevent abuses perpetuated by the tax administration at the time of the application of the tax. Therefore, it is only in the case of a substantial norm that imposes a tax that analogy is not possible. In fact, it is assumed that when the legislator imposes a new tax, he/she does so in a complete way, indicating precisely what is taxable. It logically follows that what was not expressly indicated by the legislator is not taxable: *ubi lex voluit dixit, ubi noluit tacuit.*

In conclusion, it should also be cited statute n. 80 of 7 April 2003[36], with which the Parliament delegated the Government to reform the tax system at State level. Later on, such reform was not brought about, but it is nevertheless interesting to briefly cite a line of this statute. At art. 2, first paragraph, letter *e)*, it stated the inapplicability of analogy "for tax norms that establish the object and the subject of the tax, the exemptions, and the facilitation granted"[37]. However, some scholars noted that such a rigid provision may have been of impediment for future developments of the interpretative techniques and that a better solution would have been to evaluate the admissibility of analogy case by case[38]. This even more so, in a tax system like the Italian one, where there is not a truly general (in the strictest sense of the word) anti-avoidance norm[39].

Few last words should be spent on extensive interpretation, which is different from analogy. In fact, interpreting in an extensive way means to expand the range of application of a norm up to its most broad compatible meaning. Instead, with analogy the interpreter goes beyond this compatible meaning and is focused more on the logic behind the norm rather than its exact wording.

The applicability of extensive interpretation in tax law cannot be evaluated on an abstract basis but depends on how it is used in practice. Therefore, it is important to see if in the concrete case the

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33 R. LUPI, *Manuale giuridico professionale di diritto tributario*, Milano, 2001, p. 236.

34 F. TESAURO, *Istituzioni di diritto tributario. Parte generale*, Torino, 1998, p. 55.

35 See for example judgements n. 64 of 1965; n. 67 of 1973; n. 190 of 2007.

36 G. MELIS, *L'interpretazione nel diritto tributario*, cit., p.430.

37 In Italian: "è vietata l'applicazione analogica delle norme fiscali che stabiliscono il presupposto e il soggetto passivo dell'imposta, le esenzioni e le agevolazioni".

38 M. BASILAVECCHIA, *Auspicabile il superamento dell'analogia?*, in *Corr. trib.*, 2002, p. 2303.

39 G. MELIS, *L'interpretazione nel diritto tributario*, cit., p. 431.

interpreter respected the limit of the broad compatible meaning or if the extensive interpretation was just a sort of "label" in order to cover a truly analogy and to avoid those cases in which the law pretends the highest amount of respect for the words used by the statute interpreted[40].

If it is just a "label", all it was already said for analogy applies also for the extensive interpretation. Instead, if the limit of the most broad meaning compatible with the norm is respected, there is no reason why it could not be used also in tax law. However, it should be noted that since tax statutes that impose taxes are very detailed and precise in their wording, it becomes very hard to interpret their norms in an extensive way. In fact, the legislator generally uses a very analytical approach in describing the situations subject to taxation and applying an extensive interpretation, even if with the good intention of contrasting tax avoidance, would inevitably contrast with the specific wording of the statute interpreted. And this would be a problem, since it would make the evaluation of the tax administration too much arbitrary, with serious dangers for the certainty of the law[41].

Of course, if the legislator provided also some norms with a generic content and a non analytical wording, then the tax administration can interpret them also in an extensive way, but always respecting the limit described above.

40 G. MELIS, *L'interpretazione nel diritto tributario*, cit., pp. 372 – 378.

41 S. FIORENTINO, *Il problema dell'elusione nel sistema tributario positivo*, in *Riv. dir. trib.*, 1993, p. 806.

PART II
GENERAL ANTI-AVOIDANCE PRINCIPLES AND PROVISIONS
IN THE ITALIAN LEGAL SYSTEM

CHAPTER 1 – TAX AVOIDANCE AND LAWFUL TAX SAVINGS

1.1 TWO DISTINCT CONCEPTS

Tax avoidance should not be confused neither with tax evasion, which consists in violating the legal obligation to pay taxes, nor with lawful tax savings that the taxpayer can make choosing from the various options offered by the legal system to help him/her minimizing the tax burden[42].

In fact, there is absolutely nothing wrong in choosing, among two or more different transactions that lead to the same result, the one that leads to the lowest taxes, reducing or eliminating the tax burden. The possibility for the tax payer of realizing a tax saving tolerated by the legal system (in the so called *fiscally free area*) is innate in capitalistic economic systems. And it is emblematic the fact that such opportunity was given without any hesitation also in former communist countries after the end of their planned economies[43].

It has also been noted that the pursuit of tax savings, when does not exceed the limits of lawfulness, can be very worthy even from a social point of view. In fact, it is argued, the different weight of tax burden quite often represents an instrument to stimulate (or to discourage) certain type of social or economical choices of the taxpayer[44].

Instead, the essential characteristic of tax avoidance is the circumvention of tax norms. The tax burden is not softened by falsifying tax relevant facts (like it may be in the case of tax evasion), or simulating certain transactions (like in sham), but through the careful misuse of existing tax norms and their numerous gaps. Quite often, the taxpayer willing to avoid taxes, creates very complex schemes with the precise purpose of circumventing the law. The tax avoidance behavior, in other words, consists in obtaining a certain economic result without using the normal procedure (in terms of type of contracts) provided by the legal system.

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[42] G. CHINELLATO, *Codificazione tributaria e abuso del diritto*, Padova, 2007, pp. 164 – 174.

[43] P. PISTONE, Abuso del diritto ed elusione fiscale, Padova, 1995, p. 6.

[44] A. KRUSE, *Il risparmio d'imposta, l'elusione fiscale e l'evasione*, in *Trattato di diritto tributario*, Padova, 1994, p. 1117.

The real problem[45] is to understand how far the taxpayer can go in choosing the less burdening tax solution without avoiding the law. Where is the borderline between lawful tax saving and reprehensible tax avoidance?

1.2 An ambiguous borderline

The Ministerial Relation to the introduction of art. 37-bis ITAC[46] (of which it will be said more in the next chapter) states that: "there is just legal tax saving when, between different options given by the tax system on an equal level, the taxpayer adopts the one with a lower tax burden"[47].

Circular n. 320/E of December 1997 goes on, underling that: "there is no tax avoidance as long as the tax payer chooses between two or more alternatives provided by the legal system[48]. A different solution [to the problem] would contrast otherwise with a common principle, widespread in all the tax system of the developed countries that enable the taxpayer to settle his/her tax affairs in a way as less costly as possible, and where tax avoidance rules come into place only when the taxpayer abuses of his/her freedom, giving rise to practices, manipulations, and stratagems which – while formally not illegal – end up distorting the principles of the legal system. […] Anti-avoidance rules cannot prohibit the choice of the less costly behavior between a number of other possible behaviors, whom the tax system grants equal dignity. In all these cases, the choice of the less expensive tax solution, not implicitly forbidden by the legal system but on the contrary explicitly or implicitly permitted, does not constitute an example of tax avoidance".

Therefore, it seems that the taxpayer can save taxes when he/she chooses between two or more alternatives provided by the legal system. And this would be lawful tax saving. On the contrary, when the tax payer does not choose between licit alternatives but circumvent tax norms, distorting the very basic principles of the legal system, then it will be tax avoidance.

In the attempt to further clarify the ambiguous borderline between the two concepts, the juridical doctrine[49] tried to extrapolate from the observation of the phenomenon the essential characteristics of tax avoidance. It was found out that there are always four aspects present in a tax avoidance case, which are:

- the abnormality of the transaction actually put in place, in confront of the type of transaction that would normally have been performed in those circumstances;

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[45] P. M. TABELLINI, *L'elusione della norma tributaria*, cit., pp. 15 – 23.

[46] A quasi-general anti-avoidance provision in the Italian legal system (Part II, Charter 2).

[47] In Italian: "si ha mero risparmio d'imposta quando tra vari comportamenti posti dal sistema fiscale su un piano di pari dignità il contribuente adotta quello fiscalmente meno oneroso".

[48] In Italian: "non c'è aggiramento fintanto che il contribuente si limita a scegliere tra due alternative che l'ordinamento gli mette a disposizione".

[49] F. TESAURO, *Istituzioni di diritto tributario. Parte generale*, Torino, 1998, p. 213.

- the equality in the result obtainable through the abnormal transaction, in confront of the one obtainable through the transaction provided by the tax statute;
- the suitability of the abnormal transaction to get a decrease (or the nullity) of the tax burden;
- the exclusive (or prevalent) subjective intent of escaping from the tax burden provided by the avoided norm.

Both for the first and the last characteristics (the objective and subjective elements, respectively), the tax administration will have to analyze case by case the real reasons that induced the taxpayer to deviate from the normal transaction.

CHAPTER 2 – WRITTEN GENERAL ANTI-AVOIDANCE RULE

2.1 INTRODUCTION

In the past, it was a common thought that in the Italian legal system there was not any general anti-avoidance principle, neither express nor implicitly deductible from the entire system. On the contrary, there were some specific anti-avoidance norms[50] that seemed incompatible with the idea of a general norm of the same kind.
The consequences of all of this were that those transactions, which made use of statutory gaps, were to be considered licit, productive of all their legal effects, and enforceable in front of the tax administration even if they were a mere scheme to avoid taxes. Without a general anti-avoidance norm, the tax administration could not do anything to fill the statutory gaps.
But things started to change with the entry into force of art. 10 of Statute n. 408 of 1990, replaced few years later by art. 37-bis ITAC (Income Tax Assessment Code) in 1997.

2.2 ARTICLE 37-BIS INCOME TAX ASSESSMENT CODE

As far as income taxes are concerned, article 37-bis[51] ITAC[52] represents a quasi-general anti-avoidance provision that is assuming a growing importance for business enterprises.
Article 37-bis, first paragraph, reads as follows: "The tax administration may disregard the tax effects of any transaction or series of transactions carried out without valid economic reasons, aimed at circumventing obligations or prohibitions provided by the tax system and aimed at obtaining tax reductions or refunds to which the taxpayer would not be otherwise entitled".
As it can be seen, this article gives great power to the tax administration, allowing it to evaluate a given case in the light of the economic substance underneath a transaction or a series of transaction. Even this attention to the possibility of linked contracts used to avoid taxes, shows how the legislator did its best to contemplate all the different ways in which taxes are generally avoided, by using a very generic formulation.
All of this means that the tax administration can extend its observations not only to a single suspicious transaction, but also to other previous or posteriors transactions that may result inserted in a single tax avoidance scheme. Each transaction must have been thought by the parties as a step of a larger plan, not susceptible of other outcomes. Important clues that may reveal such interconnection are the closeness in the time the transaction had been made (when the interval between the transactions is so

[50] For example art. 110 of Presidential Decree n. 917, 22 December 1986 (transfer pricing).
[51] Art. 37-bis was introduced by art. 7 of Legislative Decree n. 358, 8 October 1997.
[52] Presidential Decree n. 600, 29 September 1973.

short to make reasonable thinking about their possible interconnection), or their objective interdependence (when each transaction results not very useful by itself).
In summary, article 37-bis provides that three criteria must be fulfilled in order to determine the existence of a tax-avoidance transaction:
(a) the lack of business purpose;
(b) the circumvention of obligations/prohibitions;
(c) the result of obtaining tax reductions/refunds otherwise not due.
It is not easy to determine whether the three elements occur in a transaction and, in particular, whether a transaction has to be considered as giving rise to a legitimate tax saving or to illegitimate tax avoidance. As it was said in the previous chapter, the borderline between tax saving and tax avoidance is still very unclear. The Ministerial Report to Legislative Decree no. 358, of 8 October 1997, which introduced article 37-bis, considers that the distinctive feature of (illegitimate) tax avoidance, as opposed to (legitimate) tax saving, is the "manipulation of tax provisions or the use of stratagems which – although formally legitimate – end up being in contrast with the fundamental principles of the tax system". The statement is very broad and does not clarify the issue: indeed, it might be asked what the fundamental principles of the tax system to be complied with are. As a further clarification, the Ministry of Finance (Circular n. 320, of 19 December 1997) pointed out that the tax savings are illegitimate when they are contrary to the ability to pay principle (article 53 of the Italian Constitution)[53].
Back to the three criteria, the first one is the business purpose test. With it the legislator has stressed the importance of an economic analysis of the transactions under scrutiny. There is a "valid economic reason" when the taxpayer would have done that (or those) transaction(s) even without any tax advantage, simply for business or management reasons. Just to do an example: a group of entrepreneurs might decide to create a corporation in order to join their force and be able to compete on the market; they may choose a form of limited corporation in which the responsibility is limited in order to be sure not to risk more money than they are willing to; and so on. In all this cases, the reason behind the choices is not related to taxes but to business purposes. Therefore, the transactions have to be justified from an economic and managerial point of view, not to be suspected of being just an attempt to avoid taxes.
The business purpose test has to be done on the basis of the concrete facts of each taxpayer situation, since the valuation of whether a transaction is an attempt of avoiding taxes or not depends on the actual circumstances in which the transaction has been made. Sometimes it may be interpreted by the tax administration in a peculiar way. In 2001 for example[54], the tax administration considered as legitimate a transaction whereby the aim of avoiding the dismissal of a certain number of workers employed by the seller justified the reorganization from an economic viewpoint. In that case, the

[53] See also Part II, Charter 3, § 3.
[54] Ruling n. 25, 26 February 2001.

transaction was very complex and had features which would normally result in the declaration of abuse of law.[55]

The second criterion is the circumvention of obligations or prohibitions provided by the tax system. The legislator used the word "circumvention" both for depicting the behavior of the negligent taxpayer (who takes advantage of the limits or gaps of tax statutes by "going around" the norm), and for substitute the adjective "fraudulent" presents in the previous statute n. 408 of 1990. In fact, "fraudulent" had produced a little bit of confusion in the past because it induced to think about criminal sanctions or the private law concept of the *fraus legis*. But tax avoidance cannot be assimilated neither with a complex of stratagems and deceptions like in the case of the criminal fraud (because in tax avoidance there is not any deception), nor with *fraus legis* (because, as seen above, the nullity of the transactions would not be very effective in contrasting tax avoidance).

Moreover, "circumvention of obligations or prohibitions" underlines also the importance of identifying a contraposition between two different paths that bring to the same economic and juridical effect. One, the tax avoidance behavior, is sly and profitable from a tax point of view, but also very tortuous; the other, the rightful behavior avoided, brings to the same result more directly and rapidly, but is also more expensive in terms of tax burden. It is up to the tax administration to demonstrate the existence of this second path.

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[55] Recently, there have been several rulings, by an ad hoc committee, regarding divisions of companies. In particular, in some of the rulings, the transactions have been considered abusive. In order to illustrate the purport of the rulings, a short description of the tax consequences of divisions in Italy is required.
Divisions are tax neutral; in particular, a division may be carried out by:
(a) attributing part of the assets of the dividing company to one/more beneficiary company/ies (either pre-existing or newly established) – in this case the dividing company continues to exist following the division;
(b) dividing the company into two or more entities – in this case, the dividing company ceases to exist.
In both cases, the shareholders of the dividing company will exchange their shares (or part of their shares) in the dividing company for the shares in the beneficiary company. For example, assuming a division of a company with two shareholders, each owning 50 per cent of the dividing company shares, each of the shareholders may receive:
(a) 50 per cent of the shares in all the companies involved in the division (dividing and beneficiary), or
(b) 100 per cent of the shares in one of the companies involved in the division (either the dividing or the beneficiary).
Divisions are often utilized to segregate part of the assets of a company in a target company whose shares may be subsequently sold. Divisions may be convenient for divestitures of companies owned by non-resident shareholders. A frequent scheme entails the division of the company and the attribution to a separate company of the activities to be disposed of. The subsequent sale of shares to a third party, which would in principle be taxable in Italy, might be tax exempt in our country due to tax treaty protection. The scheme usually provides that non-resident shareholders be resident in a country where the capital gain is tax exempt.
As mentioned above, the ruling committee considered as tax avoidance driven divisions whereby the majority shareholders were resident in treaty jurisdictions and which entailed the sale of the shares in the beneficiary companies to third parties.
Therefore, divisions and the subsequent sale of the shares have been re-characterized as a sale of a business which is taxable in the hands of the Italian company. In particular, according to the committee, the divisions failed to comply with the business purpose test because they were only aimed at obtaining a tax-free sale of shares by the non-resident shareholders. The committee deemed the divisions as carried out for the exclusive benefit of the non-resident shareholders.
In addition, divisions may give rise to tax benefits in the case of the disposition of assets of a company owned by individuals. In fact, the sale of the shares in the beneficiary company (which receives the assets to be sold) may be subject to 12.5 per cent or 27 per cent lump-sum tax in the hands of the shareholders as opposed to 36 per cent corporate tax levied in the hands of the company in the case of a direct sale of assets by the latter.

The third and last criterion is obtaining tax reductions or refunds otherwise not due. According to statute n. 408 of 1990, this had to be the only scope of the transaction(s) in order to be suspected of tax avoidance. For art. 37-bis ITAC, instead, this can be also a simply potential result, not necessarily the only one. With the expression "tax reductions or refunds", the legislator meant any kind of tax advantage, in its broad meaning. Therefore, it may consist in a reduction of the amount of taxes to be paid, or in a lower tax, or in any other way profitable from a tax point of view.

Having illustrated these three criteria, the attention must be brought back on the nature of art. 37-bis ITAC. It applies only to transactions (or series of transactions) listed therein, in the third paragraph[56]*. This circumstance would probably make the article appear as another example of specific anti-avoidance rules. However, a closer look at the third paragraph would reveal an aspect not to be underestimated: the length of the list of transactions. Not only they are many, but they seem also to represent all (or at least the major) ways in which taxes can be avoided. In this perspective, art. 37-bis may not be "general" in a strict sense of the word, but can easily be thought as "almost/quasi-general". The broad wording of the first paragraph together with the very long list of transactions of the third one give to the tax administration enough space of action to contrast tax avoidance, proving art. 37-bis ITAC an effective quasi-general anti-avoidance rule.*

In conclusion, a few considerations regarding the application of the anti-avoidance provisions in a tax treaty context.

In Italy, it is not clear whether domestic anti-avoidance rules (such as article 37-bis) can be adopted in cross-border situations involving the application of a double taxation convention. In this respect, the lack of significant case law and official clarifications by the tax administration is noteworthy.

According to some scholars[57], domestic anti-avoidance provisions can be applied if the double taxation convention does not contain specific anti-abuse provisions applicable to the case (as normally happens in treaties concluded by the Italian government).

2.3 EFFECTS OF THE GENERAL ANTI-AVOIDANCE RULE

The main effects of the application of anti-avoidance norms are:

(a) *the unenforceability to the tax administration and the elimination of the tax advantages obtained.* The fact that one or more transactions constitute an attempt to avoid taxes does not produce their nullity. The only effect it produces is the unenforceability of those transactions to the tax administration and therefore the elimination of the tax advantages that came from the tax avoidance scheme. The power to neutralize or to make unenforceable the tax avoidance scheme is granted to the tax administration, not to erase the juridical effects of the tax avoidance acts, but to eliminate the economic damage suffered by the State.

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[56] (a) transformations, mergers, divisions, voluntary liquidations and distributions to the shareholders other than profit distributions; (b) contributions to the capital of companies and transactions concerning branches of activities; (c) transfers of credits; (d) transfers of excess tax credits; (e) operations carried out under the legislation implementing the Merger Directive; (f) operations concerning transfers and valuations of participations, transfers of securities, foreign currencies and precious metals and transactions on derivative instruments.

[57] P. PISTONE, *L'abuso delle convenzioni internazionali in materia fiscale*, in *Corso di diritto tributario internazionale*, Padova, 1999, p. 483.

In fact, as said before (Part I – Chapter 1), nullity would probably not be the best remedy to tax avoidance and the legislator preferred to let those transactions still produce their civil law effects. However, in recent years the Court of Cassation has developed a new position much more stricter (Part II – Chapter 3);

(b) *the detraction of what has been already paid.* From the taxes calculated on the basis of the application of the tax norms avoided, it has to be detracted those taxes – surely of an inferior amount - that have already been paid when the tax avoidance scheme was made. The logic behind this is the willingness of the legislator not to sanction tax avoidance attempts (for more on this see Part II, Chapter 4), but to simply enable the tax administration to take back the tax revenue avoided. It should be noted that if the amount of the avoided taxes and the taxes already paid was equal (or the taxes already paid were even more), there would be no tax avoidance since there would be no tax advantage;

(c) *the reimbursement of the taxes paid by third parties.* Anti-avoidance norms tend to hit only the tax advantages pursued through tax avoidance; therefore, the subjects different from those to whom it has been applied the anti-avoidance dispositions can ask for the reimbursement of the taxes paid because of the avoidance acts.

2.4 THE RULINGS

Understanding when one or more transactions may be seen as a tax avoidance attempt by the tax administration is not an easy task. Tax law is quite complex, constantly evolving, and sometimes it may be difficult to interpret its rules and to adapt to its parameters. Even more so from the point of view of the tax payer, who may not be an expert of tax law and may wonder whether is behavior will be considered licit or not. Knowing the consequences of his/her tax choices beforehand is of absolute importance, since it allows to plan an economic strategy with the awareness of its related tax burden.

In order to guarantee the certainty of law and transparent relations between the tax administration and taxpayers, the tax system provides for a number of institutes, called "rulings", with which it is given the possibility to the taxpayer to obtain a qualified opinion by the tax administration concerning the application of various norms, among which the anti-avoidance measures provided by art. 37-bis ITAC.

Each kind of ruling has its own proceeding rules and may slightly differ from one other in terms of juridical effects (for example, whether the opinion will bind the tax administration that gave it).

A ruling that proved to be very useful for a clarification concerning art. 37-bis ITAC and other norms[58] has been introduced in the Italian legal system with art. 21 of statute n. 413 of 30 December 1991[59]. This institute is very useful overall: having the chance to communicate easily with the tax

[58] Art. 37 ITAC (interposition of another taxpayer); art. 108 of Presidential Decree n. 917, 22 December 1986 (qualification of advertising); art. 110 of Presidential Decree n. 917, 22 December 1986 (deductible contributions).

[59] The procedure provided for this type of ruling is as it follows: the taxpayer may ask clarifications to the competent regional division of the tax administration. The request must contain all the data necessary to identify the taxpayer, a detailed description of the specific case for which clarifications have been asked, and the interpretative solution thought

administration and being able to get a specific answer to a specific case improves considerably the understanding of anti-avoidance regulation[60]. However, it should be noted that the tax administration is not bound by the answer it gave. Therefore, the main advantage that the tax payer will obtain with this type of ruling is that his/her future behavior (in line with the answer given) will not be subject to any sanction at all. But the eventual higher tax will be nevertheless still due. Moreover, the burden of proving that a tax has been actually avoided will lay on the tax administration.

Another kind of ruling is provided by the eighth paragraph[61] of art. 37-bis ITAC[62]. With it, the taxpayer can only ask to the tax administration not to apply the anti-avoidance rules (that limit deductions, detractions, tax credits or other subjective positions otherwise admitted by the tax system) to a certain transaction, that would normally be considered as a tax avoidance attempt. The taxpayer has to demonstrate that the transaction in question is not meant to avoid taxes and that the limits to tax reductions and refunds are therefore not justified, since there is no tax avoidance to contrast in the specific case[63]. And in this case, the answer given will bound the tax administration[64].

This type of ruling, contained in the eighth paragraph of art. 37-bis, works as a counterweight to the power given to the tax administrations with the quasi-general anti-avoidance rule. As a matter of fact, art. 37-bis ITAC contains not only a quasi-general anti-avoidance rule (in its first seven paragraphs), but also a general rule of not applicability of anti-avoidance rules (in its eighth paragraph). This way, the tax administration can decide not to recognize a certain transaction (or series of linked transactions) meant to avoid taxes and to obtain a tax advantage otherwise not due. But on the other hand, the taxpayer can demonstrate the not applicability of the anti-avoidance measures in the specific case, inverting the burden of proof. It is a great opportunity given by the tax system to the taxpayer, in order to make sure that honest transactions would not be penalized just because generally used to avoid taxes.

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by the asker. The competent regional division must send the request to the central normative and contentious head office of the tax administration. Then, the head office have to give an answer within one hundred and twenty days after the request. In case of no answer, the tax payer can formally invite the tax administration to give an answer within other sixty days. If the tax administration still does not respond, its silence is legally equivalent to an approval of the interpretative solution though by the taxpayer.

60 R. BETTI, *Parte il diritto di interpello. Ouverture con stecca*, in *Boll. trib.*, 1999, p. 373.

61 It was introduced by Ministerial Decree n. 259, 19 June 1998.

62 P. PICCONE FERRAROTTI, *Riflessioni sulla norma antielusiva introdotta dall'art. 7 del D.Lgs. n. 358/1997 (art. 37-bis del D.P.R. n. 600/1973)*, in *Rass. trib.*, 1997, pp. 1173 – 1175.

63 The procedure provided for this ruling is somehow similar to that of art. 21 of statute 413/1991. The taxpayer has to send the request (of not applying the anti-avoidance provisions to a particular transaction) to the competent regional division of the tax administration, which will pass it to the central normative and contentious head office of the tax administration. The head office must examine the request and formulate an answer in no more than ninety days. In case of no answer, the silence is not equivalent to an approval of the interpretative solution though by the taxpayer (unlike in the ruling provided by statute n. 413 of 1991).

64 Art. 1, paragraph 6 of Ministerial Decree n. 259, 19 June 1998.

CHAPTER 3 - THE COURT OF CASSATION AND ANTI-AVOIDANCE RULES

3.1 A BRIEF OVERVIEW

The first major response of the Court of Cassation to the delicate problem of tax avoidance (and the limits within which it may give rise to acts declared to be ineffective against the tax administration) can be found in judgments dating back to the years between 2000 and 2002.

With such judgements[65], the Court stated that only those behaviors that are defined by a statute, in force at the time when the facts came to existence, can be considered as an attempt to avoid taxes, and therefore of no effect.

Unfortunately this approach was not very effective. In fact, it limited the repudiation of tax avoidance practices only to those cases expressly provided for by a statute. But as the experience shows, the Parliament is often late in recognizing the occurrence of pathological behaviors, because of the rapid development of economic and trade practices at national and supra-national level, and this inevitably leads to a drastic loss of tax revenue.

A significant step forward was taken in 2005 with the enactment of important judgments of the Court of Cassation. The judgment 20816/2005 stated that the tax administration, as a relevant third party interested in the exact and correct application of tax law, is entitled to deduct the tax avoidance contracts of the tax payer, both during the administrative phase and in litigation. The burden of proof, which may be provided by any means (including presumptions), is on the tax administration.

Moreover, if the only interest pursed by the parties is to save taxes, their transaction should be considered void because it defects in the cause of the contract. In such way, the Court of Cassation reevaluated its previous position, that it had constantly affirmed for such a long time, stating that the *fraus legis* concept is applicable also in tax law. The reasons behind this judgment are not completely clear: in this case the parties admitted that the only scope of their transaction was to avoid taxes, and such admission may have played a role in the Court final decision. However, it seems that judgement 20816/2005 had not been an isolated case, and that the use of private law concepts and the nullity of contracts was suggested also by other judgments in the course of the following years[66].

Such a new position, while a laudable attempt to contrast tax avoidance, has been subject to criticism from tax avoidance scholars[67]. As they point out, private law institutes present in the civil code were though (back in 1942) to regulate the relations among privates citizens. Therefore, their *ratio* (the logic behind them) is not well suited to solve problems arising between citizens and the tax administration, which is a public entity. Moreover, applying private law concepts to tax law would give rise to the risk

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[65] Cass., 3 April 2000, n. 3979; Cass., 3 September 2001, n. 11351; Cass., 7 March 2002, n. 3345.

[66] For example: Cass., 5 May 2006, n. 10352.

[67] R. SCHIAVOLIN, *L'elusione fiscale come abuso del diritto: allo stato dell'arte, più problemi che soluzioni*, in *Il Fisco*, 2006, all. 11.

of forcing the meaning of the law, in order to make it suit the necessities of the tax administration. It is obvious that this would be a real threat to the certainty of law, and would also represent a sort of abuse of the law in order to contrast another abuse of the law. Of course these are not the intentions of the Court of Cassation, but the reasoning of judgments like 20816/2005 have not been persuasive enough, for the moment, to reassure the major part of Italian tax scholars.

In the mean time, it came also the recognition of the doctrine of the abuse of law, as developed by the European Court of Justice, in other two judgements of 2005: n. 20398 and n. 22932. The national judges found that the concept of abuse of law, while art. 37-bis ITAC was not operative yet in the Italian legal system at the time of the facts object of the judgment, should had had a central role in the application of domestic law. This had been the first time that the Court of Cassation expressly supported the direct applicability in the Italian legal system of the principle of abuse (of Community) law as developed by the European Court of Justice[68].

However, having asserted such general principle, it was not easy to apply it in the Italian legal system without any further clarification. In fact, it was still not very clear whether such abuse (of Community) law concerned only certain types of tax (most notably the VAT) or could be applied also to all of them.

The path traced by the Court of Cassation in matters of abuse of law has had significant developments in subsequent judgments. Among them it seems very important the 21221 of 2006, where it was stated that acts constituting abuse of law are not effective against the tax administration and that this principle applies to any kind of tax, both direct and indirect.

Moreover, according to the Court of Cassation, the Community law principle of abuse of law should be considered by the Italian interpreter as a warning to find the appropriate means to contrast abuses like tax avoidance. But such means can only be found inside the national legal system, and the Court of Cassation (following its new position) seems to find them in the nullity of contracts[69].

Finally, with other two judgments in 2008 (30055 and 30057), the Court of Cassation stated that the principle of abuse of law is directly recognizable in the reading of art. 53 of the Italian Constitution (without any need of referring to Community law), and the verification of whether there has been an abuse of law should be based on a punctual analysis of the facts, case by case.

Below, it will be analyzed in more detail these recent developments in the position of the Court of Cassation, which will then be compared with art. 37-bis ITAC.

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[68] European Court of Justice, judgments n. 125/76, of 11 October 1977, (Cremer case); n. C-8/92, of 3 March 1993, (General Milk Products case); n. C-206/94, 2 May 1996, (Palletta case); n. C-367/96, of 12 May 1998, (Kefalas case); n. C-110/99, of 14 December 2000, (Emsland Stárke case); n. C-167/01, of 30 September 2003 (Diamantis case).

[69] M. ANDRIOLA, *Quale incidenza della clausola anti-abuso comunitaria nella imposizione dei redditi in Italia?*, in *Rass. trib.*, 2008, pp. 270 – 282.

3.2 Judgments 20398 and 22932 of 2005

Judgment 20398 of 2005 represented an innovative decision on the taxation of capital income. According to the Court of Cassation, even before the entry into force of art. 37-bis ITAC, although it did not exist in the Italian legal system an anti-avoidance general clause, it was undeniable the presence of a general principle, deducible from the concept of abuse of the law developed by the case law of the European Court of Justice, for which it is not possible to benefit from transactions implemented and enforced for the sole purpose of avoiding taxes.

Referring to the case (known as dividend washing) where the purchaser of shares from a mutual investment fund, after having received the dividends, sales those shares again to the same fund in order to permit the circumvention of the tax regime provided for by art. 9 of statue n. 77 of 1983 on the income from equity investments held by mutual funds, the application of that principle is reflected in a defect in the cause which gives rise to the nullity of the linked contracts for the purchase and resale of the shares, since the parties would not take from them any other advantage than tax savings. In fact, there is a defect in the cause of the linked contracts because the parties are not really willing to transfer anything at all. They simply limit themselves to sell and immediately buy back the shares. But, this way there is not any transfer in practice and thus there is not any sufficient cause to justify the entire transaction.

The defect in the cause that invests in its essence the linked contracts, as the Court of Cassation pointed out, implies their non effectiveness in confront of the tax administration. This makes possible to overcome even the prospects of fraus legis or sham, both of which difficult to contrast without the pursuit by the parties of purposes contrary to public policy or morality, or other purposes expressly prohibited by law.

Just a month later, the Court of Cassation came to the same conclusions in judgment 22932. This was one of the first times in which the Court had to deal with a case of dividend stripping.

Dividend stripping is the purchase of shares just before a dividend is paid and the sale of those shares after that payment. When part of a tax avoidance scheme, it is used to distribute company profits to its owners as a capital sum, instead of as a dividend. The purpose generally being that capital gains are subject to lower taxes.

Once again, the Court of Cassation underlined the presence of this general principle developed by the European Court of Justice for which it is not possible to benefit from transactions implemented and enforced for the sole purpose of avoiding taxes. Therefore, as stated for the dividend washing cases, it is not important anymore to search for civil law solutions, given that the defect in the cause can already be declared on the lack of any other economic scope than tax avoidance.

However, the solution given by the Court of Cassation seems to contradict the position of the European Court of Justice. In fact, the principle of abuse of (Community) law should bring the Italian legislator to contrast such abuses with new norms thought for this precise purpose. It logically follows that tax avoidance would need national general anti-avoidance norms. Instead, the fact that the parties implemented certain transactions for the sole purpose of avoiding taxes cannot be a good reason to consider them as non-existent when they actually are[70].

3.3 JUDGMENTS 30055 AND 30057 OF 2008

In 2008, the Court of Cassation dealt once again with dividend washing and dividend stripping cases in judgments 30055 and 30057 respectively. The presence of a general anti-avoidance principle was reaffirmed also this time, but with an important difference: the principle, when applied to non harmonized taxes (such as income tax), does not come from EU case law, but directly from art. 53 of the Italian Constitution.

In fact, the Court of Cassation stated (in both judgments) that: "the source of that [general anti-avoidance] principle, in the case of non harmonized taxes, such as direct taxes, it is to be searched not in EU case law but rather in those constitutional principles that are the base of the Italian tax system. In fact, the principles of contributive capacity (art. 53, first paragraph, of the Constitution) and progressive taxation (art. 53, second paragraph of the Constitution) are the base both of tax norms in a strict sense and norms that give any kind of benefit to the taxpayer, being those norms finalized evidently to a better effectiveness of those principles. The consequence is that it is a direct derivation of the constitutional norms the principle for which the taxpayer cannot obtain tax benefits from a distorted (even if not contrasting any specific norm) use of legal instruments suitable for tax savings, if there are no other economic reasons to justify the transaction different from tax savings"[71].

Moreover, the Court of Cassation made clear that the presence of this general anti-avoidance principle does not contrast with art. 23 of the Italian Constitution, which provides a reserve of statute in tax law (Part I – Chapter 4). In fact, recognizing a general prohibition of abusing the law does not mean to impose new patrimonial services (as taxes are) not provided by a statute. On the contrary, it

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70 M. ANDRIOLA, *Quale incidenza della clausola anti-abuso comunitaria nella imposizione dei redditi in Italia?*, cit., p. 276.

71 In Italian: "[…] la fonte di tale principio, in tema di tributi non armonizzati, quali le imposte dirette, va rinvenuta non nella giurisprudenza comunitaria quanto piuttosto negli stessi principi costituzionali che informano l'ordinamento tributario italiano. Ed in effetti, i principi di capacità contributiva (art. 53, primo comma, Cost.) e di progressività dell'imposizione (art. 53, secondo comma, Cost.) costituiscono il fondamento sia delle norme impositive in senso stretto, sia di quelle che attribuiscono al contribuente vantaggi o benefici di qualsiasi genere, essendo anche tali ultime norme evidentemente finalizzate alla più piena attuazione di quei principi. Con la conseguenza che non può non ritenersi insito nell'ordinamento, come diretta derivazione delle norme costituzionali, il principio secondo cui il contribuente non può trarre indebiti vantaggi fiscali dall'utilizzo distorto, pur se non contrastante con alcuna specifica disposizione, di strumenti giuridici idonei ad ottenere un risparmio fiscale, in difetto di ragioni economicamente apprezzabili che giustifichino l'operazione, diverse dalla mera aspettativa di quel risparmio fiscale".

means to make the taxpayer pay the right amount of taxes that he/she should have paid since the beginning, instead of trying to avoid them with complex contractual schemes.
These two judgments are even more important if it is considered that in both of them the Court of Cassation was at "united sections", giving to its statements greater authority.

3.4 DIFFERENCE WITH ART. 37-BIS ITAC

It is important to underline the fact that while for art. 37-bis ITAC tax avoidance transactions still produce their civil law effects, the Court of Cassation, as seen above, considers void all of them.

The position of the Court is therefore much more stricter than that of legislator of 1997, even more so if it is taken into account the criterion adopted by the Court of Cassation when it has to decide whether a transaction is an example of tax avoidance or not. In fact, for the Court it is sufficient that the *prevalent* scope of a transaction is to avoid taxes. It is important to note that while for art. 37-bis ITAC there must be a *total* lack of any valid economic reason to consider a transaction suspicious, according to the recent position of the Court of Cassation even a simple prevalence of tax consideration over business purpose would be enough to classify that transaction as a tax avoidance attempt.

Moreover, as said before (Part II, Chapter 2, § 2), art. 37-bis ITAC does not limit the assessment of tax avoidance only on a lack of any business purpose, but states that also other two criteria must be met in order to consider a transaction as a tax avoidance attempt: the circumvention of obligations or prohibitions and the result of obtaining tax reductions or refunds otherwise not due. On the contrary, the Court of Cassation does not mention any of them. Therefore, even if it has not be avoided any norm, the sole fact that at the basis of a transaction there is a prevalent (and not exclusive, as in art. 37-bis ITAC) interest in having a lower tax burden is sufficient to treat the transaction as tax avoidance.

And lastly, while art. 37-bis ITAC simply makes the tax avoidance transaction unenforceable to the tax administration and provokes the elimination of the tax advantages obtained, but maintains the transaction itself operative, for the Court of Cassation the transaction is void. The nullity of the transaction, may be argued, could be useful to restore a precedent situation that would be more profitable for the tax administration in terms of tax revenue. But outside this hypothesis, it is difficult to understand the choice of the Court, especially considering that in the past it was stated time and time again the awkwardness of nullity as a solution to tax avoidance.

In order to defend himself/herself from the accusation of having attempted to avoid taxes, the taxpayer has to demonstrate that the transaction (or series of transactions) under scrutiny had alternative or concurrent economic reasons of a quite relevant importance, able therefore to justify the lawfulness of the transaction(s). In fact, considering the complexity of the modern business world, it is not unlike the use of articulated contractual schemes in order to be competitive in a globalized economy and the Court of Cassation seems to be aware of the importance for the Italian legal system to be able to distinguish when a scheme is implemented only to avoid taxes and when it is just a new,

complex, unusual way to make business. The first case should be condemned, as tax avoidance deprives the State (and society) of important economic resources; but the second one should not be impeded just because it is more articulated than the normal transaction(s) one would expect. In modern times, such complexity is not necessary a sufficient sign of tax avoidance but simply a way to be competitive on global markets. And it is up to the tax administration to prove the difference between the two situations in the concrete case under inquiry[72].

[72] Cass., 21 January 2009, n. 1465.

Chapter 4 – Tax avoidance sanctions

4.1 Sanctions applied to tax avoidance

In the Italian legal system, it is neither very clear whether tax avoidance should be sanctioned or not[73], nor the nature of the sanctions eventually to be applied: would administrative sanctions be sufficient, or should tax avoidance have criminal relevance?

The silence of anti-avoidance norms, such art. 37-bis ITAC and others, has been interpreted in completely different ways. And the same can be said about the reactions toward the tendency of the tax administration not only to pretend the amount of taxes that had been avoided, but also to apply the administrative sanctions for *unfaithful declaration*, which is considered a crime by art. 4 of Legislative Decree n. 74, 10 March 2000. In this last case, the problem is that the Decree deals explicitly with tax evasion but not with tax avoidance. Article 4, in fact, states that it is unfaithful the declaration of who indicates either positive elements in a lower amount than the real one or fictitious negative elements, with the purpose of *evading* income taxes and VAT. However, the wording "fictitious" in reference to the negative elements can be interpreted in two different way:

- like if the negative elements are completely simulated and therefore not real at all;
- like if the negative elements are real but not deductible in the specific case of the taxpayer because not relevant according to a tax statute.

The first interpretation of "fictitious" applies evidently only to tax evasion, since tax avoidance is characterized by the circumvention of tax norms and not by the falsification of tax relevant facts (Part II – Chapter 1). Instead, the second interpretation may be extended not only to tax evasion but also to tax avoidance. This way, even if it is not explicitly mentioned, art. 4 could be applied also to tax avoidance. Unfortunately, even the nature of the declaration, whether it should be considered faithful or unfaithful, is endlessly debated

Those scholars[74] who are against the application of any kind of sanctions argue that, in the case of tax avoidance, it is not possible to speak about "unfaithful declaration". In fact, as seen before (Part II, Chapter 1), a characteristic of tax avoidance is the formal fidelity of the contract to the juridical reality. The tax burden is not softened by not declaring or hiding the transaction, but thanks to the clever circumvention of tax norms. Therefore, the declaration itself is formally impeccable and should not be subject to sanctions like if it was not.

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[73] A. SPOTO, *Revisione della clausola antielusione. Si devono applicare le sanzioni?*, in *Il Fisco*, 1997, p. 6452.
[74] F. DE LEVA – M. ERTMAN – G. FAILLA, *Elusione fiscale*, Roma, 1998, p. 99.

Other scholars[75], instead, are of quite a different advise. They argue that not sanctioning tax avoidance as such would be both unfair and inopportune. On one hand, it would be unfair because there would be no logic in sanctioning those tax payers who have declared a lower income than the real one (even when the difference between the two is not that alarming), but not those who have done the same in practice, through the use of complex tax avoidance schemes. On the other hand, it would also be inopportune because, without any sanction, the dissuasive effect of anti-avoidance norms would be significantly diminished. In fact, the tax payer would feel authorized somehow to make the most strange and articulated tax avoidance schemes, knowing for sure that, in the worst of the hypothesis, he/she will have to pay only the higher tax burden that it was tried to be avoided, without any adjunctive expenses in the form of sanctions.
However, it is even more controversial whether tax avoidance should have criminal relevance. Also in this case, in the absence of any relevant case law, the doctrine has often debated on positions diametrically opposed.

The major part of scholars[76] thinks that tax avoidance should not have criminal relevance, on basis of two main arguments. The first is that art. 25 of the Italian Constitution does not allow to punish anyone if there was not a previous statute that declared a certain action or omission a crime. The logic behind this principle is that citizens should be able to know whether their behavior is considered deleterious for society or not *before* behaving in a certain way. The second argument is that tax avoidance, for its intrinsic nature (which is circumventing tax norms), does not represent such a treat for the legal system to justify the extension of criminal sanctions to it.

Other scholars[77], while noting that the legislator seems more and more inclined to punish tax avoidance as a crime (as suggested by Legislative Decree n. 74, 10 March 2000), nevertheless stress the risks represented by the negative impact that criminal sanctions would have on the economy, if the fear of being punished so harshly also for an apparently lawful tax planning would spread among entrepreneurs. Moreover, they also lament the lack of consideration shown by the legislator in front of the difficulties in applying anti-avoidance norms to real life situations, where (as seen above in Chapter 1) the borderline between tax avoidance and lawful tax saving is not that clear, especially from the point of view of the taxpayer.

[75] R. LUNELLI, *L'elusione tributaria. Le disposizioni per contrastarla, le difficoltà applicative, le modalità per superare le incertezze*, in *Il Fisco*, 2003, allegato n.25, p.15376.

[76] G. BARTOLINI, *Sulla progettata penalizzazione delle condotte elusive*, in *Il Fisco*, 1998, p. 5496; O. CUCUZZA, *L'art. 37-bis del D.P.R. n. 600/1973 e la riforma del sistema penal-tributario*, in *Il Fisco*, 1998, p. 3715; M. DI SIENA, *Brevi considerazioni sulla criminalizzazione dell'elusione fiscale*, in *Il Fisco*, 2003, p. 3316.

[77] F. GALLO, *Rilevanza penale dell'elusione*, in *Rass. trib.*, 2001, p. 321.

On the contrary, there are also some scholars[78], in a minority position, who think that tax avoidance is not that dissimilar from a fiscal fraud. Therefore, they see no reason why also tax avoidance schemes should not be punished with criminal sanctions, as in the case of the fiscal fraud. Such attitude would make Legislative Decree n. 74 of 2000 perfectly applicable also to tax avoidance. Unfortunately, as said at the beginning, there has not been yet a decisive Italian case law able to clarify the situation and stating which scholar position is the more appropriate one.

But above all this confusion, it stands an interesting judgment[79] of the European Court of Justice. It clearly states that "the discovery of a tax avoidance behavior should not bring any kind of sanctions, for which it is necessary a clear and univocal normative base, but simply an obligation to repay in part (or all) the taxes unfairly not paid". Therefore, following this judgment, the dilemma would be solved: tax avoidance should not be punished neither with administrative sanctions nor with criminal ones. However, in spite of the crystalline clearness of the European Court of Justice, it seems that for the moment the theoretic debates in Italy are not over yet and will not be neither in the foreseeable future.

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[78] A. TOPPAN, *Elusione fiscale e sanzioni penali*, in *Rass. trib.*, 1994, p. 206; S. GOLINO, *Le verifiche fiscali e le nuove sanzioni penali*, in *Il Fisco*, 2000, p. 6569; G. BERSANI, *Elusione fiscale e dichiarazione infedele*, in *Il Fisco*, 2002, p. 7678.

[79] European Court of Justice, judgment n. C-255/02, of 21 February 2006 (Halifax case).

APPENDIX – CASE STUDIES

CASE 1

A owns shares which he can sell free from capital gains tax. He sells the shares to B just before the distribution of dividends. Just after the distribution of dividends, he buys the shares back for a price that has been agreed upon in advance to be the price of the first sale, reduced by the value of the distributed dividend. It is presupposed that both transactions are legally binding private law transactions. Will the transactions be disregarded as a sham/simulation (with the result that A – and not B – will be taxed for the dividends, and that B will be denied a deduction of his loss)? Will it be treated as tax avoidance? Or will it be accepted?

In the Italian legal system, this would be considered a case of *dividend washing*. As said before (see Part II – 3.2), the problem of this transactions is not really about sham/simulation but their cause: in fact, there is a total lack of any economic reason behind the sell and the buy back of A's shares, with the exception of avoiding taxes, of course. Therefore, the transactions would be declared void for defect in the cause[80].

CASE 2

A father A and his three children B, C and D establish a limited partnership. Only the father is actively working for the partnership. The surplus of the company is divided into four equal parts and A, B, C and D each receives one part. They all declare the income as their part of the income of the partnership. Will the payments to the children be regarded in accordance with the declarations, or will they be regarded as earned by the father and taxable in his hands (to the extent that they exceed a fair compensation for the children's contribution to the company), and then transferred as a gift to the children (possibly triggering gift tax)?

The important question, in front of a situation like the one prospected by Case 2, would be: is there an abuse of company form? In other words: are the partners using a certain type of company in the way they should?
From the data given, it is not clear what would be the response of the Italian legal system. In fact, companies composed by partners who are actually members of the same family are quite common in Italy: a partner must be a trusted person and who would be more trustful than a relative?

[80] See in particular Cass., 21 October 2005, n. 20398; Cass., 14 November 2005, n. 22932.

Therefore, the fact that A established a partnership with his three children but they do not do anything for the company is not sufficient at all to give rise to suspicions of tax avoidance. There is no reason why a partner should not be able to participate in the life of the company simply contributing to its capital and it is irrelevant from a tax point of view whether the partners actively work for the partnership. On the contrary, the Court of Cassation[81] considers legitimate to presume that the profits of partnership (where the partners are few and close relatives) have been distributed, even if such distribution does not result from the balance sheet. It will be up to the partners to prove that the distribution has never taken place.

Moreover, articles 5, 115, and 116 of Italian Income Tax Law[82], in order to eliminate the problem of national double taxation, state that the economic result of a partnership should not be taxed on the company itself but on the partners, according to their part in the company capital. This is what is called "consortium relief". It should be noted that such consortium relief is automatically applied in the case of *parnership*[83], but only optional in the case of *corporation*[84] (also if having a limited number of stock-holders)[85], where it needs to be chosen by all the partners in order to be applied.

A last aspect that may be considered, is the commercial law institute of the "family enterprise". According to art. 230-bis c.c., when a family member of the single entrepreneur constantly takes part in the activity of the enterprise (of his/her relative), also that family member has the right to participate in the distributions of the earnings. And also in this case it will be applied the consortium relief (paragraph 4 of article 5 of Italian Income Tax Law), but only to the 49% of the income declared (in order to prevent possible tax avoidance misuses of the institute).

However, art. 230-bis c.c. is concerned with a sole proprietorship while Case 2 is about a limited partnership. Therefore the legislative dispositions for the two are quite different and a real comparison cannot be made.

CASE 3

[81] Cass., 20 June 1994, n. 10059; Cass., 8 April 2002, n. 9094; Cass., 17 October 2005, n. 20078.

[82] Legislative Decree n. 917, 22 December 1986.

[83] A *società di persone* is a type of company where it counts more the person of the partner rather than the amount of capital he/she invested in the company.

[84] A *società di capitali* is a type of company where it counts more the amount of capital invested by a partner rather than its specific role in the life of the company.

[85] See for example Cass., 11 November 2003, n. 16885; Cass., 16 May 2002, n. 7174; Cass., 25 July 2002, n. 10951; Cass., 25 May 1995, n. 5729.

A sells shares to his wholly owned company B Ltd for their book value. A few days later B Ltd sells the shares to unrelated C at their (considerably higher) market value. The question is whether A can be considered to have sold the shares directly to C at their market value. In the present connection, the point in focus is whether the principle that taxation has to be based on written law, applies to this question also, and not only to the application (and interpretation) of the tax law in a narrower sense.

As said more than once, in Italy the "form" is regarded much more important than the "substance" when dealing with transactions. In this case, what counts is that B Ltd sold the shares to C for *x* amount of money. Therefore, taxation will be based on the price agreed by the parties.

In fact, both in the case of direct (such as the income tax[86]) or indirect taxes (such as the VAT[87]), the Italian legislator provided as a general criterion for taxation the price set by the parties. It is only in exceptional cases that also the market value can be taken into consideration, like when the transaction has no price at all (for various reasons: it is free, it is for self consume, etc.).

Sometimes, even if there is a price, the legislator has chosen to invert this order and to give more importance to the market value of a transaction rather than the price agreed by the parties. This is the case, for example, when there is an international transfer pricing or a contract of financial location. The logic behind this different attitude is to be searched in the willingness of the legislator to contrast tax avoidance or tax evasion, evidently very frequent in certain kind of transactions.

For certain types of taxes, instead, both the price and the market value are taken into consideration when the transaction is taxed. An example may be the registry tax, where the price is confronted with the market value of the transaction. If the price is lower than the market value, then the taxation will be based on the second one.

Back to Case 3, the only criterion to be applied is the price agreed by the parties. Any other consideration not based on the "form" but on economic results would not be important here.

CASE 4

Taxpayer A owns shares in company B. The value of the shares has declined since acquisition. A wants to realize a deductible loss, but has no wish to dispose of the shares. Therefore, he sells the shares over the stock exchange and the next day his wholly owned company C buys the same number of shares in the same company over the stock exchange. There is no agreement in advance concerning the buying back of the shares.

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86 Presidential Decree n. 917, 22 December 1986.

87 Presidential Decree n. 633, 26 October 1972.

According to the data given, this would not be regarded as a tax avoidance case in Italy. Without any agreement in advance, the fact that A owns company C
does not play any role in the development of events.

CASE 5

A is a partner in a partnership with financial difficulties. The main creditor of the partnership, a bank, decides to forgive parts of the debt. Before the forgiving is binding for the bank (in relation to the partnership) and carried out in practice, A sells his part of the partnership. When calculating the capital gain on the sale, the question is whether the debt that was to be forgiven, should be taken into account as part of the sales proceeds (as is normal with debts which are taken over by the purchaser) or whether the fact that the forgiving of the debt was in reality decided, though not binding or carried out in practice at the time of the sale of the part, should prevail. Will it be of any significance whether taking substance into consideration is in the favor of the taxpayer or fisc?

According to the data given, this would not be regarded as a tax avoidance case in Italy.
In the Italian legal system, the taxation of capital gains is regulated by articles 67 and 68 of Italian Income Tax Law[88]. According to art. 67, capital gains on the sale of shares are subject to a different tax burden depending on whether those shares give a *qualified* or *not qualified participation* in the partnership. There is a *qualified participation* when the shares represent in their complex or over the 20% of the voting rights in the ordinary assembly or over the 25% of the capital of the partnership. If one of this two condition is not met, there is a *not qualified participation*.
According to art. 68, qualified participations are subject to a 40% tax, while the not qualified participation only to a 12,5% tax. Moreover, also the cost of production and the eventual losses are taken into account when calculating the amount of capital gain that has to be taxed. The 40% of capital gain is algebraically summed to the corresponding part of the losses and the eventual negative surplus is deducted by the 40% of capital gains of the next tax period, until the fourth.

CASE 6

[88] Legislative Decree n. 917, 22 December 1986.

A person being a resident of country A, sets up a wholly-owned private holding company in country B, a low tax jurisdiction. Is the setting up of the private holding disregarded for tax purposes under the laws of country A? How will dividend distributions (and other types of distributions, if any) from the holding to the shareholder in country A be regarded for tax purposes in country A?

The setting up of a private holding company in a country with low taxes would not represent a problem in Italy. The dividend distribution would be fully taxed.
In order to establish which one is the Country of residence of a private holding company for tax purposes, art. 73 of Italian Income Tax Law[89] provides for three alternative criteria: the legal seat, the seat of administration, and where the main object is performed. The legal seat is the formal seat of the company, the one indicated in the constitutive act or in the statute of the company (as provided by art. 2328 c.c.). The seat of administration is the place where it is effectively administered the company, the high office of the company where key decisions and strategies are taken. The main object is the economic activity prevalently performed in order to achieve the scope of the company, and its place is where it finds a concrete application.
However, it is hard for the tax administration to demonstrate that one of these three criteria are met, especially the seat of administration. For this reason, the legislator provided two presumptions at art. 73 (par. 5-bis) of Italian Income Tax Law. According to it, the tax administration can presume (unless there is a contrary proof) the existence of the seat of administration in the Italian territory in case the company has shares that enable it to control (even indirectly) other companies which are resident of Italy, when (alternatively):

- they are controlled by subjects who are resident in the Italian territory;
- they are administered by a Administrative Council (or another equivalent administrative organ) prevalently composed by counselors resident in Italy[90].

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[89] Legislative Decree n. 917, 22 December 1986.

[90] For a detailed analysis see G. MELIS, *La residenza fiscale dei soggetti Ires e l'inversione dell'onere probatorio di cui all'art. 73, commi 5-bis e 5-ter t.u.i.r.*, in *Dir. prat. trib. int.*, 2007, p. 781

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Università LUISS – "Guido Carli" – Roma
Facoltà di Giurisprudenza
Cattedra di Diritto Tributario

Anti – base erosion rules

Letizia Gianni
Matr. 088863

1. INTRODUCTION.

In the Italian legal system there is not a general anti – base erosion rule, unlike other European legal systems, but two types of rules can be found in the national tax law: rules with an expressly anti–base erosion content and rules with an anti–base erosion reason.

The first concern conducts in point qualified as aimed to tax avoidance: the legislator provides the Financial Administration with the power to qualify a behavior as directed to avoid a tax, in presence of determined elements, and to impose the payment of the avoided tax. With regard to income tax regulation, there is a very important provision, even if it is enforceable only to a closed number of operations. It is the art. 37-bis in the President of the Republic Decree (D.p.r.) n. 600/1973.

The second are specific rules, whose implicit anti–base erosion function resides in their purpose to prevent taxpayers from enacting tax avoidance practices: these provisions do not expressly qualify the behavior as a tax avoidance conduct, but they state rules aiming at forestalling these behaviors and the Financial Administration can grant the possibility of not enforcing them, at the instance of the taxpayers, in the case that there are not tax avoidance outlines. Examples of these rules with an only tax avoidance function are those in the matter of limited deductibility of the incorporated company losses, of thin capitalization, of transfer price, of limited deductibility of the costs coming from operations happened between resident companies and tax haven companies, of CFC legislation[91].

1.1. Rules with an expressly anti – base erosion content: the art. 37-bis.

According to art. 37-bis in D.p.r. n. 600/1973, they cannot be raised, before the Financial Administration, the acts, the facts and the contracts, also related between them, lacking in valid business reasons, if they are headed for getting around duties and prohibitions, stated by tax laws, and getting tax reductions or refund, otherwise undue. Then, in accordance with this provision, there is tax avoidance (and so the avoided tax is due) when three conditions subsist jointly:

a) if there is the bypassing of a fiscal duty or prohibition;
b) if there is a fiscal benefit (tax reduction or refund) undue;
c) if a transaction or a series of acts, facts or contracts are bereft of valid business reasons.

The three requirements are necessary all together and they have to be verified.

The first concerns the aim of the transaction to move around tax duties or prohibitions stated by tax law: the tax avoidance is referred to a specific provision, not to the entire legal system. Then he abuse of civil law forms is not necessary: the abuse can be hint of tax avoidance, but it is not a constitutional element of tax avoidance.

The second requirement is a fiscal advantage, otherwise undue: the benefit comes out from the comparison between the tax regime connected to the behaviour enacted and the tax regime related to the treatment avoided. Indeed a behaviour is a tax avoidance conduct if a specific tax rule is bypassed and, in this way, an undue tax saving is realized.

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[91] F. TESAURO, *Istituzioni di diritto tributario*, *1 – Parte generale*, Milano, 2008, p.254 e ss..

In third place it is wanted the absence of valid business reasons: every economic transaction has to have economic substance and a business purpose different from tax saving. Business reasons are not a closed number, they cannot be predetermined and they are considered in a wide way. In order to control if a transaction is pointed at tax avoidance, "*the competent national authorities cannot restrict themselves to apply general predetermined criterions, but have to proceed, case by case, at a global examination of the transaction*"[92]. Business reasons must be valid, i.e. prevailing on the fiscal advantage and there can be two hypothesis:

– no appreciable business result derives from the transaction, so its only reason is the achievement of a tax reduction[93];

– the transaction produces an business result but not such relevant as the fiscal benefit.

The art. 37-bis has a limited enforcement field, because the concerned cases are peremptorily listed. It is clear that the chosen approach concerns the specification of single cases. This is the list:

a) transformations, mergers, divisions, voluntary windings-up and distributions to partners of amounts withdrawn from net worth items, different from items formed by profits;

b) contributions in companies and legal transactions concerning business transfer or enjoyment;

c) assignments of credits;

d) assignments of tax surplus;

e) mergers, divisions, contributions shares exchange between companies of E.U. Member States;

f) transactions concerning shareholdings or foreign currencies and balance sheet classifications;

f-bis) assignments of goods between subjects allowed at taxation according to national fund debt regime.

In this list transactions such as mergers, transformations, divisions and windings-up fill a relevant place[94]. In spite of the case by case approach of the article, almost all cases are covered: this highlights the pretension, by the legislator, of providing for a general instrument against tax avoidance conducts.

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92 European Court of Justice, 17 July 1997, cause C-28/95, Leur-Bloem, in *Rass. Trib.*, 1997, 1265.

93 E.g. a company that carries out an activity in a tax haven in order to hold shareholdings which are not taxed or are taxed in a mild measure; a merger realized not to achieve a business apparatus, but only to make use of fiscal advantages.

94 What valid business reasons can potentially assist these transactions? E.g. a merger has a valid economic reason when it is aimed at a development of productive capacity of two subjects; it is not true if its only purpose is making good the losses of a company with the other. In the Leur-Bloem case (sentence 17 July 1997, C-28/95) the ECJ stated that a merger or a reorganization in the form of a shares exchange, involving a holding company just born, which do not belong any firm, can be considered as if it has a valid economic reason; but the merger is elusive if it has been realized only to make good losses (L. POTITO*, Le valide ragioni eco)nomiche di cui all'art. 37-bis del D.p.r. n. 600/1973: considerazioni di un economista di azienda*, in *Rass. Trib*., 1999, 59).

A division belongs a valid economic reason if it concerns a company, which carries out two distinct activities and it wants the separation of the productive structures, continuing business activity; but it is an elusive transaction if the aim is the creation of a container company, and the assignment to it of shareholdings in the beneficiary company, rather than first level goods (in order to realize capital gains).

The distribution to partners of amounts from net worth items can be justified, economically, only when the capital at company's disposal is on the whole redundant.

1.2. Rules with an anti – elusion reason. Tax havens.

These rules, as it has already been said, are stated with the intent to prevent taxpayers from realizing tax avoidance practices: they are implicitly anti–base erosion provisions and can be of different kind and nature. Many of these regulate problems and cases caused by relationships between resident companies or individuals and companies resident in the so called *tax havens*.

Dealing with tax havens, we refer at those States which do not have income taxes or enforce very low tax rates. These States, that adopt a privileged fiscal regime, normally have very simplified company law and bank law; the simplification often extends to criminal law, as for crimes against the estate and Public Administration.

Not always the leader States in the global economy, endowed with sophisticated tax systems and inspired by the principle of world – wide income taxation for residents, have adopted measures to contrast widthways tax havens; rather it has prevailed a not coordinated approach by unilateral measures, with the preeminent interest to tax residents, who are shareholders of tax haven companies, for profits not distributed by these societies[95].

Also Italy provides for this regulation (so called CFC legislation): we have to examine this and the other instruments provided by Italian tax system against the use of tax havens.

1.2.1. Black list and white list.

Some States (Australia, Belgium, France, Germany, Japan, Spain and USA) has passed a *black list* where States considered tax havens are listed. Other Countries (Great Britain and Canada) have chosen a *white list*, which includes States not considered tax havens.

In general the black lists have distinguished among States where:

i. it does not exist an income tax on companies;
ii. there is an income tax, ma the tax rate is too low;
iii. there is an income tax, but certain companies and activities are excluded from taxation;
iv. there is an income tax, but it apply only for incomes produced in that State; foreign source incomes are exempt.

Italy previously had adopted a black list, but the 2008 Budget Law (also thanks to the boost given by OECD at the uniformity purposes) has redrawn the geography of tax havens, appointing a white list of virtuous States, based no longer on tax advantage rate, but only on the level of collaboration with the Italian administration (new art. 168–bis, t.u.i.r.). So tax exclusion for interests, premiums and other fruits of bonds and similar securities received by residents from countries that allow an adequate exchange of information with Italy. The rewarded countries could result those that, although

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The assignment of a credit may be elusive, when the transaction happens between a profit company and a loss company, at a price lower than the nominal one, because the profit company realize a loss deductible from its income and the second company realizes a capital gain without paying tax, compensating it with its losses (F. TESAURO, *Istituzioni di diritto tributario, 1 – Parte generale*, cit., p.262.

characterized by a more favourable taxation, are linked to Italy by a bilateral tax treaty that provides for the exchange of information without any limits; they may also be penalized countries like Switzerland, that because of their confidentiality would be excluded from the White list, although its forms and rates of taxation are adequate to Italy.

The anti-base erosion legislation will be applied only to States not included in the white list.

According to art. 168-bis, the two previously sanctioned requirements, i.e. "the suitable exchange of information" and "a tax rate noticeably lower than the Italian one", will be taken into account only in the editing of the white list provided for the application of D.p.r. n. 600/73 and following modifications; in future, the only relevant criterion, to identify "untrustworthy" States, will be "the adequate exchange of information".

Another new feature is the adoption of two "white list": one referring to the presumption of natural persons residence, the second to all other subjects.

New listings - not yet effective - are intended to replace, at the end of a transition period, the current system based on black list, taken between 1999 and 2002. This provision, however, is waiting yet for the emanation of a ad hoc Decree of the Minister of Economy and Finance, stating the list.

1.2.2. CFC legislation.

The Controlled Foreign Company legislation is contained in art. 167 of Consolidate act in Income Tax (t.u.i.r.), regulating the charge regime of income produced by a controlled foreign company, localized in a State endowed whit a privileged tax regime. The aim is to attract in Italy the taxation of Italian residents income, produced through the participation in a company resident in a tax haven.

The legislation states that, if an Italian resident holds, directly or indirectly, through a trust company or a third person, the control (meant according to the civil notion provided by art. 2359, Civil Code[96]), of a company, resident or localized in States endowed with privileged tax regime, the incomes of the foreign company charge the Italian resident, in proportion to his shareholdings in the company[97]. However the rule is not applied if Italian resident proves that the company carries out an effective industrial or commercial activity, as its principal activity in the residence State, or he proves that his shareholdings do not enable him to localize the incomes in the tax haven.

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95 G. MARINO, *La considerazione dei "paradisi fiscali" e la sua evoluzione*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, Padova, 2002, pp.874.

96 According to this article, a company is considered controlled if another company has the majority of votes of the first company in the ordinary meeting; if another company has sufficient votes in the first company to exercise a dominant influence in the ordinary meeting; if another company exercise a dominant influence on the first company because of contractual obligations.

97 Privileged tax systems had been specified by a decree of Minister of Economy and Finance, on 21 November 2001, n. 429, on the basis of a tax rate much lower than Italian one and of lack of information exchanges: this black list will be replace by the new white list system.

This discipline has been extended also to connected foreign companies, resident in the same States, and the regulation is stated by art. 168, t.u.i.r.: the differences from art. 167 concern the shareholdings thresholds, necessary to configure a connection[98], and the determination of income of the foreign company. In fact, it charges Italian resident for the higher amount between the profit resulting from the balance sheet of the foreign company (before taxing) and an income determined on the basis of productivity coefficients, referred to categories of goods in the net worth.
The art. 168, t.u.i.r., differently from control cases, does not concern connection participations in subjects non-resident in tax haven, as for income of their permanent establishments, situated in States with a privileged fiscal system.

1.2.3. Rules against costs deductibility.

The art. 110, par. 10, T.U.I.R., does not allow the deduction of expenses and other negative elements, arising from transactions realized between resident companies and companies resident in States (not belonging to E.U.) endowed with a privileged tax regime. The tax regime is considered privileged if it excludes income tax or provides for a taxation in the measure totally established by a Prime Minister decree, on proposal of Ministry of Economy and Finance.
This regulation can be obviated by Italian companies. The par. 11, art. 110, states that the dispositions of par. 10 are not applied when the Italian company supply the proves that the foreign enterprises carry out mostly an effective industrial or commercial activity or that the set transactions answer to an effective business interest and they have had a concrete implement.
The expenses and the others negative elements, deductible according to the first sentence of par. 11, have to be separately indicated in the income tax return.
The Financial Administration, before issuing a tax demand, must allow the taxpayer to provide, within 90 days, these proves, advising him through a proper notice: where the Financial Administration does not regard the adduced proves suitable, it will have to explain the specific reason of this choice in the tax demand.
It is important to underline that art. 110, par. 12 (t.u.i.r.) states that rules against costs deductibility do not apply for the cases which art. 167 and 168 (t.u.i.r.) are applicable for. Naturally art. 110 is excluded when the State with a privileged tax regime had stipulated a tax convention with Italy, in order to avoid double taxation.

1.2.4. Participation exemption regime on dividends and capital gains.

The tax reform, executed by Legislative Decree (D.Lgs.) n.344/2003, has extended the exemption regime on dividends and capital gains also to resident shareholders of foreign companies, situated in a tax haven, on condition that the resident shareholder, through the consult procedure under art. 167

[98] Under this rule, the profit-sharing must be of 10% or 20%, according as the company is quoted or less on the Stock of Exchange.

(t.u.i.r.), proves that his shareholdings have not had the effect of localizing the incomes in the tax haven.

In fact the t.u.i.r. articles concerning the treatment of foreign dividends received by resident companies (art. 89), by partnerships or natural persons who carry on business (art. 59 e 47), or by natural persons who do not carry on business (art. 47), subordinate the participation exemption to the condition that the company is not resident in a tax haven (as defined by art. 167 t.u.i.r.), unless the taxpayer enables the consult procedure by art. 167, proving that, since the beginning of the ownership of those participations, he has not enjoyed of localizing his income in the tax haven.

This legislative provision stresses the necessity that incomes, wherever it is the source place, are taxed. It may be true, as it is maintained by a certain doctrine, that this legislation is the realization of a "capital export neutrality", meant for giving the same conditions to residents who want to invest in the residence State or abroad[99].

1.2.5. Transfer pricing.

Among anti – abuse regulations, the one concerning intercompany transfer prices is important: the aim is to contrast tax avoidance practices, enacted in the intercompany transactions[100], transferring profits from Italian company towards the foreign one, through the fixation of a price not corresponding to the *normal value*.

According to art. 110, par. 7, t.u.i.r., if an Italian company transfer goods or provides services to a connected foreign company, and applies prices lower than the normal value (reducing its own profits in favour of the associate), the Financial Administration can consider prices according to the normal value. The same happens when the Italian company buys goods or services from the foreign associate company, at a price higher than the normal one.

Therefore, for tax purposes, negotiated prices become unimportant: it has to be considered the "*normal value*", that is "the price or the valuable consideration applied on average for goods and services of the same kind or similar, in conditions of free competition and at the same marketing step, in the time and in the place where services have been bought or provided, and, failing it, in the time and in the place more near"[101].

There are three elements used to determine the normal value, depending on the activity carried out by the company and the type of goods and services: price comparison, price resale and increased cost. This disposition applies to relationships between:

a. Italian companies and foreign companies who control, directly or indirectly, Italian company or are controlled by it;

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99 G. MARINO, *La considerazione dei "paradisi fiscali" e la sua evoluzione*, cit., p.883.

100 I.e. transactions between an Italian company and a foreign company, belonging to the same "group".

101 Art. 9, t.u.i.r..

b. Italian companies and foreign companies, when they are both controlled by the same parent company;

c. not resident company and Italian companies, when the last carry out marketing activities of products for the first.

In this sense Italian legislator has received the criterion, suggested by the OECD report of 1979, of *dealing at arm's length principle*: the normal price, which have to be considered, is that negotiated, for similar transactions, by independent companies, which do not have any connection between them.

1.3. The abuse of law according to the recent Court of Cassation jurisprudence.

The Court of Cassation, through the three United Divisions sentences n. 30055/08, 30056/08 and 30057/08 on 2 December 2008, has established important principles in matter of tax avoidance and abuse of law: if these principles, from a legal point of view, offer relevant reference parameters to the judges, on the other hand, instead, they have caused restlessness and uncertainty in the businessmen.

The concept of abuse of law, in the course of the years, has underwent a judge-made evolutionary process, often contradictory and confused, before arriving to the recent sentences of the Court.

According to the first decisions, before the introduction by art. 7, par. 1, D.Lgs n. 358/97, of the new text of art. 37-bis t.u.i.r., a general anti - avoidance clause did not exist in the Italian fiscal system, also because of the non-retroactive application of art. 37-bis, which did not enunciate a principle of general significance[102].

In a successive moment, however, this direction has been revised[103]: the Court has established that, applying the principle of the prohibition of abuse of law, it is necessary to analyze the nature and the kinds of transactions, considering their reciprocal connections and the pursued purposes, in order to verify if they are direct or less to achieve a tax saving and if the business reasons enable an alternative explanation, different from the fiscal saving.

Lately the Court of Cassation, Fiscal Division, is harked on the argument with the sentences n. 10257 on 16 January 2008 and n. 25374 on 21 May 2008, establishing that the transactions realized essentially to achieve a fiscal advantage are "abuse of law"; anyway the proof of concurrent or alternative business reasons, which must be not merely marginal and theoretical, is up to the taxpayer, particularly when the abuse of law produces a negative element of the income or the tax. The notion of abuse of law sets aside, therefore, any reference to the fictitious or fraudulent nature of the transaction, neither it involves the verification of sham transactions, carried out in violation of the prohibition of abuse of law. However the instrument of the abuse of law must be used carefully by the Financial Administration, considering that the use of contractual and organizational forms, implying a lower tax

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[102] Cass., Sez. civ. V trib., n. 3979/2000; Cass., Sez. civ. V trib., 3 settembre 2001, n. 11351; Cass. Sez. civ. V trib., 7 marzo 2002, n. 3345.

[103] Cass., Sez. civ. trib, 21 ottobre 2005, n. 20318; Cass. Sez. civ. trib., 14 novembre 2005, n. 22938; Cass. Sez. civ. trib., 29 marzo 2006, n. 21221.

burden, is exercise of the enterprise freedom and business initiative, in the context of constitutional and communitarian freedoms.
The United Divisions of the Court of Cassation, with the three above mentioned sentences n. 30055/08, n. 30056/08 and n. 30057/08, has given important answers to questions of the doctrine and jurisprudence debate on the fiscal concept of abuse of law. The Court has asserted the existence of a general anti-avoidance principle, specifying that the source of this principle, as for not harmonized taxes (like direct taxes), is in the same constitutional principles of the Italian tax system: the principles of taxpaying capacity (art. 53, par. 1, Constitution) and of progressive taxation (art. 53, par. 2, Constitution) are the foundation both of tax rules in a strict sense and of rules which attribute to the taxpayer fiscal advantages or benefits, that represent implementation of those principles.
Then the Italian tax system contains a principle according to which the taxpayer cannot derive undue fiscal advantages from the warped use, also if not contrasting with any specific provision, of legal instruments aimed to achieve a tax saving, in absence of valid business reasons that can justify the operation.
The Court has stated that this general anti-avoidance principle does not contrast with the specific anti-avoidance rules, which, on the contrary, seem to be hints of the existence of a general rule. There is no contrast also with art. 23, Constitution (concerning statutory reserve on tax impositions), since the general anti-avoidance principle does not produce the imposition of further tax obligations, not deriving from the law, but it denies the illegal effects of transactions, enacted to avoid tax rules. Finally the Court of Cassation has confirmed the concrete possibility to point out *ex-officio* the abuse law of transactions, during its judgment.
This orientation of the Court of Cassation has alarmed part of the doctrine, that argues that the generic concept of abuse of law can compromise the certainty of the law and that it appears incompatible with a fiscal system, which follows the case by case method in the definition of taxable elements. For this reason someone invokes the intervention of the legislator, with an authentic interpretation, which confirms the taxation of the only legislative hypothesis or provides for particular procedures to favour agreements between taxpayers and the Inland Revenue[104].

2. PROBLEM OF FISCAL DEDUCTIBILITY OF INTEREST PAYABLE. THIN CAPITALIZATION.

Financial burdens, met by business activities, generally produce a fall of their taxable income basis in a measure equal to the amount really remained at expenses of the activity; so these costs reduce directly

[104] C. ATTARDI, *Elusione fiscale. Orientamenti recenti in tema di abuso del diritto,*in *Il Fisco,* 2008, 3995.

the sum which tax rate will be applied on[105]. Deductibility of interest payable by companies takes a real importance in the tax planning context: the legal conditions in the range of debt financing are a fundamental decision element for the choice of the state of residence of companies. As interest expenses can decrease the profit, many states enact rules to protect the domestic tax base against an excessive high debt financing, which can result fiscally much more advantageous for the company and its partners.

Normally companies can finance themselves increasing its own venture capital (forming net worth) or increasing debt capital, through credit supplied by third party, and firstly by banks. The two base financing techniques answer to different economic and juridical needs, but it is important to note that they undergo a different tax regime, which leads to prefer having recourse to debt financing, because it is more profitable. In fact the remuneration of company venture capital takes place through the distribution of dividends to partners: the dividend is not a cost for the income production and so it is not deductible; instead the remuneration of debt capital takes place through the payment of active interest to creditors, but the correspondent interest payable can be deducted by the funded company, because they are a cost in the production of the income. For this reason companies often choice debt financing.

In the abstract, tax relevance of this phenomenon may be minimized, because, against lower profits for company, there should be higher profits for creditors, in first place banks, and then, in the outline of public national finance, total tax revenue should result the same[106]. However, unfortunately, this technique spread as a form tax arbitrage, when creditors of debt financing are the partners of the company: this operation is useful for the company, that can deduct interest payable, paid to partners, as costs from its income, differently from dividends; it is useful also for creditors partners, who receive active interest, taxed in a weaker way than dividends, obtained conferring capitals.

The partner can finance his company directly or indirectly: in the practice, there are some basis operations, then developed in more articulated forms; different cases may happen:

a. a foreign company, resident in a privileged tax regime State, which controls an Italian company and prefers supply a loan to it, rather than conferring capitals: the Italian company can deduct interest payable and the active interest will transfer abroad and will be removed from Italian taxation;

b. a partner, instead of financing directly his company, buys its bonds: company can deduct interest paid on bonds and the partner receives bonds taxed only at 12,50%[107];

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105 M. BEGHIN, *Oneri deducibili e detrazioni d'imposta*, in AA.VV. (a cura di F. TESAURO) *Giurisprudenza sistematica di diritto tributario*, Parte prima – L'imposta sul reddito delle persone giuridiche, Torino, 1996, p. 319.

106 L. DEL FEDERICO, *La thin capitalization*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p. 490.

107 These interest, in fact, are subject to a substitutive tax regime, fixed at 12,50%; dividends, instead, as for natural persons, are taxed at 12,50% (if the participation is not qualified) or are included in the total income only for the 49,72% of their amount; as for entrepreneurs, dividends are included in the total income only for the 49,72% of their amount, apart from the fact that the participation is qualified or not. This rule is valid if the company that distributes dividends is Italian resident.

c. *financial passerby operations*: company obtains loans from a bank, thanks to the pawn of money, bonds and other values belonging to the partner; the bank receives simply a commission, because it is only formally the creditor, while the most part of remuneration is up to the guarantor partner, who is the real creditor.

This controversial problem is really at the roots of *thin capitalization*: this expression means the fiscal arbitrage enacted by an unbalanced ratio between net worth and debt financing (normally provided by partners) in a company, when the debt load appears excessive in respect of own means. Generally thin capitalization consents operations, meant for the full deduction of interest payable by funded company and a more favourable taxation on the active interest achieved by the creditor or guarantor partner.

Whereas in the other European countries general rules of contrast already existed, in the Italian legal system, until the IRES (tax on income of company) reform, the fiscal use of thin capitalization had been contrasted only through sector – based rules, not repealed by the reform: firstly art.3, par. 115 in Law 549/1995, stated the not deductibility of interest on bonds with a rate higher than the official yield rate[108]; then art.7, Law Decree (D.l.) 323/1996 introduced an additional withdrawal, in the form of substitutive tax of 20%, on proceeds resulting from money deposit, movable values and other values, different from shares and similar titles, realized by certain subjects in escrow of financings given to resident companies. However the fiscal use of thin capitalization resulted yet quite spread, continuing through operations which allowed move around these rules: so a reform of 1996-1997 (D.lgs. 30 December 1999, n.505) introduced an articulated regime direct to soften tax advantages arising from over getting into debt, on the one hand through the not deductibility of interest payable with the purpose of IRAP (regional tax on business), and, on the other hand, through a tax break of venture capital in basis of *dual income tax* (D.I.T). The D.I.T. determined that the income by legal persons would be taxed at IRPEG (tax on legal persons income) different rates, a low of 19% and a normal by 37%. The income produced by such subjects, in other words, was divided into two parts: one part, which represented the normal return on invested capital, underwent the reduced rate; the other part, calculated by difference, underwent the ordinary rate[109]. It was repealed by the reform.

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[108] This rule was modified by art.12, par.10, in D.lgs. n.461/1997.

[109] D.lgs. n.466/1996, containing provisions on "reorganization of taxes on personal income to promote the capitalization of companies", introduced the so called Dual Income Tax. This mechanism was designed the tax burden on companies, encouraging the most capitalized of them and, then, their capitalization. The law stated also a reduced rate to the increase of net equity, compared to the existing value in the budget for the tax period in progress as of 30.09.1996 and the limitation or exclusion of the benefit of the reduced rate if increases of assets were used for purposes other than those of strengthening of the production. The admitted subjects were: funds companies and cooperative corporations resident in the State; public and private resident bodies, other than companies whose only or main object was the exercise of commercial activity; individual enterprises in ordinary accounting not for option; personal trading companies in ordinary accounting not for option; permanent establishments in Italy of commercial non-resident subjects; non-commercial bodies in separate and ordinary accounting not for option.

The excluded subjects were banks, insurance companies, the subjects to which it was open insolvency proceedings or compulsory winding-up. The act introduced limitations with regard to the occurrence of possible tax avoidance cases within companies groups: it was enshrined the not deductibility of interest payable arising from financing operations carried out by parent company to provide profits to subsidiaries; Financial Administration had the power to disregard

D.l. 344/2003 introduced the IRES reform, who modified t.u.i.r. rules, concerning deductibility of interest payable; after the reform, the main articles on this matter were three:

1. art. 96, concerning not deductibility of interest payable in presence of exempt proceeds;
2. art. 97, concerning patrimonial *pro – rata*;
3. art. 98, against thin capitalization.

An order of application of the three dispositions was established: in first place it had to be applied the rule against thin capitalization; in second place patrimonial pro – rata and, eventually, the general pro – rata of not deductibility on interest payable in presence of exempt proceeds.

Recently the Budget Law 2008 has annulled art.97 and art.98[110] and modified the disposition of art. 96, that represents the only left discipline.

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the tax benefits resulting from operations without valid economic reasons; specific penalties were established if the income, subjected to reduced tax rate, resulted lower than the declared one.

[110]Art. 98 was not an anti – base erosion rule in a strict sense, it was instead a substantial rule, valid in the limits of determined obligatory elements, regardless of tax avoidance of the operation and subsistence of valid business reasons (but P. PISTONE, *Profili internazionali e comunitari* in AA.VV., a cura di F. TESAURO, *Imposta sul reddito delle società*, Bologna, 2007, p.319, made an objection, as the role of thin capitalization rule against tax avoidance should be shared in the national tax system of EU States and proved also by OECD studies in 80's). Thin Capitalization Rule tended to sterilize tax advantages arising from an anomalous recourse to debt capital, in place of venture capital, when exceeding financings were provided or guaranteed, directly or indirectly, by qualified partners, o by correlated parts and the financing amount was over the quadruple of rectified net equity, being due to qualified partners: the sterilization was obtained making not deductible interest payable, paid by funded company, and making active interest, get by creditor partner, equal to dividends. TCR punished companies that received loans from their partners, whereas DIT favoured and rewarded companies that invested own means. As for the subjective field of enforcement, TCR applied to capital companies and other IRES subjects (specified by art.73 t.u.i.r.); also to individual companies, family business and personal companies, when they had income higher than the limit established for the application of fiscal sector based studies. Banks and financial boards (ex art.1, D.lgs. n.87/1992) were subjected to TCR, apart from financings adopted in the exercise of their own activity. State and public bodies (art.74 t.u.i.r.) were not considered as qualified partners. It arose a doubt of compatibility with the EU principle of not discrimination, in respect of similar subjects coming from other States of European Union or with prohibition of state aids; the justification of the disposition was the aim of no penalizing the physiological debt situation of public subjects.

Considerable bakers were qualified partners and their related parts; as for individual businesses the reference to partner intended the person of entrepreneur, and, as for familiar businesses, intended even a spouse, relatives within the third degree and relatives-in-law within the second degree. The partner was qualified, when he controlled, directly or indirectly, the debtor subject according to art. 2359 c.c., or participated in the share capital of the debtor with a percentage equal to or greater than 25%, to whose determination combining stakes held by its related parties. In basis of art. 2359 c.c. they are considered subsidiaries:

a. those companies where a partner has the majority of the voting power in the ordinary assembly;
b. those where a partner has a majority of votes sufficient to exert a dominant influence in the ordinary assembly;
c. those who are under the dominant influence by virtue of contractual restrictions. For the purposes of the majorities they are also included voting rights of controlled companies, trust companies and people interposed, whereas they are not be included voting rights for third parties.

It was also relevant the ownership of special actions (unless they represented other relationships), of preference shares or deferred ones, of enjoyment stocks, of shares without voting rights or with restricted voting rights; they were not included, however, participations derived from securities or financial instruments similar to shares. As Revenue Service specified in the Circular 11/2005, the measure of qualified shareholdings was conducted during the period, considering the funding for the purposes of calculating the average, only for the days on which the lender had retained the qualification. Related parties of qualified partner were companies controlled under art.2359 c.c., and, if natural person, the spouse, relatives within the third degree and relatives-in-law within the second degree. In the field of related parts were not included subjects different from companies (i.e. not commercial bodies, ford foundations, associations, trusts...).

Relevant funds were those borrowed or guaranteed by qualified partner or his related parts, arising from loans, money deposits and every other relations of financial nature: it meant every form of funding, as leasing, notional cash pooling, or payment delay on commercial operations with interest terms and rates so anomalous as they become substantially financial operations. They were not relevant partners‘ payments in capital account or free grant, because the same do not oblige the debtor to repay; and, if these payments were converted into funds by partners with a shareholders' resolution, these would be relevant to TCR, as of tax period when it was taken the resolution. Regarding guarantees, they were guaranteed by the partner or his related parties, the debts secured by collateral warranties, as mortgages and pledges, by personal guarantees, by autonomous contract of guarantee and by fact guarantees; indeed, even through legal behaviours and acts that had the same economic effect (e.g. lettres du patronage and other atypical guarantees). For calculating the average number of funding, it was not relevant idle financing, provided that the average return is not higher than the official reference rate, increased by a percentage point. Art.98 spoke generically of return on the funds, but the government report to the legislative decree clarified that it limited the deduction only with respect to interest payable, a category more limited and restricted than that of financial burdens.

To determine **the average consistence of funds** it was added the amount existing at the end of each day of the tax period and then dividing that sum by the number of days in the same period; where the position of the lender or guarantor partner had changed during the tax period, with loss or acquisition of qualified status, the funding was to be computed only for the days when there was a qualifying condition.

For testing thin capitalization, it were to quantify **the amount of net assets attributable to the qualified shareholder and its related parties**: the net equity was that resulting from the budget of previous financial year, inclusive of not distributed profits of that year, with some adjustments justified by tax needs; as for newly created companies, it was referred to constitution net worth, and, as for permanent establishments, to the endowment fund allocated to PE.

The rectifications concerned:

i. credits relating to obligation of contributions, not yet executed and therefore not effective;
ii. the book value of own stocks in paper-securities;
iii. losses incurred, whether before the date of approval of budget of the second year following that considered it would not happen the recovery in equity with income or assets;
iv. the book value or, if lower, the relative accounting net equity, of shareholdings in controlled or related companies (capital or personal ones).

The rule penalized heavily the holdings, because the value of their shareholdings is the only significant post assets. However this adjustment was intended to avoid that the resources conferred by the shareholder of a company (contributing to form the assets of that company), and then used by the company for the acquisition of shareholdings in subsidiaries or associated companies (increasing the capital thereof), produced duplication of net assets (both in the first company and in the subsidiary), allowing an incorrect increase of deductible interest payable.

The share of net assets, attributable to qualified partner and its related parties, was obtained by comparing the total net worth to the first, increased of capital injections made by the partner or its related parts in the execution of joint venture contracts and profit-sharing contracts.

For the purposes of TCR, **the average rate of return of funds** had to be identified: in fact, once funds exceeding the limit had been quantified, these were subjected to this rate, corresponding to the ratio between the total remuneration of the relevant funds and the average consistence of them.

After determining all these factors, it could be made the **thin capitalization test**. The first test is based on the comparison between the average number of relevant funding and adjusted net equity attributable to qualified partners and their related parties, to determine if it is greater than 4 to 1. If the test gave a positive result, we proceeded to the second test, by calculating the excess of the relevant funds on the quadruple (if the first test gave a negative result, the TCR did not apply, though perhaps the funding came from only a few partners, who received an abnormal position). Where the ratio was greater than 4 to 1, the remuneration of the relevant excess funds, calculated at the average rate of return, became not deductible from taxable income of funded company. This not deductibility affected not only interest payable included in expenses account, but also those that, for tax purposes, could be included in property assets (e.g. instrumental goods and real estate goods, for which interest payable are allowed to be included in property assets, because they are met in connection with loans for constructing, acquisition or restructuring those goods). It should be noted that the TCR, while it operated primarily in relation to other mechanisms of not deductibility of interest expense, was subordinate to the control resulting from the application of transfer pricing rule.

For the avoidance of double taxation, that would result from taxation of exceeding interest payable, legislator treated active interest received by the shareholder as dividends: this assimilation was stated only for the remuneration of funds provided by qualified partner and not simply guaranteed by him (thus the interest income derived from non-partner creditor remained subject to double taxation).

2.1. The new regulation of interest payable. Art.96.

The new art. 96 of D.p.r. 22 December 1986, n.917 (t.u.i.r.), thanks to the modify introduced by art.1, par.33, lett. i), of Law 24 December 2007, n.244 (2008 Budget Law), regulates a new mechanism of interest payable deductibility, operative since 1 January 2008: because of the choice of leaving thin capitalization legislation, art. 96 is the only rule regulating payable interest deductibility and it has general extent. Reasons, which have lead to a structural intervention concerning interest payable, are mainly two: the need of rationalization and simplification of the discipline through enacting one sole rule, of more immediate enforcement and clearer aim; the stimulation of capitalization of companies. The main changes are that not deductibility of interest payable is never definitive and that art.96 applies to all companies, differently from TCR which did not apply to small businesses and to subjects with incomes lower than sector based studies line.

According to art.96, par.1, in every tax period, interest payable and similar burdens are deductible until the amount of active interest and similar proceeds.

Interest payable and active ones, as well as similar burdens and proceeds, are those arising from leasing contracts, loans, bond and similar securities issue and every other relationship with a financial cause (e.g. funding of partners); in the other hand they are excluded implicit interest coming from commercial debts. In the field of active interest they are relevant also virtual credits (but this is valid only for subjects who work with Public Administration and interest are cost out at the official reference rate, increased by 1%) and commercial credits. Moreover they are excluded by express provision of art. 96 par.1 (whereas they are considered under TCR) interest included in cost of goods, according to par. 1, letter b), art. 110, t.u.i.r.: in particular, capitalized interest related to funding for the acquisition of tangible and intangible assets; interest included in lefts-over of real estate under constructing or restructuring; interest included in manufacture costs of products, according the correct accounting principles.

Interest payable, exceeding active interest, is deductible within 30% of the Gross Operative Result (Italian Risultato Operativo Lordo, R.O.L., i.e. EBITDA). This parameter is defined by art.96, par.2, as the difference between the value and costs of production, about which at points A) and B) of art. 2425 of the Civil Code, with the exception of items of number 10), letter a) and b), and leasing fees for instrumental goods; as for subjects who draft balance sheet in accordance with international accounting standards, it will take corresponding voices of C / E. In this sense EBITDA is the difference between the value and costs of production, adding depreciation charges and leasing fees.

The TCR did not apply where the taxpayer had proved that the amount of funds disbursed or guaranteed by the qualified shareholder and its related parties was justified by its sole credit capacity and that the same would be provided by independent third parties with the sole guarantee of social capital: the administrative practice, with a restrictive approach, pointed out that the capacity credit was justified by a reasonable guarantee of social capital, based on subjective conditions of the taxpayer (credit, work performed, degree of goodwill, reliability of operator, the contingencies of the market), excluding the relevance of certifications issued by banks, both made by expert accounting professionals.

Thanks to art.96, par.4, interest payable and similar financial burdens, that are not deductible in a tax period, can be deducted, without time limit, from income of following tax periods only if and insofar as exceeding net interest payable is lower than 30% of EBITDA in those tax periods[111].
We find a transitory rule (art.1, par.34 of 2008 Budget Law) increasing the limit of interest deductibility of 10.000€ for 2008 and of 5.000€ for 2009.
Besides the carry-forward of not deductible interest payable, art.96, par.1 states that, from third tax period following that in progress at 31/12/2007 (practically, if tax period corresponds to solar year, from 2010) the possibility of carrying forward, without time limit, the amount of EBITDA not used for interest payable deduction, in the correspondent tax period. The aim of this choice is to protect those companies, which in a tax period are characterized by high EBITDA and low amount of interest payable. In accordance with a literal spin of the rule, which says that not used part of EBITDA "can increase the EBITDA of following tax periods", it seems that not used EBITDA share is to be added to the EBITDA of following tax period, but in this way the first sum is expressive of 30% of EBITDA, while the second is expressive of 100% of EBITDA.
Consequently EBITDA share, not used in a tax period, has to be added to the 30% of EBITDA of the following period[112].

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[111] Example 1

+ VALUE OF PRODUCTION (A)	2000
- COSTS OF PRODUCTION (B)	1500
A – B	500
+ DEPRECIATION CHARGES AND LEASIGN FEES	100
= EBITDA	600
30% EBITDA	=180
INTEREST PAYABLE	50
ACTIVE INTEREST	70
INEREST PAYABLE FULLY DEDUCTIBLE	70>50

Example 2

+ VALUE OF PRODUCTION (A)	2000
- COSTS OF PRODUCTION (B)	1500
A – B	500
+ DEPRECIATION CHARGES AND LEASIGN FEES	100
= EBITDA	600
30% EBITDA	180
INTEREST PAYABLE	80
- ACTIVE INTEREST	0
NET INTEREST PAYABLE	80
INTEREST PAYABLE FULLY DEDUCTIBLE	80<180

Art.96 does not apply to:

1. partnerships and individual businesses;
2. banks, insurance companies and other financial bodies (art.1, D.lgs. 27 January 1992, n.87), excluding industrial holding companies;
3. other particular subjects (e.g. companies operating in the field of public works and infrastructure).

Regarding banks, insurance companies and the other financial bodies, the new par. 5-bis (in force from 22 August 2008) of art. 96 establishes that interest payable, met by these subjects, are deductible from the taxable basis in the limits of 96% of its amount.

Some aspects have to be specified as for building companies of management: interest payable on loans taken out to buy of real estate assets are deductible (the strict interpretation stated by Revenue Service with circular 6/2006, which excluded deductibility of all interest payable related to such property, has been passed); then they remain not deductible only functioning interest[113]. As for these companies, new deductibility pro-rata does not apply to interest payable related to loans guaranteed by mortgage on real estate destined to building lease (at least until the revision of tax rules in the sector, and for this it has been established an proper "Study Committee on direct and indirect taxation on property companies). The Statute of taxpayers e the jurisprudence of the Court of Cassation consider that this provision has a retroactive effect.

Art.96, par.6, states absolute not deductibility for these categories of interest payable:

a) interest resulting from enforcement of transfer pricing rule or transactions with tax havens (par.7 and 10, art.110 t.u.i.r.);
b) interest exceeding the rate threshold for interest on bonds, calculated in accordance with par. 115, art. 3, Law 28 December 1995, n. 549;
c) interest paid to partners of cooperative societies resident in Italy, to the extent that it exceeds the limit laid down by art.1, par. 465, Law 30 December 2004, n.311;
d) functioning interest of building companies (art.90, par.2, t.u.i.r.).

According to art.96, par.7, in case of participation to national consolidated, the possible excess of interest expense and similar charges not deductible of a subsidiary can be brought to reduce the entire income of the group, only if and to the extent to which other consolidated participants, in the same tax period, present a capacious EBITDA and not completely used into deduction. This rule applies to the surplus carried forward, but not for those formed before the entry in consolidated; moreover, for the sole purpose of par.7, among national consolidated participants can be included also foreign companies, endowed with requirements for participating in world consolidated.

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112 S. MAYR, *Il nuovo limite di deducibilità degli interessi passivi nell'ambito del consolidato fiscale*, in *Boll. Trib.*, 2008, n.4, p.299.

113 Art. 3, par. 3, Budget Law 2008.

Industrial holdings undergo this regulation, differently from bank group holdings: it heavily penalizes them, because their EBITDA is almost equal to zero; the only possible solution for them is the option to fiscal consolidated or transformation into personal society.
In case of mergers (or divisions), company resulting from merger can recover not deductible exceeding of the incorporated company, but interest payable carried forward undergo the same limiting rule of tax losses.

3. TAX RESIDENCE.

In tax law residence carries out the task to determine if the obligation by a subject to contribute to public expenses must be estimated on territorial base or world-wide base. As for territorial base taxation, it must be intended the exercise, by a State, of imposition sovereignty only on the yields, produced by anyone (resident or non-resident) in own territory, while as for world-wide taxation we intend the exercise of imposition sovereignty also on the yields produced outside of the territory of the State by those people (residents) who have with this a connection of personal nature. In the Italian tax system the world-wide taxation and the territorial taxation coexist: a person could be subject to world-wide or only territorial imposition, depending on the existence or less of a personal connection with the territory. This personal connection is residence.
Residence plays a role in localizing incomes: in fact localization of some income cases inside or outside the territory of the State can be based on residence of who pays them (e.g. dividends, interests, royalties, that are produced in the State in paid by subjects resident in the State).
Residence is offered under consideration also like tax avoidance phenomenon: in fact, if a person qualified itself as non resident subject in the State where he lives and he works, his own imposition would be limited to those cases that have all their constituent elements within the territory of the State, avoiding the world-wide taxation; but also referring only to systems which adopt territorial taxation, concerning income tax on natural persons, residents undergo progressive rates, while non residents undergo proportional rates, in the form of taxation at source.
Apparent transfers abroad, therefore, are a lot spread, mainly among those natural persons and those companies and bodies that have the possibility to justify them with a "style" of economic and social life that has international implications[114]. All States can be characterized approximately by a high or a low taxation, depending on tax burden applied to their own residents, so transfer of residence acquires relevance in the field of tax avoidance: quick evolution of economic systems and reduction of time-space barriers in the exchange of goods, capitals and persons have produced a higher flexibility of transfer and a higher rigidity to be subject to heavy tax burdens. For this reason States may be

[114] G. MARINO, *La residenza*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p.347.

compelled to level their taxation, in order to embank easy and speedy residence escape towards more fiscally competitive Countries.

3.1. Residence of natural persons in Italian tax system.

The principle of "world-wide income" reconstructs the global economic and personal conditions of residents. Italian tax system, because of its primarily personal nature, revolves around the criterion of tax residence, which affects the determination of tax base, as for both the taxed income and the recognition of specific deductible burdens and tax allowance.

Art.2, par. 2 (t.u.i.r.) states that "to the aims of income taxes they are considered residents the persons who, for the majority of tax period, are enrolled in the register of births, marriages and deaths of resident population or have domicile or residence in the territory of the State according to civil code". The three substantial elements (identifying registration, civil domicile and residence) are alternative among them: the occurring of only one of them is sufficient to attribute the quality of Italian resident for the fiscal purposes, with the consequent taxation of subject's yields, anywhere produced in the considered tax period.

3.1.1. Enrolment in the register of births, marriages and deaths.

The first element, that is the enrolment in the register of births, marriages and deaths of resident population, is objective and formal: its main purposes are both statistics, in order to survey the resident population in the territory of a municipality, and political-economic, in order to determine the relative financial requirement. At last it has the character of publicity, thanks to the activity of transcribing and attesting, performed by officials of the registrar's office. The registration is obligatory for those persons who have fixed own residence, i.e. their usual dwelling, in the Municipality or who, without fixed dwelling, have established own domicile there. Therefore enrolment will have to happen, beyond that for the transfer of residence from another Municipality, also for the transfer of residence from a foreign country; in the same way the transfer of residence to another Municipality or abroad involves the cancellation.

Thus a subject, who has transferred of fact own residence abroad, but has remained enrolled in the register of Italian resident population, is however considered resident and taxed on world-wide base. Then, at the tax end, in this hypothesis form prevails on substance, unlike from civil field, where jurisprudence elaboration has leaded to think that register outcomes give place to relative presumptions, surmountable, if it is proved otherwise[115]; so the subject who establishes own habitual dwelling in a foreign country ,will have to ask for the cancellation from the registry and the enrolment in the registry of Italians abroad, thus not to be more Italian resident. The transfer will operate naturally from the moment of the cancellation, and not from the moment of effective transfer.

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[115] Cass., sent. 3 maggio 1976, n. 1572, in *Giust. civ.*, Mass. 1976, p. 608.

Some authors[116] advance doubts on the constitutional compatibility of this formal parameter: so that a subject is held to contribute to public expenses, fulfilling solidarity duties stated by art.2 of Constitution, he has to be connected in any way to the territory of the State, so as to have an interest to the life of that community which he is called to contribute for. Now, register of births, marriages and deaths has, instead, essentially statistics purpose, but it has been assumed as a criterion which the global tax pretension is based on. It is true that identifying registration often subtends an effective connection with the territory of the State (residence or domicile) and that it is necessary to base the taxation on an objective parameter: so the proposal that is put forward is to transform the registration, from sufficient condition to integrate tax residence, in a relative presumption of civil residence or domicile, and then of tax residence; in this way the tax rule would come closer to civil jurisprudence and other EU States, where substantial criteria clearly prevail.

3.1.2. Civil domicile and residence.

The tax rule refers to civil definitions of domicile and residence. Art. 43 states that "the domicile of a person is where he has established the main centre of his affairs and interests. The residence is where he has his habitual dwelling". Civil Jurisprudence has found, examining these two concepts, the main difference in the fact that domicile is *res iuris*[117] and residence is *res facti*[118], because the first would be a mere legal creation, free from the effective presence of the person and based on the intention of establishing there own centre of interests (subjective element); the second, instead, would be a real situation of fact, consisting in the effective presence of the person in that place (objective element). Doctrine[119] has criticized this approach, saying that, as for domicile, the centralizing of affairs and interests has to be real and concrete and, as for residence, the intentional element is relevant too: according to this doctrine, both are concrete situations, productive of predetermined legal effects, and in either cases objective element and subjective one coexist, even if objective element is preponderant between them.

In the definition of civil domicile like main centre of affairs and interests, jurisprudence[120] and a part of doctrine[121] have included not only economic and patrimonial interests, but also interests of moral nature, like those which concern the "consortium of married life": this extension of domicile increases

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116 G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, in *Rass. trib.*, 1995, p.1034.

117 E.g. Cass., sent. 21 marzo 1968, n.844, in *Giust. civ.*, 1968, I, 55.

118 E.g. Cass., sent. 3 maggio 1976, n.1572, in *Foro it.*, Mass. 1976, 343.

119 L. MONTUSCHI, *Del domicilio e della residenza*, in Comm. Cod. civ. a cura di Scialoja e Branca, Bologna - Roma, 1970, p. 1 e ss.

120 Cass., sent. 9 maggio 1956, n.1530, in *Foro it.*, Rep. 1956.

121 V. TEDESCHI, *Domicilio, residenza e dimora*, in *Nov. Dig. It., App.*, Torino, 1982, p. 165.

the practicality of tax rule, becoming basic in those cases in which the subject habitually dwells and carries out own activity in a foreign State, maintaining the centre of own familiar interests in Italy. Therefore Financial Administration has adapted to this wider interpretation, even if, in this way, residence and domicile end by blurring.

Civil residence is the place where the person has the habitual dwelling: this implies objective element of permanence, with a stability and continuity, in a certain place and subjective element of intention of remaining there.

On the probationary level it is necessary to consider fact elements, like the behaviour and customs of life of the subject. Part of the doctrine[122] thinks that residence can have to object, besides the dwelling place, also those premises where the subject is because of his activity of job. Other part of the doctrine[123], instead, thinks that the residence can be only the dwelling place, safeguarding the difference that subsists with the domicile notion.

3.1.3. Time and space elements.

The tax rule, to the aims of attribution of resident status, requires that three substantial elements have taken place for the majority of tax period and that domicile and residence have had place in the territory of the State.

The time element has been introduced because there is a matter of checking essential requirements of a period obligation and it is necessary to specify how much part of the tax period the required condition must subsist for. The majority of tax period is equivalent to about 183 days a year.

The reference to the concepts of residence and domicile under the Civil Code consents to exclude that the relevant period must be continuous, given that such requirement is not requested to the civil purposes[124].

As regards the territorial element, it is meant like political territory, on which the State exercises own sovereignty.

3.1.4. Residence of natural persons in Double Tax Treaties.

It can happen that, on the base of unilateral link criteria provided by national tax systems, a person turns out resident in more States to the tax purpose: in this case he would subjected to world-wide taxation in two or more States, giving place to serious phenomena of double imposition. Then it is necessary to attribute univocally the tax residence in one only State and bilateral Conventions against double imposition deal just with this. Conventions stipulated by Italy with the main European and non European States conform to art. 4 of OECD Model, which establishes that, to the aims of OECD

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[122] L. MONTUSCHI, *Del domicilio e della residenza*, op. cit., p. 22.

[123] According to this second thesis G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, cit., p.1056; A. FORCHIELLI, *Domicilio, residenza e dimora*, in "Enc. Dir.", XIII, Milano, 1964, p.843.

Model Convention, the expression "resident of a contracting State" designates every person who, in virtue of legislation of the said State, is taxed in the same State on the score of his domicile, his residence and every other analogous reason; so this article does not replace the unilateral definitions of the States, referring to inner legislations and establishing criteria for the solution of conflicts that could rise among States. Therefore the subject maintains a double residence and only to the aims of convention the residence in one only State is attributed to him[125]. Art. 4, par.2 provides these criteria, the so called tie-breaker rules[126]. These criteria are not alternative, but listed under a hierarchical order. OECD Model Convention uses criteria very next to those provided by art. 2, par. 2, t.u.i.r., but the first diverges from it under two aspects: in the first place OECD Model provides for a formal criterion such as the permanent dwelling, which consents easy tax avoidance manoeuvres directed to fix tax residence in determined States; in the second place the Model does not provide for the enrollment in the register of births, marriages and deaths, so this requirement will be valid only for the national context and not for bilateral relationships.

3.1.5. Presumption of tax residence under art.2, par.2-bis (t.u.i.r.).

Art. 10 of Law 23 December 1998, n.448 added, within art.2 t.u.i.r., par. 2-bis, stating that "Italian citizens, cancelled from the register of resident population and emigrants towards States or territories having a privileged tax regime, specified by a decree of the Minister of finances to publish in the Official Journal, are considered residents, until it is proved otherwise"[127]. The purpose of this rule was to contrast taxpayers' behaviours aimed to, on international base, tax avoidance.

Par.2-bis outlines a new category of subjects, in particular Italian citizens who have asked for and obtained the cancellation from the register of the resident population and have emigrated in countries having a privileged tax system: these citizens are considered tax resident in Italy, but they have the possibility of proving the opposite through the demonstration of their effective residence in the foreign country. The formulation of the rule reminds the hypothesis of the registration of Italian citizens to AIRE in case of transfer of the residence from an Italian municipality to a foreign country and in this

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[124] A. FANTOZZI, *Diritto tributario*, UTET, Torino, 1991, p.583.

[125] G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, cit., p.1070.

[126] 1. A person is considered resident in the contracting State where he has a permanent dwelling; when he has a permanent dwelling in both the contracting States, he is resident in the contracting State where his personal and economic relations more are tightened (centre of vital interests).

2. If the place where the person has the centre of vital interests cannot be determined, or if he does not have a dwelling place in neither of contracting States, he is resident in the contracting State in which he stays habitually.

3. If the person stays habitually in both the contracting States or in neither of them, he is considered to be resident in the contracting State which he has the nationality of.

4. If the person has the nationality of both the contracting States or neither of them, the competent authorities of the contracting States resolve the matter by common consent.

[127] Enacting this disposition, a decree for the "Individuation of States and territories having a privileged tax regime", including 59 Countries, was published in Official Journal, 10 may 1999, n.107.

way the reference to the citizenship could be explained[128]. A functional connection is established between the cancellation from the register and the transfer in the tax haven: if a subject is already resident in the tax haven and acquires the Italian citizenship successively, the connection is not realized. This connection could be gone around in case that a subject moves before in a State without a privileged tax system and successively in a tax haven, lacking the concomitance[129]. Given that tax residence is the essential requirement of a period obligation, the presumption will apply to tax periods when the taxpayer satisfies the two requirement, being Italian citizen and resident in a tax haven.

Then besides the already examined absolute presumption of residence for the subjects enrolled in the register of the resident population in Italy, there is a relative presumption of residence for the subjects enrolled in AIRE (moved in tax havens): two weights and two measures – an absolute presumption and a relative presumption - for the same situation, i.e. the registration in an identifying list with statistics purposes[130].

Italian citizen resident in the tax haven has the burden of contrary proof: the lacked evidence of the fact opposite to that presumed has as consequence the tax residence in Italy. Before this rule, Inland Revenue had to prove the residence of the taxpayer in Italy and he could limit himself to infer the irrelevance of elements produced by Inland Revenue or to offer the positive proof of the residence in other foreign State - even if, normally, the taxpayer tended not to expose himself too much, in order not to offer new data to Inland Revenue. After par.2-bis the change is in the form, but not in the substance: the taxpayer is not able more to limit himself to the negative proof of elements produced by Inland Revenue (that was also previously a losing strategy) and has to offer the positive proof of the residence abroad; Financial Administration, on its side, continues to collect all the elements that it collected before too, in order to contrast the theses of the taxpayer. The judge, therefore, decides on the base of the same elements which he had before par.2-bis[131].

Inland Revenue is not held to prove the residence of the subject, but however it is held to determine the undeclared income by the taxpayer: the analytic reconstruction of the income is normally very difficult, less than the taxpayer has left indelible traces of own activities in Italy, e.g. paying funds into Italian accounts. A famous case is given from a sentence, pronounced by the provincial tax Commission of Modena, against a famous Italian artist[132], where the reconstruction of the income has happened on the base of handlings on deposits opened in Italian banks. Inland Revenue can trace

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[128]G. MELIS, *Riflessioni intorno alla presunzione di residenza fiscale di cui all'art.10 della L.23 dicembre 1998, n.448*, in *Rass. trib.*, 1999, n.4, p.1080.

[129]G. MAISTO, *La residenza fiscale delle persone fisiche emigrate in Stati o territori aventi regime tributario privilegiato*, in *Riv. dir. trib.*, 1999, IV, pag.54.

[130]G. MELIS, in *Riflessioni intorno alla presunzione di residenza fiscale di cui all'art.10 della L.23 dicembre 1998, n.448*, cit., p.1083, maintains the necessity to make the absolute presumption of residence, based on register of births, marriages and deaths, relative.

[131] G. MELIS, *Riflessioni intorno alla presunzione di residenza fiscale di cui all'art.10 della L.23 dicembre 1998, n.448*, cit., p.1087.

incomes also through other elements, mainly when the notoriety of the subject is such to consent to establish his possible income sources (concerts, manifestations, sponsorships…), but in the other cases it is difficult to obtain valid results (and so the taxpayer does not have interest to oppose proof contrary to the residence in Italy, increasing in this way the cognitive elements of Financial Administration).

3.2. Residence of companies and commercial bodies.

The definition of relevant criteria of connection between a company and a State, among the various ways existing, is very complex, because of the necessity to conciliate the exigency of simplicity with that of actuality: the place of establishment, mere formal data, has the merit of certainty, but it ignores the underlying effective economic truth and it lends itself to easy tax avoidance manoeuvres; on the other hand the place of management, instead, expresses a dynamic and effective element, but it is not immune from manipulations too, because of the development of means of transport and communication[133].

In the Italian tax system the residence of subjects different from natural persons is regulated by art. 73, par. 3 (t.u.i.r.), under which: " To the aims of the income taxes, companies and bodies that for the majority of the tax period have the registered office or the place of management or the main object in the territory of the State are residents". This rule distinguishes those subjects (residents) that will be fully subject to tax on company income (Ires) on a world-wide base, from those others (non resident) that will be subject to taxation only on the yields produced in the territory of the State.

The standards of connection, alternative among them, are three:

1) the registered office, indicated in the memorandum of association and in the charter, according to art. 2328, n.2 (Civil code), turning out from the register of companies. This criterion is different from the place of establishment, quoted by the Law n. 218/95[134]: the two places will be coincidence between them only in the moment of establishment, coming less in the event of successive transfer towards a foreign country. The choice of tax legislator to abandon the criterion of the place of establishment has been criticized[135]: however the will of the legislator to watch to the company, in the genetic moment, like a "relationship" and not like a "contract", appears in compliance with the purpose of tax law to found the taxation on a criterion of effective connection;

2) the management place, such as place in which the administrative management is effectively exercised, in the sense of high direction of enterprise, the place where the key decisions are assumed

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132 Comm. trib. Prov. Modena, Sez. III, 18 maggio 1998, in *Il Fisco*, 1999, p.4018 e ss.

133 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, Roma, 2008, p.222.

134 This is the Italian Act on International Private Law.

and the strategies of companies are determined, setting aside both the formal attribution of power to certain subjects, and the place where the boards of directors are carried out[136]. The distinction between high administration and administration day by day is important too: the distance between the assumption of strategic decisions and their concrete performance will be directly proportional to the complexity and dimensions of the company (it will be necessary to have regard for high administration). Further problems arise in the groups of companies, given that it is difficult to pick out the management place of a subsidiary, constituted in a foreign country, independent from the parent company[137];

3) the main object, that it is a criterion mainly unknown to the other countries; it is meant as economic activity mostly exercised in order to achieve the business aim, as the place where the decisions of company find concrete performance. Art. 73, par.4 (t.u.i.r.) defines it like "the essential activity in order to directly realize the primary purposes indicated by the law, the memorandum of association or the charter". The assessment of fact can turn out problematic in case that company works in more States, being necessary to establish where the prevalence is verified. Art. 73, par. 4 establishes that "the exclusive or main object of the resident body is determined on the base of the memorandum of association or of the charter, if existing in form of public act or authenticated or registered private writing" and par. 4-bis asserts that, "lacking the memorandum of association or the charter in the aforesaid forms, the main object of the resident body is determined on the base of the activity effectively exercised in the territory of the State; such disposition is applied in any case to not resident bodies".

3.2.1. Presumption of tax residence under art. 73: par. 5-bis, par. 5-ter and par. 5-quater. The residence of trusts.

The fictitious localization of the tax residence by a resident company in EU or extra-EU States, in order to obtain a fiscal advantage not otherwise obtainable (tax avoidance planning), caught Italian tax legislator undefended, except a possible recourse, with numerous doubts, to the general anti-base erosion rules (art. 37-bis, D.p.r. n. 600/1973) or to the ones against the subjective interposition (art. 37, par. 3, D.p.r. n. 600/1973); moreover CFC regulation, as for controlled companies, resident in black list States. For this reason a relative law presumption has been introduced through an integration of the art. 73 t.u.i.r., with the aim to fight this phenomenon138. This rule significantly differs from art. 2, par. 2-bis, t.u.i.r., since the inversion of the burden of proof here is not connected to the transfer abroad, but it is linked to a static situation, regarding the relationship between an Italian resident company and a foreign holding, whose place of management is presumed to be in Italy if the majority of members or

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135 G. OPPO, *Categorie commercialistiche e riforma tribuatria*, in AA. VV., *Riforma tributaria e diritto commerciale: le fattispecie*, Milano, 1978, p. 28.

136 This criterion is slowly entering in crisis because of the development of telecommunication techniques (e.g. the corporate will can be formed at a distance at the same time in various places by means of communication systems).

137 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p.226 e ss..

board members are Italian residents; then, differently from art. 2, par. 2-bis, t.u.i.r., it is not requested that the foreign subject is resident in a tax haven139.

The art. 35 of D.l. n. 223/2006 has inserted in the art. 73, t.u.i.r., the following paragraphs:

1) par. 5-bis: until proved otherwise, the place of management of a subject (company or body) is considered to be in the territory of the State if it holds controlling participations (according to art. 2359, par. 1, Civil Code140) in companies, cooperative societies and mutual insurance societies resident in the territory of the State, as well as commercial bodies, private or public, different from companies, always resident in the territory of the State, as long as there is one of these conditions: a) the company, holding participations, is controlled, also indirectly, according to the aforementioned art. 2359, par. 1, Civil Code, by subjects resident in the territory of the State; b) the board of directors (or a similar management body) of the company holding participations is composed for the most part by board members resident in the territory of the State141;

2) par. 5-ter: in order to determine the existence of the relevant control, it is needed to consider the situation existing at the closing date of the financial year or of the management period by the foreign subject. If the control takes place directly through natural persons, also votes being up to relatives are noticed.

These new rules have become effective since the tax period in progress at the date of entry into force of the decree (4 July 2006). The inversion of the burden of proof has charged the foreign companies, and no longer the Financial Administration, of the proof of the effective residence abroad.

D.l. n. 112/2008 has concerned family real estate investment companies and has introduced the new par. 5-quater of art. 73, t.u.i.r.. according to which companies or bodies holding more than 50% of the shares of real estate investment companies and which are controlled, directly or indirectly, through trust companies or a third person, by Italian residents, are considered resident in Italy.

The control is intended according to art. 2359, par. 1 and 2, Civil Code, also as for participations held by subjects different from companies. The new rule has hunt down those cases of national control of investment companies that are foreign only nominally, considering them Italian and not applying the tax exemption regime normally provided for foreign investment companies.

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138 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 345, maintains that this choice does not have precedents in the world.

139 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 346: according to him, the legislator was interested to the tax regime of participations, so the rule would have a meaning only if the foreign tax is lower than Italian one (he hypothesizes the introduction of a selective criterion). He underlines also that the rule does not take into account that, lacking a Convention against double taxation, the tax avoidance effect of exemption will not take place, because according to art. 23, par. 1, letter f), t.u.i.r., capital gains from participations in resident companies are localized in the territory of the State, except those not qualified and negotiated in a regulated market.

140 Supra Note 6.

141 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 353: he wonders if the paragraph deals with civil residence or tax one: since the rule refers to decision-making centres localized in the State and where decisions are taken, he chooses the concept of habitual dwelling, which involves the presence of the subject in the place.

The Inland Revenue has maintained[142] that these choice by legislator are coherent with the directions of the Court of Cassation on the effective seat of a company and they are an instrument against tax avoidance practices, aimed at the prevalence of substance over form. Moreover it has clarified that the presumption under par. 5-bis, art. 73, is applied also when there are more foreign sub-holdings between controlling resident subjects and controlled resident subjects: the presumption of Italian residence of a foreign company, that directly controls an Italian company, will operate also for the foreign company placed at the immediately upper link of the companies chain, that will control directly the foreign sub-holding, now considered Italian resident. E.g. company W, resident in Italy, controls company X, having the registered seat abroad, which controls company Y, having the registered seat abroad, which controls company Z, resident in Italy. If the presumption of residence is applied for company Y (insofar it is controlled indirectly by company W and it holds a participation in company Z) and it is considered Italian resident, at this point also company X, since it controls directly company Y and it is controlled directly by company W, is presumed to be Italian resident. In this way it is difficult to avoid the presumption simply prolonging the companies chain: it will be sufficient to verify the Italian control on the last link in the chain and all the interposed companies will be considered Italian resident. The Inland Revenue Circular has added that, besides art. 73, the Financial Administration could infer further cases of presumption of company residence (without the inversion of the burden of proof) and that the foreign subject considered Italian tax residence has the same obligations provided by the law system for resident companies.

According to the tendency of the Inland Revenue[143], the evidence to the contrary, to overcome the presumption, can be produced only during the control by the Financial Administration: besides the possibility of presenting an ordinary consultation, the "qualified consulting activity" of Inland Revenue does not concern this case, because the check of the effective management place of a company or of the localization of the main object involves factual outlines, which cannot be faced through the ordinary consultation procedure nor through par. 8, art. 37-bis, D.p.r. n. 600/1973 (procedure not suitable to remove rules concerning liabilities).

The Budget Law 2007 has modified art. 73, par. 1, t.u.i.r., inserting trusts in the letters b), c) e d), among IRES subjects. Par. 3, art. 73, t.u.i.r., states that trusts and institutes having a similar content, established in States or territories different from those included in the Decree of the Minister of Economy and Finances under art. 168-bis, where at least one of the trustees and one of the beneficiaries are Italian tax resident, are considered to be resident in the territory of the State, until proved otherwise. The same is stated if an Italian resident conveys an immovable estate or constitutes or conveys real property rights or destination bonds on these.

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[142] Circ. Ag. Entrate 4 August 2006, n. 28/E, in *Il Fisco*, 2006, n. 32, fasc. 2, p. 4931 ss., that has given the official interpretation on D.l. n. 223/2006.

[143] Ris. Ag. Entrate n. 312/E, 5 November 2007.

3.2.2. Conflicts of residence and international Conventions against double imposition.

Art. 4, par. 3 of OECD Model resolves the problems of double residence, specifying that when a person different from natural person is resident in both the contracting States, it will be resident of the contracting State where the place of its effective management stays. Paragraph 22 of the Commentary to this article identifies this concept in the place where the key decisions are adopted on the managerial and trade plan, necessary for the exercise of the business activity: the place where the person or the group of persons who exercise managerial functions take decisions and adopt resolution (but it is necessary to take into consideration all pertinent facts and circumstances).

During the observations on the Commentary to art. 4, Italy has supported that it must be taken account also of the place where the main and substantial activity of the company is exercised. In order to get over the problem that can be happen when the localization of the place of effective management is not immediate, the TAG (Technical Advisory Group[144]) has elaborated in the document "Place of Effective Management Concept. Suggestion for Changes to the OECD Model Tax Convention", two alternatives proposals in order to define better the solving criterion[145].

4. TRANSFER OF RESIDENCE. EXIT TAXES.

The transfer of the tax residence, turning out from the movement by a subject of one or more criteria of personal connection, from a State to another, is object of great attention by the national legislators, in order to avoid that such transfer can be resolved in undue advantages to damage of the Inland Revenue. This happens when the transfer of the residence has like aim that one to avoid a tax withdrawal of money, otherwise due: as an example a contributor, before realizing a yield with the sale of a good, can think convenient to move own residence in a State where the tax burden is lower. In these cases, moreover, besides the loss of taxable income, the States can see compromised the coherence of the tax system (e.g. latent capital gain relating to a good of the taxpayer who, in the previous years to the transfer, has enjoyed deductions for amortization). The discipline of the transfer of residence is finalized to contrast, therefore, tax base erosion and tax avoidance and to protect the coherence of tax system[146]. The transfer of the residence can meet various obstacles on the legislative

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144 The role of the Technical Advisory Group (TAG) is to resolve technical issues related to the conceptual integrity and methodological adequacy of the ICP (International Comparison Program).

145 The first suggestion modifies paragraph 24 of the Commentary to art. 4 and the innovation is relative to those cases in which the decisional process is formalized elsewhere or consists of the participation of other subjects: in these cases the appraisal of ulterior facts is necessary, as the place in which the decisions have been assumed of fact or the existence of a majority shareholder that assumes such decisions. The second alternative provides for alternative hierarchic criteria (tie breaker rules) in cases of double tax residence of persons different from natural ones: the tests would be three (the first one is the place of effective management; the second is the State in which the economic relations are more tightened, the State in which mainly the activity of enterprise is carried out or the State in which the business decisions are mainly taken; the third is the place where company has been constituted). At last, if the precedent tests does not give result, this will be determined with one accord by competent authorities of the two contracting States.

146 P. DE‘ CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all'estero*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p. 378.

plan: e.g. unilateral wide concept of tax residence, which difficultly concur to accompany to the acquisition of the tax residence in the State of destination the loss of the same one in the State of departure[147]; the shifting of the burden of proof, dependent on the taxpayer, in case of transfer of residence in States endowed with a privileged tax system[148]; trailing taxes on capital gains inherent to assets closely connected to the territory of the Country of origin and in the moment of their effective realization; recapture provisions, in order to recover the deductions previously granted to the taxpayers.
However, between the more common measures, there are exit taxes, which are properly object of our study: these rules equalize the transfer of the residence to the realization (and therefore to the taxation) of latent capital gains on the securities belonging to natural persons or on the enterprise assets, individual or collective[149]. Capital gains that will come effectively (and eventually) realized only in a successive moment to that one of the transfer of residence (that implies the problem of the possible lack of sufficient currency in order to pay the tax[150] and of the esteem of the normal value of the assets of the taxpayer)[151].
In some States (France, Austria, Germany, Netherlands) exit taxes are turned also to natural persons, who do not carry on business but belong important shareholdings in companies, but essentially exit taxes have been concentrated on the subjects that carry on business, in an individual or collective form : the Italian legislation provides for an exit tax on the transfer of residence of only businessmen (individuals, partnerships, companies), not regarding the transfer of natural persons who do not practice business[152].

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147 An example is given by Italian rule on residence of companies, where the transfer of registered office or of place of effective management is not sufficient to lose Italian residence, if the main object remains in Italy.

148 e.g. art. 2, par. 2-bis in Italian t.u.i.r..

149 In the field of exit taxes they are also included the hypothesis of so called "extended tax liabilities", concerning the extension of the subjective element through presumptions of residence (unlimited extended tax liabilities) or the territorial element, extending criteria of localization of incomes produced in the territory of the State by subjects who move abroad (limited extended tax liability). These measures, however, are aimed to taxation of future incomes, while exit taxes predate the taxation of capital gains accrued, but not yet realized.

150 P. DE' CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all'estero*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p. 381, asserts however that capital gains are increases in income for the subject who belongs a good whose price has grown: the subject will be able to take into account of this fact in order to consume or to invest elsewhere, having recourse, if necessary, to debt to obtain currency.

151 G. MELIS, *Profili sistematici del "trasferimento" della residenza fiscale delle società*, in *Dir. prat. trib.*, 2004, Vol. LXXV, n.1, p.18-19.

152 Italian exit tax doe not concern natural persons: however the Internal Revenue Service (risol. 2 novembre 2001, n. 175/E) cleared up that an operation of shares exchange enacted in regime of tax neutrality, through which a natural person, who does not carry on business, acquires participations in a foreign company, making over participations in an Italian company, is subject to the anti – tax avoidance clause of art. 37-bis, d.p.r. n. 600/1973, if there is the purpose to move straight after the residence abroad to avoid Italian tax rules.

4.1. Italian exit tax: art. 166 t.u.i.r..

Corporate exit taxes present a strict link with the international - private effects of the transfer of seat. In the distinction between systems that adopt the principle of real seat or the principle of the incorporation, Italy is placed in a middle position: the basic criterion, adopted as a result of the reform of the private international law (Law n.218/1995) is that one of the incorporation, but it does not shun from the reference to the real seat. The transfer of seat, that does not involve the dissolution of the company and its winding-up, is object of a tax rule ad hoc, the art. 166 t.u.i.r., that leaves aside the events operating on the international - private plan, situating the case of transfer of tax residence on the closely tax plan[153].

D.l. 23 February 1995, n. 41, introduced art. 20-bis[154] (present art. 166) t.u.i.r., on "Transfer of seat abroad": the loss of contact by the company with the Italian tax system, resulting from the transfer of the seat abroad, is an hypothesis of realization, at the normal value, of elements of the business or of the corporate complex; the maintenance of the goods in a permanent establishment, keeping this contact, allows to freeze their realization at the normal value until the moment of their following and possible detachment from the permanent establishment. The same condition is provided for reserves in tax suspension[155].

153 G. MELIS, *Profili sistematici del "trasferimento" della residenza fiscale delle società*, cit., p.35.

154 "1. The transfer abroad of residence or of seat of subjects who practice business, that involves the loss of residence to the aims of the income taxes, constitutes realization, at the normal value, of elements of the business or of the corporate complex, except that these are merged into a permanent establishment situated in the territory of the State. The same rule is applied if successively the elements merged into the permanent establishment situated in the territory of the State are removed from it. In any case capital gains relating to permanent establishments abroad are considered realized, at the normal value. As for individual business, it is applied art. 16, par. 1, letter g), t.u.i.r..
2. The funds in tax suspension, included those taxable in case of distribution, enrolled in the last budget before the transfer of the residence or the seat, are subjected to taxation in the measure in which they have not been reconstituted in the accounting assets of the foretold permanent establishment".

155 G. MELIS, in *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p.486 e ss., wonders if the introduced rule had interpretative or innovative value, namely if the content of the discipline could be obtained or less from one or more pre-existing rules, in particular detectable in the "destination to purposes irrelevant to the practice of the business" in topic of company capital gains. The author wonders if a general principle existed in the Italian law system that required the taxation of values accrued on the assets every time they lose the connection with the company system. The question raises delicate aspects about the opportunity, also constitutional, to tax company capital gains merely accrued, weakening the productive apparatus and having recourse to complex estimates. Actual fact, in the transfer of seat by a company, the assets do not exit from the system of the company activity, that it will continue to being carried out, but exit only from the Italian tax system. The author concludes that the international context testified the nonexistence of a such general principle and that the legislator wanted clearly to close a gap of the system, qualifying the intervention like anti-tax avoidance and with an important systematic value.

4.1.1. Subjective field of application.

After D.lgs 344/2003 (IRES reform), the disposition had been confirmed and transfused in the art. 166 t.u.i.r., with the modification of the one first sentence, thus formulated: " The transfer abroad of the residence of the subjects of which at art. 2 and art. 73, p. 1, letter a) and b), that it involves the loss of the residence to the aims of the income taxes (...) "[156]. The reference to the seat had been completely eliminated, because someone had supported that such reference did not consent to include the hypothesis of transfer abroad of the main object of a company, which does not have in the Italian territory neither the registered office neither the place of effective business[157]. However, this had created clamorous gaps in relation to the subjective outline of the discipline[158]. In point of fact the gap was involuntary and the legislator, through art. 11, par. 2, letter b), n. 1, D.lgs. 18 November 2005, n. 247, have modified the first sentence of art. 166, reinstating "of the subjects who practice business"[159]. As for the European company and the European cooperative society, the Directive n. 2005/19/CE has introduced in the Directive n. 90/434/CEE a new Title IV-ter, "Rules applicable to the transfer of registered office of a SE or a SCE", in order to extend the dispositions of such directive to the " European company" (SE) and to the " European cooperative society" (SCE). Therefore, in the field of application of Directive n. 90/434/CEE, it has been included also the transfer of seat, defined as that operation "through which a SE or a SCE transfers its registered office from a Member State to another

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156 The reference to transfer of residence abroad concerns either tax residence or civil residence, but, in this second case, the concept is valid only for natural persons and this would be widely incomplete. So it must be intended in the sense of the transfer of constitutive elements of tax residence, implying the loss of tax residence.

157 G. ZIZZO, *Il trasferimento della sede all'estero*, in AA. VV. (a cura di C. SACCHETTO e L. ALEMANNO), *Materiali di diritto tributario internazionale*, Milano, 2002, p. 210.

158 The cross-reference to art. 73, letter a) and b) t.u.i.r excluded not commercial bodies; moreover partnerships, being able to qualify themselves like "instrumental subjects" to the aims of the determination of the yield, they fell within not art. 2, but art. 5 t.u.i.r. After all the transfer of the partner (natural person) of a partnership was completely insignificant, in so far, according to art. 23, par. 1, letter g) t.u.i.r, they are considered produced in the territory of the State incomes, of which at art. 5 t.u.i.r, imputable to non-resident subjects, so they would have continued to being taxed on the incomes achieved from the partnership resident in Italy.

159 The present text of art. 166, after changes is:
"TRASNFER OF RESIDENCE ABROAD. – 1. The transfer abroad of residence of subjects who practice business, involving the loss of residence for income taxes purposes, constitutes realization, at the normal value, of elements of the business or of the corporate complex, except that these are merged into a permanent establishment situated in the territory of the State. The same rule is applied if successively the elements merged into the permanent establishment situated in the territory of the State are removed from it. In any case capital gains relating to permanent establishments abroad are considered realized, at the normal value. As for individual business, it is applied art. 17, par. 1, letter g) and l).
2. The funds in tax suspension, included those taxable in case of distribution, enrolled in the last budget before the transfer of the residence or the seat, are subjected to taxation in the measure in which they have not been reconstituted in the accounting assets of the aforementioned permanent establishment.
2-bis. The losses produced till the tax period previous that one from which the transfer abroad of the tax residence has effect, not compensated with the yields produced till such period, is computable in deduction of incomes of the aforementioned permanent establishment according to art. 84 and to the conditions and in the limits indicated in art. 181.

Member State, without being dismissed and without creating a new body corporate" (art. 2, letter j). Concerning these subjective figures, regulated on community level also under the civil aspect (respectively reg. n. 2157/2001 and reg. n. 1435/2003), Italian D. Lgs. 6 November 2007, n. 199, through which Directive n. 2005/19/CE has been implemented in the Italian law system, has not dictated a special discipline for the transfer of seat of European company. Italian legislator has restricted itself to inserting the European company and the European cooperative society between IRES subjects of which at art. 73, par. 1, letter a) t.u.i.r., without inserting any ad hoc letter in art. 178 t.u.i.r. (concerning special corporate operations among Member States), relatively to the transfer of the seat of the European company. Moreover Italian legislator has modified both the general discipline of art. 166 (in topic of losses and members' position), and art. 179, par. 3 t.u.i.r (in topic of virtual tax credit), both generically referring to companies resident in Italy, that transfer the residence in another State - it being understood that art. 179, par. 3 applies to transfers only in another Member States. Consequently, now art. 166 t.u.i.r finds application also to the European company and European cooperative society, without any regulation ad hoc.

4.1.2. Members' position.

The art. 166 did take no interest in taxation of the members, as far as the introduction, happened with the D.lgs. n. 199/2007, of the par. 2-ter, according to which "the transfer of the tax residence abroad by a corporation does not give rise by itself to taxation of the members of the transferred corporation".
It is necessary to specify that in Italy, after the abrogation of the mechanism of the tax credit and the substantial equalization in taxation of foreign dividends and inner dividends, the dividends, coming from a company moved abroad and perceived by members resident in Italy, are taxed at the ordinary rate according to art. 44 or 89, par. 3 t.u.i.r. (concerning the taxation of dividends and interests). If, instead, the member is resident abroad, the Italian Inland Revenue will lose every tax right on him, as a result of the transfer of the company.
In case of transfer of residence of a company, there are only two cases in which the member can be taxed, successively to the distribution of members profits by the ex-resident company, under the art. 47, par. 7 t.u.i.r.[160]:

i. the case (very unusual, because it is limited only to cases of extra-EU transfer[161]) in which the legal system of State of destination does not recognize the Italian company that moves abroad,

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2-ter. The transfer of the tax residence abroad by a corporation does not give rise by itself to taxation of the members of the transferred corporation."

[160] Art. 47, concerning participation profits, states, at par. 7, that the sums or the normal value of goods received by members, in case of recess, exclusion, redemption, reduction of exuberant capital or winding-up of the company, are considered like profits as far as they exceed the price paid to buy or to sign the shares. It has to be remembered that dividends are included in the global income for the 49,72% of their amount, if they are received by a natural person, who belongs qualified participation, or by entrepreneurs.

producing, under art. 25, par. 3, Law n. 218/95, the dissolution of the Italian subject; it should imply the application of the rules about the tax treatment of the sums attributed to members and of art. 166 t.u.i.r[162]. Aside from this hypothesis, every direct effect on members of corporate companies is excluded;

ii. the second hypothesis is the case of partnerships, where taxation takes place "by transparency" on resident partners. About it the D.lgs. n. 247/2005 have modified art. 166 t.u.i.r., stating that, as for individual businesses and partnerships, not only letter g) of par. 1, art.17, t.u.i.r., but also letter l) of the same paragraph finds enforcement[163].

Par. 2-ter of art. 166, introduced by D.lgs. n. 199/2007, is the implementing rule of art. 10-quinquies of Directive 2005/19/CE, under which "the transfer, from to a Member State to another, of the registered office of a SE or of a SCE cannot give place, by itself, to ay taxation, either as profits or as capital gain, towards the members of the moved company".

First of all the fact that the transfer does not give place, by itself, to the taxation of the members, does not exclude, on the literal plan, the two cases of application of the art. 47, par. 7 above-mentioned.

In the second place the rule does not distinguish on the base of the residence of the member who, if resident abroad, does so that Italy loses any right on the shareholding in the (ex) resident company.

In third place, although the rule refers to only members of corporate companies, this does not consents to read it in the sense to allow the taxation of the partners of partnerships in case of relative transfer abroad (given that the analogy of taxation of non-resident member in both hypothesis)[164].

4.1.3. Determination of tax basis: goodwill, isolated assets, latent capital losses, period incomes and goods "wares"

Further problems rise in relation to the determination of the tax basis, with particular reference to the possibility to tax the goodwill, to the attraction into taxation of assets that are not part of a business complex, to the relevance of the latent capital losses, to the period incomes and the goods not

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161 This on the basis of the result of *Überseering* case, examined by European Court of Justice.

162 Then it might be more advantageous to deliberate directly the dissolution and the winding-up, in order to apply art. 182 t.u.i.r., mainly if there is a relevant goodwill, whose taxation would be excluded.

163 While letter g) refers to "capital gains, including the goodwill, realized through a assignment for a consideration of business possessed for more than five years and incomes achieved from the winding-up, also insolvency one, of businesses exercised for more than five years", letter l) refers to the members, providing for separate taxation of "incomes included in the sums attributed or in the normal value of the assets assigned to the members of companies of which at art. 5 in the cases of recess, exclusion and reduction of capital or to heirs in case of member's death, and yields attributed to the members as a result of winding-up , also solvency one, of the same companies, if the time period elapsed between the constitution of the company and the communication of the recess or the exclusion, the deliberation of reduction of capital, the member's death or the beginning of the winding-up is longer than five years".

164 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 525-529.

productive of capital gains. It is a serious situation of uncertainty, due to a precise failing fact, from the moment that the decree of the Minister of finances, that it would have had - according to art. 30, par. 2, D.l. 23 February 1995, n. 41 - to provide for the modalities of implementation of art. 20-bis, through the approval of appropriate models and attachments, indicating the assets and the other business income elements and those relating to the permanent establishment, has been never issued; indeed, after the introduction of art. 166 t.u.i.r., it has disappeared any reference about it[165].

4.1.3.1. The goodwill.

Some[166] think that the realization at the normal value should have to regard exclusively the assets enrolled in the accounting of the individual or collective business, excluding, therefore, the realization of the possible goodwill. This thesis is based or on the literal standard of the rule, or on the nonexistence of an operation typically preordered to the realization of the goodwill, or on the impossibility of registration of the goodwill in the budget of permanent establishment, to the aim not to produce the immediate taxation of it.
In reality, regarding the Italian rule, many arguments support the thesis of the taxation: in the first instance the reference of the rule to the *business complex* indicates the possible existence and legal importance of a something more as opposed to the single business elements, which they can be separate from the company without that it fails; in the second place the aim of the tax rule is however to cast up the balance of the taxable wealth produced on the territory of the State before its abandonment and the goodwill participates to this wealth; at last the goodwill is susceptible to generate capital gains, on the strength of inner system (art. 86, par. 2 t.u.i.r.) and the argument of the impossibility to register in the budget the goodwill is not relevant, because the permanent establishment will be always a business complex[167].
Art. 10-ter of the Directive 2005/19/CE states that the transfer of the registered office or the loss of the tax residence does not give place to taxation of capital gains in the Member State from which it the registered office has been transferred, turning out from the elements of assets and liabilities of SE or the SCE which effectively remain connected with the permanent establishment of SE or of the SCE in that Member State. The expression “elements of assets and liabilities” is unsuitable to include the goodwill, that cannot be registered in the enterprise budget: the different expression of the Italian rule

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[165] G. MELIS, *Il trasferimento della residenza fiscale nell’imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 530.

[166] S. MAYR, *Effetti del trasferimento della sede all’estero*, in *Corr. trib.*, 1995, p. 2708; M. PIAZZA, *Guida alla fiscalità internazionale*, Milano, 2004, p. 1225.

[167] G. MELIS, *Il trasferimento della residenza fiscale nell’imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 532; R. BAGGIO, *La perdita e l’acquisto della residenza fiscale: quadro d’insieme ed aspetti controversi*, in *Riv. dir. trib.*, 2006, p.541.

in respect of that of EU, if it confirmed the thesis of the taxation of the goodwill by art. 166 t.u.i.r., on the other side it required a coordination between the two rules, that it has happened by means of the renewal of such hypothesis inside art. 166 t.u.i.r..

4.1.3.2. Isolated assets.

As for latent capital gains relative to the assets not included in the business concept - in absence of a permanent establishment where they can merge into - someone expresses himself in favor of their importance to the tax purposes (because of "the aims of the rule")[168], others, instead, are against[169]. Financial Administration has pronounced itself on the point only indirectly, retaining the regime of the participation exemption applicable in the event of transfer abroad of the company seat, therefore implicitly recognizing the importance of isolated assets within art. 166 t.u.i.r.[170].

The wording of the rule is precise and it does not seem to leave space to extensive interpretations. Therefore there is a gap that needs to be plugged in legislative way, provided that the tax avoidance potentiality of the transfer of residence abroad, concerning isolated assets, is undoubted. In fact the entire discipline of the effects of realization related to the transfer of the tax residence now must be thought contained in art. 166 t.u.i.r[171].

4.1.3.3. Latent capital losses.

The rule refers generically to the realization, at the normal value, "of elements of the business or of the corporate complex", using an expression suitable to include capital gains and capital losses; however then it specifies that "in any case capital gains relating to permanent establishments abroad are considered realized, at the normal value". This element of semantic ambiguity, however, can find easy solution in the ascertainment of the nonexistence of a "normal capital gain", coming in relief the difference between normal value of the foreign permanent establishment on the whole and its cost fiscally recognized to the aims of the Italian income taxes. It is not possible to admit the relevance of accrued capital gains without a correspondent relevance of accrued capital losses, both on the constitutional plan and on the plan of the company system[172].

4.1.3.4. Period incomes.

If the transfer happens before reaching the temporal requirement of the majority of tax period, only the yields produced in the territory of the State will be important, under art. 23 t.u.i.r., according to the

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[168] M. PIAZZA, *Guida alla fiscalità internazionale*, cit., p. 1225.

[169] S. MAYR, *Effetti del trasferimento della sede all'estero*, cit. p.2711.

[170] Circ. Ag. Entr., 4 agosto 2004, n. 36/E, punto 2.2., in *Il Fisco*, 2004, n. 31, 2, p. 4879 ss.

[171] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 535 ss.

[172] This solution is sustained by the report accompanying the D.lgs. n. 199/2007, section 17.

territorial principle in force for incomes produced by nonresident subjects; if, instead, the transfer of the residence abroad happens once completed the temporal requirement, in such case they will be relevant incomes everywhere produced in the tax period (on condition that the rule becomes operating with the loss of the tax residence in the following tax period).

4.1.3.5. Goods "wares"

As regards goods different from those producing capital gains, the rule refers generically to the realization, at the normal value, of elements of the business or of the business complex: this expression can include goods productive of proceeds, such as the goods-stock and shares, if not merged into a Italian permanent establishment. However, really the importance of the goodwill induces, in the cases in which the lacked merging concerns an entire business complex, to refer to the assignment of business of art. 86, par. 2 t.u.i.r. Regarding, instead, the assets of the foreign permanent establishment, only capital gains will be important.

4.1.4. The use of losses of the financial year and of previous losses.

We must wonder which workability the ordinary losses of exercise and the carry-forward of the previous losses have.

Regarding the losses of exercise, these can clearly compensate the possible positive balance of the capital gains and the capital losses: the balance arising from the realization contributes to form the total income of the subject, or positive or negative (art. 8, par. 1 and art. 83, par. 1 t.u.i.r.). Naturally, in this event, the subject does not have to make use of separated taxation, occurring the conditions, as in such case he will not be able to use the losses.

The same it can be thought for the previous losses: the subject is closing the accounts with the Italian system, therefore it does not have sense to deal them various[173].

With regard to the losses remained in the moved company after this compensation, it is necessary to distinguish between two cases.

If the subject maintains in Italy the connection of the permanent establishment, art. the 166, par. 2-bis (introduced by D.lgs. 6 November 2007, n. 199) states that "the losses produced till the tax period previous that one from which the transfer abroad of the tax residence has effect, not compensated with the yields produced till such period, is computable in deduction of incomes of the aforementioned permanent establishment according to art. 84 and to the conditions and in the limits indicated in art. 181". This disposition has its source in the art. 10-quater, par. 2, Directive n. 2005/19/CE, that it expressly allows the possibility to recognize the previous losses, provided that the faculty of carry-forward is recognized in the operations carried out within national borders.

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173 G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 542.

As far as the hypothesis in which the subject does not maintain a permanent establishment in Italy is concerned, the reference to the isolated determination of the single incomes for IRES subjects changes the situation: the art. 152, par. 2 t.u.i.r. refers, as for the determination of incomes of foreign subjects without a permanent establishment in Italy, to art. 8, par. 3[174]. The subject will not have more a company income in Italy, therefore neither the IRES subjects, neither individual entrepreneurs will be able to put forward the losses of enterprise compensating with their other possible yields considered produced in the territory of the State.

4.1.5. The loss of tax residence to the aims of art. 166 t.u.i.r.. Tie-breaker rule.

The subject is considered fiscally nonresident in the same year in which the transfer of the constituent elements has happened (and the realization of capital gains can be estimated in the same exercise) if the loss of the constituent elements happens before the maturity of the majority of tax period. If the loss, instead, happens in a successive moment, when the taxpayer has already caught up the resident status, the loss of the tax residence will take place in the following tax period (unless the subject brings back in Italy the constituent elements in useful time). In this second case the problem arises about which is the important moment: that one in which the transfer of the last constituent element, involving the possible loss of the tax residence, has happened or that one of the effective loss of the tax residence.

Now, the literal dictation of the rule refers to the transfer of the constituent elements, that it involves the loss of the tax residence; moreover if the reference were made to the moment of the effective loss of residence, the determination of the moment to the normal value of the business assets would be a mobile element in the time and it would produce distortive effects concerning the dispositive actions business, acted after the transfer of the last constituent element, but before the loss of the tax residence[175].

On the other side, the mere loss of all the constituent elements cannot be considered sufficient, being based on the loss in abstract of the tax residence, really because the subject could return in Italy before such loss.

Therefore the thesis of the change of tax residence as "mere external condition to the taxable fact" [176] is preferable: the relevant moment, that constitutes essential requirement of art. 166, is the transfer of

[174] Art. 8, par. 3 states that:"The losses deriving from the exercise of business and those deriving from participations in commercial or limited partnership are calculated in deduction from the relative incomes, achieved in the tax period and for the difference in the following ones, but not longer the fifth, for the entire amount of their capacity". The rule concerns only individual business and partnerships, but G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 545, maintains that it is suitable to be extended to IRES subjects.

[175] M. PIAZZA, *Guida alla fiscalità internazionale*, cit., p. 1223.

[176] M. NUSSI, *Trasferimento della sede e mutamento della residenza "fiscale": spunti in tema di stabile organizzazione e regime dei beni di impresa*, in *Rass. trib.*, 1996, p. 1345.

the constituent elements, that involve the possible transfer of the tax residence, but the operativeness of the rule will be conditioned by the effective taking place of the loss of residence[177].

It could happen that the company maintains in the State of departure one or more constituent criteria of the tax residence, but that it loses however the residence in the relationships with another State, because of the enforcement of a Double Tax Treaty stipulated with it. In our law system it exists the so-called "principle of not worsening", that consists in the impossibility for conventional localization in a State of a certain income to create a new taxable case (except that it is already established by the inner legislation), or in the impossibility to derive from the enforcement of the international convention an unfavorable effect for the taxpayer in respect of the national regulation[178]. Therefore the prevalence, based on the tie breaker rule, of the linking criterion of localized abroad cannot produce the operativeness of the inner rule: for this the national legislators expressly establish the possibility of enforcing the exit taxes also in the event in which the loss arises from the enforcement of a convention against double taxation[179].

4.1.6. Reserves in tax suspension.

The par. 2 of art. 166 t.u.i.r states that "the funds in tax suspension, included those taxable in case of distribution, enrolled in the last budget before the transfer of the residence or the seat, are subjected to taxation in the measure in which they have not been reconstituted in the accounting assets of the aforementioned permanent establishment". It deals with reserves raised in the net equity in accordance with particular tax rules in order to take advantage of the possibility to postpone the inclusion in the company income of determined positive elements or to predate the inclusion of negative elements in the company income. These reserves are however wealth increments, embezzled from taxation until those events that extinguish the suspension regime take place.

The Italian legislator tax them at the moment of the transfer of the residence, unless they are attributed to a permanent establishment in the Italian territory: in such case the taxation is put off at the moment when the ordinary taxable cases happen.

Regarding the reserves different from those in tax suspension, nothing is established. Therefore the reserves formed by profits will not undergo any taxation at the moment of the transfer of the seat, even if they have not flown together in the permanent establishment.

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[177] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 552.

[178] This principle, whose existence is not pacific in the international context, has found space, in Italy, not only in ministerial acts, but also in a sentence of Cassation Court (Cass. sez. trib. 10 dicembre 1999 – 8 maggio 2000, n. 5768, in Riv. dir. trib., 2000, II p. 316 – 317).

[179] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 558.

The art. 10-quater, par. 1, Directive 2005/19/CE, asserts that the reserves in tax exemption must remain in the within of the permanent establishment[180]: so on this point the national rule complies with the community one.

4.1.7. Permanent establishment.

The legislative choice renounces to tax at the normal value the assets of the business or the company that is moved in the event in which these assets have flown in a permanent establishment situated in the territory of the State, forming its endowment fund. Art. 166, par. 1 states that: "The transfer abroad of residence of subjects who practice business, involving the loss of residence for income taxes purposes, constitutes realization, at the normal value, of elements of the business or of the corporate complex, except that these are merged into a permanent establishment situated in the territory of the State. The same rule is applied if successively the elements merged into the permanent establishment situated in the territory of the State are removed from it".

The attention of jurists is concentrated on the meaning of the terms "merged" and "removed". The question covers a remarkable importance, or as for the immaterial assets inherent in the business activity (e.g. trademarks, licences), or as for the goods that do not have any economic – functional link with the business activity carried out by the permanent establishment (e.g. merely patrimonial real estates situated in the territory of the State).

Who maintains the so-called "power of attraction of the permanent establishment"[181], thinks that those assets and activities that as a result of the transfer of the society remain in Italy, but directly are not connected with the activity of the permanent establishment, would not exit from the regime of the yield of enterprise.

In the second place the expression "merged" has been intended as mere accounting connection, admitting the possibility to attribute to the permanent establishment also assets not effectively connected with it[182]: in so far as the confluence would be resolved in the simple registration of the good in the patrimonial situation of the permanent establishment[183].

Others[184], instead, have pointed out that, while, with regard to goods hold for investment purposes in Italy, the effective connection could be the accounting correlation, in the event of goods situated abroad and which are not part of the permanent establishment it would be necessary the existence of a connection with the functioning of the permanent establishment.

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180 The discipline derives from art. 5 of Directive n. 90/434/CEE.

181 On this point, F. VARAZI, *Reddito d'impresa e trasferimento di sede all'estero*, in *Rass. trib.*, 1995, p. 692.

182 S. MAYR, *Effetti del trasferimento della residenza all'estero*, cit., p. 2711.

183 This reading is sustained by the Government Report to D.l. n. 41/1995.

184 A. LOVISOLO, *Profili fiscali della fusione transfrontaliera di società*, in AA. VV., *Studi in onore di Victor Uckm*ar, Padova, 1997, II, p. 789.

If the accounting connection consents to solve the problem of immaterial goods, whose functional connection to the permanent establishment would be difficult to prove because of their lack of material consistency, at the same time the functional criterion is also valid: Financial Administration should be able to prove the functional purpose of a good towards the Italian permanent establishment, but also the taxpayer might have an interest to block the enforcement of art. 166, in the case of a hidden permanent establishment[185].

Similarly, therefore, the term "removed" must be meant as accounting elimination of the good, that before has been enrolled and then has been cancelled from the accounts of the permanent establishment, from which it has been detracted also in a functional sense.

Finally art. 166, par. 1 establishes that "in any case capital gains relating to permanent establishments abroad are considered realized, at the normal value". Therefore all the assets attributed to the foreign permanent establishment in the distinguished accounting, stated by art. 14, par. 6, d.p.r n. 600/73, in the event in which the Italian company works abroad through a permanent establishment, or in some way connected to it, participate to the formation of the income according to art. 166 t.u.i.r. The reason of this rule is clearly the tax interest: in the event of a foreign permanent establishment, the Italian State loses any connection with those assets, because of the transfer of residence.

Before the D.lgs. n. 199/2007, the discipline of art. 166 differed deeply from that of art. the 10, Directive 90/434/CEE, providing for the so called "notional tax credit"[186]: this means that, where a company has a permanent establishment abroad, it is up to the State, in which the permanent establishment is situated, levying tax on accrued capital gains. For this the State of (ex) residence can draw the tax only as far as it exceed the tax levied by the source State. Moreover the directive n. 2005/19/CE, extending the Directive 90/434/CEE to transfers of seat of SE and SCE, did not extend the art. 10 to these transfers.

The Italian legislator, with the D.lgs. n. 199/2007, has solved this arbitrage providing for the possibility to apply what is established by art. 179, par. 3 (implementing art. 10 of the aforesaid communitarian directive) also "in the event in which a company resident in Italy transfers own tax residence in another Member State, considering as value on which calculating the virtual taxation of the permanent establishment abroad, the normal value that the other Member State would have determined in case of

[185] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 578 ss.

[186] The par. 5 of this article states that if a permanent establishment, situated in another Member State, has been conferred, the relative capital gains are taxable towards the conferring resident as realization at the normal value, with deduction from the relative tax, until its total absorption, of the tax amount that the State, where the permanent establishment is situated, would have effectively levied in absence of the rules of the communitarian directive n. 90/434/CEE".

realization at the normal value of the permanent establishment"[187]. However the possibility to have use of the "virtual credit" is excluded when the transfer happens outside EU.

4.2. Italian exit tax and EU law. The "Hughes de Lasteyrie du Saillant" judgment.

Although the competence on direct taxes is up to the Member States, this finds own limit in the respect of the four fundamental freedoms stated by the Treaty. The European Court of Justice, in evaluating the compatibility of the national tax rules with the communitarian ones, focuses on the respect of the principle of not discrimination and on the restrictions to the fundamental freedoms. Generally a national rule is considered compatible if it satisfies the four tests of the "rule of reason" , i.e. the norm:

1) must not be applied in a discriminatory way;
2) must be justified by imperative reasons of public interest;
3) must be suitable and appropriate to the aims of the public interest persecuted;
4) must be proportioned to the persecuted purpose[188].

Taxes levied on latent capital gains at the moment of the transfer contrast with the applicability of the freedom of establishment provisions, stated in articles 43 and 48 of the EC Treaty itself.

In the Daily Mail case[189], however, the European Court of Justice ruled against the taxpayer (a company), stating that the question of transfer of seat was a matter of national law and, therefore, not entitled to Treaty protection. The result of this case was that companies were not granted the primary freedom of establishment.

Actually, this judgment is not rid of criticism, since the Court, by excluding the applicability of the freedom of establishment on the basis of "the differences in national legislation concerning the required connecting factor", not only left the harmonization of different national company laws[190] to Member States, but also disregarded the fact that the procedural restriction was not based on UK private international law, but on UK tax rules. Moreover, the principle stated by the ECJ – according to which the adoption of the "deemed liquidation" approach and the levy of an exit tax can be considered as the consequence of the existing differences among Member States private international rules –

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187 The Government report to d. lgs. n. 199/2007 (par. 30-39) presents this choice as an alternative to that of granting a tax suspension in case of transfer abroad, and it explains that this choice is considered more compatible with the EU Law and simpler from the operative point of view.

188 G. Marino, *La residenza*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p.372.

189 European Court of Justice, judgment in case *Daily Mail*, C-81/87, in *ECR*, 1988, p. 5483 and ss. In this case a company incorporated and centrally managed in UK wanted to move its place of management to the Netherlands in order to become fiscal resident of the Netherlands and sell some shares under the Dutch participation exemption. However, under UK Income and Corporation Law the company had to obtain the consent of the UK Treasury in order to be able to move to another country.

190 The enactment of the Regulation on the Societas Europaea, where EU has legislated on tax treatment of the transfer of seat by this commercial body (art. 7 - 8, Reg. EEC 8 October 2001, n. 2157), allowing the transfer of seat between Member States without any deemed dissolution effect, has aimed to prevent the negative effects at the basis of the Daily Mail case: however this has not solved the problem of those company incorporated under different national laws.

cannot be applied in the Italian system, which never considers the company transfer of seat as a deemed liquidation, ensuring, on the contrary, the continuity of the company[191].

The recent judgment in the French "Hughes de Lasteyrie du Saillant" case (C-9/02) has had a different outcome: the Court has declared incompatible with EU law the French rule, that levied tax on latent capital gains of the taxpayer (a natural person) who had transferred own residence abroad. Several elements of the French exit tax192 has highlighted as its main purpose was to contrast tax avoidance, put into effect through the transfer in a State with a lower tax rate. The Court of Justice however, even though it recognized the existence of a tax interest by the Member States against tax avoidance cases, has found in French exit tax an obstacle to the freedom of establishment stated by the Treaty, not justifiable simply by the tax avoidance purposes of the rule.

In the Italian tax system exit tax does not concern accrued capital gains on company securities belonging to individuals who move their residence abroad and who do not carry on a business activity, as it was in the French case, but only those subjects – individuals, partnerships and companies – who exercise an entrepreneurial activity. In any case, in the light of these arguments, we can thus assume that the Italian exit tax constitutes a restriction according to EC law both for individual entrepreneurs and companies. Now our reasoning has to focus on possible justifications for this restriction in Italy, analysing, in particular, the arguments of the fiscal coherence and prevention of tax avoidance.

Starting with the fiscal coherence justification of the Italian exit tax and its taxation of accrued capital gains before the moment of emigration, one may argue that it is just an application of general Italian tax law principles, such as the equal treatment of taxpayers or the personal and progressive base of taxation. Unlike the French exit tax, the Italian one does not provide for a credit as for the taxes maybe paid by the taxpayer in the State of destination at the moment of the realization of capital gains: such capital gains are accrued in Italy and the taxpayer enjoys deductions for the amortization of the assets to which they pertain, therefore Italy intends to make sure the imposition on the income of these assets, protecting the coherence of the fiscal system[193].

Moreover, with regard to entrepreneurial activities, the exit tax could be considered in line with one of the general rules of Italian business taxation, according to which accrued capital gains are taxed whenever the corresponding assets go out of the business regime, even if not actually sold.

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191 G. MELIS, *Some reflections about the Italian exit tax after the «Hughes de Lasteyrie du Saillant» judgment*, speech delivered at the Open conference of Wintercourse 2006 in topic of *Open question in EC Tax Law*, Tilburg, 1 April 2006.

192 The taxpayer must have had French residence for more than six years in the last ten; he could postpone the tax levy at the moment of the effective realization if he gave suitable guarantees for the payment and appointed a tax representative; a reverse tax credit was stated for taxes paid in the State of destination on capital gains realization; losses accrued after the transfer reduced the tax burden in France; if the taxpayer did not sell goods yet five years after transferring, he was free from any tax obligation and he had the right to the return of what he had paid.

193 P. DE' CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all'estero*, in AA.VV. (a cura di V. UCKMAR), *Corso di diritto tributario internazionale*, cit., p. 388. The author cites Bachmann case, where EU judges stated that the protection of fiscal coherence can allow the restriction of fundamental freedoms provided by the Treaty.

Finally, it could be considered as a way to assure "intercountry" equity among States, by taxing capital gains accrued during the period of fiscal residence in the State of emigration.
Nonetheless, the coherence justification could not be maintained whenever the company assets (and the corresponding capital gains) were still taxable in Italy, even after the company transfer of residence. This is not only the case, expressly stated in the Italian tax provisions, of assets kept in an Italian permanent establishment, but also the case of capital gains on immovable assets, which are still taxable in Italy according to double taxation conventions[194].
In the bargain, as for the coherence justification, the art. 166 substantially follows the Merger directive n. 90/434/EEC: as we know, this directive states the fiscal neutrality of cross-border mergers only if the assets are kept in a resident permanent establishment, which is the same approach adopted by the Italian exit tax provisions. The fact that "interjurisdictional equity"[195] can be considered "coherent", does not however mean that it is also proportional; moreover someone has underlined the possibility that the same Merger directive is in contrast with the primary EU law[196].
With regard to the prevention of tax avoidance justification, the Italian exit tax could be considered as directed to prevent temporary transfer of tax residence outside Italy exclusively for tax reasons: it could be argued that the exit tax was introduced in the Italian tax law system through a D.l., February 23th 1995, n. 41, containing measures directed to the prevention of tax avoidance. However, differently from the French provision, the Italian rule doesn't contain any period of time after which the presumption of tax avoidance can be dropped, nor the possibility of a deferred payment subject to the set up of a guarantee is provided, nor a credit for foreign taxes is allowed.
Nonetheless, even accepting an avoidance justification, the exit tax could not meet the proportionality test, as far as the immigration state taxes accrued capital gains on company assets and the taxpayer does not come back to the emigration state in a short period of time. In fact, under these circumstances the tax avoidance scheme could easily be excluded.
In conclusion it seems that the main aim of the Italian exit tax is to prevent the loss of tax revenues, which has never considered by the Court of Justice as an acceptable justification, and the need to protect the coherence of own fiscal system, argument used by the Court of Justice in the Bachmann case.
However, even if the exit tax can be considered consistent with the actual EU law under some conditions, it remains an obstacle for the freedoms of circulation and establishment of citizens.

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[194] G. MELIS, *Some reflections about the Italian exit tax after the «Hughes de Lasteyrie du Saillant» judgment*, cit..

[195] This principle of equity among States is finalized to attribute to every State the right to tax incomes accrued in its own territory.

[196] On this point C. ROMANO, *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea*, in *Rass. trib.*, 2004 , p. 1332; against this point of view, P. DE' CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all'estero*, cit., p. 390, who considers the protection of fiscal system coherence as the last bulwark defending tax power of Member States.

Also the “permanent establishment” solution, provided in Directive n. 90/434, cannot be considered as proportional: in fact, the obligation to keep the business activity in Italy actually means that it is impossible to transfer this activity to another State without paying taxes on accrued capital gains, so that a more proportional means has to be introduced, like for instance a previous assessment of accrued capital gains, which will be taxed only in case of actual disposal by using the Mutual Assistance Directive[197].

Neutral models of taxation, which guarantee the correct division of tax basis among States, exist, but still today they are lacking EU rules that could satisfy both the needs of the States as for the protection of tax basis and the fundamental freedoms of the EU citizens[198].

4.3. Exit taxes and international double imposition.

The presence of exit taxes can produce considerable double imposition cases. The risk is when capital gains on assets, already taxed by exit taxes in State A, come effective in State B and there the entry value of assets does not include taxed capital gains or a tax credit is not recognized for exit taxes paid in State A. In fact, if exit value of assets from State A and entry value in State B coincide, there is no problem; but if the second value is lower than the first, the same capital gains will be taxed twice, if State B does not provide for a credit as for tax paid in State A[199].

This problem of double imposition, because of exit taxes, can be solved by means of unilateral or bilateral solutions.

States can provide for different measures:

I. the grant, by the State of immigration, of a credit for the exit tax paid in the State of emigration;
II. the grant, by the State of emigration, of a reverse credit for taxes paid in the State of immigration;
III. the step up of tax cost of taxpayer’s assets, at the moment of entry in the State of immigration.

The step-up-value solution consists of attributing to assets a value (according to the normal value criterion, the exit value criterion and others), in order to avoid that capital gains, accrued and taxed in the State of emigration, are taxed also in the State of immigration. These measure can be found on unilateral and bilateral level, as for both participations of natural persons who do not carry on business and assets belonging to entrepreneurs.

With regard of participations of natural persons, on bilateral plan, an example is given by the paragraph 12 of Protocol at the Italy-Germany Convention, establishing that the purchase cost, in case of further

[197] G. MELIS, *Some reflections about the Italian exit tax after the «Hughes de Lasteyrie du Saillant» judgment*, cit..

[198] P. DE‘ CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all’estero*, cit., p. 390.

[199] The lack of exit taxes, instead, can give place to a tax gap, if the State of immigration considers as entry value of assets their normal value, so that the difference between fiscally recognized value and normal value will be never taxed.

sell of the participation already taxed by exit tax, will be the same that the first State stated as theoretical value at the moment of the transfer[200].

4.3.1. The entry value in Italian tax system.

Regarding Italy, the solution of the estimate problem about the assets that enter in the regime of company income, as a result of the transfer of the residence, is difficult[201]. The doctrine expresses contrasting opinions on the question: someone argues that the absence of property transferring aspects can justify the keeping of the initial cost (in compliance with the solution adopted by art. 65 t.u.i.r, as for the introduction of instrumental assets in the individual business)[202]; others are in favour of the estimate at the normal value of the assets, in order not to charge the company income with capital gains produced previously to the insertion of the assets[203].

On the legislative plan there are not punctual provisions which allows to assert with certainty the attribution to assets of a entry value different from the historical cost: in the event of the transfer of residence, then, the justification of a different estimate of the assets is made still more difficult or by the legal continuity that the transfer produces, or by the always business sphere in which the assets are inserted. Neither it seems sufficient to point out generic iniquity outlines of the historical cost, because of the duplication of tax withdrawal that would happen whereby the State of emigration levied an exit tax[204].

In an international perspective, moreover, the dualism between historical cost and normal value of the asset, at the moment of the entrance in the State, does not hold account often of what happens in the State of emigration, causing now a double imposition (if there is an exit tax and the asset is taken in at the cost), now a tax gap (if there is not an exit tax and the asset is taken in at the normal value): so the ideal method to be adopted in the State of immigration is in function of the exit value from the State of emigration[205].

In a national perspective, however, the criterion of the normal value is the most suitable, because it consents to give relief only to the wealth accrued in the State. A solution in this direction is findable in the introduction, by IRES reform, of the heterogeneous transformation provisions. The art. 171, par. 2

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200 Ris. Ag. Entrate, 30 marzo 2007, n. 67/E. Financial Administration has clarified that this rule is valid only in the case of participations of companies fiscally resident in one of the contracting States at the moment of the transfer. Moreover it has maintained that this criterion of step-up-value is the most suitable in order to protect the tax right of the State where the value increase of participations takes place and to avoid double imposition.

201 It is a crucial matter of the so called "system of fiscal values of the company", since the cost of the assets is the reference term not only for the determination of capital gains and losses, but also for the determination of depreciation charges, of the ceiling for maintenance expenses etc..

202 D. STEVANATO, *Inizio e cessazione dell'impresa nel diritto tributario*, Milano, 1994, p.97.

203 M. MICCINESI, *Le plusvalenze d'impresa*, Milano, 1993, p. 151; G. ZIZZO, *L'imposta sul reddito delle società*, in G. FALSITTA, *Manuale di diritto tributario*, Parte speciale, Milano, 2005, p. 541.

204 M. PIAZZA, *Guida alla fiscalità internazionale*, cit., p. 1230.

t.u.i.r states that, in the event of transformation from a non commercial body in a company, it is put into effect a contribution limited to assets different from those already included in the business complex of the same body.
This mechanism answers to the need of inserting the assets in the company system in such a way to avoid tax gaps, on the one hand attributing immediate relevance to capital gains and losses classifiable like various incomes[206], on the other hand assigning to capital gains a new start value in the enterprise.
The rule wants also to avoid the attraction in the company regime of values accrued outside it: therefore, if capital gains and losses accrued before the insertion of the asset in the enterprise system are irrelevant for Italian legislator, this could be valid also for the assets coming from the foreign country[207].
However it is difficult to reconstruct interpretative principles starting from particular provisions, and this is demonstrated by the recent resolution of Inland Revenue on the application of par. 12 of the Protocol at the Italy-Germany Convention, where it is asserted that, in the lack of a specific national rule, the normal value criterion is the most appropriate in order to avoid double impositions and tax gaps, reserving the possibility of evaluating, case by case, the convenience of the solution[208].

4.3.2. The compatibility of exit taxes with conventional rules.
Exit taxes can be object of international conventions: in fact they are still income taxes. However neither the OECD Model, neither the UN model specifically face the matter of taxes on the transfer of residence, but some articles of the OECD Model become prominent.
The art. 13 of OECD Model assigns the right to tax capital gains, arising from the alienation of real estates, to the State where they are situated (par. 1); the right to tax capital gains, resulting from the alienation of movables of a permanent establishment, to the State where the permanent establishment is (par. 2); the right to tax residual capital gains to the State where the alienor is resident. The art. 13, then, refers to capital gains deriving from alienation: exit taxes, instead, concerns the mere transfer of the subject, apart from the effective realization of latent capital gains. According to a literal interpretation, exit taxes would be wrongful, because the tax right on these capital gains should be reserved to the residence State at the moment of their realization. On the other side, this rule does not seem concerning specifically the case of exit taxes; then the art. 1 of the Commentary at the OECD

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[205] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 596.
[206] In the art. 67, par. 1 t.u.i.r., concerning various incomes, letter n) has been introduced to include capital gains realized after a heterogeneous transformation.
[207] G. MELIS, *Il trasferimento della residenza fiscale nell'imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 597.
[208] Ris. Ag. Entrate, 30 marzo 2007, n. 67/E, supra footnote 85.

Model asserts that suitable measures by contracting States against the transfer of residence, realized with tax avoidance purposes, are justified[209].

In absence of other applicable provisions, it could be assumed the application of the general clause of which at the art. 21, par. 1 of the OECD Model, according to which every income, whose taxation is not specifically regulated by the Model, should be taxed in the residence State of the taxpayer. In our case the State of emigration should be free to tax the accrued incomes until the taxpayer is its resident. However the second paragraph of art. 21 denies the tax power of the residence State on foreign permanent establishments: so exit taxes that hit these capital gains of foreign permanent establishments would be wrongful.

Someone suggests to add an article in the Model, dealing with exit taxes. Someone else asserts the necessity that the State of immigration grants, at the moment of realization, a credit for what has been paid in the State of emigration: but, on this point, there is the obstacle of the non-identity between the tax periods in which double imposition takes place (timing mismatches)[210]. This double imposition seems to be in contrast with art. 23 of the Convention[211].

However some Tax Treaties solve directly the question by means of a specific discipline of exit taxes.

In conclusion, failing express provisions, any obstacle does not derive from International Convention as for exit taxes on accrued capital gains, neither any right to obtain an entry value equal to the exit value, while there is a glimmer to obtain a credit for the exit tax paid.

Regarding exit taxes levied on foreign permanent establishment, the Italian exit tax does not provide for a credit, concerning tax levied on latent capital gains by the State where the permanent establishment is situated, with the only exception of transfers inside EU (art. 179, par. 3 t.u.i.r.). Some authors suggest the provision of a virtual tax credit: the tax that the State of the permanent establishment would have levied on latent capital gains of the assets belonging to the permanent establishment there situated, should be deductible, till its total absorption, from the national exit tax[212].

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209 P. DE‘ CAPITANI DI VIMERCATE, *Le imposte sul trasferimento di residenza o sede all’estero*, cit., p. 393.

210 The Commentary at the OECD Model has introduced a new par. 32.8 at art. 23B, stating that the residence State must grant the tax relief from double imposition apart from the moment that taxes are levied.

211 G. MELIS, *Il trasferimento della residenza fiscale nell’imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 607.

212 G. MELIS, *Il trasferimento della residenza fiscale nell’imposizione sui redditi – Profili critici e ipotesi ricostruttive*, cit., p. 612.

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Barcellona

Università LUISS – "Guido Carli" – Roma
Facoltà di Giurisprudenza
Cattedra di Diritto Tributario

TREATY SHOPPING

Rossella Sabia
Matr. 086123

1. Treaty shopping as an abusive situation in tax treaty law

Tax avoidance is a serious problem for any tax system, and it is further compounded with respect to international transactions and arrangements. As a matter of facts, the globalization of financial markets, the reduction in barriers to international trade and investment, and the development of sophisticated financial products have enhanced the opportunities for tax avoidance. This situation has compelled the States to adjust both their legal and tax systems and to elaborate proper means to face international tax avoidance. Moreover, the intersection of foreign and domestic tax systems and the existence of a growing network of bilateral tax treaties increase chances for tax avoidance. Among the numerous forms of this phenomenon, over the years has become particularly prominent the abuse of international tax treaties, in its different expressions. Treaty shopping is probably the most important one: it is an indirect violation of the treaty and in general terms it consists of a taxpayer's behaviour aiming to obtain benefits of a tax treaty which is normally not available to him.

However, the concept of abuse is wider and is not unambiguous. It is necessary to approach it with reference to the different meanings it has assumed.

1.1 Position of the concept of abuse

The concept of "abuse" lies within the two different notions of tax evasion and tax avoidance. Evasion is characterized by the following elements: despite of the existence of the tax precondition, the taxpayer escapes from its tax obligation; as a consequence, there are administrative and legal sanctions; the control flows through the ordinary instrument of assessment. Evasion is illegitimate because it contrasts with positive law: the taxpayer omits tax return or does not pay taxes.[213] Tax avoidance is different, on the one hand, from legal tax saving; on the other hand, it differs from tax evasion. Tax avoidance is characterized, according to doctrine, by three requirements:

- the subjective element, that is the only taxpayer intention of tax saving, without other extra-fiscal reasons;
- the objective element, that should consist in setting abnormal procedures (referring to the actions normally performed in this instance);
- considering the aspect of the effects, the taxpayer's act must be appropriate to ensure him a reduction of the burden of taxation, or a complete tax exemption.

To sum up, there is tax avoidance when a behaviour is intentionally set in order to not complete the model fact situation that founds tax obligation, but, at the same time, in order to permit the achievement of an analogous economic result, with the only aim of minimizing or nullifying tax requirement.[214]

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[213] C. GARBARINO, *Manuale di tassazione internazionale*, 2 edizione Milano, 2008, p. 895.

[214] P. ADONNINO, *Riflessioni in tema di pianificazione fiscale internazionale,* in AA.VV., *Studi in onore di Victor Uckmar*, Padova, 1997, p. 17-18.

The concept of abuse, as a limit of the exercise of subjective rights, is shallow-routed in Italian legal culture. There is the exception of some legal branches, in which Italian civil doctrine tried to piece together the concept of abuse of rights. It is possible to refer to the Italian Constitution[215] to verify that it admits the property right as not unlimited: its limits are the social function and the accessibility to everyone of the property. And so, the anti-social exercise of a right with the only purpose of damaging the others[216] is an expression of the right that is not allowed by Italian legal system[217]. In general terms, in consideration of some decisions of the courts, it is possible to say that this principle has been rarely acknowledged by Italian tax law[218]: consequently, Art. 1344 c.c. (it establishes that a contract is void because of its illicit cause when it is signed to avoid the application of imperative law) does not apply to tax law. For this reason, it is necessary to refer to the conventional and EC notions of abuse.[219]

1.2 The concept of abuse in international tax treaties

Is it today possible to talk about the concept of abuse of international tax treaties? To single out the existence and the limits of application about this concept of the abuse, it would be appropriate to start from the studies made on the theme by OECD. Then, the focus would be on US Model and bilateral tax treaties.

To start with the OECD Model, 1963 and 1977 versions of it referred to the purposes of the Model as the elimination of double taxation and the prevention of fiscal evasion. But the reference to fiscal evasion obviously did not include tax avoidance and its expressions, which are universally considered to be different from tax evasion. The OECD Model contains few provisions such as the beneficial ownership rules, which might be considered to be specific anti-avoidance rules. But until 2003, the provisions of the Commentary to the OECD Model were equivocal about the general problem of the treatment of tax avoidance under tax treaties; only the extensive revisions of January 2003 to the Commentary significantly clarify the relationship between tax treaties and domestic anti-avoidance rules and the problems concerning the improper use or abuse of tax treaties[220]. Referring to the latter issue, the OECD Model does not contain an explicit definition of the "abuse", also if it pays attention to the phenomenon in Arts. 10, 11 and 12 (about the notion of "beneficial ownership"). And so, the reconstruction of the abuse of tax treaties' concept should be based on the provisions of the

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[215] Cfr. art. 42, Cost.

[216] Cfr. art. 833, c.c.

[217] P. PISTONE, *L'abuso nel diritto tributario internazionale*, in V. UCKMAR, *Diritto tributario internazionale*, 3 edizione, Padova, 2005, p. 814-815.

[218] See Cass., 26 October 2005, n. 20816/2005.

[219] C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 895.

[220] B. J. ARNOLD, *Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model*, in *Bulletin*, 2004, No. 6, p. 244.

Commentary to Art. 1 to the OECD Model. In fact, the Commentary to Art. 1 contains a specific section entitled "improper use of the Convention": there, in paragraphs 9.2 and followings, the abuse of international tax treaties is explicitly mentioned. The Commentary offers "a guiding principle": it should be considered abusive when the taxpayer tries to obtain treaty benefits, not available to him according to the Convention, acting with this main specific purpose and contrary to the object and purpose of the Convention itself.[221]

Moreover, could the collocation of principles concerning the improper use of tax treaties in Art. 1 of the Commentary to the OECD Model lead to a definition of the concept of abuse in tax treaties (the treaty is the source of the concept of abuse's regulation)?

To ask the question it is necessary to move from the function attributed by the States to the treaty they stipulated.

The 2003 changes to the Commentary on Art. 1 also concern this area; in fact, the prior Commentary did not clarify the interpretation and application of the OECD Model to prevent tax evasion or tax avoidance, but only suggested that tax treaties should not promote tax avoidance (and this suggestion is not equivalent to a positive statement that one of the purposes of tax treaties is to prevent tax avoidance). After 2003 changes, the Commentary on Art. 1 clarifies in simple, direct language provides: "It is also a purpose of tax conventions to prevent tax avoidance and evasion".[222]

The effect of clarifying that one of the purposes of tax treaties is to prevent tax avoidance relates to the interpretation and application of treaties. Art. 31(1) of the Vienna Convention provides that a treaty should be interpreted in light of its purpose. Therefore, it is possible to say that today, for OECD's Member States, the abuse of tax treaties contrasts with the purposes of the Model. But is not possible to argue the same with reference to the conceptual aspects of the abuse: both the abuse of tax treaties (the convention is the object of the abuse) and the abuse in tax treaties (the convention is the source of regulation) are still influenced by the relations with domestic law.

The United States, instead, are the country that has developed the most effective and well-constructed measures -both unilateral and tax treaty measures- to contrast the practice of treaty shopping, co-ordinating them in a really systematic international tax policy. It is the only country that has pushed itself over the introduction of unrehearsed anti-abuse provisions, preferring a consistent contrast approach to the phenomenon of the abuse of treaties.[223] The United States consider the inclusion in the tax treaties of provisions with a specific anti-abuse purpose as the most convenient instrument to face this problem. The introduction of appropriate anti-abuse clauses in tax treaties -as the choice in agreement of two international law subjects- seems to be the better solution in order to guarantee a correct and at the same time homogeneous application of them, with a flexibility that could be not

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[221] See Para. 9.3 and 9.5 of the Commentary to the OECD Model on Art. 1, as modified in 2003.

[222] See Para. 7 of the Commentary to the OECD Model on Art. 1, as modified in 2003.

[223] L. DELL'ANESE, *L'evoluzione della disciplina anti-abuso di trattato nelle convenzioni contro le doppie imposizioni sottoscritte dagli Stati Uniti*, in *Dir. prat. trib.*, 1998, VI, pt. III, p. 702.

obtained by applying unilateral measures on the part of each contacting State.[224] A short analysis of US Models will show the different solutions provided to the problem of the abuse by United States. Also if the US adopted their own Model since from the second post-war period, it has been finally published in 1976. From that moment, three are the Models United States refer to: 1977 Model (in its three versions), 1981 Model and 1996 Model. In each of these Models, the struggle against the abuse of treaties is a lead role theme, accordingly with US policy of using tax treaties not only to eliminate double taxation, but also to face international tax evasion and tax avoidance.[225]In fact, the main difference between OECD Model and US Model is the existence of a specific anti-abuse clause included in the latter to face treaty shopping. These provisions (Art.16 in 1977 Model and 1981 Model; Art.22 in 1996 Model) considerably limit the application of tax treaties signed by United States when a resident is controlled by a company or a person resident in third States. In that way the bilateral tax treaty benefits are not extended to third States. The interesting element is that US tax authorities should verify the intentionality of the abuse: it means to verify through some "tests" if there is the contracting parties' effective will to abuse of the treaty.

These remarks help in researching a definition of the concept of abuse in tax treaties: the abuse of a provision is verified with respect of its purpose (as it often occurs in domestic tax law). So, an abusive situation could be found when taxpayer's behaviour aims to save on taxes on the basis of the tax treaty, but it contrasts with the logic interpretation of the treaty itself.

The abuse of tax conventions could be defined as the phenomenon in which a taxpayer, to save on taxes, looks for the benefits of a treaty not available to him because of his substantial position.[226]

This definition of the abuse of tax treaty could be applied to describe both these hypothesis: not only the abuse of the tax treaties (the abuse is externalized in the abuse of the tax treaty), but also the abuse in tax treaties (situations in which the object of the abuse is not the tax treaty directly).

1.3 The concept of abuse in European Community Law

The European Court of Justice has developed the concept of abuse in Community tax law. The Court has made concrete the anti-abuse clauses contained in the sixth directives respectively relating to value added tax and direct taxes, applying to them the general Community law principles. The anti–abuse clauses of Community tax law establish that national authorities can stop benefits deriving from the application of secondary Community law if, in the concrete case, there is an abusive phenomenon.[227]

This common key concept comes to light by analysing the clauses, as it follows. In the sixth directive concerning value added tax, Art. 27, par. 1, admits the possibility for Member States to derogate from

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[224] L. DELL'ANESE, *L'evoluzione della disciplina anti-abuso di trattato nelle convenzioni contro le doppie imposizioni sottoscritte dagli Stati Uniti*, cit., p. 705.

[225] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p.828-829.

[226] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p.826, C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 897.

the provisions of the directive also "in order to…prevent certain types of tax evasion or avoidance".[228] In the directive 90/434/EC, concerning company reorganization, Art. 11, first par., letter a) allows that a Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of the directive where it appears that one of the company operations there listed: "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…may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives".[229] Lastly, the directive 90/435/EC on the common system of taxation applicable on dividends distribution, at Art.1 par. 2 synthetically provides that the directive itself "shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse".[230]

Analyzing the texts in their different language versions, it is easier to find the ratio of these clauses: the avoidance of every sort of abuse.

According to the decisions of Court of Justice, these provisions are applicable to every situation of undue benefits deriving from the application of primary and secondary Community law. And the analysis of tax case law shows that, according to the Court, there is abuse in Community tax law not only when the violation concerns an EC provision and its spirit; but a situation of abuse can be also found when a taxpayer evades or avoids a domestic provision.[231]

For this reason, the Court stated its jurisdiction in examining if there is compatibility between derogations provided in domestic tax law and EC system, with the purpose of avoiding the abuse of domestic law. In fact, it is rightful that Member States in their domestic law can provide derogations to Community law, with the scope of safeguarding national Treasuries; but these domestic provisions cannot contrast with principles and fundamental freedoms guaranteed by TCE. In particular, there are limits to the application of anti-abuse domestic provisions; in these cases, it is necessary to verify that:

- there is an actual risk of abuse;
- the domestic anti-abuse provision is not discriminatory;
- the domestic anti- abuse provision's justification is based on imperative reasons of general interest;
- the domestic anti-abuse provision must respect the principle of proportionality, and so, the measure that causes the less restrictive effect on EC system would be applied.

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227 P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p. 833.

228 Dir. 77/388/EC

229 Dir. 90/434/EC

230 Dir. 90/435/EC

231 P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p. 834.

In those terms, the European Court of Justice has ruled out the compatibility with the EC system of all absolute presumptions as anti-abuse measures[232]. The Court has also stated that simple presumptions could contrast with Community law when their effect is to make more burdensome the taxpayer's exercise of fundamental freedoms.[233]

It seems clear that today a Community law autonomous concept of abuse exists. To sum up, this notion includes both the abuse of Community law and the repercussions on Community law and its fundamental freedoms caused by Member States' restrictive measures with anti-abuse function adopted in several domestic legal branches. Moreover, among these anti-abuse measures not only the domestic ones, but also the tax treaty law (as double taxation conventions[234]) can contrast with Community law; and so, the respect of EC principles must be also guaranteed by this kind of provisions.

2. TYPOLOGIES OF ABUSE OF TAX TREATIES

It seems appropriate to start the analysis of single model fact situation of abuse, as characterized by doctrine and tax case law. A first distinction may be found among subjective and objective expressions of the abuse of tax treaties: the first type includes the most important abusive situation, so called "treaty shopping", and the triangular cases. The objective form of abuse of tax treaties instead, embraces phenomena as rule shopping and negative conflicts of qualification.

2.1 Subjective form of abuse: Treaty shopping

The expression "treaty shopping" has been invented in the US, but now it has been adopted, and it is usually used by the community of international tax experts. The term is of an American origin: it is in fact related to the expression "forum shopping", used in US civil procedure, that describes a behaviour by which a party in a court case tries to 'shop' into a jurisdiction where he expects a more favourable decision to be rendered.

Accordingly, treaty shopping means that a taxpayer shops into the benefits of a treaty which normally are not available to him[235]. It may be defined as the use of tax treaties which aiming at reducing a person's tax burden, by taking advantage of the tax treatment provided by a particular treaty for a certain type of income[236].

The term is related to the practice of some investors of borrowing a tax treaty by forming an entity (usually a corporation) in a State having a favourable tax treaty with the State of source or investment.

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232 See Court of Justice 17 july 1997, C-28/95, *Leur-Bloem.*

233 C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 897-898.

234 Court of Justice 21 september 1999, C-307/97, *Compagnie de Saint-Gobain.*

235 H. BECKER, F. J. WURM, *Treaty shopping: an emerging tax issue and its present status in various countries*, Deventer, 1988, p. 1-2.

The aim of the investor is often to take advantage of a State's treaty network, with respect to the taxation of dividends, interest, royalties and capital gains and to benefit from the treaty's definition of permanent establishment and tax residence, thus enabling the investor to use the foreign tax credit.
Treaty shopping is not always the result of considerations as to which treaty is the most convenient, but may also occur if there is no tax treaty between the investor's State of residence and the State in which the investment is made; therefore, the investor uses the treaties between the State of the investment and third States.
Whether or not there is a tax treaty between the State of residence of the investor and the State of the investment, treaty shopping involves arrangements generally referred to as "conduit structures"[237], which may be classified according to the adopted structure. Treaty benefits may be obtained through a conduit in these principal forms: (a) a direct conduit company, (b) a stepping-stone company and (c) a holding structure.

a) The term 'direct conduit company' involves the classical "conduit" structure. Such a type of company is usually used, for example, when a company, resident of one State, invests in another State and there is no tax treaty between the two States; or, if there is a treaty, it does not grant sufficient benefits. The investment is made through a subsidiary, owned by an intermediate holding company situated in a third State, that has double taxation treaties with both the States of residence of the investor and the State in which the investment would be located.
The intermediate holding shall grant the benefits of both treaties, with the consequence of reducing tax on cross-border income flows (for example, dividends, interests or royalties) come from the State in which the investment is localised.

b) A stepping-stone conduit company adds another step to the direct conduit company. As in the mentioned example, a company resident in one State (A) wants to invest trough a subsidiary in a second State (B), and there are no tax treaty between these two States (or there is a treaty which does not grant sufficient benefits). Anyway, the State of residence of the investor (A) has a favourable double taxation treaty with a third State (C); but the latter State has no tax treaty with the State in which the investment would be located (B). But this third State (C) has a tax treaty with a fourth State (D), and this fourth State has a tax treaty with the State in which the subsidiary will be organised (B).
Therefore this structure involves the incorporation of two conduit companies (intermediate holdings), one in the third State (C) and one in the fourth State (D). These companies are used to transfer income flows (dividends, interests or royalties) from the country in which the subsidiary is located (B) to the country of the investing company (A).

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236 P. VALENTE, M. MAGENTA, *Analysis of Certain Anti-Abuse Clauses in the Tax Treaties Concluded by Italy*, in *Bulletin*, 2000, No. 1, p. 41.

c) In contrast, a holding structure uses holding companies as a vehicle to manage interests and to channel dividend flows deriving from the State in which the investment is made. Through the holding, interposed between the investor and the subsidiary, it is in fact possible to optimize the earning of the investment in terms of distributed dividends, opportunely taking advantage of the provisions concerning the dividends' treatment (and of other types of income) contained in double taxation treaties.

2.2 Subjective form of abuse: Triangular cases

A subjective abuse of the tax treaty may also occur in the so called "triangular cases". Triangular cases - unlike treaty shopping situations, where there is an interposed person - usually involve a permanent establishment, that is a fixed place of business, without a separate juridical personality distinct to its head office located in another State.

Accordingly, the term "triangular cases" has been usually used to indicate the application of tax treaties where three States are involved. The OECD Committee on Fiscal Affairs has described the typical triangular case as one in which:

- income from dividends, interests, or royalties is derived from a source in State S;
- such income is received by a permanent establishment in State P;
- the permanent establishment depends on an enterprise in state R.

Tax treaties are generally concluded on a bilateral basis, and do not explicitly address triangular situations. This lack of coverage may lead to situations of double taxation, despite the existence of bilateral tax treaties between all three states; or, on the other hand, situations may also arise in which income is entirely (or almost entirely) untaxed.[238]

In analyzing the phenomenon, to show the abusive potential of triangular cases it could be appropriate to focus on a typical example: the Saint-Gobain case[239]. A French company had a permanent establishment in Germany; through this permanent establishment, the French company had direct participations in an US company, but also indirect participations in other companies (residents in Switzerland, Austria, and Italy). The situation to be focused is the control of US company trough the permanent establishment: in 1988, the permanent establishment in Germany could not invoke the application of Germany-US treaty, because it was not a German resident, and for this reason, its subjective situation was not covered by the application area of the treaty. However, it seems clear that in the concrete case the situation determining the abuse of the treaty lacked, because of the substantive

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237 P. VALENTE, *Elusione fiscale internazionale: strumenti unilaterali di contrasto e disposizioni convenzionali in materia di treaty shopping*, in *Dir. prat. trib.* , 1998, II, pt. III, p. 16-20.

238 S. V. WEEGHEL, *The improper use of tax treaties*, cit., p. 124.

239 Court of Justice 21 september 1999, C-307/97, *Compagnie de Saint-Gobain*

business operations of Saint-Gobain's permanent establishment in Germany. And for these reasons, the European Court of Justice stated that there was no abuse in this specific case[240].
The conclusion about triangular cases might consider that the risk of the abuse of treaties is not always necessarily high; as a result, to not apply the tax treaties of the permanent establishment State to third states could cause the raw deal of the permanent establishment itself. The abuse is not an automatic consequence of the application of treaty benefits towards non residents of the two contracting states, but it can derive from the use made of the treaty by these non residents, with the only purpose of minimizing tax burden. It is necessary to think about triangular cases' current treatment.[241]

2.3 Objective form of abuse: Rule shopping

The rule shopping[242] is an objective type of abuse that concerns a tax treaty clause whose application is required by the taxpayer. Tax planning in these cases aims to allow the application of those articles of the treaty providing the only tax jurisdiction of one of the two contracting states (in the place of those articles that state the allocation of tax jurisdiction between source state and residence state) . Consequently, the tax benefit is the avoidance of source state withholding taxes, which otherwise would be due. The most relevant rule shopping cases pertains to the treaty clause on taxation of dividends.
The OECD Model limits the taxation in the source state in this way:

- 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends;
- 15% of the gross amount of the dividends in all other cases.[243]

In the place of this conventional clause, the taxpayer angles for the interest clause and capital gain clause. The first hypothesis is the hidden dividend distribution between connected companies: an actual dividend flow between the parent company and its subsidiary is converted and re-qualified in interest flow. The purpose is the limitation or the avoidance of the source state withholding tax: as a matter of fact, the OECD Model states that the taxation in the source state could not exceed the 10% of the gross amount, and several treaties even grant the full exemption.
The second hypothesis is the so called "dividend stripping": the taxpayer increases his participation value (otherwise payable as a dividend) selling the participation itself, with the application of capital gains clause (Art. 13 of the OECD Model). According to this clause indeed, there is taxation only in the

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[240] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , p. 841-842, C. GARBARINO, *Manuale di tassazione internazionale*, cit. , p. 900.
[241] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , p. 841.
[242] C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 900-901, P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p. 843 ss.
[243] See art. 10 of the OECD Model.

residence state of the alienor[244]. As a consequence, the participation alienation (when the budget is approved and the dividend distribution is deliberated) before the effective distribution allows the application of Art. 13 instead of Art. 10 of the OECD Model.

2.4 Objective form of abuse: Conflicts of qualification

The main problem concerning the so called conflicts of qualification is the qualification of a concrete fact with reference to the provisions of the treaty. Difficulties are mostly connected with the interaction of treaty provisions and domestic law: in fact, the treaty language often uses also domestic law terms. Different situations need to be considered in that respect. Taking account of the fact that each contracting state could apply the treaty in different ways, it is possible that positive or negative conflicts of qualification arise. The former case (double qualification) gives rise to international double taxation; taxpayer could commonly resort to the mutual agreement procedure[245] in order to resolve this type of conflict. The other case (lack of qualification of the concrete fact) instead causes double exemption in both contracting states, and it is obvious that the taxpayer will have no interest in making his situation known. In conclusion, conflicts of qualification seem to be acknowledged as a form of abuse of tax treaties by some authors: states do not renounce to exert their tax jurisdiction in order to make tax exempt extra-national transactions that are taxed when nationally carried out.[246] According to another part of the doctrine, the taxpayer instead must be guaranteed more, and consequently the conflicts of qualification are considered abusive within the limits of the given definition of the abuse.[247]

3. MEASURES AGAINST THE ABUSE

The abuse of tax treaties is a tax avoidance expression, faced by each state with many different measures. These measures are usually classified as it follows[248]:

- a first criterion distinguishes between anti-abuse domestic measures, anti-abuse measures provided by tax treaties and Community anti-abuse measures;
- secondly, anti-abuse measures could be differentiated on the basis of their law system origin (civil law systems refer to abuse of right, common law systems to the business purpose);
- lastly, there are general clauses, sector-based clauses and specific clauses.

These are all important criteria, which could certainly overlap each other.
However, the analysis will focus on the first issue that seems to be the most complex and interesting.

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244 See art. 13, para. 5 of the OECD Model.
245 See art. 25 of the OECD Model.
246 S. V. WEEGHEL, *The improper use of tax treaties*, cit., p. 160.
247 P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , p.849.

3.1 Anti-abuse domestic measures and tax treaty measures

Is it possible to apply the anti-abuse domestic measures also to tax treaties? To verify this, it is necessary to remember tax treaty singularity: there is a high interaction between the treaty provisions and the domestic ones. The treaty language often refers to domestic law concepts. Traditionally, in international tax doctrine there are three different positions.[249]

a) According to some authors, tax treaty provisions and domestic measures are on different levels; consequently, domestic measures cannot interfere with tax treaty provisions rationae materiae.

b) Other part of the doctrine asserts that tax treaties provisions are lex specialis, which prevails on domestic law (also subsequent domestic law).

c) The third is mainly the US position: the lex posterior principle grants the application of domestic law (and it can determine the phenomenon of treaty override at least).

Anyway, to apply anti-abuse domestic measures to tax treaties might cause their asymmetrical application. Anti-abuse approaches, indeed, could be quite different in each state, and it seems not appropriate that different strictness of single domestic tax law frustrates international transactions. For these reasons, despite the application of anti-abuse domestic law often gets good results, doctrine and case-law of many states stand up for a restricted use of it.

The problem is different when the tax treaty includes its own anti-abuse clauses (for example, the beneficial ownership clause in Arts. 10, 11 and 12 of the OECD Model). In this case, the application of domestic anti-abuse measures is admissible within the limits of treaty provisions.[250]

3.2 Anti-abuse treaty measures and EC LAW

In considering the connection between anti-abuse measures included in tax treaties and Community anti-abuse provisions, two issues arise.[251]

Firstly, it is necessary to focus on the influence of anti-abuse EC clauses on tax treaties. The Community anti-abuse clauses (the directive 90/434/EC, concerning company reorganization and the directive 90/435/EC, on the common system of taxation applicable on dividends distribution) preclude the application of the favoured treatment they provided when there is an abusive situation; they also allow the application of tax treaty provisions meant for preventing the abuse.

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[248] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , p. 850.

[249] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , p.851.

[250] C. GARBARINO, *Manuale di tassazione internazionale*, cit. , p. 883-884, P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , 853-854.

[251] C. GARBARINO, *Manuale di tassazione internazionale*, cit. , p. 884, P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit. , 855-856.

A different situation instead is that of the influence of anti-abuse treaty provisions on Community law. In that respect, two kinds of relations might be considered:[252]

a) Relationship between Member States: the Community law is supranational and must be respected by all Member States. As a consequence, the Community law has a position of supremacy also on tax treaties concluded by Member States. And so, in their mutual relations, Member States may not conclude tax treaties containing provisions which violate Community Law. Such provisions (therefore, also anti abuse-provisions) are invalid, whether these treaties were concluded before or after the entry into force of the EC Treaty (or, as the case may be, the date of accession of the Member State involved).

b) Relationship between a Member State and a third state: as regards treaties between a Member State and a third State, if concluded before the entry into force of the EC Treaty, they will be respected.[253] Anyway, where these treaties are incompatible with EC law, the Member State is obliged to try and renegotiate the treaty. The problem is that many bilateral treaties with a third State are from a later date. It is clear that the Member State, in these cases, fails to fulfil its obligations under Community law; but the third State is not bound by EC law, and it is of no concern to the third State that its treaty partner possibly violated its obligations under Community law. The problem may often occur in connection with anti-abuse clause in bilateral taxes with third State, especially those conclude with the US. Some anti-abuse clauses (for example, the limitation on benefits clause) contained in this kind of treaty may preclude the access to treaty benefits also contrasting with Community law.

3.3. Anti-treaty shopping measures in the OECD Model

The Commentary to the OECD Model on Article 1 indicates a number of possible approaches[254] against treaty shopping; the Contracting States could acknowledge the countermeasure they prefer in their particular tax treaties. These approaches are known as the "abstinence approach", the "exclusion approach", the "look-through approach", the "subject-to-tax approach" and the "channel approach". Each approach is described below with the respective provision of the Commentary.

3.3.1. The abstinence approach

This approach is not included among those of the Commentary, but the States also may use it because it is a very simple but effective remedy. Often treaty shopping involves the interposition of companies in countries with a favourable tax regime. Most countries unilaterally respond to this by abstaining from

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[252] B. TERRA, P. WATTEL, *European Tax Law,* London – New-York, 2001, p. 112-113.

[253] See art. 307 of the EC Treaty.

[254] S. V. WEEGHEL, *The improper use of tax treaties*, cit. , p. 213 ss. , H. BECKER, F. J. WURM, Treaty *shopping: an emerging tax issue and its present status in various countries*, cit., p. 5 ss.

concluding tax treaties with the countries they consider to be tax havens. Ando so, the abstinence approach means that a country will not conclude a treaty with States that are known for either their low taxation regime or as a place for conduit companies.

3.3.2. The exclusion approach

No provision of the Convention conferring an exemption from, or reduction of, tax shall apply to income received or paid by a company as defined under Section…of the…Act, or under similar provision enacted by…after the signature of the Convention.[255]

The improper use of double taxation conventions is often related with the creation of low-taxed companies: for example, a company which in its resident State enjoys a so favourable tax status that it may be assimilated - with regard to the taxation modalities - a non resident. Therefore under this approach, a tax treaty will be concluded with another State, but special low-taxed companies resident in the other State will be excluded from the treaty benefits. Accordingly, the tax treaty excludes such types of companies from the purpose of the treaty itself or from the access to treaty benefits.

3.3.3. The look-through-approach

A company that is a resident of a Contracting State shall not be entitled to relief from taxation under this Convention with respect to any item of income, gains or profits if it is owned or controlled directly or through one or more companies, wherever resident, by persons who are not residents of a Contracting State.

Contracting states wishing to adopt such a provision may also want, in their bilateral negotiations, to determine the criteria according to which a company would be considered as owned or controlled by non-residents.[256]

Treaty benefits are granted to a company only on condition that it is owned by residents of the State in which the company is organised. The entitlement of a company to treaty benefits depends not only on the company's State of residence; in determining whether or not the company is granted treaty benefits, also the residence of the company's shareholders is looked at. A refined version of this approach refers not to the nominal shareholder, but to the beneficial owner.

3.3.4. The subject-to-tax approach

Where income arising in a Contracting State is received by a company resident of the other Contracting State and one or more persons not resident in that other Contracting State

[255] See para. 21 of the Commentary to the OECD Model on art. 1, as modified in 2003.

[256] See para. 13 of the Commentary to the OECD Model on art. 1, as modified in 2003.

a) have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such company, in the form of a participation or otherwise, and

b) exercise directly or indirectly, alone or together, the management or control of such company, any provision of this Convention conferring an exemption from, or reduction of, tax shall apply only to income that is subjected to tax in the last-mentioned state under the ordinary rules of its tax law.[257]

This solution provides that the treaty benefit is based on the condition that the income derived from one State is actually subject to a minimum taxation in the other State. It prevents a company's income being exempt from taxation in both contracting States.

3.3.5. The channel approach

Where income arising in a Contracting State is received by a company that is a resident of the other Contracting State and one or more persons who are not residents of that other Contracting State

a) have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such company, in the form of a participation or otherwise, and

b) exercise directly or indirectly, alone or together, the management or control of such company, any provision of this Convention conferring an exemption from, or reduction of, tax shall apply if more than 50 per cent of such income is used to satisfy claims by such persons (including interest, royalties, development, advertising, initial and travel expenses, and depreciation of any kind of business assets including those on immaterial goods and processes).[258]

The channel approach mainly deals with the stepping-stone structure. Under this method, a company is denied treaty benefits on dividends, interests and royalties, if a certain percentage of its gross income is used to make payments in return for charges by individuals or companies not resident in one of the contracting States. It prevents the income of the interposed company being absorbed by payments made to related persons or companies, in the form of business expenses.

3.3.6. The 'bona fide' cases

These approaches described in the Commentary are of a general nature, and need to be accompanied by specific provisions to ensure that treaty benefits will be granted in bona fide cases. To this purpose, the Commentary provides special provisions to guarantee that bona fide transactions and structures may be not exempt from the treaty benefits. The provisions suggested are the following[259]:

a) General bona fide suggestions

[257] See para. 15 of the Commentary to the OECD Model on art. 1, as modified in 2003.

[258] See para. 17 of the Commentary to the OECD Model on art. 1, as modified in 2003.

[259] See para. 19 of the Commentary to the OECD Model on art. 1, as modified in 2003.

The foregoing provisions shall not apply where the company establishes that the principal purpose of the company, the conduct of its business and the acquisition or maintenance by it of shareholding or other property from which the income is derived, are motivated by sound business reasons and do not have as primary purpose the obtaining of any benefits under this Convention.

b) Activity provision

The foregoing provisions shall not apply where the company is engaged in substantive business operations in the Contracting State of which it is a resident and the relief from taxation claimed from the other Contracting State is with respect to income that is connected with such operations.

c) Amount of tax provision

The foregoing provisions shall not apply where the reduction of tax claimed is not greater than the tax actually imposed by the Contracting State of which the company is resident.

d) Stock exchange provision

The foregoing provisions shall not apply to a company that is resident of a Contracting State if the principal class of its shares is registered on an approved stock exchange in a Contracting State or if such company is owned - directly or through one or more companies each of which is a resident of the first-mentioned State - by a company which is a resident of the first mentioned state and the principal class of whose shares is so registered.

e) Alternative relief provision

In cases where an anti-abuse clause refers to non-residents of a Contracting State, it could be provided that the term 'shall not be deemed to include residents of third States that have income tax conventions in force with the Contracting state from which relief from taxation is claimed and such conventions provide relief from taxation not less than the relief from taxation claimed under this Convention.'

As it clearly appears, the treaty benefits depend on the meeting of certain requirements. Thus a company is not entitled to treaty benefits unless: its interposition has been motivated by good commercial reasons, or it is engaged in substantive business operations in its State of residence, or the amount of taxes paid in its State of residence exceed the amount of reductions claimed or it is registered on an approved stock exchange.

3.4. The US approach and the "limitation on benefit" clause

According to the American Law Institute, it is possible to classify into three categories the US approaches[260] against the abuse of tax treaties:

- The special measures approach. It seems to be the similar to the exclusion approach provided by OECD Model, and consequently particular categories of taxpayers will be excluded from the treaty benefits.
- The principal purpose approach. It reminds to the channel approach provided by the OECD Model; it excludes the application of the treaty when the connection between two companies has an abusive purpose.
- The comprehensive approach. Nowadays this approach characterizes most of the US tax treaties. It limits the application of the treaty on the basis of both subjective and objective requirements, with reference to the type of the activity and to the income.

However, the US approach in facing international tax avoidance is mainly characterized by the large use of the 'limitation on benefits' clause. It appeared the fist time in 1981 US Model and today it is the cornerstone of the US treaty approach to the abuse of tax treaties. The limitation on benefits' (LOB) provisions[261] aiming at denying treaty benefits to taxpayers which are not qualified on the basis of a number of anti-treaty shopping 'tests' contained in the treaty. The LOB purpose is to limit the access to treaty benefits for non residents in the Contracting States; accordingly, treaty benefits are restricted only to residents of the Contracting States. The LOB clause involves complex judgements, mainly structured in 'tests' which charge the burden of proof on the taxpayer: only if the taxpayer passes one of these tests at least, the treaty benefits will be granted to him. The LOB clause is inspired by the 'business purpose' principle: it could be defined as a justifiable business reason for carrying out a transaction. The last-mentioned principle is connected with the 'substance over form' principle: this is a common law doctrine of general application, not restricted to tax case, which requires that the substance rather the mere form of a transaction or agreement be given full legal effect. The effective intention of the parties governs rather the form of the transaction or agreement. Tax authorities' approach to treaty shopping is commonly orientated to deny tax treaty benefits whether, applying the substance over form principle, to enjoy the treaty benefits seems to be the only scope of the business operation.

This clause is incisive, but also restrictive towards international operations; it causes also problems of compatibility with the EC system.

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[260] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p.860 ss., C. GARBARINO, *Manuale di tassazione internazionale*, cit. , p. 907-908.

[261] P. VALENTE, *Elusione fiscale internazionale: strumenti unilaterali di contrasto e disposizioni convenzionali in materia di treaty shopping*, cit., p. 41-46.

The problem of LOB clauses' compatibility with EC law really comes to light looking at some famous decisions of the European Court of Justice, the "open skies" cases[262]. These cases illustrate that the Member States may not contract to restrict the rights of another Member State even if that contract is with a third country (such as the United States) and even if the contract concerns an area which is primarily the responsibility of the Member States, rather than the European Commission (such as aviation rights or direct taxation).

These are the facts. In 1992, the United States began to renegotiate its bilateral aviation agreements with some of the Member States in order to facilitate, in particular, free access to all routes, the granting of unlimited route and traffic rights, the fixing of prices in accordance with a system of "mutual disapproval" and the possibility of sharing codes. In 1995 and 1996, seven of the eight Member States involved in the "open skies" cases (Austria, Belgium, Denmark, Finland, Germany, Luxembourg and Sweden) entered into full aviation agreements with the US. A key feature of the agreements is the so called "nationality clause": they gave the airlines owned by nationals of the contracting parties the right to fly onward from a destination in that country to a third country; each country could refuse the rights provided for in the agreement to carriers designated by the other state but not owned or controlled by nationals of that state (the UK draft aviation agreement contains a similar nationality clause, but it is more restrictive).

In the cases brought before the European Court of Justice[263], the European Commission disputed whether the Member States, rather than the Commission, should conclude bilateral aviation agreements and whether the nationality clause was precluded by the freedom of establishment rules (Art. 43 of the EC

Treaty).

The ECJ rejected the claim made by the Commission that the Member States should not negotiate aviation agreements with third countries, and stated that the Member States retained power over the allocation of aviation rights. However, the Member States had not exercised their powers consistently with EC law; the nationality clauses in the "open skies" agreements were precluded by the single market rules on freedom of establishment. As a matter of facts, these clauses are a restriction on the fundamental freedoms of nationals of other Member States guaranteed by the EC Treaty.

Under the "open skies" agreements, traffic rights are reserved to those carriers that are majority-owned and controlled by nationals of the contracting parties and this prevents EU carriers of one Member State from establishing themselves in another Member State and offering direct air services from that country to US destinations. The difference in treatment cannot be justified, according to the ECJ.

The Member States may not contract with the United States to carve out flying routes in bilateral agreements which restrict benefits to national air carriers.

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262 A. CRAIG, *Open your eyes: what the "Open Skies" cases could mean for the US tax treaties with the EU Member States,* in *Bulletin*, 2003, No. 2, p. 64.

263 See Court of Justice, C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98.

The judgements have forced the Member States to reconsider key provisions in their aviation agreements with the United States.

4. Beneficial ownership

One of the most important anti-treaty shopping measures adopted in tax treaties is the "beneficial ownership" clause, contained in Arts. 10, 11 and 12 of the OECD Model. These provisions limit the tax in the source State on the condition that the beneficial owner of the dividends, of the interest and of the royalties is a resident of the other contracting State. Thus the purpose of the clause is to oppose the interposition of an intermediary between the beneficial owner of the income and the payer of the income; as a matter of facts, the interposition only aims to benefit from the more favourable tax treaty concluded between the source State and the State in which the intermediary is resident.
To define the correct meaning of the term "beneficial owner" in double taxation bilateral treaties, it could be appropriate to start from doctrine, case-law and international practice about the theme.

4.1 History and origin of the notion

The term "beneficial owner" first appeared in the OECD Model in Arts. 10, 11 and 12, in 1977 and, almost ever since, the question has been "what does it mean". There seem to be a number of possibilities or even just uncertainty as to what meaning, or meanings, it might have. The notion of beneficial ownership was incorporated into the OECD Model in 1977 without defining it explicitly and with only limited reference in the Commentary on the articles of the OECD Model as to its meaning.
It should be noted that 1977 was not the first introduction of beneficial ownership to the world of international tax. It was used much earlier: for example, in Art. III of the 1945 United Kingdom–United States treaty on the estates of deceased persons. But "beneficial ownership" was also used before 1977 in double taxation tax treaties concluded between some common law States[264].
It is important to point out that the origin of the "beneficial owner" concept should be searched in common law systems[265], in particular in the United Kingdom and the US systems. The concept could be first found in UK courts of equity's decisions: in the "dual ownership" notion, the equity 'case-law' has distinguished the legal owner, as a person holding legal title on the asset, and the beneficial owner, as a person who has the benefits of the property, yet does not nominally own the asset itself. This partition is clearly shown in the 'trust' arrangement: the legal owner of the property (trustee) has the right to possession, the privilege of use, and the power to convey those rights and privileges. The

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[264] J. D. B. OLIVER, J. B. LIBIN, S. V. WEEGHEL AND C. DU TOIT, *Beneficial Ownership*, in *Bulletin*, 2000, No.7, p. 310-311.

[265] A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano,* in *Rassegna tributaria,* 2006, I, pag. 210-211.

beneficial owner instead gets all the benefits of the property. The trustee has a fiduciary duty to the beneficial owner to exercise his legal rights, privileges, and powers in such a way as to benefit not himself but the beneficiary.
From the perspective of the common law systems, to describe the 'beneficial ownership' concept it is correct to refer to some ownership attributes[266], which include, for example, the right to possess, use or manage the income, the capital (including the power to alienate and the ability to consume, waste or destroy), the risk of depreciation and hope of appreciation.
Anyway, the problem of adopting this notion as the meaning of the 'beneficial ownership' within the framework of the tax treaties should be to reconcile it with the civil law.

4.2 The interpretation of 'beneficial ownership' in the OECD documentation

When the notion of 'beneficial ownership' was included into the 1977 OECD Model[267], the Commentary only shortly stated that the limitation of tax in the source State was not applied when, between the payer of the income and the beneficial owner, the intermediary was an agent or a nominee.
The "OECD Conduit Companies Report" instead, adopted by the OECD in 1986, under the heading "Anti-avoidance provisions", states:

14. The OECD has incorporated in its revised 1977 Model provisions precluding in certain cases persons not entitled to a treaty from obtaining its benefits through a "conduit company".
(a)...
(b) Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit company is not its "beneficial owner". Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income... The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or agent.
Thus a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).

266 J. D. B. OLIVER, J. B. LIBIN, S. V. WEEGHEL AND C. DU TOIT, *Beneficial Ownership*, cit., p. 319.
267 A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano,* cit., pag. 211-212.

Finally in 2003, with the OECD Commentary review, also some paragraphs have been added to the Commentary on Arts. 10, 11 and 12 of the OECD Model, to offer guidelines in interpreting the 'beneficial owner' notion.

For example, Para. 1 of the Commentary on Art. 12 in that respect states:

"…the term beneficial owner is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

[…] Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and the purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State. The immediate recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

It would be equally inconsistent" –according with the mentioned OECD Conduit Companies Report- "with the object and the purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned.

[…] The limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, in those cases where the beneficial owner is a resident of the other Contracting State".

However, these clarifications introduced in 2003 OECD Commentary has not banished all doubts in interpreting the "beneficial owner" concept.

4.3 Towards an independent concept of beneficial owner in tax treaty interpretation

To move on to what the treaty meaning might be, it could be appropriate to look first at some of the principles of treaty interpretation[268] and see how they would apply in seeking the meaning of the term.

The first point is that the Vienna Convention on the law of treaties[269] governs the interpretation of tax treaties; in particular, Art. 31(1) provides: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". Art. 31(4) also states: "A special meaning shall be given to a term if it is established that the parties so intended".

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268 J. D. B. OLIVER, J. B. LIBIN, S. V. WEEGHEL AND C. DU TOIT, *Beneficial Ownership*, cit., p. 217-318.

269 Vienna Convention on the law of treaties, done at Vienna on 23 May 1969.

In general terms, the context of a tax treaty concluded by OECD Member States may include (besides the elements mentioned in Art. 31(2) of the Vienna Convention) also the OECD Model and its Commentary.
Accordingly, with reference to the interpretation of tax treaties, Art. 3, para. 2 of the OECD Model Convention states:
"[…] any term not defined therein shall, unless the context otherwise requires, have the meaning it has at that time under the law of that State for the purposes of the taxes to which the Convention applies…". In brief, for terms not explicitly defined by the Convention, it is possible to fall back upon the domestic meaning, unless the context otherwise requires; and so, it is important to state if the "context" under the Vienna Convention and under the OECD Model has the same meaning. Traditionally the doctrine gives a meaning to the "context", as used in Art. 3(2) of the OECD Model, wider than the same term as used in Vienna Convention.
As a consequence, the remand to domestic law finds its limit in the context; in fact, from the latter can arise the meaning of a term, and the integration through the domestic law might be not necessary anymore.
In this frame, has developed the thesis of term 'beneficial owner' as an independent concept in tax treaty law: it has its own meaning and do not need to be integrated by domestic law.
Among the other reasons, this choice allows to disregard the meaning given to the term in common law systems, and to provide also an appropriate solution to the systems which do not discipline the "beneficial ownership"[270].
Anyway, this autonomous concept should be defined. The doctrine has elaborated three different possible treaty meanings[271]:
a) the domestic law meaning in the common law states, imported into the OECD Model as a universal meaning;
(b) a definition which excludes agents and nominees (the only mentioned in the OECD Commentary);
(c) the person to whom the income is attributable for tax purposes under the law of the residence state or the source state.
In a few words, the fist hypothesis introduces the problem that civil law countries may nevertheless have difficulties in accepting the domestic law meaning of the common law states as the ordinary meaning to consider for purposes of applying a tax treaty. The hypothesis under b) instead, seemed to have some support in the past OECD Commentary; but after the 2003 review, also this position is not as strong as before. The latter thesis is based on the US Commentary on Art. 11(1) of the 1996 US Model Income Tax Treaty which states: "The 'beneficial owner' of a payment of interest is understood

[270] A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano,* cit. , p. 213-214.
[271] J. D. B. OLIVER, J. B. LIBIN, S. V. WEEGHEL AND C. DU TOIT, *Beneficial Ownership*, cit., p. 318, A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano,* cit. , p. 214-215.

generally to refer to any person resident in a Contracting State to whom that State attributes the payment for purposes of its tax". But this approach seems to be not consistent with the origin of the "beneficial ownership" clause in the OECD Model: in fact, it has been included there as an anti-treaty-shopping clause, not as a surreptitious subject to tax clause (as it seems to be in the US Model).
For these reasons, all these approaches should be refused; the OECD Commentary remains the main instrument of interpretation to reconstruct the autonomous treaty meaning of 'beneficial owner'. According to the Commentary, it is possible to rule absolutely out from the notion of the beneficial owner:

- the agent or the nominee, which is not considered the owner of the income for tax purposes of the State of residence;
- a conduit company, with very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties.

It means that, to identify the beneficial owner, it is not sufficient the fact that the dividends, interests or royalties are attributed to the individual or entity according to the law of his State of residence; as a matter of facts, also if he is the legal owner of the income, he could have such limited rights on it that he results only a mere intermediary, acting on behalf of another person, which in fact is the beneficial owner of this income.
Therefore, to single out the beneficial owner, it should be mostly checked the juridical relations between the interposed person and the income, through a functional analysis of the activity of and the risk run by the interposed person; insofar as the flow of the income is consistent with the latter elements, the status of 'beneficial owner' should be given to the interposed person.

4.4 The beneficial owner in EC law

The term 'beneficial owner' has been introduced first in the EC law with the directive 2003/48/EC on taxation of savings income in the form of interest payments[272].
The definition of beneficial owner is contained in Art. 2: "For the purposes of this Directive, "beneficial owner" means any individual who receives an interest payment or any individual for whom an interest payment is secured, unless he provides evidence that it was not received or secured for his own benefit".
The Commentary to the directive gives other indications: the individual who receives an interest payment is in general considered the beneficial owner of it unless he provides evidence that it was not received for its own benefit. Moreover, the Commentary adds that the recipient of an income is not considered the beneficial owner of it if he acts as a paying agent for another person, or on behalf of a legal person, or on behalf of an OICVM authorised or an equivalent entity.

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272 BAGNARDI B., *Il concetto di "beneficiario effettivo" nella direttiva sulla tassazione del risparmio*, in *Dir. prat. trib. int.*, 2003, I, p. 193-196, C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 894-895.

When the recipient acts as a paying agent, or on behalf of a legal person, he is an intermediary and he could be not considered the beneficial owner.
The meaning of the beneficial ownership in this directive may be analyzed according to its aim, described in Art. 1: "The ultimate aim of the Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident for tax purposes in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State". This purpose is realized through a system of exchange of information.
These provisions apply only if the beneficial owner of the income is an individual; the fact that the legal persons are not covered is relevant, because if the interposed person is a company or a trust, the recipient of the interests (that is the beneficial owner) suffers a withholding tax in the source state, but it has the benefit of being anonymous towards the tax authorities of its State of residence.
These considerations cannot be extended to the definition of beneficial owner contained in the directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States[273]. With this directive, uniform provisions in the payment of interests and royalties have been introduced; the purpose is to fight the possible cases of double taxation, only partially removed by double taxation treaties.
The 'ratio' of the directive is the introduction of a common system of taxation of interests and royalties for all Member States, which may widely follow the principles contained in double taxation treaties concluded according to the OECD Model.
The directive provides the elimination of withholding taxes on payments of interests and royalties made between associated companies of different Member States, accordingly to Art. 1: "Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that State, whether by deduction at source or by assessment". The condition which allows to grant this treatment is that interests or royalties should be paid to a company of another Member State (or to a permanent establishment situated in another Member State of a company of a Member State) qualified as 'beneficial owner'. Art. 1, para. 4 of the directive states: "A company of a Member State shall be treated as the beneficial owner of interest or royalties only 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".
Therefore, the interest and royalty payments made between associated companies are subjected to tax exclusively in the Member States where the receiving company is located, whereas taxation at source (which causes economic difficulties to cross-border transactions) is removed.
In this directive (as in the OECD Model) the definition of beneficial owner has the function of avoiding that the benefits provided by these provisions - benefits otherwise not available - should be enjoyed by interposed companies, constituted with this only aim. The context is different in the

[273] P. VALENTE, *Fiscalità sovranazionale*, 3 edizione, Milano, 2008 p. 230-231.

directive on taxation of savings income: it provides uniform provisions for individuals, in obedience to the general rules of the Common Market based on the fundamental freedoms.
Despite of the different wording, it is possible to suppose that the two directives refer to the same concept of beneficial owner. Moreover, the EC documentation does not recall the definition of the OECD Model, and therefore the meaning of the beneficial owner in the Community law is independent from the meaning of the tax treaty law.

4.5 The implementation in Italy of the directive 2003/49/EC

In Italy the implementation of the directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States has been realized with the legislative decree 30.05.2005, n. 143[274].
This D.Lgs. has mainly modified the Title III (Deduction at source) of the President of Republic decree 29.09.1973, n. 600 on the assessment of income tax.
The subjective area of application of the new provisions states that interests and royalties paid to non resident company or to a permanent establishment located in another Member State, shall be exempt from taxes in case that the receiving company of interests and royalties and the company whose permanent establishments are recipient of the same income:
- are qualified as one of the companies listed in the annex A of the President of Republic decree 600/1973;
- are resident of a Member State for tax purposes, without being considered extra-EU resident according to a double taxation treaty with a third State;
- are subjected, without exemption, to one of the taxes listed in the annex B of the President of Republic decree; or in addiction or substitution, to an identical or similar tax.
Moreover, the individual or entity as described shall be the beneficial owners, and this condition is verified when:
- the company receives the payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person.
- debt-claim, right or use or information which generate the payments of interests or royalties behalf the permanent establishment represent the income for which the permanent establishment is subject in the Member State where it is situated to one of the taxes mentioned in annex B.
With regard to the associated companies, the directive qualifies the relationship between the paying company and the receiving one; in fact, the directive provides that two companies may be considered "associated companies" if, at least, one of them:
(i) has a direct minimum holding of 25 % in the capital of the other, or
(ii) Member States shall have the option of replacing the criterion of a minimum holding in the capital with that of a minimum holding of voting rights.

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274 P. VALENTE, *Fiscalità sovranazionale*, cit., p. 234 and ss.

Italy has chosen the second hypothesis, that is the count of the qualification percentage with reference to voting rights that could be exerted in the shareholders' ordinary meeting, according to arts. 2364, 2364-bis and 2479-bis of the civil code.

As far as the objective precondition of disapplication of the deduction at source is concerned, the D.Lgs. has reproduced the definitions of interests and royalties of Art. 2 of the directive (which are the same of the OECD Model[275]).

As a matter of facts, shall be regarded as 'royalties'[276] the payments of any kind received as a consideration for the use of, or the right to use:

- any copyright of literary, artistic or scientific work, including cinematograph films and software;
- any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience;
- industrial, commercial or scientific equipment.

Shall be regarded as 'interests'[277] instead:

- income from debt-claims of every kind, whether or not secured by mortgage and in particular, income from securities and income from bonds or debentures, including other proceeds attaching to such securities, bonds or debentures.

The directive provides at Art. 4 some cases of exclusion from benefits of the deduction at source's disapplication, which also the Italian legislator has acknowledged: the area of application of the exemption as described, in fact, is limited[278] so that it should be consistent with the Legislative decree 344/2003 (Italian tax reform of the taxation of companies' income).

Art. 5 of the directive states that it "shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse". In application of it, the Italian legislator has included among the anti-avoidance provisions - that is Art. 37-bis of the President of Republic decree 600/1973 - a new transaction potentially subjected to control of tax authorities: that is payments of interests and royalties, as contained in Art. 26-quarter, if made to entity directly or indirectly controlled by one or more non residents of a Member State.

It is also important the transposition of the para. 2 of Art. 4 of the directive. The provision[279] disciplines the cases in which the deduction's exemption is applied only to the normal value, if:

- the payer of interests and royalties controls or is controlled by, directly or indirectly, the beneficial owner; or
- both are controlled, directly or indirectly, by a third entity; and

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[275] See art. 11, para. 3 and art. 12 para. 2 of the OECD Model.

[276] See art. 26-quater, comma III, letter a) of the President of Republic decree 600/1973.

[277] See art. 26-quater, comma III, letter b) of the President of Republic decree 600/1973.

[278] In detail, see art. 26-quater, comma III, letter c) of the President of Republic decree 600/1973.

[279] See art. 26-quater, comma V of the President of Republic decree 600/1973.

- the amount of interests and royalties exceeds the normal value.

Therefore, the surplus shall be subjected to the common deduction provided by Art. 25 of the President of Republic decree 600/1973, or to the deduction provided by double taxation treaties concluded by Italy.

Art. 3 of the Legislative decree states that these new provisions are applied to interests and royalties accrued from 01.01.2004.

4.6 Anti-treaty shopping clauses in tax treaties concluded by Italy

Italian legislation does not deal specifically with the possible misuse of tax treaties for the purpose of avoiding or mitigating taxation. The term 'treaty shopping' is practically unknown in Italy: there are no similar terms used in Italian case-law or tax literature to describe this misuse of tax treaties. Italian law does not deal specifically with any of the treaty shopping structures[280].

As to international tax treaties, first of all it could be appropriate to notice that most of the treaties concluded by Italy with other States conform to the OECD Model; consequently, according to OECD Model provisions, most of the tax treaties concluded by Italy also includes the beneficial owner clause[281]. The clause, as is common knowledge, is used to deny treaty benefits (for example, reduced rates of withholding tax on dividends, interest and royalties) in a contracting State if the taxpayer, resident in the other State, is not the beneficial owner of the income derived in the first State.

The beneficial owner clause contained in the majority of the treaties concluded by Italy is worded similarly to the OECD Model clause. A significant example may be Art. 10, para. 2 of the 1989 Italy–Germany treaty, which provides that: "dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed 15% of the gross amount of the dividends". Art. 11 (Interest) and Art. 12 (Royalties) also have a beneficial owner clause, using similar language.

The treaties concluded by Italy with Belgium (1983), Kuwait (1987), Malta (1981), Sri Lanka (1984) and the United States (1999) contain an indirect formula of the beneficial owner clause; for example, Art. 10(2) of the Italy–Belgium treaty states that "dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State ...".

This wording is less restrictive than the wording in the Italy–Germany treaty, because it does not require the beneficial owner to be the recipient of the income, but simply to be a resident of the other contracting state.

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280 A. MAMOLI, *Report from Italy,* in H. BECKER, F. J. WURM, *Treaty shopping: an emerging tax issue and its present status in various countries*, cit., p. 161.

A different wording instead is adopted in the Italy–Turkey treaty of 1990; the paragraph V of the protocol states: "[i]t is understood that the 'beneficial owner' clause should be interpreted in the meaning that a third country resident will not be allowed to get benefits from the Tax Agreement with regard to dividends, interest and royalties derived from Turkey or Italy, but this restriction shall in no case be applied to residents of a Contracting State".

It is possible to find a close interconnection between the status of "resident" and "beneficial owner" in Art. 4(5) (a) of the Italy–Switzerland treaty (1976). This article states: "The following shall be deemed not to be resident in a Contracting State within the meaning of this Article: (a) a person who, while fulfilling the conditions laid down in paragraphs 1 to 3 is merely the seeming recipient of the income in question whereas the person who actually receives the income – either directly or indirectly through other individuals or legal entities – is not deemed to be a resident of that State within the meaning of this Article".

Therefore, it makes sense to say that treaties often use the concept, but do not generally provide a definition of "beneficial owner". As a result, in order to determine its scope, it is necessary to construe the meaning of 'beneficial owner' in accordance with the domestic law of each State. The mentioned Italy–Germany treaty, however, is an exception. Paragraph 9 of the protocol to that treaty in fact establishes that "[t]he recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if he is entitled to the right upon which the payments are based and the income derived therefrom is attributable to him under the tax laws of both States".

The beneficial owner clause is the most recurrent in Italian double taxation conventions, but it is not the only one. There are some other kind of anti-abuse clauses in tax treaties concluded by Italy, such as a sort of LOB clauses. It is possible to find examples of it in Italy-United Kingdom and Italy-Switzerland tax treaties. With reference to the first, the treaty permits UK shareholders of Italian companies to benefit from a particularly favourable tax regime for the dividends received. This regime consists of a tax credit granted by Italy relating to the dividends distributed by the Italian subsidiary to the UK company. In particular, Art. 10(4) of the Treaty states:

(a): a UK resident who receives dividends from an Italian resident company is entitled, if he is the beneficial owner of the dividends, to a tax credit equal to that which would have been granted to an Italian resident individual upon receipt of the same dividend, subject to the deduction of the withholding taxes provided by Art. 10(2)(b) (i.e. 15% of the gross dividends); and

(b): if the beneficial owner of the dividends is a UK resident company which, either alone or jointly with one or more associated companies, controls directly or indirectly 10% or more of the voting power in the distributing company, the UK company is entitled to "a tax credit equal to one half of the tax credit to which an individual resident in Italy would have been entitled had he received those dividends, subject to the deduction of the tax provided for in ... [Art. 10(2)(a), i.e. 5% of the gross

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[281] P. VALENTE, M. MAGENTA, *Analysis of Certain Anti-Abuse Clauses in the Tax Treaties Concluded by Italy*, cit., p. 42-43.

dividends] and provided that the company receiving the dividend and the tax credit is subject to United Kingdom tax in respect thereof".

Briefly stated, the tax credit granted by Italy is equal to all, or half, of the tax credit that would be granted with respect to the same income if it had been received by an Italian resident individual, depending on the percentage shareholding held and on whether or not the receiving entity is a company.

Art. 10(5) of the Treaty contains an anti-abuse clause which provides that the person who applies for the tax credit refund under the Treaty has the burden of proof and must demonstrate that the shareholding was acquired for commercial or business reasons, without the specific purpose of benefiting from the tax credit. The same provision also applies in the opposite case of dividend distributions by UK subsidiaries to Italian resident shareholders.

The second example is that of Art. 23 of Italy-Switzerland double taxation treaty. According to this article, a repayment of withholding taxes under the terms of the treaty will be denied where there has been abuse. Abuse occurs when a foreign-controlled legal entity which is resident in Switzerland fails one of the 4 following 'tests':

a) the entity must have a reasonable debt/equity ratio (generally the total of all interest-bearing loans should not exceed six times the company's equity);

b) the entity must not pay excessive interest rates on debt (for the purposes of this test the accepted rate varies from time to time); c) the entity must not pay more than 50% of its income as management fees, interest or royalties to non residents;

d) the entity must distribute at least 25% of the income which could be distributed as dividend.

4.7 The voidness of the contract to contrast dividend washing and dividend stripping in the decisions of the Court of Cassazione

It seems to be interesting to analyze two judgments of the Court Of Cassazione which have had an important impact on both Italian tax and legal systems. The judgments concern different transactions: the first (n. 20398/2005) refers to a dividend washing operation, whereas the second (n. 22932) is about the dividend stripping. Anyway, both judgements are strictly bound each other, may be for two main reasons: firstly, those operations were -at the time- practices widely used to minimize the tax burden, and the purpose was realized 'getting around' the tax provision which disciplined the tax credit on dividends. Moreover, with these judgments the Court has changed its previous guidelines and has stated the substantial illicitness of such operations, turning to different and unexpected solutions. As a matter of facts, at the time of the events in chancery, there were no appropriate law provisions to contrast such forms of tax avoidance: consequently, the Court has affirmed the voidness, for a lack of cause, of such connected transactions aiming to realize dividend washing and dividend stripping.

Cass. , 21 October 2005, n. 20398 - In this case[282] the Italian tax administration has rectified, increasing it, the income of a corporation, concerning the tax year 1992. The administration, in fact, did not acknowledge a capital loss realized and deducted by the corporation, with reference to a transaction of purchasing shares from, and subsequently selling them to, the same mutual fund. This transaction in its entirety has been considered a dividend stripping operation, and therefore, a form of tax avoidance.
In fact, the transaction, as made, completed the classic scheme of dividend washing: a corporation purchased shares from a mutual fund after the decision of distribution of dividends, but before the detach of the coupon. The cessionary corporation collected the dividend and immediately after sold the shares to the same fund, spotlighting a capital loss of grant in nearly every case corresponding to the amount of the dividends cashed. Benefits were relevant for both parts: this transaction allowed the mutual fund to replace cashed dividends (through the assignment of the shares), that was subject to a withholding tax, with a capital gain (which was not taxable at the time); the cessionary corporation instead, could cash the dividend with the tax credit (ex Art. 14 T.U.I.R., before its 2003 reform), and could realize, with the subsequent sale, a deductible capital loss.
The tax demand pointed out some elements, to confirm the transaction's purpose of avoiding tax: the purchase and the sale of the shares were realized in a very narrow period of time; the collection of the dividend immediately after the first operation, or simultaneously with the second; the lack of extra-fiscal reasons of the transaction; the coincidence between the grant of the dividend and the difference between the price of transfer and sale of shares.
According to the tax authority, those elements showed the existence of an anomalous transaction aimed to grant tax benefits defined as 'exchange of income with the purpose of tax gain, realized through the interposition of the corporation in collecting the dividend addressed to the mutual fund'.
It caused the replacement of the natural taxation's regime with a more advantageous one. The correct taxation's regime should be the application of Art. 6 T.U.I.R. and Art. 37, comma 3, of the President of Republic decree 600/1973: it means that the income perceived by the mutual fund as 'transaction's capital gain' should be qualified as 'profit sharing'.
The Italian Corte of Cassazione approves the thesis of the tax office, which considered the juridical effects realized with such a transaction not opposable to the tax authority; but the motivation of the Court is completely different from that of the tax office. The transaction, in the whole, cannot have an effect on the tax authority because it has no other economic reasons than the tax saving, and it is consequently void because of a lack of cause, ex arts. 1325 and 1418 of the civil code.

[282] G. CORASANITI, *La nullità dei contratti come strumento di contrasto alle operazioni di dividend washing nella recente giurisprudenza della Suprema Corte*, in *Dir. prat. trib.*, 2006, II , pag. 275-277.

Cass., 14 November 2005, n. 22932 - The second Court decision concerns a typical dividend stripping transaction[283]. The scheme is the following: a non resident company (which cannot benefit from the tax credit) left in usufruct to a resident company its shareholdings in a resident company. In that way the non resident perceived dividends as compensation for leaving the usufruct, without suffering deduction, whereas the resident usufructuary could benefit from the tax credit and could deduct the cost of the usufruct.

It would be reasonable think that the tax office in its assessment would have charged the non resident with the lack of the taxation of dividends indirectly perceived, or, as an alternative, the usufructuary with the right of benefit from the tax credit on dividends not available to him (because he was not the beneficial owner). The tax office instead, charged the resident usufructuary company with the lack of the deduction towards the non resident ex Art. 27, comma 3, of the President of Republic decree 600/1973. The tax office considered the transaction and the obtained tax benefits contrasting with the mentioned provision and, therefore, charged the usufructuary company with a non-made payment of the greater deduction (which should be made, if only dividends would be distributed to the foreign company owner of the shareholdings).

Also in this case, the Court validates the assessment of the tax office, but the motivation is not that the assessment is based on; the Court instead, recovering the arguments of the judgement n. 20398, asserts that connected transactions from which parts obtain no other benefits than saving on taxes are void, lacking of cause.

To sum up, according to the arguments of the Court, these two judgements has stated the voidness of the operations of dividend washing and dividend stripping deriving from a lack of cause of the contracts they are based on (purchase and sale of shares in the first hypothesis, assignment of the right of usufruct in the other).

Moreover, the principle that the tax authority can produce the voidness of contracts (in the tax assessment and during the legal dispute) stipulated by the taxpayer with the only purpose of saving on taxes is reasserted.

[283] G. CORASANITI, La *nullità dei contratti come strumento di contrasto alle operazioni di dividend washing nella recente giurisprudenza della Suprema Corte*, cit., p. 278-279.

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Facoltà di Giurisprudenza

Cattedra di Diritto Tributario

THE ITALIAN CONTROLLED FOREIGN COMPANY LEGISLATION

Paola Maria Plantamura

Matr: 088883

1. ANTI-AVOIDANCE RULES

The Italian legal system has always been reluctant in inserting general anti-avoidance clauses in the fiscal system. Nonetheless, a very meaningful anti-avoidance rule has been introduced, which is very similar to a general anti-avoidance clause.

In fact, Art 37-bis President of Republic Decree number 600 of 1973 aims at disclaiming fiscal advantages deriving from acts, facts and contracts, even linked among them, which are not based upon valid business reasons and which are aimed at circumventing tax obligations or prohibitions, and to obtain tax reductions or tax refunds which would otherwise not be due.

The wording of the article is very wide and includes any human act, whether voluntary or not.

The Italian tax authorities may challenge the tax benefits obtained and consider all the acts, facts and contracts which, linked together, have allowed an undue tax relief, as elusive. Therefore the application of the provision is broad, as a given transaction, when connected with different acts and contracts, can lead to various elusive results (even if not explicitly described by Art. 37-bis) . Indeed, the legislator has aimed at extending the possible intervention by the tax authorities. Obviously, the various transactions carried out by the taxpayer must be considered as a whole.

Art. 37-bis clearly conceives tax avoidance as fraud, that is the elusive use of lawful means in order to obtain benefits which are contrary to the legal system. In fact, the advantages obtained by the taxpayer are qualified as undue. A tax benefit may be seen as undue, for the purposes of the anti-abuse analysis, when, even if it is formally legitimate based on the applicable rules, it is achieved through the implementation of an "artificial" transaction.

According to the article, in order for avoidance to exist, three conditions must jointly be met:

- the transaction is not based upon valid economic reasons;
- the transaction is aimed at circumventing tax obligations or prohibitions provided for by the tax laws;
- the transaction is aimed at obtaining tax reductions or tax refunds which would not otherwise be due.

Therefore, economic transactions must have economic substance and a business purpose, other than tax relief.

In fact, the first condition acknowledges the principles of "good business purpose" and of "substance over form". It is necessary to consider the actual substance of the transaction which the taxpayer carries out.

The notion of economic reasons comprehends all reasons which are non-fiscal, these must be valid, and therefore prevail on the reasons constituted by fiscal advantages.

For example, there is tax avoidance when the transaction does not have a significant economic result, and therefore the undue tax saving is the only reason of the transaction.

Obviously the fiscal advantage of the transaction does not constitute a valid economic reason, but a transaction which has valid economic reasons, may have as a positive and legal effect a tax advantage.

According to some scholars[284], the existence of valid economic reasons must be evaluated by an objective point of view. Therefore, there is economic substance if a transactor endowed with reasonable care, would have carried out the transaction even in the absence of fiscal advantages.

According to the second condition, the objective of the transaction must be the avoidance of duties and prohibitions which are provided for by the tax system.

The avoidance of fiscal duties can be interpreted as the avoidance of the duty to subject income connected with a certain transaction to tax. It has to be referred to a certain provision, not to the fiscal system in general. The term prohibition stands for a provision which excludes a fiscal benefit for the taxpayer.

Therefore, according to the second requirement mentioned above for the application of Article 37-bis, the transaction should have an "artificial" structure (which would not be adopted in cases where there is no tax benefit), aimed at "circumventing" Italian tax laws. Based on the principles elaborated by the academics and by the same tax authorities, Article 37-bis may apply when a given transaction provides a tax benefit and, in order to achieve this tax benefit, it is structured in an "artificial manner", which would not be adopted and which would not make economic sense if it were not for the tax benefit which, by so structuring the transaction, the taxpayer may achieve. On the contrary, if the taxpayer has different alternative structures to execute a given transaction which are subject to different tax treatments, and all the alternatives make sense under an economic point of view and could be adopted even in the lack of any specific tax benefit, the taxpayer is free to elect the structure which provides for a more favourable tax treatment. In such latter case there would be no "circumvention" of tax obligations but only a legitimate choice between alternatives which are all based upon valid economic reasons and which are all available under the tax laws.

Another requirement is the achievement of an unduly fiscal advantage(tax refund or relief), which, therefore, could not have been obtained in another way.

A tax benefit may be seen as undue, when even if it is formally legitimate, it is achieved through the implementation of an artificial transaction.

Some scholars [285] believe that the fiscal advantage must be present when the transaction is carried out. Others[286] don't agree. In fact, although the benefits cannot be hypothetical, the actual existence of a fiscal advantage when the transaction is accomplished is not necessary in order to qualify it as elusive. It is, instead sufficient that the transaction aims at obtaining an undue tax benefit. The benefit pursued by the taxpayer must be determined and identifiable, but can be merely potential.

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[284] P. PICCONE FERRAROTTI, *Riflessioni sulla norma antielusiva introdotta dall'art. 7 del D. Lgs. n. 358/1997 (art. 37-bis del D.P.R. n. 600/1973)* , in *Rassegna Tributaria,* 1997, V, p. 1147-1178.

[285] TABELLINI, *Il progetto governativo antielusione,* in Bollettino Tributario, 1997, p.1063

It will be necessary to compare the less burdensome behaviour actually held and the one that has been avoided by the tax payer.

Article 37-bis is applicable to the transactions which are enumerated in the third paragraph of the article. As examples, we can recall mergers, acquisitions, conversions, split-ups and winding-up of companies (even if these take place between corporations located in different member states of the EU).

For example, a merger between two companies, which are winding-up, with the objective to compensate the losses of one of the companies with the profits of the other one, lacks economic substance.

This provision is applicable to cases which take place outside the Italian territory, as long as they produce effects in Italy in terms of undue tax saving.

Essence of the provision is the need to limit the taxpayer's freedom in carrying out acts, facts and legal transactions which aim at avoiding fiscal norms or achieving undue fiscal advantages.

The elusive acts, facts and legal transactions aren't exceptionable to the tax administration, which disclaims the fiscal advantages obtained.

Therefore, a special tax assessment act applies the avoided provision.

An additional tax (equal to the difference between the duty due on the basis of the avoided provision and the taxes due to the behaviour held) must be paid. Therefore, the circumvented taxes are compensated by the discharged ones.

In fact, the disownment of the fiscal advantages does not represent a sanction on the taxpayer. Instead, it must be seen as a way to safeguard the provisions and principles of the tax system, by re-establishing the effectiveness of the avoided provision.

2.CFC LEGISLATION

2.1. Introduction

In the last decades techniques which transfer taxable income from jurisdictions with an ordinary taxation to tax havens have been frequently used.

Therefore, the States which have higher tax rates have developed measures aiming at contrasting these practices. Among these, the controlled foreign company legislations play a fundamental role. In fact, the CFC legislations contrast the phenomena of tax deferral by allocating the income of controlled companies, situated in tax havens, directly to its controlling persons, independently from the distribution of the income.

The mechanism involves the disregard of the separate legal personality of foreign low-tax subsidiaries and usually consists of either imputation of the foreign subsidiary's profits directly to the domestic

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286 PICCONE FERRAROTTI, cit. *Riflessioni sulla norma antielusiva introdotta dall'art. 7 del D. Lgs. n. 358/1997 (art. 37-bis del D.P.R. n. 600/1973)* .

parent company (treating the CFC as a branch) or taxing a deemed dividend in the hands of the parent.[287]

According to some scholars[288], "the new Italian CFC legislation is designed to prevent Italian companies from delaying the repatriation of low taxed foreign earnings, and is specifically aimed at those situations that are deemed to have been set up merely to obtain tax advantages without economic substance".

Article 1 of the law 342/2000 introduced Art. 127-bis(renumbered Art 167) of the Italian Income Tax Code, which concerns the allocation of the income of controlled foreign companies resident or localized in states or territories which have a privileged fiscal regime.

According to Art. 167, if an Italian resident person controls, directly or indirectly, an entity resident or localized in states or territories contained in the ministerial decree, the income of the cfc, will form part of the taxable income of the Italian controlling person.

The income of the cfc is allocated to the controlling person on accrual basis(and taxed at the Italian shareholders level), regardless of the distribution of the profits of the cfc and notwithstanding its juridical and fiscal autonomy. In fact, if it were not for the CFC legislation, the revenues of the controlled companies would be subject to taxation towards the controlling person only if distributed as dividends.

Furthermore, the legislative decree 344/2003 introduced Art. 168, which states that the CFC legislation is also applicable to foreign affiliated companies (resident in countries included in the black list) in which the Italian resident subject holds, directly or indirectly, a shareholding in the profits not lower than 20 per cent (10 per cent if the foreign company is listed at a stock exchange) .

2.2. Objective

The objective of the CFC legislation is above all anti-avoidance, in fact, these rules pre-empt profit transfers from the tax jurisdiction of the home State to low tax jurisdictions.

According to some scholars[289], by considering the report accompanying the 2000 Financial Act, we can infer two main reasons which inspired our CFC legislation. First of all, the fact that all legal systems of the developed countries had provided for a CFC legislation. Furthermore the European Union (by means of the Code of Conduct[290]) and a report of the OECD[291] (regarding harmful tax competition) had encouraged the adoption of the above-mentioned rules.

Nonetheless, anti-avoidance can not be considered the only purpose of our CFC legislation.

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[287] TERRA-WATTEL, , *European Tax Law,* 5th edition, Kluwer Law International

[288] D. BUSETTO-A. RUSSO, *Final controlled foreign companies legislation enacted,* in *European Taxation,* 2001 p.32

[289] A. BALLANCIN, *Note ricostruttive sulla ratio sottesa alla disciplina italiana in tema di controlled foreign companies,* in *Riv. dir. trib.,* 2008, I, p. 18.

[290] ECOFIN Council conclusions on fiscal policy, December 1 1997

[291] OECD, *Harmful Tax Competition: An Emerging Global Issue*, Paris, 1998

In the opinion of some authors, the main objective of Art.167 is to contrast tax deferral of the profits of the cfc. There can be a substantial fiscal advantage in deferring the taxation of the profits of the entity resident in the tax privileged regime if the controlling person avoids collecting the dividends. It follows that the rule is applicable only when there is participative control, because only in this case the controlling entity can actually play a role in the deferral of the income. According to certain scholars[292], in fact, the cfc provisions cannot be applied when control is based on contractual arrangements.

According to Cordeiro Guerra[293], instead, the aim of art.167 is to target income which is only apparently produced outside the Italian territory, but actually generated throughout an activity which still has its management and its operating centre in Italy. Another objective of the CFC legislation is that to avoid the deviation of profits realized through behaviours referable to real interposition. In fact, the income is fictitiously diverted to the controlled company, in order to obtain tax benefits.

These arguments can be confirmed by the text of Art. 167, par. 1 of ITC, which instead of referring to the dividends due to the controlling subject, refers to the income generated abroad by the foreign entity. Another proof would be given by the third paragraph of the abovementioned article, according to which an exemption can be granted if it is proved that the foreign entity carries out a genuine economic activity.

Rather than stressing anti-avoidance aims, other scholars[294] state that objective of the Italian CFC legislation is to guarantee equal treatment to whom generates income abroad and to who does so in the Italian territory , that is capital export neutrality. Tax neutrality is possible, if it is indifferent (under a fiscal point of view) for a person whether to invest in its state of residence or abroad. In fact, investments are taxed equivalently regardless the place where they are made.

In order to implement a capital export neutrality policy, the tax system should contrast the phenomena of tax deferral, as the latter causes the outflow of investments towards low tax jurisdictions.

Therefore, the discipline is considered expression of a tax policy which guarantees a charging standard that does not depend on the place where the income is produced, when it is not possible to prove that a certain activity has been located in a given State because of valid entrepreneurial reasons[295].

This explanation allows us to justify the application of the legislation to connected companies as well.

According to some scholars[296], the current CFC legislation tends to avoid the outsourcing of income towards tax havens, in order to guarantee that the income is adequately taxed, in the viewpoint of tax neutrality.

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[292] D. STEVANATO, *Controlled Foreign Companies: concetto di controllo e imputazione del reddito,* in *Riv. dir. trib.,* 2000, I, p. 799.

[293] R. CORDEIRO GUERRA, *Riflessioni critiche e spunti sistematici sulla introducenda disciplina delle Controlled foreign companies,* in *Rass. Trib.,* 2000, V, p. 1399.

[294] R. FRANZE', *Il regime di imputazione dei redditi dei soggetti partecipati residenti o localizzati in paradisi fiscali, in* AA.VV., Diritto Tributario Internazionale(a cura di V. Uckmar), Padova, 2005, p. 927 ss.

This remark is supported by articles 167 and 168, and other provisions contained in ITC which regard participation exemptions.
To synthesize, our legislator's aim is to ensure that the profits which are generated abroad are subject to proper taxation.

3. DEFINITION OF A CONTROLLED FOREIGN CORPORATION

3.1.1.
The notion of Italian persons subject to the provision is very wide and includes individuals, partnerships, corporations, public and private entities, which carry out commercial or non-commercial activities. Instead, Italian permanent establishments of foreign entities are excluded as they are not Italian resident entities.
As for the notion of entities resident in tax privileged jurisdictions, it comprehends enterprises, partnerships, corporate entities and other entities. Also trusts and foreign permanent establishments of non-resident subjects can be considered entities according to the CFC legislation.
According to our legislation, profits of a foreign entity, resident or located in a privileged tax regime, are considered to be the profits of an Italian resident person, which directly or indirectly controls the foreign company.
Foreign entities in which the resident taxpayer does not exercise control are therefore excluded from the scope of the CFC legislation, even if located in low tax jurisdictions (unless the requirements contained in Art. 168 are fulfilled) .Article 167 defines the concept of control by explicitly referring to article 2359 of the civil code.
Therefore, the control requirement is satisfied when one of these conditions is met:

- the Italian controlling person has the majority of the voting rights exercisable at the shareholders meeting of the cfc(that is holding 50%+1 of a company's voting shares) (legal control)
- the controlling person has sufficient voting rights to exercise a predominant influence at the meeting of the cfc (de facto internal control)
- contractual arrangements grant a dominant influence to the Italian person over the entity resident in the privileged jurisdiction (de facto external control)

Since the CFC legislation aims at contrasting tax deferral, it must target those situations that actually allow the controlling entity to postpone the distribution of the dividends by the foreign company.
If contractual arrangements grant a dominant influence to the Italian person over an entity resident in the privileged jurisdiction, the cfc legislation will be applicable on one condition: provided that there's a participation to the profits of the privileged entity.

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[295] R. DOMINICI, *Considerazioni sul regime delle CFC,* in *Corriere Tributario,* 2003, p . 3123-3127
[296] A. BALLANCIN, *Note ricostruttive sulla ratio sottesa alla disciplina italiana in tema di controlled foreign companies,* in *Riv. dir. trib.,* 2008, I, p. 18.

As for natural persons, the votes belonging to the family members enumerated by Art. 5, par. 5 of the ITC are considered as well.

3.1.2.Indirect control

Control can be exercised directly or indirectly.

Indirect control is exercised by means of trust companies and interposed entities. It also includes cases in which control is realized through sub-holdings and any kind of real interposition.[297]

In order to determine the existence of control also the votes which appertain to controlled companies, fiduciaries or interposed subjects are considered (while the voting rights on behalf of third parties are not computed) .

3.1.3. Joint control

Joint control exists if the dominant influence on the cfc is exerted by two or more resident entities, bound by an agreement regarding the exercise of this power.

The decisions must be taken jointly at the shareholders' meeting. The income is allocated proportionately to the quotas held by each of the participating persons.

According to the Ministerial Decree number 429 of 2001, the fulfilment of the control requirement is tested at the end of the controlled entity's business period (which coincides with the moment in which the income is attributed to the controlling company) . Otherwise, it will be necessary to refer to the end of the fiscal year of the controlling company.

In case behaviours which determine a division or a temporary loss of control are enacted (tax avoidance schemes) , the provisions of article 37 and 37-bis of the ITC will be applied.

In order for the CFC legislation to be applicable, in addition to the control requirement, profit sharing is necessary.

3.2. Related Companies

According to Art. 168, paragraph 1, the CFC legislation is also applicable to foreign related companies (resident in countries included in the black list) in which the Italian resident subject holds, directly or indirectly, a shareholding in the profits not lower than 20 per cent (10 per cent if the foreign company is listed at a stock exchange) .

Art. 168 is applicable only if external de facto control is not provable, but the profit sharing required by the article is satisfied.

If the connection takes place by means of a resident entity, in order to avoid double taxation, Art. 168 will be applied towards the company which constitutes the first link in the chain.

According to some authors[298], when companies are related, it is not certain that the resident entity can actually enact outsourcing of the income and tax deferral, by from delaying the repatriation of low taxed foreign earnings. Instead, it is possible that the participating subject passively undergoes these

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[297] Cfr. Assonime, Circular February 18 2000, n. 65, par 2.5.

[298] D. STEVANATO, *La delega fiscale e la CFC Legislation,* in *Il fisco,* n. 18, 2002, I, p. 2732.

policies. They believe that the extension of the provisions contained in Art. 167 to related companies, comes into conflict with Art. 1 of ITC. This contrast would not be justifiable by the need to avoid the outsourcing of passive incomes.

Other scholars[299] denounce that the extension of the provisions contained in Art. 167 to related companies contradicts the ratio of the CFC legislation. In fact, whatever the objective of the rules concerning the allocation of the income of foreign entities, it is difficult to extend them to connected companies. Only control allows an influence on the participated entity strong enough to permit tax deferral or the use of the foreign company in order to outsource profits.

4. Scope of the CFC-legislation

Italy applies a designated jurisdictional approach, in fact, the CFC legislation is only applicable in relation to cfcs resident in specific jurisdictions, which are identified in appropriate lists.

This approach is regardless of the nature of the income and focuses on the country where the controlled foreign company resides.

Art. 167 states that the CFC provision applies to foreign entities which are resident in jurisdictions included in a black list issued with ministerial decree.

It must be emphasized that the law number 244 of 2007 modified these guidelines. In fact, according to Art. 168-bis, a ministerial decree will draw up a white list indicating States and territories which guarantee and adequate exchange of information and in which the taxation level is not considerably lower than the Italian one.

In the meantime, the privileged tax jurisdictions are determined by the ministerial decree 21 November 2001, which identifies three parameters: a considerably lower level of taxation in comparison with the Italian one, the absence of an adequate exchange of information between Italy and the state in question, and other equivalent criteria.

The financial administration believes that the second criterion is satisfied when there is not a convention against double taxation between Italy and the other state.

Moreover, the decree divides the black list territories in three kinds: states and territories which are always fiscally privileged, states and territories considered fiscally privileged, but with the exclusion of certain entities, states and territories which are considered fiscally privileged limitedly to certain companies and activities. All three lists are peremptory.

Therefore, if the cfc meets the requirements indicated in articles 167 or 168 and is resident in a state or territory included in the black list the CFC legislation will be applied.

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[299] R. CORDEIRO GUERRA., *La stabile organizzazione e le disposizioni in materia di rapporti internazionali previste dal progetto di riforma del sistema tributario,* in *Atti del Convegno "Riforma fiscale: la nuova imposta sul reddito delle società",* organizzato da Ipsoa il 15 ottobre 2003 a Milano.

The request of a ruling by an Italian entity controlling a company in Malay gave the tax authorities the chance to emphasize the compulsoriness of the black list.
In order to be granted the exemption from the CFC legislation, the applicant tried to demonstrate that Malay could not be comparable to a tax haven, as the tax rate applicable therein is higher than 27%. According to Art. 167, par. 5, it is necessary to prove that the income of the connected entity isn't localized in a tax privileged regime. The claimant instead, asked for the non application of the black list.
With the Ministerial Resolution number 262/E [300], the fiscal authorities stress that the black list has been laid out by considering a series of elements, among which, not only the tax rate applicable to resident entities, but also the existence of a complete and efficient exchange of information with the Italian tax authority. This assessment is not questionable during a ruling.
The administrative circular November 16 2000, no. 207/E comments article 167 and clarifies that the level of taxation must be determined not only in relation to the nominal tax rate but also in relation to the taxable base. Furthermore, the concept of a considerably lower level of taxation does not refer merely to the level of the tax rates, but also to other characteristics of the tax system, which result in a lower tax burden for the taxpayer.
The measures adopted in order to identify tax privileged regimes are also applicable to connected companies.
With the 2008 financial act (law no. 244, 24 December 2007) , the criteria have been modified. In fact, according to the reformed art.168-bis ITC, the states or territories which allow an adequate exchange of information and provide a level of taxation which is not considerably lower than the Italian one will be indicated in an appropriate white list. This new system will be implemented by the issuing of a ministerial decree, which will lay out the list.
Therefore when the decree will be issued, the black list will be substituted by a white list and the notion of privileged regimes, contained in articles 167 and 168, will be replaced with the states that are not included in the white list.
Until five years from the issuing of the decree the countries which are not part of the present black list will be considered part of the white list (in the meantime they will have to conform to the requirements contained in the latter) .
This turnaround involves that countries excluded from the current black list may not be included in the forthcoming white list, because unable to provide an adequate exchange of information.
It is believed that nothing obstructs the exclusion of a Member State of the European Union from the white list, as the law doesn't expressly deny this possibility. For the possible consequences of such exclusion, see paragraph 8.

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[300] Resolution 21-09-2007, n. 262/E

5.ATTRIBUTION OF INCOME TO THE SHAREHOLDER OF THE CFC**Errore. Il segnalibro non è definito.**

5.1.

Errore. Il segnalibro non è definito. The application of the CFC legislation implies that the foreign income, even if not distributed, will form part of the taxable income of the Italian controlling person.

The income of the controlled foreign company is calculated (in order to avoid that the cfc benefits from the more favorable tax haven provisions) in accordance with the Italian rules governing the taxation of business income, indicated by paragraph 6 of article 167.

The profits of the cfc resulting from the balance sheet, drawn up according to the rules of the State where the privileged entity is located, must be adjusted on the basis of the ITC.

Instead, for connected foreign companies the provisions contained in paragraph 1 and 2 of article 168 will be applied.

Article 168, par. 2 of ITC, provides for the determination of the income of the connected entity for an amount equal to the higher between

- profit before tax as indicated in the financial statement of the CFC
- income determined on the basis of performance ratios(determined with reference to categories of goods pertaining to the assets of the entity)

The first criterion is probably due to the fact that it would be difficult for the controlling company to acquire the data and information necessary to apply the provisions of the ITC regarding income tax. Nonetheless, it may foreshadow the circumvention of Art. 167, as well as the erosion of the tax base[301].

The allocation of the income to the resident entities takes place at the end of the fiscal year of the cfc.

The foreign income is allocated by way of a look through attribution method to the Italian persons in amounts proportionate to the participation they hold, directly or indirectly, in the taxed privileged entities. Therefore, the profits made by the cfc are attributed pro-quota to the resident shareholders.

So, after having determined the income of the cfc, the stake attributed to the resident subject is calculated by referring to the share ownership.

The shareholders are taxed separately on the cfc income at the average tax rate, which cannot be lower than 27 per cent.

The taxation on a separate basis avoids confusion between the cfc's income and the profits of the controlling entity. Furthermore, if a parent company controls several foreign entities, it guarantees that the economic results of the various cfcs are considered separately.

Art. 3, par. 7 of the ministerial decree 429/2001 provides the disownment of behaviours enacted in order to reduce the taxable income of the cfc.

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[301] D. STEVANATO, *La delega fiscale e la CFC Legislation,* in *Il fisco,* n. 18, 2002, I, p. 2732.

It is not possible to transfer the losses of the cfc to the resident entity. Instead, the foreign company can carry forward its losses. Nonetheless, according to Art. 5, par. 3 of the Ministerial Decree 21 November 2001, the losses reduce the fiscally recognized value of the shares of the cfc (in case of transfer of shares which don't benefit from the participation exemption) .

Also taxes eventually paid in the CFC jurisdiction can be deducted from the tax levied in Italy on the CFC income. The deduction of these taxes is subject to the provisions concerning foreign tax credit.

The dividends received from the cfc are not subject to tax up to the amount which has already been taxed according to the CFC provisions.

The profits distributed by the cfc after the CFC legislation has come into force are excluded from taxation on the basis of paragraph 7 of article 167. While the dividends distributed by the cfc before the CFC legislation became effective maintain the original tax regulations.

5.2.Elimination of Double Taxation

The taxable income of the cfc will be subject to corporate income tax in Italy (paid by the controlling entity) and to the taxes paid by the cfc in the foreign state.

In order to avoid double taxation of the income of the cfc, the provisions contained in Art. 165 regarding foreign tax credit, are applied (with some adjustments) .

According to Art. 167 par. 6, the resident subject can deduct the definite income taxes supported abroad by the participated entity. Article 165, instead only refers to the taxes paid by the resident company. Therefore, in this case the provision is applied extensively. Since the cfc's income is allocated to the Italian entity, also the taxes paid by the foreign company can be deducted. So, an underlying tax credit is granted for the income taxes paid abroad by the participated entity [302].

Paragraph 7 of Art. 167 allows the deduction of the taxes which the controlling resident entity will pay in the tax privileged country when the dividends (already taxed by means of a look-through attribution) are distributed. Thus, the taxes paid in the foreign state on the dividends distributed by the cfc (which generally correspond to the withholding taxes applied in the source state) to the resident entity can be deducted according to Art. 165. Therefore, if the controlled company distributes the profits to its Italian controlling entity, the income which has already been taxed according to Art. 167, par. 1, will not form the tax base

Paragraph 7 provides for an ordinary credit, regulated by Art. 165.

In fact, the CFC legislation does not intend to punish resident subjects who invest in fiscally privileged regimes, but aims at preventing tax avoidance and deferral.

[302] Circular Assonime December 18 2000 n. 65, par. 2. 1. 2.

6. EXEMPTIONS

6.1.

Not all allocations of assets, activities or investments in fiscally privileged regimes are unlawful, but only those which lack a valid link with the foreign states and which therefore only aim at obtaining tax benefits. Thus the legislator will break the "corporate screen" only if the "rootedness" of the assets and activities is very modest. Instead, if there is a strong link with the foreign country, due to the production of goods, the presence of facilities adequate to the turnover, the application of the CFC legislation will not be justified.[303]

Therefore, the Italian CFC legislation envisages two alternative exemptions.

The first one concerns the type of activity carried out by the tax privileged entity. In fact, the legislation does not apply if the controlling company proves that the foreign entity carries out an industrial or commercial activity-as its main activity- in the country where it is resident or located.

The probationary requirement will be fulfilled if it is demonstrated that the cfc carries out commercial and industrial activities indicated by Article 2195 of the civil code (production of goods or services, intermediary, transport, financial or insurance activities). It has been pointed out[304] that all these activities must be "rooted" to the foreign country. This connection has to be attested by the existence of industrial establishments, facilities, local customers. Furthermore, the activity taken into account must be the cfc's main activity.

The business carried out has to be effective. According to the Ministerial Decree number 429 of 2001, there must be an organized structure suitable to allow the exercise of the activity, in fact, the foreign entity must be a company of substance. Therefore, the local market does not necessarily have to be the main destination of the cfc's economic output. Otherwise, the right of establishment would be violated, notwithstanding the existence of a genuine economic activity.

Nonetheless, in a recent Ministerial Resolution an opposite view has been stated.

In fact, with the Ministerial Resolution number 427/E of November 10 2008, the fiscal authorities pointed out that, in order to demonstrate the "rootedness" of the cfc, the existence of an organizational structure in the foreign State is not sufficient. So, for the exemption to be granted the local market should be the main outlet of the cfc's economic output.

The turnaround is justified on the basis of a Decision by the European Commission of February 13 2007.

However, some authors[305] believe that the Ministerial Resolution does not comply with the provisions of the ITC. Indeed the latter simply demand the existence of an adequate and effective organizational

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303 LUPI R., *Principi generali in tema di CFC e radicamento territoriale delle imprese,* in *Rassegna Tributaria,* 2000, VI, p. 1730-1739

304 LUPI R., *Principi generali in tema di CFC e radicamento territoriale delle imprese,* in *Rassegna Tributaria,* 2000, VI, p. 1730-1739

305 M. PIAZZA, S. SIMONTACCHI, *Senza mercato locale il Fisco applica la CFC,* in *Il sole 24 Ore,* 16 Febbraio 2009-N. 46

structure. Whether the goods or services are put forward for to the local market or to exportation is irrelevant. This interpretation would be confirmed by the parliamentary records, which unequivocally demonstrate that the legislator has intended to exclude the relevance of the local market. Moreover, these conclusions are supported by the judgement C-196/04, which stresses the genuineness of the economic activity, without requiring that the turnover is made in the foreign state.
As for the second exemption, it must be demonstrated that the CFC entity has not been created purely in order to allocate income in jurisdictions where it is subject to a privileged tax regime. The ratio of this exemption is to avoid the application of the CFC legislation to companies which have localized subsidiaries in black list countries for effective needs (and not in order to obtain tax benefits).
In order for the exemption to be granted, the resident entity must demonstrate that the income, allocated by way of a look through attribution method, has been subject to proper taxation. Therefore, the taxation levied must be comparable to the Italian one (by considering the tax rate and the general tax treatment).
For example, if an Italian entity indirectly controls a foreign corporation, situated in a black list country, by means of a company resident in a non privileged tax regime, it is possible that the income of the cfc is subject to proper taxation in the latter.
It is useful to recall the Ministerial Resolution number 63/E of March 28 2007, according to which the localization of shares in a tax privileged regime does not imply tax avoidance, if the tax treatment isn't substantially lower than the Italian one and there are no risks regarding lack of transparency (for the determination of the income) and an unjustified tax deferral.
The abovementioned resolution certainly marks a turning point in the interpretation of the anti-avoidance rules concerning controlled foreign companies.[306] In fact, it breaks with the restrictive approach which characterized the previous interventions of the tax administration. Indeed, in the past, the second exemption described by Art, 167, par. 5 of ITC was granted only if strict conditions were satisfied. According to Art. 5, par. 3 of the Ministerial Decree number 429 of 2001, it was necessary to demonstrate that at least 75% of the foreign company's income was produced in a State not included in the black list through a permanent establishment.
The author points out that in order to understand if a certain corporate structure aims at achieving elusive goals, it is necessary to consider the group's overall situation. Therefore, the taxation that the income is subject to along the links of the corporate chain must be taken into account.
With the Resolution no. 63/2007, the fiscal administration considers the overall fiscal burden crippling on the income produced by the cfc. Both the taxes paid in the black list country, and the taxes paid in other countries, when the income is distributed, are considered.

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[306] F. VITALE, *Disapplicazione della normativa CFC e localizzazione del reddito in Paesi a fiscalità privilegiata in una recente Risoluzione della Agenzia delle Entrate,* in *Rivista di diritto tributario,* 2007, V, p. 320-325.

With the Ministerial Resolution, the fiscal authorities state that the CFC legislation will not be applied (the second exemption described by Art. 167, par. 5 of ITC will be granted) if the overall taxes to which the income of the cfc is subject are at least equal to 27% of the cfc's profits.

However, according to the author, the predetermination of a threshold can be considered incoherent. In fact, the level of taxation results from both the tax rate and the way in which the tax base is calculated.

Thus the Resolution broadens the visual angle by considering the other companies part of the group, and abandoning a stifling view, which only considers the black listed company. In fact, the latter can either distribute dividends to its controlling companies or receive income from its subsidiaries.

Therefore, the fiscal administration believes that the objective of the second exemption described by Art. 167 is to guarantee that the foreign income is taxed properly at least once. The administration conceives the CFC legislation as an instrument to avoid tax deferral.

It is pointed out that the specification contained in Art. 5, par. 3 of the Ministerial Decree number 429 of 2001, only constitutes an example. Indeed, it is possible to demonstrate that the income has been subject to proper taxation, and that the cfc has not been created purely in order to allocate income in jurisdictions where it is subject to a privileged tax regime, by other means[307]. The fact that the provisions contained in the Ministerial Decree are not peremptory has been acknowledged by the financial administration as well.

6.2.The Tax Ruling

The Italian person who wants to benefit from these exemptions must request a tax ruling and the non-application of the provisions to the financial administration

The request of such ruling must be filed with the competent tax office in accordance with the procedure established in Art. 11 of Law no. 212 of July 27 2000. It must be asked before the presentation of the income tax return.

The filing of a ruling request has no effect on the usual statute limitation terms provided by the Italian tax law.

If the ruling is not requested and the requirements of the CFC legislation are fulfilled article 167 will be applied.

The petition may be presented by the taxpayers or by the subjects that fulfill the tax performances on their behalf.

The request must contain the following documentation:

- The data of the taxpayer
- The data of the cfc
- Indication of the domicile where communications by the fiscal administration must be delivered

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[307] STEVANATO D., *Valutazione del carico fiscale gravante sul gruppo per disapplicare la normativa CFC,* in *Corriere Tributario,* 2007, XXI, p. 1743-1746.

- Documentation apt to provide the evidence of the inapplicability of the CFC rules
- Signing of the taxpayer or his legal representative

The person who wants to take advantage of the exemptions may add other documents such as: the company act and statute of the cfc, a report describing the organization of the structure aimed at carrying out the main activity of the foreign controlled company or a report describing the structure of the permanent establishment localized in a state or in a territory included in the blacklist, fiscal and accounting documentation (such as the balance sheet and the tax income declaration) .

According to the Ministerial Decree of August 6 2006 the resident entities can ask for the non application of Art. 168 ITC by asking a ruling, which demonstrates the existence of one of the conditions provided for by Art. 167, par. 5.

The ruling must be released by the tax authorities within 120 (in case of companies and entities which, on 10 December 2000, were not operating in a country having a fiscal privileged regime) or 180 days (for companies and entities which on 10 December 2000 were operating in a country having a tax privileged regime) . If it isn't released within this period, it means that the tax authorities agree with the solution proposed by the taxpayer, therefore article 167 is not applicable.

If the ruling is positive, the tax authority won't be able to assess the controlling company on the basis of the CFC legislation, nor it will levy sanctions.

A positive answer by the financial administration will also be valid for the following tax periods, as long as, the circumstances and assumptions, on the basis of which it was granted, have not changed in the meantime. In this second case, the taxpayer can ask for a ruling again, but will only have to explain the circumstances that have changed.

7. COMPATIBILITY OF CFC-LEGISLATION WITH TAX TREATY LAW

7.1

. The Italian CFC legislation increases Italy's taxing power, as it constitutes an exception to the ordinary rule, according to which, dividends are taxed when collected.

These rules affect the taxing power of other states and therefore their legitimacy on an international level must be questioned.

In fact, there is a possible conflict between our CFC legislation and the conventions against double taxation, in particular with article 7 of the OECD model- acknowledged in all treaties concluded by Italy-according to which "The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.".

The Italian CFC legislation attributes income, produced and not distributed by a foreign company, in the hands of its controlling person even if there is no permanent establishment (a controlled company does not constitute a PE) .

Consequently, one may argue that CFC rules may not be enforced unless the tax treaty in question contains a clause that permits the application of the CFC rules. The Italian tax authorities, however, take the opposite view.

According to the Ministry of finance[308] Art. 7 of the OECD model cannot be invoked from the taxpayers resident in Italy, in order to avoid the application of the CFC legislation, as for the latter doesn't contrast with the provisions of the conventions. Therefore the legislation is applicable even if the conventions do not contain safeguard clauses.

Various arguments can be put forward to demonstrate either the compatibility of the CFC legislation with the conventions or its incompatibility.

7. 2. Arguments in favour of compatibility

With the report on harmful tax competition[309], the OECD stated that in order to fight harmful tax competition, the OECD model and commentary must be modified in order to remove any uncertainties regarding the compatibility of domestic anti-abuse provisions with the Model Tax Convention. Moreover, the fight against tax avoidance and evasion is one of the OECD's main objectives, so a provision which has these aims must be maintained effective. Therefore, the OECD states the compatibility between the CFC legislations and tax treaties and suggests the insertion of safeguard clauses in tax treaties.

The OECD supports the thesis according to which the CFC legislation subjects to tax the controlling subject resident in the state and not the income produced by a foreign entity. In fact, according to Art . 7, paragraph 10. 1 of the 2003 OECD Model Commentary: "tax so levied by a state on its own residents does not reduce the profits of the enterprise of the other State and may not, therefore, be said to have been levied on such profits".

In fact, the purpose of Art. 7, par. 1 is to limit the right of a contracting state to subject business profits of a company resident in another contracting state to tax; whereas it does not limit the right of a state to tax its residents according to the CFC legislation.

Also some scholars[310] believe that the CFC legislation does not subject the controlled foreign company to tax but the controlling subject resident in Italy. In fact, its taxable basis is expanded, as it also comprehends the cfc's income.

Art. 7 par.1 and art. 10 par. 5, instead, concern the company which is situated abroad.

In addition, the objective of the OECD model is the elimination of juridical double taxation. In fact, the introduction to the Model states that it "provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation". Since the CFC rules

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[308] Cfr, Ministerial Circular n.207/E November 16 2000

[309] OECD, *Harmful Tax Competition: An Emerging Global Issue*, Paris, 1998

[310] C. SACCHETTO - S. PLEBANI, *Compatibilità della legislazione CFC italiana con le norme convenzionali e con l'ordinamento comunitario*, in *Dir. Prat. Trib. Intern.,* 2002, p. 13 e ss.

can only generate economic double taxation, they would not be subject to the treaty provisions. Anyway, the Italian CFC legislation avoids economic double taxation, by granting an indirect tax credit equal to the taxes paid by the controlled entity in the State where it is resident.

Furthermore, Art. 10 of the OECD model admits the possibility of economic double taxation.

According to par. 37 of the Commentary, the abovementioned measures do not contrast with Art. 10 par. 5 because "the paragraph is confined to taxation at source and, thus, has no bearing on the taxation at residence under such legislation or rules. In addition the paragraph concerns only the taxation of the company and not that of the shareholder."

7. 3. Arguments in favour of incompatibility

According to other scholars[311], instead, there is a potential contrast between the CFC legislation and international tax treaties, in particular with Art. 7 of the OECD Model, which has been absorbed by all treaties concluded by Italy. In fact, the national provisions are applied outside the Italian territory.

Certain scholars[312] believe that, the pursuance of the Italian CFC legislation towards companies resident in countries with which Italy has concluded treaties against double taxation constitutes a form of treaty override, which distorts the division of taxing power. Therefore, it is necessary that the Italian courts deal with the problem concerning the compatibility between our legislation and the tax treaties, taking the conclusions reached by the French Conseil d' Etat into account (the Italian and French legislation are in a way similar). According to the same author, in the meantime Italy should insert a safeguard clause in tax treaties which will be concluded in the future.

These authors don't agree with the fact the avoidance of economic double taxation isn't part of the objectives of the OECD model. By interpreting art. 7 paragraph 1 and art. 10 paragraph 5, they infer that the principle of the deferral of the taxation of the income is accepted by the OECD.

Another contrast has been hypothesized between the CFC rules and Art. 10 paragraph 5 of the OECD Model, according to which: "Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State." In fact, controlled foreign companies legislations subject to tax profits which haven't been distributed.

The same argumentations cited for article 7 can be repeated for Article 10.

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311 S. MAYR, G. FORT, *Compatibilità delle norme "CFC" con le convenzioni internazionali,* in *Corriere Tributario,* 2001, IX, p. 646.

312 PISTONE P. , *Normativa CFC, convenzioni internazionali e diritto comunitario,* in *TributImpresa,* 2004, I, p.47-55.

In certain authors' opinion[313], the compatibility of the CFC legislation with the international conventions must be assessed on a case by case basis, as it is necessary to consider the features of the provisions in force in the various states. In fact, the characteristics and objectives of the national legislations must be taken into account. It is often possible to analyze the way that the national provisions and the international treaties interact by looking at the Constitutions of the various states.
For example, Art.117 of the Italian Constitution states that in exercising its legislative power Parliament must respect obligations rising from international conventions.

8. IMPACT OF EC LAW

8.1. Compatibility between the CFC legislation and the fundamental freedoms guaranteed by the EC Treaty.

The Italian CFC legislation can have an impact on EC law in two cases.
First of all if a resident entity controls a foreign company situated in a Member State which is included in the black list.
Companies and entities concerned by the Parent-Subsidiary directive and establishments situated in the European Union (except for the Luxembourgian holding companies, established by the law 31 July 1929, Malta and Cyprus) are not included in the Italian black list.
It is possible to question the compatibility of the Italian CFC legislation with the provisions contained in the European Community Treaty, in particular with the right of establishment (article 43) and the free movement of capital (article 56).
In fact, the imputation of the foreign subsidiary's profits directly to the domestic parent company makes the exercise of the right of establishment more burdensome.
Furthermore, the CFC legislation restricts the free movement of capital as it discourages capital flows. By allocating the income of participated companies situated in other member states to a resident shareholder, it limits the free movement of capital.
It is explained[314] that the application of the CFC provisions to a foreign company constituted in a tax privileged Member State implies that the foreign income, even if not distributed, will form part of the taxable income of the Italian controlling subjects.
Instead, if the parent company controls a subsidiary which is located in the Italian territory, it will benefit of the tax deferral, as the profits of the subsidiary will be taxed when distributed. Since there is no equivalent legislation concerning domestic companies, the cross-border investments are put at a disadvantage. Therefore, the CFC legislation can determine a restriction of the right of establishment.

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[313] P. BRACCO, *CFC legislation e trattati internazionali: le recenti integrazioni al commentario OCSE e il loro valore ermeneutico,* in *Rivista di diritto tributario,* 2002, II, p. 179-216

[314] C. SACCHETTO - S. PLEBANI, *Compatibilità della legislazione CFC italiana con le norme convenzionali e con l'ordinamento comunitario*, in *Dir. Prat. Trib. Intern.,* 2002, p. 13 e ss.

Nonetheless, some authors[315], stress that Articles 167 and 168 allow to eliminate International double taxation, thus removing one of the aspects of incompatibility. In order to benefit from the exemptions, the controlling subjects must ask for a ruling. This requirement may appear as a procedural restriction to the fundamental freedoms guaranteed by the treaty.
However, the Italian CFC legislation can also be applied in the case of indirect control of a black list company by means of an entity resident in a Member State, or if a company located in one of the Member States (controlled by an entity resident in Italy) has a permanent establishment in a country indicated in the black list. It has been pointed out[316] that in these cases the right of establishment is limited as well.
The anti-avoidance aims pursued by the Italian legislation fall within the public policy reasons which can justify restrictions to the freedoms guaranteed by the Treaty. Nonetheless, the fact that the income generated abroad by the cfc is allocated to the controlling entity, irrespective of the taxation it is subject to in the source state, could determine the application of the CFC legislation to cases in which the controlled company does not obtain any tax saving (thus the proportionality principle would not be satisfied) [317].
One of the main objectives of the Italian CFC legislation is the achievement of capital export neutrality, which has been acknowledged by the European Court of Justice. These restrictive provisions are justified as they aim at guaranteeing the cohesion of the tax system. Nonetheless, in order for the proportionality principle to be satisfied, it is necessary that the controlling subject can actually influence the repatriation of the cfc's income, that it does not subject to tax income which would not be taxed if attained by resident entities, and that it eliminates tax deferral.

8.2. Relation between the CFC legislation and the Parent-Subsidiary Directive

According to the Parent-Subsidiary Directive[318] the Member State in which a mother company is resident cannot tax the dividends distributed by its subsidiary localized in another Member State (unless it eliminates double taxation by giving the mother company the right to deduct the taxes paid by its subsidiary) .
The CFC legislation, instead, allocates the income of a controlled foreign company to its controlling entity. Therefore, the cfc's profits will be taxable in the State in which the participating subject is resident.

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[315] PISTONE P. , *Normativa CFC, convenzioni internazionali e diritto comunitario,* in *TributImpresa,* 2004, I, p.47-55.

[316]ROTONDARO C. , *Note minime in tema di compatibilità dei regime CFC con il diritto comunitario. Alcune riflessioni sul caso italiano,* in *Rivista di Diritto tributario,* 2000, p. 517

[317] C. SACCHETTO - S. PLEBANI, *Compatibilità della legislazione CFC italiana con le norme convenzionali e con l'ordinamento comunitario*, in *Dir. Prat. Trib. Intern.,* 2002, p. 13 e ss.

[318] Council Directive 90/435/EEC of July 23 1990

Certain authors believe[319] that the Italian CFC legislation is compatible with the abovementioned Directive, as according to paragraphs 6 and 7 of Art. 167 ITC, a credit is granted for the taxes paid abroad by the controlled entity. Therefore, our legislation conforms to the Directive's aims regarding the elimination of economic double taxation within the European Community.

8.3. CADBURY SCHWEPPES

In Cadbury Schweppes(C-196/04), the European Court of Justice stated the compatibility of the CFC legislation with the right of establishment, if applied to "wholly artificial arrangements, not reflecting economic reality", that is companies which lack economic substance and whose main purpose is the attainment of a fiscal advantage.

Therefore, "genuine relocation of economic activity, is no abuse of rights, but on the contrary, legitimate use of the internal market for the purposes for which it was intended…At any rate, automatic exclusion of categories of foreign subsidiaries without checking for individual artificiality is prohibited"[320]. In other words, if a genuine economic activity is carried out, the transfer of profits from the home state to low tax jurisdictions is allowed and the right of establishment cannot be limited. The ECJ has expressly confirmed that it is legitimate for tax considerations to play a role in the decision on where to establish a subsidiary.

Certain authors[321] have metaphorically described the right of establishment as "malleable". In fact, it takes account and tries to adapt to other principles. Anti-avoidance provisions can coexist with the right of establishment, by counterbalancing and correcting it. As a matter of fact, the State in which the mother company is resident can resort to anti-avoidance rules, if the controlled entities are "wholly artificial arrangements, not reflecting economic reality". Therefore, different interests must be balanced.

In the light of Cadbury Schweppes, we must ask ourselves if the Italian CFC legislation affects the freedom of establishment.

As mentioned before, the Italian legislation is applied towards companies resident in the countries indicated in the black list. The Member States included in the latter are Cyprus, Malta and Luxemburg (in relation to holding companies established by the law of 1929) . Furthermore, the CFC legislation is not applied if the resident entity is granted an exemption from the financial administration.

According to Art. 167, par. 5, letter a, the applicant must prove that the controlled entity carries out an industrial or commercial activity in the country where it is resident or located. Therefore, some scholars point out that the Italian CFC legislation allows the taxpayer to demonstrate that the cfc physically exists in terms of premises, staff and equipment, and therefore carries out a genuine economic activity in the territory of the host Member State. Consequently they believe that the Italian CFC legislation is

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319 C. SACCHETTO - S. PLEBANI, *Compatibilità della legislazione CFC italiana con le norme convenzionali e con l'ordinamento comunitario*, in *Dir. Prat. Trib. Intern.,* 2002, p. 13 e ss.

320 TERRA-WATTEL, *European Tax Law*, 2008, p.822

321 M. BEGHIN, *La sentenza Cadbury Schweppes e il "malleabile" principio della libertà di stabilimento,* in *Rassegna Tributaria,* 2007, III, p.983-993.

compatible with the right of establishment and responds to the requirements expressed by the European Court of Justice in Cadbury Schweppes[322].

Nonetheless, certain authors[323] believe that this exemption can be too restricted. In fact, a genuine economic activity is compatible both with the possession and administration of goods and with the carrying out of a main activity in a state different from the one in which the controlled company is located.

8. 4. Holding Companies

According to the European Commission, "objective factors for determining whether there is adequate substance include such verifiable criteria as the effective place of management and tangible presence of the establishment as well as the real commercial risk assumed by it. However, it is not altogether certain how those criteria may apply in respect of, for example, intra-group financial services and holding companies, whose activities generally do not require significant physical presence."[324]

The Italian Financial Administration expressed itself on the issue concerning holding companies with the Ministerial Resolution January 29 2003 number 18/E. The tax authorities considered that, with regard to financial holdings , the income (dividends and interests) resulting from the business activity (ownership of stocks) is generated in the State where the holding is located (because it is the place where the source of the income is situated) . Subsequently, the Circular no. 26/E of June 16 2004, reaffirmed this principle, by stating that the dividends received by a holding company are considered as produced in the place where the capital is located, that is the country in which the shareholder is resident.

Certain scholars[325] stress that this criterion contrasts with the ordinary methods used in order to localize passive income, which is usually considered as generated where the payer is resident (Art. 23, paragraph 1, letter b of ITC) . Furthermore, in the light of the aforementioned Ministerial Resolution no. 63 of 2007, this criterion must be revised. Moreover, the author believes that Resolution 18/E is irrational, because it penalises holding companies which are controlled by a resident entity, and, at the same, time control a company localized in a non privileged tax regime.

According to some authors [326], the fact that a sub-holding manages financial, organizational and accounting services (on payment) in its subsidiaries favour, may demonstrate the existence of an effective entrepreneurial activity in the country where it is located. In fact, if the holding company does

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[322] C. ROMANO, *L'utilizzazione dei paradisi fiscali nel diritto europeo: il caso Cadbury Schweppes e la disciplina in materia di società estere controllate,* in *Rivista di diritto tributario internazionale,* 2006, II, p. 141-154.

[323] MELIS G. – PERSIANI A. , *Sulle controllate estere i giudici Ue fissano la linea*, Il sole 24 ore, 2006

[324] Communication from the Commission 785/2007

[325] F. VITALE, *Disapplicazione della normativa CFC e localizzazione del reddito in Paesi a fiscalità privilegiata in una recente Risoluzione della Agenzia delle Entrate,* in *Rivista di diritto tributario ,* 2007, V, p. 320-325.

[326]STEVANATO D., *Valutazione del carico fiscale gravante sul gruppo per disapplicare la normativa CFC,* in *Corriere Tributario,* 2007, XXI, p. 1743-1746.

not merely limit its activity to a passive ownership of shares, it exercises an economic activity by supplying services (which are often complex) to the group. Therefore, the overall tax burden crippling on the group must be considered.

9. SWITCH-OVER CLAUSES

The Italian legal system does not provide for switch-over clauses, which generate a switch from the exemption to the credit method, thus increasing the taxing power of the resident states.
Therefore, the decision Columbus Container Services BVBA & CO (C-298/05), concerning the German CFC legislation providing for a switch-over from the exemption to credit for foreign direct investment exposed to less than 30% taxation abroad, has not had a significant impact on the Italian anti-deferral rules.

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Cattedra di Diritto Tributario

IMPLEMENTATION OF EC DIRECTIVES AND ANTI AVOIDANCE RULES

Roberta Piccinni

087203

INTRODUCTION

Art.2 of the EC Treaty contains the mission statement of the European Community in the form of a list of high Community objectives, such as harmonious and sustainable growth, full employment, social protection, competitiveness, cohesion, and solidarity, a better quality of life, etc. It also enumerates the means to reach these targets: the establishment of a common market and an economic and monetary union, and implementing the common policies and activities referred to in the Articles 3 and 4[327].

A common market requires, in particular, free movement of goods, services persons and capital, and the so-called "level playing field".

Europe suffers the lack of a fiscal legal order because of the lack of fiscal competence. There aren't European taxes in addition of Nationals [328].

Certainly is actually existing an European Tax law. It does not concern a real fiscal legal order but a legal system of rules involving the evolution and structure of Member States tax system in the light of European [329] objectives as before said.

This is due to Member States *"jealous"* defence of their power of imposition; they do not accept any interference by Community institutions. European tax policy was born in the Treaty as a *negative policy* [330] in order to prevent "*the four freedoms*" (of persons, capital, services and goods) from National measures which could frustrate them. It is forbidden to Member States to obstruct the "natural" allocation of factors of production or to discriminate among goods or services produced in other Member States.

European Community is not directly concerned with tax law, but only in the light of the objectives of Art 2. We can find the sole relevant disposition of this matter (a part from custom union which is explicitly provided in Articles 3 and 4) in the Third Section of the Treaty, (Articles 90-93) immediately after provisions about competition which means that they are referred not only to indirect tax and freedom of goods circulation, but also to every objective of Art 2 [331].

In EC Treaty there are other references to fiscal law system, as Articles, 23 ,58, 293, 299. In particular, Article 90 provides for the prohibition of tax discrimination on goods importation from other Member States. These provisions set *"negative limits"* about the European Community intervention, on the contrary Article 93 provides for the harmonization of National legislations about indirect taxes. There are no provisions in the treaty which refer to direct taxes.

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327 B.J.M.TERRA-P.J.WATTEL, *European tax law*, Alphen aan den Rijin,2008,p.3

328 F. ROCCATAGLIATA, *Diritto tributario comunitario*, in Corso di diritto tributario internazionale,Uckmar, Padova CEDAM, 2002

329 E. DIBOUT, *fiscalitè et construction europèenne: un paysage contrastè*, in *Revue des afaires Europènnes*, 1995, 5

330 F. ROCCATAGLIATA, *Diritto tributario comunitario,*p.1206.

331 FARMER PAUL-LYAL RICHARD, *EC Tax Law*, Oxford, II ed., 2004.

Articles 94 allows the Council to intervene when differences among Member States legislations could interfere with the single market. Member States are not free to choose the mean by which doing it .They are obliged to employ directives, which normally are not self-executing, they need implementation, requesting, in this way, the control of the National Parliament [332].

Article 293 of the EC Treaty requires Member States to enter into negotiations with each other in the aim to abolish double taxation within the Community. This was the basis on which Member States adopted the arbitration convention.

Thanks to European Court Justice and national Judges, these few tax dispositions are becoming increasingly important. The ECJ often affirmed that the Treaty provision have to be considered as self executing when there is risk of damage of fundamental freedoms.

According to Italian scholars [333] *unification* is different from *coordination* of national legislations, the first one is executed by regulations, the second one by directives. *Harmonization* is in halfway between the two previous concepts; according to part of the scholars [334] it is the specific application in fiscal area of *"draw near"*. Actually the EC Treaty applies the terms *"harmonization"* and *"draw in"* indistinctly. It is necessary to specify that the Art. 93 limits the harmonization to indirect tax; for what concern direct tax they are subject to Art 94 (draw near) because they traditionally constitute the mean by which Member States realized their fiscal policy.

Numerous attempt to reach the harmonization were done since 1962 with *"Neumark report"*. Few objectives were achieved. Only two acts are worth remembering: EC Directive 77/779 (about assistance) and EC Regulation 2137/85 (EEIG), in addition in 1985 was adopted the white book on fulfillment of common market. The differences on direct tax influenced the decision of international investors increasing the phenomenon of "investments localization".

On 20th April 1990, EC Commission presented a *Communication* in which indicated its program of work giving more evidence to transnational cooperation because economic advantages of Common Market are achievable only by the growth of transnational activities. Obviously it appeared necessary to eliminate some obstacles: tax on capital gain resulting by merger, division etc; double taxation on dividends distributed by a subsidiary to the non-resident Parent company; tax on transnational royalties and interest paid by the subsidiary to the non-resident parent company.

On July 1990 by the agreement of the Council were approved :

- EC Directive 90/434 OJEC, L 225-1, 20th August 1990 (Merger Directive)

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332 F. ROCCATAGLIATA, *Diritto tributario comunitario*, in Corso di diritto tributario internazionale, Padova CEDAM, 2002

333 C. SACCHETTO, *L'armonizzazione nella Comunità Europea*, in *Dir. Prat. Trib.*,1989, 564.

334 D.WAELBROECK, *L'harmonisation des regles techniques dens la CEE*, Bruxelles, 1988, 250ss. A different thesis is sustained by Victor Uckmar, *Progetti e possibili soluzioni dell'armonizzazione fiscale dell'UE*, in Dir. Prat. Trib., 1995, 9 according to whom "harmonization" has not a technical legal meaning but it is only a more general concept than "draw near".

- EC Directive 90/435 OJEC, L 225-1, 20th August 1990(Parent-Subsidiary) modified by EC Directive 2005/19.

Recently other provisions were approved , such as

- EC Directive 2003/48 (Interest on savings Directive)
- EC Directive 2003/49 (Interest & Royalties Directive)

1 Council directive 90/434 EEC

Taxation of unrealized capital gains, tax-free reserves among the assets transferred or shares exchanged or the lack of possibility to neutralise not yet exhausted losses from previous tax years connected to the transferred business. These are some of the problems that could raise from a merger operation. For domestic mergers Member States in general allow some sort of tax deferral or the carrying over of losses in the course of a domestic merger.

On the other hand cross-border merger are typically unfavourable in comparison with domestic ones from the fiscal point of view. Obviously this is an impediment for cross-border company and group of company expansion.

For this reason the EC decided to step in. The Council of the EC on 23 July 1990 adopted Directive 90/434/EC "on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member state [335]".

Domestics mergers are not involved. They continue to be subjected to national law. The directive provides some benefits or tax breaks. But there is a strong limit specified in Art 11 (a). A Member State could reject to apply the favourable disposition or revoke benefits when the operation has the principal or one of its principal objectives in tax avoidance or tax evasion. If there are not valid economic reasons in the operation there is a presumption of tax avoidance or fiscal evasion.

In Italy the Fiscal Merger Directive 90/434 was implemented by Legislative Decree 544/1992. It is applicable in the operations listed in Art.2 , that involve companies resident in different EC Member States. 1) *Legal merger* :one or more companies transfer all of their assets and liabilities to another company. The transferring companies are dissolved without entering in liquidation. They legally "disappear"[336]; 2)*Legal division* : an existing company transfers all of its assets and liabilities to two or more newly incorporated or existing companies, which become its legal successors and the transferring company ceases to exist. In return the receiving companies issue shares to the shareholders in the

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[335] B.J.M.TERRA-P.J.WATTEL, *European tax law*, 2008,p.517

[336] The receiving company is the legal successor of the disappearing companies, issuing shares to the former shareholders in the disappearing companies in exchange for their shares in the disappearing companies. There are three subtype of such legal merger: a)one or more existing companies merge into another existing company; b)two or more existing companies merge into a company newly formed by them especially for that purpose; c)a wholly owned subsidiary collapses into its parent company. B.J.M.TERRA-P.J.WATTEL, *European tax law*, 2008,p523

disappearing company;[337] 3)*Transfer of assets* : an existing company transfers one or more branches of its activity to another existing or newly incorporated company, in consideration for which the receiving company issues shares to the other company. As a result they become Parent and subsidiary; 4) *Exchange of shares* The regulation is provided by President of Republic Decree 917/1986 (as modified firstly by Legislative Decree 544/1992 and then by Legislative Decree 199/2007 in implementation of Directive 90/343 and 05/56) in Articles 178-181 which define to which kind of companies this provision are applicable [338] and the regime. In particular Art 179, entitled *"fiscal neutrality"* provides the application of Articles 172 and 173 even in the operation listed in Art 178. Articles 172-173 contain the domestic operations regime; it means that cross-border division, merger etc, as specified by Art 178, are treated as domestic operation obeying to Art.4 Directive 90/434 according to which these operations shall not give rise to any taxation of capital gains to the extent the assets and liabilities transferred remain effectively connected to a permanent establishment in the State of their fiscal residence before the operation [339].

1.1. Anti avoidance rule

Like the Parent-Subsidiary Directive (art.1(2)) and the Interest and Royalty Directive (art.5) the Merger Directive includes a general anti abuse clause (art.11). It differs from the one in Parent-Subsidiary Directive, however, in that it also covers a perceived non-fiscal abuse, and contains a negative specification of fiscal abuse. The anti-avoidance rule was implemented by Legislative Decree 358/1997 that inserted in the President of Republic Decree 600/73 the Art 37-bis "anti-avoidance rules". The first paragraph of art 37-bis is quite similar to art 11 EC Directive 90/434. In fact, it contains the concept of "valid economic reasons". The acts, facts and trades (concerning mergers, divisions, transfers of assets and other specific operations)without valid economic reasons with the aim of tax avoidance are not opposable to the tax office. So it would enforce the taxes avoided applying common procedures. According to the last paragraph the taxpayer can demonstrate that the operation involved are not done in the aim of tax avoidance so the tax office would not apply the anti-avoidance rule. The ruling procedure consist of an express request of the taxpayer to the tax office and an analytical description of the operation recording the law dispositions that he ask not to apply. Obviously this reverse of burden of proof weighting on the taxpayers makes more unfavourable his position. It is

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[337] The 2005 amendment introduced the *"partial division"(*it is a vehicle for the formation of an SE). An existing company, without being dissolved, transfers one or more branches of its activity to one or more separated new or existing companies in Exchange for shares to be issued by the receiving companies to its shareholders. The "drop-down" division is not covered by that provision: the receiving companies issue their shares not to the transferring company, but to the shareholders of the transferring company. A drop-down division is covered by transfer of assets.

[338] The provisions of Art 178 are applicable to a) Mergers among s.p.a., s.r.l., s.a.p.a., cooperatives, mutual companies, public and private bodies which exercises commercial activity resident in Italy and non-resident subjects . b) Division among the same subjects c)transfer of assets among the same subjects d) exchange of shares among the same subjects.

subject to full judicial review. On the other hand, according to Italian scholar [340], the benefits granted by the community law trough the directive 90/434 have to be assured by the Member State except in the case of operation without an economic valid reason. For this reason Member States can provide some presumptions, respecting the principle of proportionality. So they cannot absolutely exclude some case from the spread of the EC Directive using, for example, a general provision. Proportionality principle means that the restrictions on taxpayers have to be not more heavy than necessary to reach the aim of the law [341]. The European Court Justice assert that it is not sufficient setting general principles to distinguish between allowable operation and not-allowable ones, it is necessary an singular analysis of each case, and the possibility to ask the judge (as in Italy).

The concept of "*valid commercial reasons*" was developed by Anglo-American jurisprudence. To know whether an economic operation (merger, division etc...) has valid commercial reasons it is necessary a global analysis because, often ,they are composed by other under-operation that appears legally only if individually taken, but globally it lose this requirement.

According to Italian scholar there are "valid commercial reasons" when the operation takes additional, not fiscal, utility as the restructuring or rationalization of the activities of the companies participating[342]. It is a "*concept involving more than the attainment of a purely fiscal advantage".*

In order for an operation not to run the risk of being considered abusive, there must be non-incidental non-fiscal reasons for it, but that if such genuine business reasons are present, there is no abuse to be found in structuring the operation so as to attract the smallest possible tax exposure. "*Any tax advantage resulting for providers of services from the law taxation to which they are subject in the member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State*" [343]. According to Italian scholar the application of art. 37-bis [344] to cross-border transfer of shares is not effective in order to prevent from fiscal abuse especially after the extensive interpretation of "valid commercial reasons" [345] of the European Court Justice. For this reason, in this particular case it would be

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339 The P.E. requirement ensures that the state within whose jurisdiction the unrealized gains have accrued , retains jurisdiction over the assets to which the as unrealized gains connect. B.J.M.TERRA-P.J.WATTEL, *European tax law*, 2008, p. 537

340 M. RAVEZZI,R*egime comunitario delle fusioni di società e scambio di azioni*, in *Dir. Prat. Trib*. 1998 III p.274-279

341 M. RAVEZZI, *Regime comunitario delle fusioni di società e scambio di azioni*.

342 G. MARINO,*Conferimento transfrontaliero di partecipazioni*; in *Rass. Trib*.,II, 1999, p.403-421

343 B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008,p.556

344 G. MARINO, *conferimento transfrontaliero di partecipazioni*, in *Rass. Trib*. 2/1999

345 P.PICCONE FERRAROTTI Actually the concept of "valid commercial reasons" in Art 37-bis is autonomous and evaluable regardless of tax law.on the contrary in the light of Art 11 EC Directive 90/434 it would represent a presumption of tax avoidance. For this reason it would be that the legislator in Art 37-bis ,in the limit of operation involved in Legislative Decree 544/1992, exceeded European Directive provisions

applicable art 37 (3) P.R.D 600/73 [346] because it allows to tax the operation on the company which receives the shares without waiting for distribution of dividends to the transferring company. Although this provision is too difficult to apply. Therefore somebody suggested to apply Art. 87 (3) T.U.I.R.[347].

1.2 C-28/95 Leur-Bloem

In Leur-Bloem case the Netherlands legislation of implementation of the EC Directive 90/434 was involved. The legislator chose to apply the same rules either to cross-border operation and domestic ones. The case concerned a domestic operation. Advocate-General Jacobs advised the court not to answer the substantive questions, considering them to be outside the Court's task as defined in Article 234. In spite of that, the ECJ affirmed its jurisdiction because it involved EC principles. This was the first question. The most relevant was the second: if the exchange of shares of L.B. was a merger (with exchange of shares), so she would benefit of an exemption (as L.B. sustained) or not (as in the opinion of tax inspector). Mrs Leur-Bloem would be the sole director/shareholder in the holding. Economically nothing would change, except for the creation of horizontal loss offsetting possibilities. The company in which Mrs Leur-Bloem would became the sole director was just an holding. It did not meet the Netherland's requirement of carrying on an active business which is durably united both financially and economically with the business of its subsidiaries. Deferral of tax was therefore denied.

According to the ECJ the community law is not too precise so Member State are free to determine the way of implementation in respect of proportionality principle. It is not possible to exclude a priori some kind of operation from the benefits without an individual evaluation (it would go too far from the necessary) or to entrust the administrative discretion. The aim of the directive is the creation of a neutral tax system so the companies could improve their international competitiveness and productivity. The simple aim of fiscal advantage as horizontal loss offsetting does not justify the non-application of the directive [348]. In Italian doctrine opinion a restructuring through shares exchange which involved an holding just constituted with any company yet controlled could be considered an operation with valid economic reasons. A fortiori it is reasonable even the transfer of shares in a just pre-existing holding with a real economic-financial activity. The Directive does not contain any mention about the residence State of shareholders nor on their *status,* for this reason in concern of exchange of shares it should be applicable also to corporations, to partnerships, individuals and other subjects even if they are not entrepreneurs. That was confirmed by ECJ. On the contrary, in Italy, the Directive was implemented with a restriction: at least one of the shareholders have to be resident in

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[346] It is a subjective anti-avoidance clause. It provides that in case of weighty and precises presumption of effective possession of income on a taxpayer, when it appears that they belong to others, (possession through a third party), these incomes are taxable on the effective owner. But Italian law does not provide a definition of *"effective owner"* . Art 37 (3) provide to the Fiscal Office the mean by which leave aside "form" affirming the prevalence of *"substance over form"*.

[347] Testo Unico sulle Imposte sui Redditi, D.P.R. 917/1986, about taxes on incomes.

Italy, or the share exchanged has to concern a non resident company with a permanent establishment in Italy.[349]

In Leur-Bloem the ECJ states that if the operation will be temporary there is a tax avoidance. On the contrary in this case the company structure is not transitional so it would be applicable the directive.

On the other hand even if the structure had a limited life time because it is for economic reasons that in a given moment in the life of a company legal restructuring of the structure would be necessary. Independently from the subjective element that driven the taxpayer.

Under Italian law the concepts of *"carrying on business"* and *"permanent merger"* are related to *"valid and commercial reasons"*. As before said it is necessary to prove that the operation is not carried out only or primarily for tax avoidance purpose; having also affirmed that this point concerns a case-by-case analysis, as a result it is not possible to affirm that in absence of a carrying on business or a permanent merger the operation will not benefit of Directive advantages. On the other hand these concept would arise to presumption of valid commercial reasons of art 11, even if it is always necessary to permit to demonstrate the contrary. The Directive requests only "economic reason" not a particular kind of reason, so it would includes also temporary and transitional operations. What is more it is not even necessary to carry on business because, according to Italian scholar [350] also this case could be justified by an economic reason. In conclusion all depends on the demonstration of Art. 37-bis.

1.3 C-43/00 Randers sport

As Netherlands, even Denmark chose to apply the same treatment both to cross-border and domestic merger, division, etc…

Even in this case the ECJ affirmed its jurisdiction.

The judge of the principal judgment asked whether Article 2 of EC Directive would be interpreted in the sense of being a "transfer of assets" when the capital of the funding rests in the hands of the transferring company and the passivity are transferred on the beneficiary.

Article 2 "transfer of assets shall mean an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer", moreover "branch of activity" shall mean all the *asset and liabilities of a division of a company which from an organizational point of view constitute an independent business, that is to say an entity capable of functioning by its own means*". The concept is the same of Italian "line of business" (ramo d'azienda). The Italian law of implementation of Article 2 of the directive is applicable to transfer of business or line of business between subjects resident in different Member States.

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348 E. MINOZZI,*Norme nazionali di rinvio al diritto comunitario per la disciplina di situazioni puramente interne e competenza della Corte di Giustizia*, in *Dir. Prat. Trib*. 1998, II, p.1091-1117

349 R. LUPI, *Rass. Trib*., 1997, p. 1265 e ss and D. STEVANATO, in *Corr. Trib*. 1997, p. 3666 ss

350 P. PISTONE, *Uguaglianza, discriminazione a rovescio e normativa antiabuso in ambito comunitario*, in *Dir. Prat. Trib*., III, 1998 p. 581-622

There is no reason, neither in logical order nor in legal order, to forbid to parties excluding from the transfer some element of the assets. In fact the directive makes a referral to "all the asset and liability" as a complex capable of functioning by its own means".

Although the ECJ interprets the statement as all the elements of the assets (none excluded) should be transferred. In its opinion the lack of one of the elements forbids to consider the operation as a "transfer of assets" and to apply the directive.

Our scholars [351] and jurisprudence don't share the Court decision because it is different from directive provisions of Article 2.

In Italy parties can exclude some element of the assets with the only limit that the transferred elements are sufficient and able to function by itself. So we distinguish between "necessary elements" and "auxiliary elements" depending on whether they are essential or not for its functioning, for this reason some elements would be excluded from the transfer on condition that it does not compromise the *economic business unit* of the branch of activities. That criterion is the same of art. 2 that requires only organizational autonomy of the branch of activities and its capacity "*of functioning by its own means"*.

Therefore, it appears contradictory to believe that without cash transfer it is not a "transfer of assets" asset up in Directive 90/434. There is no reason to think that the transfer of a debt with the rest of assets and liabilities harms the capacity of autonomously functioning by its own means. What is more, branch of activities are frequently transferred with the compression of assets, assigning to the receiver company some debts because it is often more convenient from an economic point of view [352].

1.4 C-321/05 Kofoed

Case 321/05 concerns monetary payment made by an acquiring company to the shareholders of the acquired company. According to the European Court Justice it would not be classified as a "cash payment" for the purpose of Art 2(d) of the Directive 90/434 merely because of a certain temporal or other type of link to the acquisition, or possible fraudulent intent. On the contrary, it is necessary to ascertain in each case, having regard to the circumstances as a whole, whether the payment in question has the characteristics of binding consideration for the acquisition. A dividend paid by an acquiring company to shareholders of the acquired company shortly after the exchange of shares, but not forming an integral part of the consideration payable by the acquiring company, is not to be included in the calculation of the "cash payment" provided for in Article 2(d) of Directive 90/434.

Art 11 (1)(a) states that Member States may refuse to apply or withdraw the benefit of all or any part of the provisions of that directive when the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives. But, as in the case under analysis, when the national law of the State involved does not contain any specific provision according to European Court Justice *" taxation of the exchange of shares in question may be justified if national law contains a provision or general principle*

[351] D. STEVANATO, *Sulla configurabilità del conferimento d'attivo*,in *Rass. Trib*. II 2002

[352] For an efficient management of activities in view of transfer of the receiver company or a branch of its activity. D. STEVANATO, in *Sulla configurabilità del conferimento d'attivo.*

prohibiting abuse of rights or other provisions on tax evasion or tax avoidance" which might be interpreted in according with art. 11 of the Directive 90/434.
All authorities of a Member State, in applying national law, are required to interpret it as far as possible in the light of the wording and purpose of Community directives in order to achieve the result pursued by those directives.
The solution of the ECJ transposed in Italian jurisdiction would give as result a condemnation because of the presence of Art 37-bis[353] in the Legislative Decree 600/1973, an "anti-avoidance rule" that prevent from abuse of law.
This matter was recently tackled by Italian Corte di Cassazione, in judgment 2008 n° 30057 and 2009 n°1465. In the last one the question involved was a problem of tax avoidance which date back in a moment when art 37-bis were not yet came into force. So the situation is similar to Kofoed. In the opinion of the Court there is no lap between "fiscal advantage" and "abuse of law". To sanction an operation it is requested that the particular advantage achieved would be in contrast with the aim of fiscal provision, or, to be more precise, in the goal of getting an illegitimate tax saving (abusive advantage). There is no abuse where there is no deflection from the actual aim of law. This conclusion was reached thanks to our constitutional provisions. In sentence n°30057 the Court stated that the prohibition to take undue advantages from the distorted (though not contrary to any specific provision) use of legal instruments to achieve a tax saving in absence of appreciable economic reasons to justify the operation, is an unwritten general principle of Italian system applicable based on Article 53 of the Constitution according to which *"All are required to contribute to public expenses in accordance with his means. The tax system is based on criteria of progression".*
This provision is not directly connected with tax abuse but it is a parameter (above all the first paragraph) to commensurate the burden of taxes. In this context, according to our Court, it would be the parameter to check whether there is an illegitimate tax saving or not.

2 Council directive 90/435 EEC

Two tax problem may arise where a subsidiary company in one State distributes its profit to its parent company in another state:

- the State of establishment of the subsidiary may levy a withholding tax on outbound dividends
- the State of establishment of the parent company may include the incoming dividend in the taxable income of the parent company, leading to economic double taxation of the profit out of which the dividends were paid, once in the hands of the subsidiary and once in the hands of the parent

[353] It is an "anti-avoidance rules". Written in the light of art 11 EC Directive 90/434, it contains the concept of "valid economic reasons". The acts, facts and trades (concerning mergers, divisions, transfers of assets and other specific operations)without valid economic reasons with the aim of tax avoidance are not opposable to the tax office. According to the last paragraph the taxpayer can demonstrate that the operation involved are not done in the aim of tax avoidance so the tax office would not apply the anti-avoidance rule.

The need to encourage the development of cross-border activities by avoiding the double taxation of dividends has brought on July 23th 1990 the adoption of Directive 90/435 [354] which introduced common rules for the distribution of profits between Parent companies and Subsidiaries established in different Member States. It seeks to abolish both tax impediments to cross-border payment of dividends within group of companies, thus improving the functioning of the internal market, especially the free movement of capital and the freedom of establishment. The Preamble to the Directive states that it is aimed at eliminating the disadvantages of cooperation between companies within one Member State, and facilitating the cross-border grouping together of companies within the EC. The directive applies only to cross-border situation (art. 1).

In the light of these objectives the Directives provided that:

- intragroup cross-border payments of dividend must be exempted from withholding tax by the Member State of the Subsidiary (Art.5)
- the Member State of the recipient parent company must either refrain from taxing the incoming dividend altogether (exemption method), or tax it, but in that case credit, against the parent's corporation tax, the corporation tax already paid by the subsidiary in its Member State (indirect credit; credit for underlying tax) (Art.4)

In order to be eligible for the Directive benefits, a taxpayer must be both a company of a Member State and Parent or a Subsidiary company. Art. 2 defines "company of a member State" and Art. 3 sets the "Parent" and "Subsidiary" requirements. It requires two conditions to be satisfied:

- *Minimum Holding* (gradually lower) The Parent have to hold at least 15% (as of January 2009 at least 10%) of the capital of the subsidiary. The 2003 amendment reduced the original 25% holding requirement to 20% as per 1th January 2005 and to 15% as per January 2007 [355].
- *Minimum holding period* possession for an uninterrupted period of at least two years.

Italy has implemented the Directive under consideration by the Legislative Decree 163/1993, which introduced Article 96-bis of CITA which provides, met certain requirements, does not contribute to the

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354 It took the Council more than 20 years to adopt the Directive. The Commission tabled its first proposal on 16th January 1969. The adopted Directive is more modest in aim than the Commission proposal; it thus differs from earlier versions in several respects. In the first place, the adopted version provided for some transitional exceptions to the ban on dividend withholding tax for the benefit of three MS. All of these exception are now expired and have since 2004 been deleted from the directive. By contrast a new exception on Estonia was introduced on the occasion of the accession of ten new Member States in 2004. Secondly the adopted Directive does not make a choice between capital import neutrality (CIN) and capital export neutrality (CEN). The original proposal was based on CIN, requiring the State of the Parent company to exempt incoming subsidiary dividends. The adopted version leaves Member State a choice between exemption and credit . Finally in the 1969 proposal a 20% holding was sufficient for the parent-subsidiary status, whereas the adopted version was in keeping with the 25% threshold contained in the widely used OECD Model Double Taxation Convention. Since 1st January 2007, however, a 15% holding suffices. The amending Directive came in force in February 2004 and had to be transformed into national law by 1st January 2005. The Parent-Subsidiary Directive was then amended upon the accession of Bulgaria and Romania in order to include their corporation tax in Art 2. B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008, p. 475-477.

355 The Member States remain free to grant Parent-Subsidiary status also to companies affiliated by smaller shareholding. (art. 3)

entire income of the company the 95% of dividends received from a EC subsidiary , and Art 27-bis of D.P.R. 600/73 provides for the rebate of tax on dividends distributed to non-residents or exemption. As a consequence of the reform of the national tax system through the Legislative Decree 344/2003, the exemption of dividends has been extended (under Article 89 of Consolidated Income Tax Act, C.I.T.A.) to the stakes held both in resident and in non-resident companies [356] (on condition that the State of residence is not a "tax heaven"; tax heavens States are specifically identified by a decree of the Attorney General).

According to article 1 (2) of Council Directive 90/435 EEC Member State have a certain discretionary power to apply domestic or treaty-based anti-abuse provisions in derogation of the substantive rules of the Directive. It means that Member States may limit the Directive benefits in specific cases of abuse which could not be anticipated by the Community legislator.
Many Member States introduced or maintained national provisions in order to specify the concept of "*bona fide*" in the context of anti-abuse legislation. Consequently, all the business structure with the requested characteristics can benefit from the directive.
The process of implementation of EC directive has to be done in respect of all the principle of EC law. For this reason the introduction of anti-abuse provision by each Member State must be in accordance with the *proportionality principle*, not more restrictive than necessary to reach their aim but sufficient to strike the abuse. "*The abuse must be real, and the companies involved must at least have an opportunity to rebut, under judicial review, any legal presumption of abuse, by demonstrating their transactions although possibly entering the scope of anti abuse provision, nevertheless served bona fide business purposes*[357] ".
In Italy the Directive 90/435 EEC was implemented by Legislative Decree 136/1993. To avoid juridical double taxation there are not withholding tax on dividends distributed by Italian subsidiary to the parent company located in another Member State. On the other hand economic double taxation is avoided by credit or exemption in the parent's company resident State . Obviously there are some conditions to benefit of this treatment
In particular, for what is concerned with anti-abuse provision art 1 (2) is implemented by art. 27-bis of P.R.D. 600/73. The necessity is to avoid that companies resident in non-EC State could benefit of the exemption tax system by creating "conduit companies" in EC States. From that point of view the Parent company has to prove that the subsidiary was not founded exclusively or primarily for this aim . The procedure is provided in Art 11 Law 413/1991.
The provision contains an inversion of the burden of proof. Regularly it is due to the Tax Administration. Not in this case. But it is so difficult to give a negative proof, for this reason, it is

[356] C. GARBARINO, *diritto tributario comunitario*, in *Manuale di tassazione internazionale*, IPSOA 2008 , pp.774-775
[357] B.J.M.TERRA-P.J.WATTEL, *European tax law*, cit.,p.475

sufficient to give elements according to which it is reasonably understanding that the subsidiary was founded to exercise an effective economic activity.
On the contrary, there is no inversion of the burden of the proof if the parent company obtain the acceptation of the Financial administration by the procedure described in Art 21 L. 413/91.
The same procedure is requested for dividends distributed by Italian subsidiary to EC parent company.
Article 7(2) of Council directive 90/435 EEC provide that the directive is not intended to influence the enforcement of other agreement-based provision against double taxation. It creates problems concerning on which international agreement it is not prevalent. According to Italian doctrine there are two different case.1) The directive obviously does not prevail on International agreement with non-Member States. 2)On the other hand, there are some doubt for what is concerned with international agreement between ECMS. According to Community law the directives should be prevalent, but art 7(2) provide the contrary. Unfortunately there is no solution suggested to solve the problem[358].

2.1 Case C-168/01 Bosal
In C-168/2001 Bosal the ECJ affirmed that the Netherlands law contrasts either with the "freedom of establishment" and with the Council Directive 90/453. MS cannot deny expense deducibility. Actually the directive, in some way, allows that but this statement (Art 4(2)) could be implemented by MS always in respect of freedom of establishment. This is not the case of Netherlands.
According to Italian doctrine "territoriality" principle allows the deduction of costs for acquisition of shares whether profit are taxable in another Member State[359]. The same principle was used by the Court in another case (Futura Participation and Singer) but in this case it was considered not relevant[360]. Moreover, Art 4 provides only a faculty for MS. So they can opt for the denial of deduction only if they don't distinguish between resident subsidiary costs and non-resident subsidiary costs[361]. In the opinion ECJ this case involves the "coherence principle". This principle justifies a discrimination between resident subsidiary and non-resident subsidiary if it would regard 1)the same taxpayer; 2)there is a direct bond between fiscal advantages and a tax withdrawal; 3)it concerns the same tax. All these elements are necessary. if one of them is missed the discrimination is illegal as in the case of Netherlands[362].

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358 F. BOSELLO, *Giurisprudenza delle imposte*,2001, IV, pag 1155-1156

359 F. TESAURO, sulla *deducibilità dei costi inerenti a partecipazioni in consociate estere nella giurisprudenza comunitaria*, in *Giur. It*., 2004 p.1979-1980.

360 R. RAUCCI *dalla rigorosa applicazione delle libertà fondamentali alla continua interferenza comunitaria nelle regole fiscali nazionali:il caso Bosal*.,in *Dir. Prat. Trib. Int*. 2004 p.1149-1180

361 A. PIRI*, deducibilità dei costi di partecipazione*. In *Rass. Trib*.,2004,I,p.332-339.

362R. RAUCCI *dalla rigorosa applicazione delle libertà fondamentali alla continua interferenza comunitaria nelle regole fiscali nazionali:il caso Bosal*.,in *Dir. Prat. Trib. Int*. 2004 p.1149-1180

3 COUNCIL DIRECTIVE 03/49 EC

An initial proposal for a directive concerning taxation of interest and royalties between companies of the same group of different Member States was presented by the Commission at the end of 1990 [363]. Though this project was included in 1992 among the measures to be taken as a priority in the completion of the Single Market, the Council failed to reach an agreement and the proposal was finally withdrawn. Subsequently, the Commission presented a new proposal, which was largely incorporated into Directive 2003/49 adopted by the Ecofin Council of 3rd June 2003. It is one of the measures which together with the proposal for a directive on savings and the code of conduct on business taxation, forms *"Monti package"* a group of tax measures introduced in 1997 to pursue tax competition . the implementation period was half a year: national law of the 15 Member States had to be adapted to the Directive by 1st January 2004. Three States (Greece, Spain and Portugal, were temporarily allowed to maintain a withholding tax for budgetary reasons.

Also in Directive 2003/49 the problem involved is double taxation of cross-border income flows. The first EC measure to that effect was the abolition of withholding taxes on intragroup cross-border dividend payments (Parent-Subsidiary Directive). Two other type of cross-border flows of intragroup income were still hindered by withholding taxes, however: interest and royalty payment. Withholding taxes on cross-border interest and royalty payment between companies pose less problem than withholding taxes on dividends, because, unlike dividend payments, interest and royalty payment are deductible from the taxable profit of the debtor company.

The Directive "Interest & Royalty" was implemented in Italy by the Legislative Decree 143/2005 (G.U. n.172 of 26th July 2005) which introduced an innovative regime. Before L.D. 143/2005 interest and royalties payment were subjected to withholding tax, or to particular benefit drawing from Agreements (which in general consisted in reduction not in removal of the withholding tax).

The introduced provisions stated that it was applicable to interest and royalties *"matured"* since 1st January 2004. On the contrary the criterion used by the directive is the moment of *"payment",* for this reason, after an infringement procedure, Italy eliminated the contrast by Decree 10/2007. Paid withholding taxes have to be paid back to beneficiaries of interests or royalties by compensation (Art. 17 Legislative Decree 241/1997).

Directive "Interest-Royalty" eliminates double taxation on interest paid on the transnational level between EU companies by abolishing the withholding tax and giving power to tax to the State of residence of the beneficiary.

The basic rule of the Directive is laid down in Article 1 (1): *" Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that state, whether by deduction at source or by*

[363] After the adoption of the Parent-Subsidiary Directive in July 1990 the Commission submitted a Directive proposal in December 1990 to abolish withholding taxes on interest and royalty payments within groups of companies. The Ruding Comette and the Commission urged the Council to adopt it, which happened only in 2003, as part of the adoption of the "package of three" to tackle harmful tax competition. The original proposal was withdrawn by the commission at the end of 1994 for lack of agreement within the Council.

assessment, provided that the beneficial owner of the interest or royalties is a company of another Member State of a company of a Member State".

The Directive does not involve taxation of interest and royalties in beneficiary residence State, Article 1 (9) provides *" nothing in this Article shall prevent a Member State from taking interest or royalties received by its companies, by permanent establishment of its companies or by permanent establishments situated in that State into account when applying its tax law".*

Article 5 "fraud and abuse" is a wide and general anti-abuse reservation. It provides that the directive does not preclude the *"application of domestic or agreement based provisions required for the prevention of fraud abuse",* nor does it preclude the Member States withdrawing the benefit or refusing to apply the directive *"in the case of transactions for which the principal motive or one of the principal motives is tax-evasion, tax-avoidance, or abuse".* The wording of paragraph I is a literal rendition of Art. I(2) of the Parent-Subsidiary Directive, and it is therefore expected the ECJ to apply in the same manner as the latter anti-abuse reservation. The second paragraph does not appear in the Parent-Subsidiary Directive, but resembles and is a better framing of the first part of Art II(I)(a) of the Merger Directive. There are little differences between the various anti-abuse provisions in the different corporate Directives but they may be applied in the same restrictive manner as the anti-abuse provision of Merger Directive involved in the case Leur-Bloem (see paragraph 1.2). The ECJ concentrates on object and purpose of the Directive and on the appropriateness and the proportionality of the national or bilateral anti-abuse measure at issues. It tends to prohibit automatic exclusion of categories of suspect cases and into instead require individual assessment of both intent of the economic operator and objective effect of transaction. Unclear is how far Member State may go in reversing the burden of proof as regard presence or absence of valid commercial reasons for transactions (see paragraph 1.1). The general anti-abuse clauses in the three corporate tax Directive do not add too much to the discretion the Member State already have under the Court's general "abuse of right".

In Article 5, Member States find a legal basis for anti-base erosion rules and for limitation benefit, measures ensuring that the ultimate recipient of the interest or royalty is a Community resident, provided they are specifically targeted at abusive schemes. The Court only accepts disqualification of "wholly artificial arrangements[364]".

To be granted an exemption from restraint, as required by the new Article 26-c (1 (a)), P.R.D. 600/1973, the companies that make payments (on interest and royalties) shall have their fiscal residence in the territory of the State, and shall be subjected (without any exemption) to IRES (Italian Corporate Tax). What is more they shall have the form[365] requested in the attachment. The legal forms required

[364] B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008,p.622

[365] Relevant juridical forms are contained in attachment "A" to the decree,which was written on the basis of the attachment to the Directive 03/49.

are: Corporations(S.p.a, S.r.l., S.a.p.a.,) public and private entities whose sole or principal object the performance of business, resident in Italy.[366]

At first sight the requirements requested are the same of EC Directive 90/435.

The exemption also applies to payments made by a permanent establishment ,situated in the territory of the State, of a company resident in another EU member state, provided that it is of the legal forms required by the Legislative Decree and meets other requirements. For the application of the exemption, the it is necessary that additional requirements are met. in particular, Article 26-quater (4 (b)) of CITA provides that interest and royalties paid to non-residents are subject to a tax listed letter "a" of that paragraph 4. It is asked that these incomes are effectively taxed on beneficiaries, in the purpose of removing double taxation on cross-border payments ensuring at the same time that they are subject to taxation in the state of residence of the beneficiary. It is also necessary that the non-resident companies receiving royalties and interest or permanent establishments of such company situated in another Member State, are actual recipients of income. With this intent, the law states that the companies shall be deemed the beneficial owner of interest or royalty payments they receive as a benefit and not as an intermediary, as agent, trustee or nominee of an 'other person. is therefore not possible to exclude the nature of beneficial owner in companies that meet the above criteria. In respect to permanent establishments, the requirement under consideration is satisfied with the claim, the right or use of information that generate payments of interest or royalties is effectively referred to such permanent establishments, and such interest or royalties are income for which they are subjected, in the Member State where they are located, to a tax expressly contemplated in the legislation, or a tax identical or substantially similar application in addition to or in place of those taxes.[367]

4 COUNCIL DIRECTIVE 03/48 EC

On the contrary of Parent-Subsidiary or Interest & Saving EC Directives, the Interest on Saving Directive does not focuses on removal of double taxation. The aim is to provide information about destination of interest on Saving.

Directive 2003/48 (in OJ L 157 of 26 June 2003) aims to ensure, through information exchange, the effective taxation (in the State of residence of the perceiver) of his income from savings (in particular the interests) paid in one Member State to an individual resident in another Member State.

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[366] the solution adopted on the legal form would have the effect of excluding from the benefits of the Directive payments made or received by companies incorporated in the form of Societas Europaea (SE) or European Cooperative Society (SCE). The Commission presented on December 30th a proposal to update the attachment to enlarge the legal forms of subjects to which the directive shall be applied and the introduction of the condition according to which the exemption is up only to the beneficial owner who is actually subject to tax on interest and royalties payments .(art.1 of the proposal) the amendment, inspired by anti-abuse purposes, is in particular related to the case where the beneficiary, although subject to corporation tax, however, take advantage of a special national tax scheme exempting interest payments and royalties received from abroad.

[367] C. GARBARINO, *manuale di tassazione internazionale*,pp.480-482, IPSOA, 2008.

In Italy the Directive was implemented by the Legislative Decree
Article 1 of the Directive states that the purpose of the measure is "to enable savings income, in the form of interest payments in a Member State to beneficial owners, who are individuals resident in another Member State, to be subject to an effective taxation in accordance with the laws of that State".[368]
The scope of the directive appears limited as it confined to interest payments made by a *"paying agent"* in one of Member State to a "*beneficial owner*" being an *individual* resident of another Member State, therefore to intra-EC cross-border situations. However the directive must be applied irrespective of the source of the interest. It focuses not on source but on where payment are "made" to the beneficial owner. Therefore, whether the debt-claim producing interest was issues inside or outside the EC and where the legal debtor is located are in themselves irrelevant. Decisive is whether the paying agent is usually either the debtor himself or a bank or a financial intermediary.
The paying agent is required to gather the information listed in article 8 (identity, residence and account numbers of the recipients, coordinates of the paying agent, and amount of the payments) and to communicate it to the tax authorities of its State of establishment, which must in turn automatically exchange that information, at least once a year and within six month from the closing of fiscal year, with the tax authorities of the Member States of residence of the beneficial owner of the payments.(art. 9)
The ultimate aim of the Directive is clearly stated both in paragraph 8 of its recitals and in art.1 (1) : effective taxation of EU-sourced saving interest in the home State of individual recipient through exchange of information. Ultimately, all Member States will be required to make interest payers in their territory provide information to the tax authorities, to be exchanged automatically with the tax authorities of the States of residence of the individuals entitled to the interest payments.
The Directive does not preclude Member State from levying withholding taxes according to their national laws, especially not from requiring the debtor to withhold tax, as long as they also exchange the required information with the residence State of the beneficial owner. It does not seem very likely , however, that a Member State would want to operate two different systems alongside each other: an information exchange system and a debtor-type withholding tax system.
For good measures, it is stressed that the retention of Luxemburg, Belgium or Austria on interest payments received by a resident of another Member State in no way relieves the beneficial owner from his obligations to declare the interest in his tax return and to pay income tax on it.
Where tax was withheld by the source state, Art 14 (2) requires the resident State of the beneficial owner to prevent double taxation by crediting the withholding tax against his individual income tax . if the source State withholding tax exceeds the beneficial owner's tax exposure in respect of the interest, his home state must refund the excess. This provision seems to imply that the residence State is

[368] C. GARBARINO, *manuale di tassazione internazionale*,2008

repaying tax levied by the Source State, but that is not so, as, indeed, the source State is required to remit the 75% of its tax revenue on the interest payments to the residence State.
For anti-avoidance reasons, paragraph 2 of Article 14 extends the definition of "paying agent" to any EC-based entity receiving interest, except where such entity is a separate legal person subject to business taxation itself, or a UCITS (undertaking for collective investment in transferable securities), which came under the regular definition(any economic operator)[369]. Member States feared that the Directive Provisions would be circumvented by interposition between the beneficial owner and the economic operator of fiscally transparent entities such as trust, partnership or portfolio investment clubs, which are not under comparable fiscal scrutiny as regular banks . the economic operator paying to these entities would not be a "paying agent" any more, at least it would not be paying to the beneficial owner, and would therefore not be required to comply with the Directive. Art. 14 (2) makes sure that in such a situation, the obligations of the "paying agent" are shifted from the economic operator to the entity concerned. Entities thus caught, may opt to be treated as a UCTIS (therefore as a regular paying agent).

The over discussed concept of "beneficial owner" got origin from USA. The original meaning is too different from the up-to-date because of the numerous meaning now linked. The major difference insist between common law and civil law. According to the first one the property is a bundle of autonomous rights. In civil law there is a different kind of composition of this bound. That is due to differences insisting between some regulatory scheme such as *"Life estate*" and *"Residual life estate*" . in Italy there are a "*limited property right*" and a *"partial right on someone else's real estate"*. On the other hand in common law both the *legal owner* and the *beneficiary* have the property.
In the context of OECD model there are various interpretation of the "beneficial ownership". Problem arises also for what is concerned the autonomy level of the concept from domestic law,. Worldwide doctrine is now divided on this point.
In the opinion of Italian doctrine it would be better to give an autonomous interpretation in order to build an unique notion even if this aim is dangerous for civil law because of the prevalence of common law States inside OCSE.
For this reason it would be better to apply it only if expressly provided.
In Italy this provision is contained in 1)international Treaty with Germany and 2) EC Directive 2003/48.
In the first one the beneficial owner is the subject that receive dividends, interests, royalties if it is the holder of the right for which he receive payments and the holder of income. The concept in both Italy and Germany is the same in order to avoid different applications.

According to directive 03/48 it is the subject who receive interest payment on his behalf. The advantages is due to the fact that the provision is referred only to interest paid to individual resident in a different Member State from the payer.
Moreover art. 3 provides the same subsidiary criterion of the OCSE model to determine the effective tax domicile. By the way art. 4 allows Member State to check the requesting characteristics on them[370].
In the light of Directive 03/48 in the aim of combat tax avoidance are provided many rules to identify the beneficial owner.[371] The paying agent is required, if it has indications that the receiving individual is not the beneficial owner of the payment, and not representing a legal person either, to take reasonable steps to identify the beneficial owner. If he is unable to identify the beneficial owner, it must consider the receiving individual to be the beneficial owner. (art 4(2))
In summary, the definition of "beneficial owner" is framed such that an individual receiving an interest payment is presumed to be the beneficial owner unless he either demonstrates that he is representing a legal person or identifies the ultimate beneficial owner. This has been done to minimize the administrative burden on the paying agents.

5 ABUSE OF LAW

According to European Court of Justice Art. 43 CE prevents Member States from limiting the deduction of interests on loans granted by a parent company resident in another Member State but not on loans granted by a resident company.
In case 524/04 the High Court of Justice of England and Wales asked the ECJ about the compatibility of UK legislation with Art. 43 EC.
At first the ECJ observed that the UK law involves group of companies for this reason it is strictly connected with freedom of establishment (as in *Cadbury Schweppes*). In some circumstances interest on loans paid to a company of the same group would be considered dividends, so they are not deductible. Actually it depends on the residence State of the Company moneylender. They are not deductible only if the Parent company is not resident. This is a clearly violation of freedom of establishment because it discourage foreign companies from investment, buy-out, creation or conservation of Subsidiary in UK.
The restriction of freedom of establishment is proved without checking whether some companies have actually gave up this kind of operation on UK Subsidiaries.
This raw deal between resident and non resident Parent company is not justified by necessity of system coherence even if it is appropriate to reach the aim of preventing tax avoidance on profits produced in UK.

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[370] P. PISTONE, *l'abuso nel diritto tributario internazionale*, cap. XXII, in Diritto tributario internazionale, 3 ed, Padova, CEDAM,p. 851-872

The ECJ gave an equivalent solution about the case of loans granted by a foreign company subject to the control of the same foreign Parent company of the UK subsidiary [372].
The adoption of remedies is a national judge duty because individual rights ascribed by EC law are involved. In particular the MS must compensate tax payer for damages due to violations of Community law when it ascribe individual rights, the violation is enough defined and there is a direct causal link between the violation of law and damages. It is also requested a correct behaviour of the tax payers (avoiding bigger damages).
In Italy we no longer have a thin capitalization provision. Although before the reform the provisions were applied until proved otherwise.
In a more general prospective of abuse of law problems still arise in connection with tax avoidance. As before said, we have a general anti-avoidance provision placed in art 37-bis in P.R.D. 600/1973. For particular case are also set specific provision as art. 27-bis of P.R.D. 600/73 (which implemented art. 1(2) 90/435 Council Directive), art 26-quater (4(c)) of C.I.T.A. (which implemented art. 5 Council Directive 2003/49).
Recently, as before said, our Corte di Cassazione faced the problem of abuse of law, in particular of how we can distinguish between allowable and abusive operations. The first important judgment of this Court was the 30056/2008 (very similar to 30055/2008) in which it was stated that there is a general anti-avoidance principle, clarifying that the source of this principle, concerning non-harmonized taxes, such as direct taxation, is not community case law but constitutional principles about tax system (art. 53; art.23; art 3).
In fact the principles *of ability to pay* (article 53 (1)) and *progressivity of taxation system* (Art.53 (2)) form the foundation of both the tax rules in the strict sense and rules which assigns advantages or benefits of any kind to taxpayers, given that the latter are especially aimed at full implementation of those principles. For this reason the principle that the taxpayer cannot obtain tax advantages from the distorted use of legal instruments to obtain a tax saving (in the absence of appreciable economic reasons to justify the operation, other than the mere expectation of that tax savings) cannot be regarded as a derivation of the constitutional provisions (even if this behavior is not in contrast with any specific provision). The specific anti-avoidance provisions are not incompatible with the existence of a general anti-avoidance principle, on the contrary they are a mere symptom of its existence. It cannot be considered in contrast with the *statutory reserve* (riserva di legge) of Article 23 of the Constitution because the recognition of a general prohibition of abuse of the right does not create additional tax that do not derive from the law, but the denial of the effects of illegal shops with the sole purpose of avoiding the application of tax rules.
As recognized in sentence 25374/08 of the same Court, the same principle is applicable also in different legal areas; sentence number 23726/07 could be an example of that.

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372 Le disposizioni nazionali che fanno dipendere l'applicazione del trattamento fiscale favorevole dalla sede del contribuente contrastano con il trattato ce, Dir. Com. Scamb. Int., 2007, p 519-520

What is more the exemption linked to abusive operations and favorable would be get also by the tax office.
According to the Court abuse *"constitutes indeed a way to bypass the tax law, using shapes and patterns legally admitted, and there is a closed relation between the conduct allegedly elusive and the application of mechanisms of compensation and deduction, so implying that the two phenomena cannot be assessed independently from each other".*
It is up to the court to qualify the behavior as abusive or not, taking into account and respecting the principles of the tax system.
As far as concern Italian scholar [373] Art. 37-bis introduces two different concept : *"the getting around"* of law prohibition and duties and the *"valid economic reasons".*
The first one regard the getting around of legal principles by behaviors which at first sight could appear legal but they are actually heading for the achievement of fiscal advantages in contrast with legal system. It is a necessary, but not sufficient condition to complete the abusive character of the operation. It is needed also the second element, to be more precise it is requested the absence of *"valid economic reasons"* . This character becomes relevant only after the check of the first one; there is no tax avoidance whether the operation in discussion carries out a tax advantage in contrast with law principles, in the purpose of a valid economic (non exclusive fiscal) reason. The result have to be compared to the applicable regime in absence of the operation involved, or in presence of a different operation.
It is necessary to underline that not all the fiscal advantages are undue, only the advantages achieved by the getting round of legal system. So the less fiscally expensive choice is not always abusive [374].

6 ENFORCEMENT OF TAXPAYER RIGHTS

Case C-101/05 Skatteverket v. A. involved an individual ,resident in Sweden, who owned a shareholding in a Switzerland resident company.(Switzerland does not belong to the EEA). He received, as dividend, shares of a subsidiary of the Swiss parent company. This transaction, whether carried out by a Sweden company, or by another company resident in EEA State, or in a State with which Sweden drew up a Treaty against double taxation which provide exchange of information, would have been exempted. For this reason the Sweden taxpayer asked to the Sweden tax Commission to benefit of the same treatment of above. The tax office agreed because, in its opinion even if the exemption does not arise from Sweden law (as the Treaty Switzerland-Sweden does not provide any duty of exchange of information) it was, however, a consequence of the freedom of the free movements of capitals provided by Article 56 EU Treaty. Otherwise the restriction of this freedom, in

[373] D. STEVANATO, *Uso e abuso della clausola antielusiva*, in *Corr. Trib*. 24, 2007, p.1962-1966

[374] "getting round" (in Italian "aggiramento") litterally means the moving around, the trick of the law without manifestly break it. It is included in the category of abuse of law (in fraudem legis vero qui, salvis verbis, legis sententiam eius circumvenit). Not every situation in which the tax payer chose the more convenient alternative, should be considered abusive, nor the behavior justified only by fiscal reason without a valid economic aim. D. STEVANATO, *Uso e abuso della clausola antielusiva*,cit. p. 26.

the light of the necessity of tax control when Directive 77/799 EEC [375] (Assistance Directive which provides exchange of informations either about direct and indirect taxes) is not applicable, would be not proportionate in regard of the objective above all because the bilateral agreement allows to obtain necessary information for the enforcement of domestic la. What is more the tax payer had the possibility to demonstrate the presence of law condition to benefit of the exemption. The Sweden tax office contested this decision because, in its opinion, the provisions on free movement of capitals, in regard of relationship between Member States and Third States legitimates however a restriction towards those Third State which do not allow exchange of information. This is justified by the aim of grant tax control.
The ECJ was requested to pronounce about this. In its opinion EC Treaty forbid all restriction to free movement of capital, either among Member States, and Third State. It was underlined the concept of "restriction of free movement of capitals". According to Sweden tax office it does not have the same meaning in regard of relationship between Member State their selves ,and with Third State, because, in the last case there is no aim to realize the singular market. On the other hand the application would realize only a one-side liberalization by European Community in advantaging Third State without any mutual support. The Court did not share this opinion. Art. 56 forbids measures that put off non resident from investing in a Member State, or put off resident from investing in another Member State. In this case Sweden domestic law deny the exemption on dividend distributed by non EEA resident companies (which does not allow exchange of information) to Sweden shareholders. It put off Sweden resident from investing in non EEC resident companies.[376]
Art 58 EU Treaty provide the possibility to adopt all necessary measure to avoid domestic law breaking. the ECJ often justified some restriction with the necessity to assure the regularity of tax control, as long as the restriction is proportional with this aim. Otherwise , in this case, according to the Court it is possible to deny the more favourable tax treatment when it is difficult to receive necessary information from the non EC State.
Italy provides an exemption also on dividends distributed by non resident companies either they are set in EC Member State and in non EC Member State as long as it does not concern "black listed" States. According to Law 244/2007 the exemption of 95%, provided by the already mentioned Art. 89 of CITA[377], concerns only profit which came from companies resident in "white listed" States[378]. For

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[375] According to Art 11 EC Directive 77/799 The foregoing provisions shall not affect the rules that provide more extensive obligations than those arising from other instruments on the exchange of information. Community provisions governing exchange of information shall also apply in not harmonized tax area because of the necessity of assurance of correct market working. This disposition contrast with more restrictive bilateral International Agreements which could limit the Exchange of information.

[376] ECJ retained applicable the exception of Art. 57 n.1 EU Treaty, because the restriction of Sweden law was already existent up to 31st December 1993. D. STEVANATO, *l'efficacia dei controlli fiscali giustifica le restrizioni ai movimenti di capitali con Paesi terzi*, in *Corr. Trib.*,7/2008, p 557

[377] See par. 2 "Council Directive 90/435.

this reason the more favourable treatment would be denied also to ordinary tax level State when they do not provide a suitable exchange of informations. This new provision would fall into same problems of *Statteverket v. A.* case because it would be considered in contrast with Art.56 EU Treaty which is applicable also to capital movements among Member States and non EEA States. On the other and Art 56 and 58 EU Treaty do not forbid the denial of the exemption on dividend distributed by non European companies when the exemption is subjected to conditions that could be verified only by information provided by the foreign State. But this is not Italian case because the 95% exemption on dividend is no subjected to any condition. Only foreign source dividends are excluded from this treatment when distributed by company resident in *"black listed"* state. According to Italian scholar there are not justifications in limiting this benefit to dividend coming from States which do not assure information exchange on the sole basis of law tax level given that this is a legal condition known by the State. Probably, in this case it would be necessary to provide information on the actuality of the taxation of profits. This information would be provided also by the taxpayer. Therefore there is no reason to appeal the exchange of information with the foreign tax Authority as the sole mean by which the information requested(in order to verify the existence of condition for the application of the exemption) are provided.

7 TAX COMPETITION

Many Member States apply some sort of legislation on controlled foreign companies (CFC legislation) in order to pre-empt profit transfers from the tax jurisdiction of the home State of the group to low tax jurisdictions. The mechanism involves the disregard of the separate legal personality of foreign low-tax, law-substance (usually passive investment and finance) subsidiaries and usually consists of either imputation of the foreign subsidiary's profits directly to the domestic parent company (treating the CFC as a branch), or taxing a deemed dividend in the hands of the parent.

Case C-196/04, *Cadbury Schweppes* concerned the application of the UK CFC legislation to Irish low-taxed [379]group finance subsidiaries. There were provided several exception but none was applicable to Cadbury Schweppes's Irish subsidiaries, which were thus deemed to have distributed their profits to their UK parent. The question thus arising is whether branches of non resident companies must be given national treatment by the host State: does the freedom of establishment preclude the Parent company State from taxing a non resident subsidiary's profits as it were a non resident branch of a resident company? The Court found a discrimination in contravention of Art. 43 of the EC treaty because parents of domestic subsidiaries were not taxed for their subsidiaries results. It also depends on whether a good enough and proportionate justification was available for the different treatment in the

[378] States which allow Exchange of information even if they provide tax level not much lowera than Italy. D. STEVANATO, *l'efficacia dei controlli fiscali giustifica le restrizioni ai movimenti di capitali con Paesi terzi*, in *Corr. Trib*.,7/2008, p 557

[379] For UK CFC purposes, "low tax" means less than three quarters of the UK corporation tax level. B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008,p.820

cross-border position. The UK pleaded the need to prevent tax avoidance. The Court was not entirely convinced. The main drift of the judgment is that genuine relocation of economic activity is no abuse of rights, but on the contrary legitimate use of internal market for the purpose for which it was intended. At any rate, automatic exclusion of categories of foreign subsidiaries (law-tax, non-trading, non-quoted, non-distributing) without checking for individual artificiality is prohibited. The CFC rules are acceptable in so far if they would catch "wholly artificial arrangements". In this case Cadbury Schweppes subsidiaries seemed to have more substance and presence than just a" letterbox". It involves tax competition.

Member states trying to attract economic activity by being more tax efficient than other States. There is nothing wrong with this if it means offering the best possible infrastructure and public services at the lowest possible tax cost, both on labour within the general tax structure. However tax competition may also take the form of special tax scheme, derogating from the general tax system, such as tax holidays , selective base or rate deduction or other tax breaks not normally available, which are designed solely to undercut competition in a certain sector, usually mobile capital[380].

Tax competition between EU Member States has been quite visible, notably in special tax schemes applied by many Member State for financial and co-ordination centres, distribution centres and intermediate holding companies of multinational groups, and various sorts of special tax break. About tax competition there are two opinion 1) it is necessary to keep national government on their toes to be tax efficient. Prohibiting policy competition at EC level or co-ordinating it at a intergovernmental level amounts to a protective distortion of sanitary interjurisdictional tax competition, it amounts to interstate cartel-making; 2) it constitutes economically counterproductive sponging on other Member State budgets; it leads to fiscal degradation.

Both approaches may have their merits, depending on the nature and the external effects of the specific national tax incentive at issues. Harmful tax competition is commonly understood to exist where Member States damage each other's budgets rather than to help create economic activities. Harmful competition became an important issue on the political agenda in the nineties of last century, not only in the EC, but also in OECD, which in 1998 starts bullying tax havens and banking secrecy jurisdictions.

General exclusion from tax benefits of an entire category of cross-border cases for possible abuse is prohibited as the ECJ stated. In case C-294/97 *Eurowings* and case C-196/04 *Cadbury Schweppes* it was affirmed that Member States may not penalize the use of tax low regimes in other jurisdictions, as long as the economic activity is genuine. Cadbury Schweppes concerns a controlled group financing subsidiary of a UK group benefiting from the special law tax IFSC regime in Ireland. The UK applying its CFC legislation taxed the UK parent for the subsidiary profits on an arising basis as if it were a

[380] The latter form of tax competition is counterproductive from an internal market point of view in that it, on balance, does not create economic opportunity and activity, but merely drains activity from one jurisdiction to another, at high cost for the drained State, and to less benefit for the draining State. B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008

branch, crediting the corporation tax paid in Ireland. The court apparently did not consider relevant that they were benefiting from a special law tax regime, regarded as a State aid by the Commission, and stuck to its *"wholly artificial arrangements"* test: however controlled the subsidiary and however suspect its tax regime, if its establishment and economic activities are genuine, than no restriction of the freedom of establishment is acceptable for prevention of abuse.

As the ECJ affirmed in the light of Community law *"wholly artificial arrangements"* cannot benefit of the Treaty which has the aim of develop actual and effective economic forms of establishment in another Member State.[381] In respect of the principles of proportionality the legal presumption of "artificiality" shall be connected with the possibility of proving the absence of elusive aims. According to ECJ the resident company is the company which boasts the best position.

In Italy Art. 167 CITA makes the taxpayer able to prove that the controlled company manage an effective industrial or commercial activity as main activity, in the State where it has its legal head office. This provision has the features requested by EC law[382].

In "*Columbus Container*" C-298/05 was involved the freedom of establishment of German resident, it was a limitation in outlet, on the contrary in the case C-524/04 Thin Cap GLO it was a restriction in entrance. National law discouraged and obstructed freedom of establishment as granted by EC Treaty.

This condition was due to provision of the bilateral Treaty between Germany and Belgium which provided exemption on income produced by German resident by permanent establishment in Belgium. Although , another German law (Aubensteuergesetz 1992), provides that when the withdrawal on foreign incomes is less than 30% in the source State, there is no exemption but credit.

In the opinion of taxpayers the domestic law which replaced the exemption method (provided by a bilateral agreement between Germany and Belgium) with credit would have the effect to makes cross-border activity less attractive. What is more the elimination of fiscal advantage (credit, on the contrary of exemption does not block off a more favourable foreign tax regime, but it adjust the foreign taxation level to domestic) was a violation of Art. 43 EU Treaty (freedom of establishment).[383] According to national judge there was also a violation of freedom of capital movement because these provisions discourage German resident from foreign investments without having any justification.

ECJ was asked to verify whether these provisions were unfitting with EC Treaty.[384] The pronounce of the Court underlines some important principles.

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[381] G. MELIS –A. PERSIANI, *sulle controllate estere i giudici Ue fissano la linea*, in *Il Sole 24 ore*, 2006

[382] This prove could appear too limited because of the effective activity would be compatible either with the detention and management of goods and with an activity leaded in a different State from that of the subsidiary. [382] G. MELIS – A. PERSIANI, *sulle controllate estere i giudici Ue fissano la linea*, in *Il Sole 24 ore*, 2006

[383] According to taxpayers there was also a violation of the bilateral agreement but as the Court affirmed this aspect is not under ECJ jurisdiction because of it does not involve Europen Community issues. D. STEVANATO, *tassazione delle partnership e libertà di stabilimento*, in *Corr. Trib.* , 4/2008

[384] G. D'ANGELO, Commento alla sentenza 298/05, Fisconline, banca dati tributaria

Member State are free to determine incomes tax method in the aim to avoid double taxation (in particular by agreements) in respect of the of Community law.
There were applicable also provisions concerning freedom of establishment. In particular the Court distinguished between *"freedom of establishment"* and *"non-restriction"* principles[385]: art. 43 concerns domestic legislation of the *"host"* State and provides that shall be provided the same treatment either to residents and non residents. On the other hand it concerns also the domestic law of the State of *"guest"* investors, it is forbidden to discourage the establishment of a citizen or of a resident company. German law does not discriminate between resident partnership incomes and non-resident ones. There were no disadvantage for a German resident to establish in another Member State through a participation into a non resident partnership, given that its income would be taxable in the same level of income of resident partnership.
According to taxpayers, problems arise also in concern of investment instruments; infacts, using a company(Italian *società di capitali*) instead of a partnership (Italian *società di persone*) the lower level of Belgium taxation would be definitive. The court affirmed that Art. 43 provided only to treat in the same manner national company with foreign activities and similar activities conducted on National territory. In this case it was respected.(The comparison would be between resident partnerships incomes and non resident partnership incomes).
In the ECJ case law the violation of freedom of establishment presupposes a discriminatory treatment (to make an example of *non restriction* principle, the residence State should not makes less attractive foreign investments than a domestic ones).
Otherwise the court affirmed the discretion of Member State to choose the criteria to coordinate partnerships and partners taxation. For this reason also the credit method is allowable. It is irrelevant that the result is an equal taxation of domestic participation incomes.
According to the Court the credit method does not discriminate against foreign investment as compared to domestic ones and therefore there is not unfavourable treatment of the Columbus participants as compared to participants in domestic partnership.
This case is similar to *Cadbury (*C-196/04) in fact as CFC legislation repeals the treaty in part. Foreign income produced by residents are taxed differently depending on source State tax regime. But in that case the ECJ considered positively the distinction ,even if contra freedom of establishment, because of its function of contrasting abuse of law. The solution of ECJ in this case was the same. There is no discrimination among residents who produce income by a Permanent Establishment or by German Partnership in regime of transparency

8 TAX TREATMENT OF LOSSES

Case C-446/03 *Marks & Spencer II*, concerned losses incurred by the French, German and Belgian subsidiaries of the UK-based Marks and Spencer group. The defence argued that the UK should allow

deduction of the foreign subsidiaries losses by the UK parent, since the UK also allowed deduction of losses of foreign branches and losses of UK subsidiaries through group loss carry-over rules which were limited, however, to domestic group companies. The Court affirmed that there was a discrimination under Art. 43-48 of the EC Treaty on the basis of comparison with the domestic group loss-carry over rules. On the contrary of the case C-168/01, *Bosal Holding BV*, in which strict equal treatment was required of foreign and domestic subsidiary results, irrespective of whether that would cause serious interjurisdictional mismatching of losses and profits, the Court this time accepted that in principle, there was a justification for avoiding such a mismatch by way of a difference in treatment, being the need for jurisdictional coherence[386], as losses belong in the same jurisdiction as where the corresponding profits are subject to tax, which is the subsidiary State.

The first principle involved in this Case, to which UK made reference is *territoriality principle*. From this point of view not just the foreign tax base, but the entire taxpayer was not subject to UK taxing jurisdiction. According to UK and the other State which presented observations, the discrimination was not in contrast with the Treaty, it is justified by the difference of the situation depending on the fact that the subsidiaries were or not resident in the same state of the parent company. They does not have tax jurisdiction on the Member State of the subsidiary[387]. What is more income and losses are two side of the same coin so they would be subject to a symmetric treatment, therefore on the one hand income of non resident would be non-taxable on the other hand the impossibility to carry over in parent residence State; otherwise the losses could be considered twice (double losses deduction) in addiction of a risk of tax evasion because of it is more convenient to transfer losses to high tax jurisdiction.

The Court explored whether this objectives could be pursued trough less restrictive measures. In its opinion UK measures were excessive than necessary to reach its aim in particular when the non resident subsidiary, has not or no more the possibility to carry out losses in its residence State. For this reason, according to ECJ opinion, when the parent company succeeded to demonstrate the existence of this conditions to national tax authorities , it would be in contrast with art 43-48 of EC Treaty not to allow the carrying out of losses of the non resident subsidiary.

This solution request a difficult case by case analysis of the treatment of this losses in the subsidiary residence State. The parent company has to take charge of this possibility for the subsidiary. In this way it is set a principle of " territorial precedence" in carry out of losses. They would be firstly carried over in the state in which the activity is conduct , and only if it is impossible it would be done in the parent residence state.

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385 D. STEVANATO, *tassazione delle partnership e libertà di stabilimento*, in *Corr. Trib.* , 4/2008

386 "Symmetry in the same tax system"; "balanced allocation of the power to tax". B.J.M.TERRA-P.J.WATTEL, *European tax law*,2008

387 Income of non-resident company of the group are taxable, when produced, only in its residence State. The parent residence State can tax this profits only when received as dividends. (a part from the case in which they are exempted, so taxable only in the source State) D. STEVANATO, *Libertà di stabilimento e consolidato fiscale "europeo"* in *Corr. Trib*. 4/2006, p. 289

It make illegitimate ipso facto all the jurisdiction in which it is possible the domestic group tax relief but it is forbidden to offset of losses of foreign companies. The last one shall be admitted at least subordinating it to the miss of carry out of losses of subsidiary in its residence State.[388]

In Italy there is a consolidating international system of either losses and profits of subsidiaries. According to Italian scholar it is necessary, in the light of the ECJ case law, to tax in the parent State of future income of the subsidiary until overlay of transferred losses; otherwise the parent company would deduct losses of foreign companies but not the profits.

The theoretical tax system outlined by the ECJ, inspired to the *capital export neutrality* principle, it burden the weight of losses of the foreign company to the tax office of the parent, with no opportunity to recapture these losses. The Court, in fact, did not accepted the suggestion to subordinate the deduction of losses to the condition of their reinstatement into the future taxable income of the company which benefited of the compensation until the amount of reinstated losses.

Member States may, however, subordinate the recognition of losses of foreign affiliates to the condition of restoration, without be accused of having introduced a measure too restrictive

In the year in which the subsidiary suffer a loss, this would be covered by parent profits. Supposing that it is provided a restore mechanism, in the following tax period, if the non-resident subsidiary produces an income at least equivalent to loss, this loss would be assigned to the same subsidiary.

The initial compensation of subsidiary loss with parent profits will only have temporary effects, because the loss would be restored and carried over the profit of the same subsidiary, while parent profit would be increased in an equivalent amount of the losses. It is forbidden, obviously, to deduct the loss twice. Once in subsidiary, once in parent residence State. According to this method (*deduction/reintegration approach*) the loss would be suffered by the State of the subsidiary. According to the alternative approach, there is no restore no subsequent correction not even when the subsidiary produce taxable income. In this way the loss definitively weight upon the tax revenue of the residence State of the parent company. This solution is reasonable when the State of the holding company in a worldwide or European consolidate provides the taxation of subsidiaries incomes.

In Italy, in the worldwide consolidate, the results of subsidiaries are calculated *pro quota*; while in domestic consolidate it is in full.

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[388] D. STEVANATO, *Libertà di stabilimento e consolidato fiscale "europeo"* in *Corr. Trib*. 4/2006, p. 289

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Facoltà di Giurisprudenza

Cattedra di Diritto Tributario

The limits to Tax Planning, Minimizing Taxes and Corporate Social Responsibility

Vito Giuseppe Liotine
084123

1. General Principles governing tax avoidance and tax evasion

Principles governing tax avoidance/evasion are provisions that go against the evasive behavior put in place by the taxpayers, through complex and coordinated operations. If we try to discover such principles in the Italian legal system we will find that is necessary firstly to give a meaning of the various behavior of the taxpayer in order to understand the real connection between them and the principles above.

The behaviors we are referring to could appear similar to whom that is not involved in tax law, but in this circumstances we have to state the meaning three basic behaviors: tax avoidance, tax saving, tax evasion.

1.1.Tax Avoidance & Tax Saving

In order to define the concept of tax avoidance, it is necessary, first, to address the issue and provide the meaning of tax saving.

The concept of saving of tax is broader and more general than that of tax avoidance; putting first in relation with the second, it could be argued that the tax saving is a set that includes all sub-set definable as tax avoidance. By that relation considered it is clear, therefore, a first, immediate but essential definition of the concept of tax avoidance, the tax avoidance is a tax savings.

This definition is, however, so fundamental as inadequate: by the same relation if there is no doubt say that tax avoidance is a tax savings, it is equally clear that saving tax is not only represented by avoidance, since the latter is a sub-set of their tax savings. This implies that the tax savings can be realized in forms, methods and techniques different from those represented by avoidance.

It is necessary to clarify that the various "choices of saving" are acceptable and include economic and social benefits to the extent that the taxpayer does not spill over to this way in the open and obvious violation, or even indirect, of a valid tax obligations.

So unfulfilling this obligation, onwhile it remains the personal benefit in relation to minimizing the economic sacrifice, but the other produces a social damage, which sooner or later, as experience has shown, leads to reprisal from personal point of view.

So it is important to make clear that avoidance as such and legitimate tax saving are both to be considered as tax saving, but they are different way to save taxes: the first illegitimate and so, illegal, the second legitimate, and so, legally admitted.

The element of distinction of the conducts aimed at legitimate tax saving, compared to those aimed at illicit tax saving, is detectable in limiting the occurrence of the tax precondition. In other words, the taxpayer has the right to legally adjust his economic relations in order to save taxes if he is able to determine the occurrence of the tax precondition in a way as limited as possible, if he is able to make not true the precondition of any tax or to make true a condition which creates a lower tax.

So a final definition of tax avoidance, mostly known as tax avoidance is reflected in an abuse of the tax savings through the violation of fundamental principles of legal system.

The tax avoidance violates the constitutional principle of "tax ability[389]" stated in art.53 of the Italian Constitution causing a loss to the State.
If in fact to the taxpayer is a minor expense, to the state represents a tax loss.
From that article of the Constitution, derives the principle of equality of taxation which, in this context, takes on the meaning of equality in the sacrifice caused by the imposition[390].

1.2. Tax Evasion
The type of tax savings that always is under a sphere of illicit, constituting the overcoming of the limits (and thus the violation of the rule) is the evasion.
The tax evasion is the behavior that the taxpayer determines a direct violation of the obligations of the tax, arising as a result of the occurrence of all the elements relating to the birth of the tax including the precondition of the object.
The evasion is when, in practice, the taxpayer escapes totally or partially the obligation to pay taxes using illegal means to hide all or part of the tax basis or alterating the investigation or the payment of a tax which is due. These tools may consist of illegal conduct merely negligent: that is non-submission of tax return, non-billing of transactions, etc., or may result in positive conducts, that could be the annotation of invoices for nonexistent transactions.
Behavior aimed to the evasion, then, is pretty simple: once the tax described in the rules exists in its integrity, the action of the taxable person is not aimed at changing the legal structure, but only to illegally escape the consequences.
Situations like evasion and avoidance usually happens where there are patterns or negotiating corporate transactions (mergers, divisions, transformations, etc.) put in place not for "valid economic reasons", but to obtain an unfair tax advantage, or a tax saving disapproved by the legal system(order) (even if not by specific rules).
The tax avoidance should be first separated from other cases referable to the pathology of tax relation (simulation, fraud, etc.). The *rationale* of the evasion is an *asystematical tax saving*.

1.3. The Italian discipline for avoidance and evasion
To counter the phenomena attributed to circumvent tax (ie the adoption of lawful conduct with the purpose of breaches of obligations or prohibitions tax) was introduced in Italian legal system in Presidential Decree n. 600/1973 the Article 37-bis.
That provision is in force from November 1997 states that the elusive operations carried are unenforceable to financial administration, which may disallow the tax benefits derived by applying the tax regardless of them (but excluding taxes due in respect of the conduct elusive).

389 I. Manzoni – G. Vanz, *Il Diritto Tributario*, Torino, 2008
390 I. Manzoni – G. Vanz, *Il Diritto Tributario*, Torino, 2008

Characters referred the dispute of the avoiding operations by the taxpayer is subject to the demonstration by the revenue that this is behavior:

- Direct to circumvent obligations or prohibitions established by the tax
- Direct to obtain tax reductions or undue refunds
- Lack of valid economic reasons (ie appreciably business management)

This rule only applies to taxes on income, and refers to a comprehensive elusive plan, that is, acts, facts or transactions, also connected to each other and not to a single operation (as in the circular 19.12.1997, No 320 / E).

The explanation of art. 37-bis involves the issue of the application of such provision, this is in fact a provision that has an application almost general, even if the 37-bis indicates specifically the cases of application.

In fact even there is a listing of the cases of application[391] of the 37 bis, such cases are so wide that allow us to say that the art. 37 bis of Presidential Decree no. 600 of 1973 has a general application

Ultimately, Article 37-bis should be used by Tax Administration and also by the taxpayers especially as the "cut" to behavior possible in the area of taxation, or as invisible border between the scope of "lawful savings tax "and that the malicious conduct intended to obtain a benefit not payable.

2. THE PRINCIPLE OF ABUSE OF LAW IN RELATION WITH ITALIAN LEGAL SYSTEM

2.1. The ruling of Italian Supreme Court

The last four years since 2005 have been characterized by several decisions of the Italian Supreme Court regarding the application of the "abuse of law" principle to tax matters.

The importance of these decisions is due to the fact that (until now) a general principle of "abuse of law" was not explicitly provided for by Italian law, also because of the particular authority of this decision, taken by the "Joined Chambers", that means more authority and importance of the decision and enormous influence on the Italian Law.

Differently from tax fraud, the "abuse of law" lies in the formal observance of the legal rules, through which, however, the taxpayer substantially pursues unlawful tax savings. In such cases, when the tax authorities prove the lack of economic substance, they may disregard the tax effects of the transactions carried out by the taxpayer and, accordingly, deny the tax advantage as well as declare void the transaction.

As in two decisions issued in 2005 (n. 20398 of October 23 and n. 22932 of November 14), the Italian Supreme Court had disregarded the tax benefits of a dividend washing and dividend stripping transaction on the ground that they lacked a valid legal cause and therefore were null and void under the general principles of Italian contract law, which should be interpreted consistently with a general anti-abuse of law doctrine deriving for EU law.

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[391] Art. 37-bis , para 3 Presidential Decree no.600 of 1973

In three decisions (n. 8772/08, n. 10257/08 and n. 25374/08), the Supreme Court held that the notion of "abuse of rights" can be derived from EC law, as defined by the European Court of Justice in the Halifax case (C-255/02).
Therefore, according to the Italian Supreme Court, the "abuse of rights" principle must be considered as part of the Italian legal system as well, and, as such, encompasses the whole Italian tax system.
As a result, not only does the scope of the "abuse of rights" doctrine cover taxes that are harmonized within the EU (like V.A.T.), but also those that are not, i.e. direct taxes.
The Supreme Court made clear that the taxpayer has the burden of proof that the legal forms chosen for a series of transactions correspond to a "sound business purpose" (other than tax savings); on the other hand, the tax authorities are required to provide evidence that the aforesaid transactions lack "economic substance". The Tax Authorities shall thus act cautiously, taking into account that the taxpayer's choice to use contractual forms that may result in a lower tax burden is part of his business freedom, enshrined in the Italian Constitution as well as in the EC legal system.
Finally, the Supreme Court stated that, having its source in the EC law, the "abuse of rights" principle can be applied ex officio by the judge at any time in the course of the proceedings.
In two very important decisions issued on December 23, 2008, the Italian Supreme Court for the first time held that the Italian tax system contains a general anti-avoidance principle deriving directly from the Italian Constitution, pursuant to which the tax administration can disregard a transaction entered into for no real economic reasons, but for the sole purpose of obtaining a tax advantage.
According to the Court, the general anti-avoidance principle derives from article 53 of the Italian Constitution and not anymore from the EC Law as stated in the previous ruling[392], establishing that everybody must pay taxes according to their ability to pay, at higher rates for higher income, and it is a general principle of the tax system that applies on top of and above any other specific anti-avoidance provisions of the tax code.

The first decision, n. 30055 of December 23, 2008 concerns a "dividend washing" transaction[393].

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392 Decisions no. 20398 and no. 22932 of 2005 of Italian Supreme Court

393 An Italian company purchased stock from an Italian investment fund immediately before the payment of a dividend declared on the stock, at a purchase price reflecting the amount of the dividend declared and payable on the stock.
The Italian company collected the dividend and received a tax (imputation) credit for an amount equal to the underlying corporate taxes paid by the issuer of the stock on the profits out of which the dividend was paid, which eliminated the tax on the dividend for the buyer. If collected by the investment fund, the dividend would have been subject to a gross basis withholding tax.
Immediately thereafter, the Italian company sold the stock back to the investment fund at a price equal to the purchase price less the amount of the dividend, thereby realizing a taxable loss which reduced its taxable income.
The tax administration denied the benefit of the tax loss under the theory that the the real beneficial owner of the dividend was the investment fund and the Italian company acted merely as a conduit for the collection of the dividend on behalf of the fund.
At the time of the facts of the case, the provision of article 14, paragraph 6-bis of the tax code denying the dividend tax credit for dividend distributed to companies which have bought stock from investment funds after the declaration but before the payment of the dividend had no been enacted.

The second decision, n. 30057 of December 23, 2008 concerns a "dividend stripping" transaction[394].
The Italian Supreme Court with the two decisions at issue has completed its controversial path towards the creation of a general anti avoidance principle in the Italian tax system.
Therefore, according to the Italian Supreme Court, the "abuse of rights" principle is embodied in Italian Constitution, whereby a taxpayer is not allowed to obtain tax saving through an "artificial use of legal forms", if these have no other substantial motive than the tax saving itself.
The joined chambers of the Supreme Court observed that the introduction of specific anti-avoidance rules in the Italian tax system does not interfere with the existence of an inherent and general anti-avoidance principle; on the contrary, specific anti-avoidance rules should be interpreted as an actual indication of the existence of a general anti-avoidance rule.
From now on, any transaction that generates a significant tax benefit must be tested under the general anti-avoidance rule of Italian tax law, which requires that the transaction be entered into for non insignificant economic reasons beyond that of obtaining a tax advantage, as well as under any of the specific anti abuse provisions of the tax code that may apply to that specific transaction.
We can see the passage of the source of such principle, from an EC Law ambit to a national Constitutional ambit.

2.2. Artificial Transaction and Italian Discipline
For artificial Transaction Italian legal system has not a general tax clause that defines such term. On this topic the case-law has discussed considering the relationship between artificial transactions and provisions concerning transactions lacking of cause[395].
Also the Italian Doctrine has discussed on this issue and in particular authoritative doctrine[396], for some time, argued that Article no. 1344 of Italian Civil Code[397] must be configured as an expression

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[394] A U.S. company not engaged in business in Italy owned stock of an Italian company and transferred the right of use of that stock (so called usufruct), including the right to collect the dividends on the stock, to another Italian company, at a price reflecting the amount of the dividends that were reasonably expected to be declared on the stock during the time of the contract.
Italian tax law treats the dividend equivalent amount paid to the transferor of the usufruct as foreign source income not taxable in Italy.
The Italian company collected the dividends and received a tax (imputation) credit for an amount equal to the underlying corporate taxes paid by the issuer of the stock on the profits out of which the dividend was distributed, which eliminated the tax on the dividend, and took amortization deductions for the the cost of the usufruct, which reduced its taxable income.
If paid to the U.S. company, the dividends would have been subject to a gross basis withholding tax.
The tax administration denied the amortization deduction on the ground that the Italian company was not the real beneficial owner of the income but acted merely as a conduit for the collection of the dividends on behalf of the U.S. company.
At the time of the facts of the case, the provision of article 14, paragraph 7-bis denying the tax credit for dividends collected by Italian companies which purchased the usufruct on the stock from foreign companies had not been enacted.
The Supreme Court held that the transactions lacked significant economic reasons other than the tax benefits and can be disregarded under the general anti-avoidance principle set forth above.
[395] Art. 1344 Codice Civile

of a general anti-fraud principle applicable in several areas of the system every time when transactions or operations which, while formally respect the letter of the law, they violate the spirit in substance.
Article 1344 of the Civil Code is therefore applicable rule in the case of avoidance, and (more so) in case of tax evasion, as well as substantive tax rules.
Sometimes particularly could be a fraud to the law when they meet formally a legislative command, but, basically, if they violate its terms.
These concepts were then incorporated by some decisions of the Italian Supreme Court (see judgments No. 20398 of 21 October 2005 and No. 22932 of 14 November 2005), the courts have ruled void contracts affected by a lack of cause, to be understood precisely as a lack of purpose (legitimate) of the operations to carried out.
The ruling of 5 May 2006, n. 10353 of Italian Supreme Court finally states that the assessment of the abusive and elusive character of the economic operation, it is incumbent upon the Judge, which must give adequate reason. Indeed, the Court concludes, it in the internal legal system the principle that taxpayers can not improperly or fraudulently take advantage of legal rules. The jurisprudence of the European Court of Justice, moreover, for long time (see sentence Leur-Bloem, 17.7.1997 Case C-28/95) had confirmed that the signs of the pathology of a plan, intended to achieve tax advantages otherwise due, may be found in a series also coordinated of transactions, acts and behaviors.
To effectively counteract these illegal transactions, we have then to evaluate them in their entirety.
Each step is, in fact, closely connected to the next, representing the cause and the condition. The judges, referring to previous decisions (see judgments No. 12401/1992 and No. 5917/1999 of Italian Supreme Court), have reaffirmed that "the finding of the cause - defined as a economic social scope - must be undertaken on the transaction or on the related transactions, as a whole, and not by reference to individual acts. (…). Therefore, the existence of the cause of contracts must be sought in the whole operation"
So though Italian System has not a clear definition of artificial transaction, the case-law and partly the doctrine have contributed to achieve a sort of answer on the issue, deriving from the interpretation of a civil law provision - Art. 1344 of Italian Civil Code - thanks to the inputs that came from ECJ case-law.

3. Tax Planning

3.1 General Remarks

The tax planning is a *Systematic analysis of differing tax options aimed at the minimization of tax liability in current and future tax periods* and in particular involves conceiving of and implementing various strategies in order to minimize the amount of taxes paid for a given period.

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[396] F.Gallo, *Brevi spunti in tema di elusione e frode alla legge*, in *Rass. Trib*., 1989, I, p. 11

[397] He considers illegal the cause when the contract is the means to circumvent the application of a mandatory provision

3.2. Between illicitness and legality

Article 37-bis of Presidential Decree No 600/1973, introduced by Legislative Decree 8 October 1997, n. 358 review profoundly anti-avoidance rule, previously contained in art. 10 of L. 408/1990. Such review caught obviously tax planning activities.

Among several changes, the most important point concerns demarcation of tax avoidance vis-à-vis the legitimate tax savings; the new rule, demanding the bypass of obligations or prohibitions and the derivation of "undue" advantage, it refers to "pathological" tax savings.

Arises then the distinction between a tax savings "pathological", and so elusive, and a tax savings "physiological", which may be carried out without any problem, without having to justify with real or alleged "valid economic reasons."

Tax savings in the physiological taxpayer is limited to "use" the existing legislation, while in the pathologically the taxpayer's "abuses", twisting in his favor incompleteness or defect of the law in order to obtain results that (although formally legitimate) discard to the system as a whole, as it often results from unambiguous indications of legislation.

Referring to the concept of "bypass" (circumvention), paragraph 1 of art. 37-bis aims precisely to clarify that the rule affects only the loopholes, the escamotages and stratagems. And only in the presence of these "pathologies" the "valid economic reasons" are needed, thanks to which also loopholes and stratagems can become the unassailable by Tax Administration (the "valid economic reasons" may legitimize the "pathology").

In the world of business is spreading the fear that any tax saving related to conversions, mergers, duty, and other transactions referred to in paragraph 3 of art 37-bis Pres. Decree no. 600 of 1973 should be accompanied by "valid economic reasons", in the absence of the latter would be the risk of being disregarded all the tax advantages tax real or supposed.

So far, even after the entry into force of the anti-avoidance provision in 1990, the operators have continued to engage in activities tax planning, consisting in choosing, between different forms of conduct permitted by system, the ones less onerous in terms of taxes. Nothing wrong to continue even today in these planning strategies, but doing careful in order to not intrude into pathological tax savings affected by anti-avoidance rule. To this purpose it is essential to have some criteria to distinguish legitimate tax savings and avoidance, among which we could indicate the following:

1) from an initial point of view the question arises whether the legislation applied by the taxpayer is, in the system, on an equal dignity[398] in relation to other laws that lead to equivalent results (see 3.2.1.);

2) from a second point of view has to wonder whether the benefits tax achieved, although formally legitimate, are disapproved[399] by tax system as a whole, that is negatively evaluated in the light of the rules dictated by case contiguous (for example on trade loss or tax credit on dividends) (see

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[398] F. Gallo, *Rilevanza penale dell'elusione*, in *Rass. trib.*, 2001, II, p. 321

[399] F. Gallo, Rilevanza penale dell'elusione, in cit., 2001, II, p. 323

3.2.2.).

3.1.1. First Criteria: Position of the legislation in the system

By combining the points above it is not difficult to distinguish legitimate tax savings from avoidance. A first clue [art 37-bis par.1] refers to the status, location the rules used in the physiological savings tax relates generally to the use of legislation of equal level compared to other legal instruments used.

All the laws that underpin the different behaviors are part of full rights of our tax system. Some of them are more expensive, others are less so, but our system does not expected at all, the obligation to follow the road tax more expensive: you can also follow other roads, provided they are not tricks, short cuts made by contributor to their own use and consumption using the present stretch marks into.

The choice between these opportunities, on an equal level substantially among themselves in the tax system, is let to the discretion of entrepreneur, and it is normal that he would use the tools for less onerous tax amount. Up to this point there are not loopholes, tricks etc., and tax planning may be done without any problem, with no need to hide behind real or alleged economic reasons.

Are therefore physiological savings due to schemes placed into the system on an equal level in respect of other onerous regimes; avoidance, which is a pathological saving result often by provisions concerning special cases, often lacking.

The application of less onerous tax rules, which has equal dignity compared to other regimes in the present, not then the tax goes in dissolving and remains within the limits of physiological savings tax, subject to the considerations set out in paragraph below.

3.1.2. Second Criteria: A benefit disapproved by the system

The principle set out at the end of the preceding paragraph has however, its exceptions, because sometimes the avoidance can occur even when the taxpayer takes the tax rules and institutional physiological system. The case may occur when the taxpayer combines two or more institutional tax in order to obtain a distortive result: the combination of more tax physiological can sometimes lead to a pathological state tax savings. This ability to link physiological operations to obtain a pathological result is taken into account in the rule, which refers to acts "connected together", thus putting the emphasis rather than on the elusive single operation, the "elusive project" in its entirety.

In this case, with the use of legal and institutional physiological tools, which technical reason leads us instinctively to say that this is tax avoidance? The clue findings of the detector are to achieve a result that the system itselfdisapproves. This disapproval is often readily visible from prohibitions dictated by case contiguous to those entered into by taxpayer.

4. Abusive tax Planning and Responsibilities

About the responsibilities for the abusive tax planning in Italian Legal system, should first be noted that no provision refers to the direct conduct elusive as independent criminal offense. So we have to examine whether the elusive behavior - namely the tortuous behavior directed not to conceal all or part the assumption of the tax, but only out to make art.37-bis of Presidential Decree a prerequisite in order

to achieve a savings (or even no payment) of taxes – integrates the specific case of unfaithful tax return by provided by Legislative Decree no. 74/2000 Art 4.
There is no trace of it in particular, nor in art. 1, where it clarifies the meaning of words "avoided tax", nor in the Arts. 2, 3 and 4, where we identify, both subjective and objective, crimes fraudulent declaration (tax return) and unfaithful Declaration.
It seems, therefore, necessary first to delimit the coverage of that article and compare the contents of it with that of 37-bis.
We firstly should notice that art.4 of Legislative Decree no.74 of 2000 considers as "unfaithful" the tax return that "in order to evade taxes on income and V.A.T. indicates (…) positive elements of an amount smaller than the real one, of negative fictitious elements"[400]
According to the major part of the expert, avoidance should not have criminal liability, even if – like the evasion – it means the payment of an amount smaller than the one due.
The new provisions introduced with Legislative Decree no. 74 of 2000 seems not having the aim previously indicated.

5. DISCLOSURE OF FACTS CONCERNING TAX EVASION OPERATIONS

5.2. General Remarks

In the Italian Legal System the activity and the operations aimed at avoiding and evading taxes are carried out not only by the taxpayer himself. Indeed he often and necessarily "moves" and "acts" with the help of who knows perfectly the laws and consequently knows the ways to circumvent them, the professionals.
So in this cases the treatment of the disclosure of facts or transactions regarded as tax shelter activities is strictly related to the so-called, *the professional secrecy.*

5.3. The professional secrecy

5.3.1. Definition

The professional secrecy constitutes a sophisticated tool of safeguard of a determined position and of some elements to it pertinent. Circumscribing the area within which the law grants one "protection", it legitimates every activity that is set to the outside of the sphere of affairs protected.
In these cases the professional secrecy is destined to confront with the values that are on the basis of the tax law and to which cannot remain insensitive in reason for their public characteristic.
There is no doubt that the provision from which it is necessary to build content for the definition of the concept of professional secrecy is made by art. 622[401] of the Italian Penal Code, which punishes the disclosure and use for their own benefit or profit of others, a secret which is known due to the conduct of a profession. The case is subjectively characterized as places the ownership of secrecy to

[400] Art 4 Legislative Decree no. 74 of 2000
[401] "Whoever, having known, for reason of their status or office, or profession or art, a secret, and reveals it, without proper cause, that is used at his own or another's profit, is punished, if from the fact may result a damage",

those persons who carry on a profession and that, during the performance of their skills, learn the facts, data, evidence relevant to the customer to ensure that the most strict confidence as required by custom and professional ethics.

5.3.2. Professional Secrecy and Tax Law

The provisions by which we must take steps to draw the borders the protection of professional secrecy are two, both concerning the investigation phase:

- For Value Added Tax, the Article 52 of the Presidential Decree 26 October 1972, n. 633 on accesses, inspections and audits;
- and for Income Tax, the Article 32 of the Presidential Decree 29 September 1973, n. 600 on the assessment of taxes on income.

In the context of the VAT Decree (no.633 of 1972) Art. 52 states, in particular at paragraph 3, with respect to inspections, we have that 'It is in any case required the authorization of the Attorney Republic or the nearest court (...) to examinate documents and requests for information for which the professional secrecy is objected to".

Yet, the need to create a system of rules on ascertainment taking into account the secrecy was a concern that he had found space inside of. Art 10, No 4, the Law 9 October 1971, n. 825. Such provision stated that audits with invasiveness as to reap the full data from the accounting data of the taxpayer, should have been done in compliance with professional secrecy, allowing the acquisition of data and information about the third parties who are obliged to maintain professional relationships with the object of control.

So it is necessary to find on which acts is possible to exercise professional secrecy.

If the activity of the office of the tax administration is related to the taxpayer and not to the professional, there is no reason for which the professional could legitimately exercise the secrecy on the documents having direct fiscal relevance that are in his availability.

So if we try to give a conclusion, the rationale of the professional secrecy stays in the necessity the ascertainment activity would not become occasion for the knowledge and diffusion, by third parties, of news and elements belonging to the taxpayer-client, if he is not part of the ascertainment.

6. Tax law and Retroactivity

6. 2. The retroactivity: General Principles

The effectiveness of laws in time is dominated by the principle that "the law provides for the future: it has no retroactive effect": the general rule is the non-retroactivity. The rule is set by law, however ordinary, which may be displaced by other provisions of law. The non-retroactivity may address the situation, effects or both elements of the tax provision.

The issue of retroactivity of the rule, however, has peculiar characters with respect to so-called imposing character of the law (which introduces a new tax, increase the rate of an existing one).

Italian Doctrine[402] soles distinguish between two types of retroactive laws. a) Proper Retroactivity: when the law places previously to its entry into force " the case, and its effects"
b) Improper Retroactivity: it is the case of the law when connects a new tax or the increase of an existing tax, to be paid after its entry into force, on assumptions occurred prior to that effect
For some doctrine[403] does not seem that this distinction has a foundation. Even in the case of the so-called proper retroactivity the effects produced by the law are not "advanced".
In practice it is not possible that a new rule goes back in time and gives rise to legal consequences in the time already elapsed.
The rule has retroactive for the future, however, assume a set of assumptions or facts effects occurred in the past, a modified treatment.
Furthermore, decisions of the Constitutional Court in the absence of an express prohibition in this regard should be accepted that the rules in question can be provided with retrospective effect, provided they do not go to infringe any constitutional principle.

6.3. The Retroactivity in Italian Tax Law

The operability of the retroactivity in Italian Tax law is a particular issue that differs whether we talk about substantial rules or procedural rules.
But according to the principle of Italian System, procedural rules, such as the 37-bis of anti-avoidance are the "immediate implementation", with which it does that also apply to proceedings under way at the time of force of the new law, relating to events in the past.
In tax Avoidance and tax evasion if we want to consider the circumstances that permit the application of retroactivity we have firstly to regard to art. 37-bis of Presidential Decree no.600 of 1973, a procedural rule that introduces the tools for anti-avoidance.
In particular, the retroactivity of the tax will be constitutionally prohibited wherever its tangible result act as a violation of the principle of ability to pay[404] (see 1.1.).

7. Offshore activities and tax regime

7.1. General Remarks

The legal regime for offshore activities or for any other activity held by the taxpayer, abroad or in tax havens does not provide substantial rules different from the ones applied to national cases. We have at least some rules that make the difference between the offshore activities and national ones. Those are substantial rules that concern procedures.
The rules we are talking about are art 2.2bis, art 73.5bis, art. 110 para 10, art. 167 and 168 of TUIR (DPR 1986 n. 917)
The main articles that could have relevant position are the 2.2bis and 73.5bis.

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402 G.A. Micheli, *Legg e(dir.trib.)*, in *Enc.dir.,* XXIII, Milano, 1973, p.1087
403 Falsitta, *Manuale di Diritto Tributario*, Padova, 2005, p.199
404 Art.53 Italian Constitution

7.2. Residence and Income Taxes: the art. 2.2bis,

With respect to taxes on income resident makes the function of identify those taxpayers whose taxable income is taxed everywhere it is produced (global or worldwide taxation income taxation) in contrast to those (non-residents) for which the levy is limited to the income in produced in the State (or territorial taxation- source principle).

That said, the rule in this sphere is represented by. 2 par. 2 Presidential Decree 22 December 1986, n. 917 (called TUIR), which, for the purposes of income tax, the residence connected to one of the following situations:

a) enrolment on the registry of the resident population,

b) a domicile in the territory of the State under the Civil Law,

c) always resident in the State under the Civil Law.

The status of non-resident may be more favorable than the on of a resident. This condition can cause the taxpayer to transfer deceptively to be resident abroad in order to be subject to tax in a state only on income there generated and enjoying all the benefits reserved to non-residents. Where the residence is transferred to a "favorable tax system"- country in addition the tax burden of the tax payer is greatly reduced. So that the transfer of residence abroad may therefore be used for tax evasion.

To deal with these phenomena in Italy, was introduced on art. 2 of TUIR a new paragraph, the 2-bis, which provides that: "It is also considered residents, unless proved otherwise, the people removed from the Italian registry of the resident population and migrants in countries or territories which have a favorable tax regime, identified by a decree of the Minister of Finance to be published in the Official Gazette. "

This innovation provides a presumption of residence for Italian citizens who take up residence or domicile in the so called "tax havens" in order to be excluded from the number of residents in Italy, they therefore have the burden to prove that they actually reside in those countries or areas specifically identified by a decree of the Minister of Finance.

This rule applies only if the Italian residence and the enrolment in the registry are before taking up residence in the country with a privileged tax regime, while it is inapplicable in cases where a person already resident in a tax haven acquiring after the Italian citizenship, obtaining enrolment in the registry. And the same conclusion seems to have to reach where an Italian resident transfers his residence in a first state to tax non-privileged, and only then, in one of the so called "Tax havens".

Furthermore, accessing this thesis, the application of art. 2, co. 2, TUIR would be easily avoidable, except to consider the applicable case the provisions of the provisions anti-avoidance Article. 37-bis, Presidential Decree. 29 September 1973, No 600 if this 'triangulation' will accompany the occurrence of one of the cases expressly provided for in that last rule.

With the Article. 1, co. 83, lett. a) l. No 244/2007, the legislator has intervened to change the basis for the identification of countries with privileged tax in respect of which operates the presumption of residence as provided by art. 2, co. 2-bis, TUIR, ruling that such "tax havens" are not more states and

territories in detail in a black list (such as that contained in dm 4 May 1999), but, rather, those not specifically included in a forthcoming white list as provided by art 168-bis of TUIR.

The white list will indicate the States in which the Italian resident, deleted from the registry of the resident population, they can move without shifting the burden of proof with regard to the residence.

At issue is the matter of reporting how the criteria of which shall be approved in the drafting the list mentioned have not been specified.

7.3. Resident Companies controlled by foreign entities: art. 73 para.5-bis

The other instrument for the procedures concerning the offshore activities carried by resident is given by art. 73 para.5-bis of the TUIR.

The art. 73 par.5-bis says that:

Until proved otherwise, shall be deemed to exist in the territory of the State headquarters of the companies' and institutions, which hold controlling stakes, according to Civil Law, if, alternatively:

a) are controlled, even indirectly, pursuant to Civil Law, by persons residing in the State;

b) are administered by a board of directors or other equivalent management body, composed mainly of directors resident in the State.

This rule applies to companies and entities not residing in the state that meet simultaneously the following two requirements:

(i) holding controlling stakes under the Civil Code (art. 2359, para. 1) in company and commercial entities resident in Italy.

(ii) are controlled, even indirectly, by residents, or are administered by a body composed mainly by directors resident in the State.

To counter the phenomenon of offshore companies and shell entities, introduces a legal presumption on the basis on which we consider in the territory of the State headquarters of companies and non-residents who meet the two requirements above.

The same article we are discussing on, have been again recently modified with paragraph 5 concerning the mutual funds.

By virtue of that paragraph shall be considered allegedly residing in Italy “(...) companies or entities that hold more than 50 percent of the shares of real estate investment closed funds (…) and are controlled directly or indirectly, through trust companies or through intermediaries, by persons resident in Italy.

The provision has included norms substantially affecting the phenomena of national control funds that are only nominally foreigners, and brought the effect of the “Italianization” of these funds.

That said it is important to note that in order to overcome the presumption in question, it is necessary for the company or entity not resident demonstrate that, despite the presence of the above requirements, their head office is still located within the foreign country in which have their registered office.

On the contrary, it should be stressed that if the non-resident company is not able to overcome this presumption, they would be considered to Law, tax-resident in Italy. These considerations may be neither conclusive nor entail tax consequences to society or the foreign entity if they have established in

a country with which Italy has concluded a convention to prevent double taxation. In this circumstance is reflected the so-called "Conflict of residence" among the involved countries (Italy and the country in which the company or that have been set up and / or have their registered office), as both countries would be interested in supporting the company or body tax resident in its territory. Having regard to the conventions concluded by adhering to the definition of residence as provided by the OECD Model Convention, the conflict is usually resolved in favor of the country in which exists the so-called place of effective management. Obviously, if and to the fact that the conflict is resolved in favor of the foreign country, the legal presumption introduced by the news would in fact be non-operational (see Art 4 Convention on Income and on Capital Model OECD).

8. Foreign Income

8.1. Actual Framework

With the enactment of Council Directive No 88/361/EEC of 24 June 1988 (with Law no. 178 of 1988) which, as regards the EU, enshrined the principle of freedom of economic relations with foreign countries - has seen increasing freedom of capital.

Of course, the increasing ease to move capital across borders has facilitated the camouflage of income finalized to tax evasion and, therefore, there was a need to make provisions to monitor (check) the presence of foreign taxable amounts not reported by those tax-residents. On the other hand, the same Community measure mentioned above explained that "the provisions of this Directive do not prejudice the right of Member States to take measures to prevent infringements of the laws and regulations, especially on fiscal matters."

Concerning the limitations that Italian tax law has involving tax havens and offshore activities, we should notice the particular system for foreign income and their declaration in Italian tax returns.

Moreover Italy has approved legislation aimed, in fact, to discourage (and hitting) the phenomena of evasion related to sources of income outside the national borders; in order to check the consistency investments held abroad and capital transfers.

8.2. The monitoring of the taxes

Rules on Monitoring introduced by Law Decree no. 167 of 1990 apply to individuals fiscally resident in Italy - so excluded from monitoring the subject non-residents for tax purpose - and requires such taxpayers, to indicate in a separate part of the statement of income (tax return) (so called RW) the Foreign income.

8.2.1. The Italian experience: the "RW" box in the tax return

The RW is a box in the tax return introduced by Law Decree no. 167 of 1990.

In such box should be indicated this type of income:

a) foreign investments and financial activities abroad through that the taxpayer can obtain foreign incomes taxable in Italy, or transfers to and from abroad that during the year interested investments and activities.;

b) Transfers of money from and to abroad, made by non-residents, without going through intermediaries residents.

The RW is a box in the tax return introduced by Law Decree no. 167 of 1990.

On this point we there has been a ruling[405] from the Court of Cassation, which has helped shape the subjective ambit of application of this legislation.

The principle expressed by the Cassation was that the obligation to declare in the table imposed by RW covers not only the real beneficiaries or holders of accounts hidden abroad but also those that are in the availability and possibility of handling leaves perplexed, since the tax legislation on the monitoring was established to prevent the free movement of capital in the international phenomena can lead to avoidance. The legislation in question, then, arises as a tool for financial administration to verify income declared. If we lose sight of the ratio of Law Decree n.167/1990 there is the risk to impose to a wide number of taxpayers of obligations that nothing to do with fighting tax evasion.

In other words, the purpose that the remark will pursue through the obligations imposed on taxpayers (and brokers) is not to have an overview of the movements carried out by certain parties, but rather that of determining the “possession 'income related to amounts and / or transfers.

8.2.3. Provisions for Informing Procedures

Italian tax law does not provide rules on rewarding informants or whistleblowers.

On this point at least we have rules regarding the effect during tax investigation of the declarations of third parties.

The use in tax process of non-typical sources of proof (non legally legitimized) has experienced a progressive and trend extension in Italian tax Law. The thoughts go first to those rules that, on investigation, expressly recognize the possibility of using various data and reports “still in possession” in the financial Administration or “in any collection or come to his knowledge” (art 37-41 DPR 600/73) and other papers and documents in its possession”, different from those formed or acquired in the exercise of powers of investigation typical of the tax proceedings.

Completes the scheme the provision - art. 36 par 4 Presidential Decree no.600 of 1973 - requiring an obligation on the part of public responsibility to conduct institutional inspections or surveillance, to communicate to the Guardia di Finanza (Tributary Police) data relating to facts or circumstances likely to incorporate significant assumptions fiscally by providing any documents as proof of

Overall, therefore, the tax system not only allows the possibility of widespread use of evidence obtained outside the procedure, but also takes care to ensure their input into this process through specific rules governing the passage of relevant material acquired in other proceedings.

For these reasons, the role of atypical evidences in tax proceeding is intended to take over increasingly important, considering also the wide spaces of operation that tends to add to the presumptive instrument in tax investigation. That the effectiveness of typical evidences, in fact, is a problem that, in the tax law, it is hard to find a satisfactory solution, particularly with reference to the value of so-called

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[405] Decision June 11th 2003, no. 9320

summary information obtained by police in criminal investigations (and, more generally, the value of the statements by in the third parties during phase of inquiry), given the ban testing witnesses in the tax process, laid down. 7 of Legislative Decree no. 546/1992.

9. European Accountancy Rules and their implementation in Italian legal system

9.1. Introduction of IAS in Italian System and coexistence with traditional system

Italian tax system about the implementation of the European Accountancy and commercial rules had to face the issue of the question whether, in the legal system, particularly the company law can allow the coexistence of several (different) accounting systems that can, or should, be adopted and used by public companies. Then, if this is justified by the plurality of systems in different tax area, the presence of other taxable according to the accounting system adopted.

According to the legislation on accounting, the issue arises in Europe and in individual Member States by virtue of coexistence of the system of international accounting standards (known as IAS / IFRS, as set out in EU Regulation No. 1606/2002 of 19 July 2002) with the traditional system provided by IV and VII of the Directive on company respectively on the annual and consolidated accounts (Directive 78/660 of 25 July 1978 and No. 83/349 of 13 June 1983).

IAS/IFRS, as such, differ from traditional accounting principles, referred to the Fourth and the Seventh Directive, both as to patterns of representation and classification of assets and what criteria and mechanisms for assessment (in the first, the criterion of fair value, the central system in IAS / IFRS, compared with the historical cost basis, the central accounting system in the traditional). Since 2005, IAS/IFRS are mandatory for the preparation of consolidated accounts of listed companies (Article 4 of Council Regulation No 1606/2002), while individual Member States are allowed the option (of which art. 5 Regulation No 1606/2002) to extend the adoption of IAS even beyond the original ambit (ie, the accounts of listed companies, and also consolidated accounts and / or pursuit of other companies). The Member State holding any of these options is thus authorized to waive, to the extent to which the option was exercised, the traditional accounting standards referred to IV and VII to the Directive. The exercise of such options by Italy, who has been used with the legislative Decree 28 February 2005, n. 38.

In Italy, the adoption of international accounting standards has been so extended, as mandatory, to financial statements for listed companies and public companies, to annual accounts and consolidated accounts of banks and financial intermediaries, even if not listed, and the annual accounts for certain insurance companies (those listed who do not prepare consolidated financial statements).

An optional adoption of IAS/IFRS has been allowed to all other companies that overcome the thresholds provided for by art. 2435-bis of the Civil Code for the preparation of financial statements in abbreviated form (for some of these companies, the option of adopting IAS / IFRS is delayed in time as decided by the interministerial decree provided by art. 4, 6, Legislative Decree No 38/2005, that right now in under discussion).

For banks and insurance that have to adopt IAS/IFRS proposes the "peculiarity" due to the specialty of their business.

For other companies that are obliged to use IAS / IFRS also for the accounts, the criteria is from being or not being on listed regulated market (or otherwise shares disseminated to the public).

9.2. Consequences of the coexistence and remedies

It follows that companies engaged in the same business and compete on the market, will highlight different results and capital situations, although, hypothetically, the same industrial and production framework only because adopt different accounting systems for the detection and measurement of income and asset components.

From the coexistence of different accounting regimes could raise some distortion, that obviously need to be remedied.

Some corrective elements are already in the national and community legislation. At Community level, a directive on accounting modernization (most recently, Directive No 2003/51 and before, it the Directive 2001/65 of 27 September 2001) were enacted specifically to the purpose of approximate the traditional accounting framework of the IV and VII Directive to International accounting developments. For sure with the proximity of disciplines it will be a rapprochement of the results, then a mitigation of the distortion reported: however, the differences remain and, where such differences should be marginal, so as not to be significant, there will be questionable if not the case of correcting the whole, standardizing on a single accounting system.

At national level, the Italian legislature has adopted as a corrective the "sterilization" (or "neutralization") of the *fair value*, requiring to put aside, not for distribution of the profits corresponding to the capital gains arising from the application of fair value (art. 6, Legislative Decree. No 38/2005).

In this way, the fair value measurement becomes mere information measure, rather than organizational principle.

The question is whether this correction of the "sterilization" of the fair value is sufficient and appropriate to re-establish equality between players who have used different accounting systems and to prevent that the adoption of different accounting systems will result in a distortion of competition. The impression is that this is not a sufficient corrective. And, among other things, this is the extent to which legitimacy may also have doubts.

The described mechanism of "sterilization" covers only the capital gains from fair value. First, the application of the fair value may also lead to the provision in the budget of losses that, however, is not reflected in traditional accounting principles.

And secondly, as already pointed out, it is not only the fair value of the criteria IAS/IFRS for determining different modes of recognition and representation of corporate assets. Thus, the correction of "sterilization" only partially neutralizes the differences and is therefore not sufficient to correct the distortion resulting from the coexistence of different systems.

The argument that was used to justify the introduction of the mechanism of "sterilization" was that this would make the application of the criteria of fair value reliable with the prudence principle that, in accordance with Community and national level, lead the drafting of budgets.
However, it should be noted that among the criteria that the EU Commission has to follow for the "approval" of the IAS to enter into Community law (Article 3 of Regulation No 1606/2002), there is the true and fair view principle, that in composed also by the prudence principle [art. 31, comma 1, letter c) of Directive IV].
It follows that economic performance and property arising from application of IAS/IFRS, as they have been accepted and settlement approved by the EU Commission, should in itself, without any further corrections or adjustments, be compatible with the requirement of "true and fair view" and thus useful to measure actual and prudently determined.
The adoption of the "sterilization" of the fair value is likely to be a unilateral change and thus illegitimate, of the evaluation criteria IAS / IFRS, whose scope is substantially emptied and circumvented
The solutions adopted or advanced to remedy the inequalities and distortions arising from the coexistence of different accounting systems do not seem so satisfactory.

9.3. The Legislative Decree no. 38 of 2005
The choices of Italian system in regard to tax basis for companies that adopt IAS are first with the Legislative Decree no. 38/2005 and with L. No 244/2007. The initial choice in the system, implemented by Legislative Decree no. 38/2005, was to pursue, "when possible", the goal of "neutrality", meaning no difference of effects on the tax of the different rules concerning accounting.
The pursuit of this objective has had to compare with the two main principles governing the revelation of income using IAS, and in particular the principle of fair value and with that the so-called "prevalence of substance over form". Regarding the former, does not put particular obstacles for the pursuit of "neutrality".
What is relevant in Italian tax system has now been established for over a decade, the fiscal irrelevance of the capital gains (and losses) registered.
More sensitive and less linear, it is instead the profile of IAS on the prevalence of substance over form, already present in the principles of preparation contained in the Civil Code for the preparation of financial statements by the generality of companies, but in fact the subject of restrictive interpretation and non-application, for the representation of the legal and formal findings of acts is related to it that there are major differences between national accounting standards and IAS.
The main issue that Italian tax law had solve was the fact that the income of enterprise outlined in the tax law is the culmination of three decades or more of continuous changes and adaptations to a model that is - and remains - that of national accounting standards.
This ended up creating many difficulties for full explication of the principle of neutrality. In tax Law, however, that means reflecting on which of the two principles of Legislative Decree no. 38/2005 -

"neutrality" on the one hand, "derivation" on the other - would prevail, given that their contextual prosecution had proved almost impossible.
Now, with regard to the principle of "neutrality", it moves from condition for which two entities should be taxed identically whatever the accounting system adopted. In fact, it is doubtful that two persons in equal economic events have a different ability to pay simply because income is differently represented in response to requirements that operates in civil law and that, alone, does not seem to justify a different "measurement" of the tax, following a principle of reasonableness of the legislation.
It seems, moreover, that such view is reinforced by the civil rule that provides for the "sterilization" in order to have a distribution of gains by fair value.
The most significant obstacle to a constitutional relevance of the divergence lies instead in the "faculty", as provided by Legislative Decree no. 38/2005, of implementing IAS also from other companies, with the exception of those admitted to the drafting of the budget in abridged form.
These other companies, as effect of this option, could therefore enter the system that is more favorable for them, although it is important in this regard revealed that the problem remains partially open to the absence so far of the inter-ministerial decree provided by. 4, 6, Legislative Decree no. 38/2005, which is conditional enactment the exercise of power by certain individuals. Failure to apply the principle of neutrality implies, finally, some disadvantages in practice, both in relation to the tax arbitrage that may arise where the taxpayer decides to allocate between IAS and non IAS companies different assets according to the most tax advantages, both for the considerable complications that would in groups that adhere to the rules of consolidation.
In any case, it is clear that the choice to promote the principle of neutrality on the derivation principle would require complex technical solutions, through the establishment of a system of tax rules articulated and made so as to effectively self-sufficient for determining the enterprise income as it was the system accounting adopted.
In other words, a "double track" tout-court, with a massive intervention on the rules on income taxation.
The principle of derivation, on the other hand, assumes that the income as ascertained for accounting purposes is likely to represent faithfully the actual income. That bring to that the income assessed following civil law is equivalent to the income ascertained thru the tax law. For this feature, it is this time conforming to the profile of effectiveness" of the fiscal capacity, which requires, to tax net income.
By the way is, a "neutral" profile for our purposes, as in both cases we are in the presence of net income.
The principle of derivation has also an important incident, when affect the determination of given the representation of accounts to the rules developed by the International Accounting Standards Board (IASB), subtracting this figure to any control by the national law, and thereby creating the basis for a further split of the result of the year depending on the accounting rules adopted.

9.4. The Law No. 244 of 2007

Notwithstanding the foregoing, the Italian legislature, with the Law No 244/2007, has made a clear choice in favor of the principle of derivation (see above at 10.3), by on one hand providing for those who apply the accounting standards IAS will apply, "the criteria of qualification, classification and time allocation in the budget provided by these principles", and on the other hand, introducing a series of changes to the Income Tax Law.

The solution therefore implies, first, the entry in the system of enterprise income of IAS principles in their original form, secondly, the identification of a number of cases to be regulated specifically.

Therefore, a solution of "compromise" which would mean reducing fiscal changes imposed on IAS companies, but, on the one hand, amplifies the problems posed by a vagueness that surrounds the IAS, especially in relation to the application of the principle of substance over form, with the associated risk of developing a large (and mostly unpublished) litigation concerning the proper application of these principles, and the other, will probably end up on a technical level, in continual adjustments to meet all those disadvantages (double deductions, double taxation, arbitrage, etc.).

In conclusion, the rush is also almost alone, the Italian legislature has created many more problems than it has solved.

It has shed IAS businesses in uncertainty (civil and fiscal), has forced to bear costs not indifferent to the new management system, imposed to the Administration considerable interpretative effort which is not always led to shared choices and unshared, finally culminated in a resolution that -- even in its declared transitoriness "pending the reorganization of regulation of the business income, resulting in complete transposition of No guidelines 2001/54/EC and No 2003/51/EC on budgets - it accepts as "Physiological" the divergence of taxable income because of the ways of recognition adopted.

9.5. Conclusions

However, conclusions that can not be generalized, depending on the principles (constitutional and otherwise) and from accounting rules, civil and tax law in each national level.

In any case, it seems unlikely that it is questionable that such choices, as for large players operating in a (at least) intra-communitary field should not forego a coordination with those that will be done in Community, in relation to the so-called "common tax basis".

10. CORPORATE SOCIAL RESPONSIBILITY, PENAL RESPONSIBILITY FOR CORPORATIONS

10.2. Introduction

Italian legal system does not know, however, forms of criminal liability on legal persons: continues to apply the individualistic principle of Romanistic origin, *societas delinquere non potest*. But the growing recognition that some of the most serious forms of crime are real manifestations of the enterprise crime or so-called corporate crime has put on the floor of overcoming the problem of the old principle of criminal liability of legal persons. The major drawbacks of the application of this principle consists in all those cases where the offense is the result of specific choices of enterprise policy for which the failure in punishing the enterprise, results in an unjustified extensive responsibilities to another subject,

which seems to have, the exclusive role of scapegoat. On the other hand, the renewed debate in the Italian doctrine has been driven by the laws existing in other European systems, and particularly in the Anglo-Saxon countries who have long known the role of corporate crime.
Recognized the political need to establish criminal sanctions to be paid by corporate bodies, it remains very difficult to identify the possible mechanisms of the Italian penalties measures to be taken.
The persistent difficulties related to the identification of a satisfying model of criminal liability of legal persons, explain why the doctrine is in favor of newer models alternative sanction[406], of an administrative or civil law.
So has been introduced a new model of responsibility to prevent the commission of crimes within the corporate bodies and legal persons has been included in Italians system with the major reform which introduced with Legislative Decree no. 231 of 2001 the so-called administrative responsibility of corporate bodies for the crimes committed by their bodies or by their employees.
The introduction of this type of responsibility is characterized by its classification as an "administrative" rather than as "criminal", the new form of liability is the result the need to alleviate the considerable tension in the business world very concerned about the possible economic impact of the reform.
The framework is set down in such a way as to give the impression that the legislator wanted to formally define "administrative" a responsibility that in essence has a criminal aspect: the responsibility of the entity, in fact, tightly coupled to the commission of a fact of offense, and the place where it is found is still a criminal trial.

10.3. The discipline of Legislative Decree n. 231/2001.
So for tax corporate social responsibility Italian legal system has introduced some rules for corporate penalty: Legislative Decree n. 231/2001.
Before of 231/2001 was not present a regulatory system providing sanctionary consequences for crimes put in place by administrators, managers or employees to the benefit of these companies.
Before of 231/2001 (Former Arts. 196 and 197 Penal Code) there was only obligation for the company to take over the payment of fines and penalties: personally handed to the legal representative and administrator; in case of insolvency of those who have completed the crime.
Aims of the 231/2001 are to establish the administrative responsibility of the offenders entered into by directors, managers and / or employees in or for the benefit of the institution. But if we want to establish what kind of responsibility is, we will see that we have administrative responsibility, criminal responsibility, responsibilities of the combined system of criminal and administrative system. The rule establishes the criminal liability of the company that is in addition to the individual liability. The responsibility involves the assets of the institution and, indirectly, the economic interests of shareholders.

[406] G. Fiandaca – E. Musco, *Diritto Penale – Parte Generale,* Bologna, 2008

Conditions for responsibility are provided by art. 5 of the Decree no. 231: requires that the crime has been made in the interest or for the benefit of the company. In fact Art. 5, paragraph 2, the responsibility of the company where the individual has committed the crime for his own benefit exclusive of third parties. This notes that:

• The D. Lgs 231/01 establishes the criminal liability of the company to be added to that of natural persons

• The responsibility involves the assets of the institution and, indirectly, the economic interests of shareholders

Definitely the 231 brought to the overcoming of the principle "*societas delinquere non potest*" deriving from Article 27 Italian Constitution.

So the company that wants to avoid his responsibility under 231 has to adopt:

• A model of organization, management and control characterized by criteria of efficiency, practicality and functionality in a position to reasonably minimize the likelihood of commission of offenses in the area of risk related to the company. • A body which has internal to the task of initiating and monitoring the effectiveness of the model and is equipped with full autonomy in exercising supervision and disciplinary powers.

Concluding the Legislative Decree no 231 of 2001 introduced a particular and discussed type of corporate responsibility. It's an Administrative Responsibility as effect of the commission of crimes. The crimes concerned are not all the crimes of the whole Penal system, but only the crimes that the legislature, through the law, connects to such responsibility (see Law No. 300 of 2000)

Although the decree is not mentioned specifically referred to tax offenses provided by Decree no. 74/2000, the formulation of provision is far broader and that they can consider the new system of penalties on the administrative liability of legal persons as an "open system" which, although restricted to a series of crimes defined in Law No. 300/2000 has defined the contours, substantive and procedural, is intended to be implemented by subsequent legislation, bearing in mind the principle of legality.

In addition, the manager, as holder of power of representation of society, is also the recipient of tax obligations relating to the company, such as submitting the annual tax return, thereby leading to - in the same head - even accurate accountability in fiscal matters.

10.4. The discipline of Tributary non-penal sanctions

The 231 of 2001 is not the only instrument to ensure a corporate liability, if the 231 provides the tools concerning the Penal System, there is a set of laws (no. 471, 472, 473 of 1997) that is about the tributary system of non-penal sanctions.

Article 3, paragraph 133, Law of 23 December 1996 n.662 delegated the Government to adopt rules containing provisions for the review and the organic completion of the system of non-criminal tax penalties. The delegation has been enacted with the legislative decree n.471, n.472 and n.473 of 18 December 1997 and subsequent amendments thereto.

This review has entered fully into force on 1 April 1998. The Legislative Decree no. 472 indicates the general principles applicable to breaches of taxation, the Decree no. 471 determines the penalties for income taxes and VAT, and the Decree no. 473 governs the administrative penalties for violations relating to taxes on business, production and consumption and other taxes, including local taxes.
The decree no. 472 has general application and introduces the basic rules for the applications of the sanctions common to all the taxes; its principles could be summarized in:

1) Repeal of the distinction between fine and surcharge and contextual adoption of a single kind of administrative sanction consisting in the payment of a sum of money. The penalty is determined in changeable amount between a minimum and a maximum limit, in proportion to the tribute which the violation is related to; or a fixed amount in some cases. Another principle established by the provisions in issue, is that, unlike the past, the sum imposed by way of penalty for late payment shall not bear moratory interests
2) Reference of the sanction to individual author or co-author of the infringement (Article 2). This principle is confirmed in Article 27, where it is determined that the violations committed by companies, associations or entities shall be deemed to refer to individuals who are perpetrators.
3) Introduction of the principle of legality (Article 3), under which a taxpayer may be subject to sanctions only on the basis of a law that entered into force before the occurrence of the fact. This principle is further specified in paragraphs 2 and 3 of that Article.
4) Article 6 examines the causes of non-criminality. In particular, paragraph 2 provides for the non-punishment pf the author of the violation when it is caused by:

• objective conditions of uncertainty about the scope and the scope of regulatory measures;
• lack of requests for information;
• lack of models for the declaration and payment.

Are not punishable violations not affecting the operation of the control and not affect the determination of the tax base, tax and payment of tax.

5) Adoption of criteria in determining the punishment in relation to the gravity of the violation.Article 7, first paragraph, provides that in determining, in practice, the penalty (of course if graduated or scalable between a minimum and maximum), it must have regard:

- the seriousness of the breach, also derived from the conduct of the author;
- the work undertaken by the agent on the removal or mitigation of the consequences;
- the personality of the agent, inferred by its previous fiscal history;
- economic and social conditions of the agent.

In essence it states the principle that, whenever the sanction is fixed to a variable extent, its size, in the imposition, it must be established in the light of criteria in which the subjective component prevails. The first two, in fact, are intended to lead the attention of conduct imposed on the offender in the act of committing the violation, the remaining require the consideration of his personality and his living conditions.

6) Affirmation of the principle of non-transmissibility of the financial penalty to the heirs. This provision stems from the principle of the personality of the penalty.
7) Prediction of a solidarity borne by individual, company or institution, which benefits or assets of which are reflected the economic effects of the violation.

10.5. The discipline of penalties for tax violation by companies

Art. 7 of Law Decree no. 269 of 2003 disciplines the penalties for tax violations committed by corporations or legal entities.

The Article concerned, is entitled "Exclusive reference to the legal persons (ie Enterprises, Companies) of tributary administrative sancitions, and states at the para. 1 that the administrative sanctions related to the fiscal relationship of companies or enterprises are exclusive charged to such legal persons.

This provision applies to violations:

- Not contested (para 2);
- For which the penalty was not imposed on 2 October 2003 (para 3).

The final paragraph states that the to cases of application of the article concerned will be applied Legisl. Decree No. 472 of 1997 (see 11.3).

10.6. Innovation and Products

Introduction

Italian legal system has different instrument to protect innovation, we should consider first different kind of innovation that have different protecting tools:

- Technical Innovation protected with Patent
- Aesthetic Innovation protected with Design
- Distinctive Innovation protected with Trademark
- Creative Innovation protected with Copyright

In fact is possible in Italian Legal system to consider the Intellectual Property as a big set composed by two sub-sets, the first one – so-called Industrial Property – is composed by Trademarks, Designs, Patents, Know-How and is protected by Legislative Decree no. 30 of 2005, and the second one that consists in the Copyright introduced by Law no. 633 of 1941.

Technical Innovation

Technical Innovations, protected by Patents, in Italian Legal Systems are disciplined by art. 45 of Legislative Decree no.30 of 2005 that states "May be the subject of *Patents* for invention, new inventions that involve an *inventive activity* and are *capable of industrial application*"

The same article continues indicating that: "Are not to be regarded as inventions:

a) discoveries, scientific theories and mathematical methods;

b) the plans, principles and methods for performing intellectual activities, for fun or for business activities and computer programs;

c) presentations of information.
The requirements for patentability are:
Novelty: "An invention is considered new if it is not part of the state of the art. The state of the art is made up of all that is made accessible to the public in the State or elsewhere before the date of filing the patent application, through a written or oral description, by use, or any other means" (Art. 46 Legislative Decree no.30 of 2005).
Originality: "An invention is considered as involving an inventive activity if, for a person skilled in the art, it is not obvious from the state of the art" (Art. 47 Legislative Decree no.30 of 2005).
Industrial – "An invention is considered as susceptible of industrial application if it can be made or used in any kind of industry, including agricultural" (art. 48 Legislative Decree no.30 of 2005).
The Request for Patent: involves the claiming of the invention, sufficient description of the invention, filing of patent application that must be filed at the Italian Patent and Trademark Office by mail or even at any of patent offices at the Chambers of Commerce.
After the application the office proceeds to a "formal" exam of the invention and if it is accepted, the author of the invention acquires the rights to the invention as a consequence of the protection of the patent.
The inventor has the burden of implementing the industrial invention patent, if no the will be subject to the revocation of the rights granted (art. 69).
The patent for industrial invention lasts twenty years starting from the deposit of the application and can not be prorogated nor renewed. (art. 60)
The patentee may waive the patent (art. 78).
The patent may be declared invalid (Article 76) if at least one of the basic requirements for patentability, if the description is not clear or is insufficient, if there is an extension compared to the original application.
Distinctive Innovation
Distinctive Innovations, protected by Trademarks, in Italian Legal Systems are disciplined by art. 7 of Legislative Decree no.30 of 2005 that states "Can be subject of registration as Trademark all the signs capable of being graphically represented, in particular words, also names, paints, letters, numbers, sounds, the shape of a product or its box, the combination of colors, provided they are susceptible to distinguish the products or the services of a company from the ones of another companies"
So each object in order to have the protection of trademark must have a distinctive function and a distinctive capacity.
The requirements for trademark are:
Novelty: Marks that are not customary. Not identical or similar to trademarks or signs (company name or company, and signboard, a firm, domain name) used to distinguish goods or services identical or similar (possibility of confusion) (art. 12)

Originality: “Can not be registered as trademark signs devoid of any distinctive character and, in particular those that consist exclusively of generic names of products or services or descriptive that they refer to” (art. 13)

Lawfulness– “Can not be registered as trademark:

a) signs contrary to law, public order or morality; b) signs capable of deceiving the public, particularly on geographical origin, nature or quality of products or services; c) signs the use of which would constitute a violation of others' copyright, industrial property or other right of third parties "(art. 14).

Content of the right – “The rights of the proprietor of the registered trade mark consist of the right to have exclusive use of the mark. The holder has the right to prohibit third parties, apart from his consent to use it in business:

a) a sign identical to the mark for goods or services identical to those for which it has been registered;

b) a sign identical or similar to registered trade mark for goods or services identical or similar activities, if because of the similarity between the marks and identity or affinity between the goods or services, may occur, a risk of confusion for the public, which may include the possibility of association between the two signs;

c) a sign identical or similar to registered trademark for products or services even not similar, where the trademark enjoys a reputation in the state and whether the use of the sign without due cause takes unfair advantage of the distinctive character or repute of the mark or is detrimental to them.(art. 20)

The duration of the right is ten years renewable without limits.

Aesthetic Innovation

Aesthetic Innovations, protected by Designs, in Italian Legal Systems are disciplined by art. 31 of Legislative Decree no.30 of 2005 that states ““May be subject to registration as designs the appearance of the product or part of it which is, in particular, the characteristics of the lines, contours, colors, shape, texture or materials of the product itself or its ornamentation, provided that they are new and have individual character.

Product means any industrial or handicraft item, including, inter alia, the components to be assembled to form a complex product, packaging, get-up, graphic symbols and typographic typefaces, excluding programs.

For complex product means a product made up of several components that can be replaced permitting disassembly and re-assembly of the product.

The requirements for Design are:

Novelty: “A design is new if no identical design is known before the date of application for registration or, if priority is claimed, before the date thereof. Designs are deemed to be identical if their features differ only in immaterial details. (art. 32 CPI)

Individual Character: "A design has individual character if the overall impression that arouses the informed user differs from the overall impression produced on such user by any design which has been disclosed before the date of application for registration."(art. 33)

Content of the right: "The registration of a design gives the holder the exclusive right to use it and to prevent third parties from using it without his consent. Constitute acts of use the manufacture, supply, marketing, import, export or use of a product in which the design is incorporated or to which is applied, or stocking such product for these purposes.

The exclusive rights conferred by registration of a design are extended to any design which does not produce on the informed user a different overall impression. In determining the scope of protection is taken into account the degree of freedom of the implementation of the design." (art. 41)

The duration of the right is 5 years renewable until 25 years.

Creative Innovation

Creative Innovations, protected by Copyright, in Italian Legal Systems are disciplined by Law no.633 of 1941 that at art. 1 states: "Are protected under this Law the works of creative character that belong to literature, music, visual arts, architecture, theater and film, whatever the mode or form of expression. Are also protected programs (...) and databases for the selection or arrangement of the material are an intellectual creation".

Art. 2 of the Law no. 633 of 1941 (Copyright Law) states that "in particular, are under the protection:

• the literary, dramatic, scientific, educational, religious, so if in writing as if oral;

• works and musical compositions, with or without words, dramatic-musical works and musical variations constituents of original work in itself;

• choreographic works and pantomime, of which the track is fixed in writing or otherwise;

• works of sculpture, painting, art of drawing, the engraving and similar figurative arts, including set design;

• drawings and works of architecture;

• works of art cinema, silent or sound;

• the photographs;

• works of industrial design that have in themselves a creative and artistic value. The requirements for Copyright are:

Novelty: Not Copied works.

Originality: individual character: Minimum Creativity.

Article 6 of Copyright Law states that "The original title of the acquisition of copyright is the creation of the work, especially as an expression of intellectual work".

Content of the right The author's moral rights are unlimited. The economic rights of exploitation are up to 70 years after the author's death

110.7 Protection of Software

Protection of Software with Patents

Software patent does not have a universally accepted definition. One definition suggested by the Foundation for a Free Information Infrastructure is that a software patent is a "patent on any performance of a computer realized by means of a computer program". In 2005, the European Patent Office suggested that a software patent is a patent for a computer program claimed as such, or an algorithm or computer-implemented business method that make no technical contribution.

The EPO and other national patent offices have issued many patents for inventions involving software since the European Patent Convention (EPC) came into force in the late 1970s. Article 52 EPC excludes "programs for computers" from patentability (Art. 52(2)) to the extent that a patent application relates to a computer program "as such" (Art. 52(3)). This has been interpreted to mean that any invention which makes a non-obvious "technical contribution" or solves a "technical problem" in a non-obvious way is patentable even if that technical problem is solved by running a computer program.

Protection by patent protection and copyright constitute two different means of legal protection which may cover the same subject-matter, such as computer programs, since each of these two means of protection serves its own purpose. Software is protected as works of literature under the Berne Convention, thus any software written is automatically covered by copyright. This allows the creator to prevent another entity from copying the program and there is generally no need to register code in order for it to be copyrighted.

Patents, on the other hand, give their owners the right to prevent others from using a claimed invention, even if it was independently developed and there was no copying involved. In fact, one of the most recent EPO decisions T 424/03 clarifies the distinction, stating that software is patentable, because it is basically only a technical method executed on a computer, which is to be distinguished from the program itself for executing the method, the program being merely an expression of the method, and thus being copyrighted.

Patents cover the underlying methodologies embodied in a given piece of software, or the function that the software is intended to serve, independent of the particular language or code that the software is written in. Copyright prevents the direct copying of some or all of a particular version of a given piece of software, but do not prevent other authors from writing their own embodiments of the underlying methodologies. Copyright can also be used to prevent a given set of data from being copied while still allowing the author to keep the contents of said set of data a trade secret.

Protection of Software: between Patents and Copyright, present Italian discipline.

The Italian Law expressly provides that the software is protected under the copyright law (Law No.633 of 1941) as a result of the amendment introduced by Legislative Decree 29 December 1992 no. 518.

The Law on Copyright protects the "source program", meaning the language in which programs are written almost the listing and the "programs which understood as the translation of the language of the program in bits or machine language. The protection is extended to the preparatory work, including in them the flow charts, which represent "the ideas and principles that are behind them." The protection extends also to the "expressive form" that practically covers the interface seen from the point of view

of science and technology. If in the pictures are moving or other creations, they should be protected independently under the general rules of Copyright law.
The Patent as form of protection, seen more than enough from independent developers, is sometimes considered too weak by companies who would like to see protected technical solution found for a certain program.
For this reason that over the years the offices (the Italian Office for Trademarks and Patents) have begun to accept patent applications related to software, although with some limitations.
The type of deposit varies depending on whether the program is published or not. In the first case we proceed with the registration at the public register of the software, while in the latter case we proceed with a regular deposit of unpublished work. Public registry for the software, set up at the Office of the SIAE, there can be registered software published that have creative character, ie with originality compared to the background. [407].
Use of Software and Royalties
On the matter concerning the protection of the software fundamental is the role of the royalty as result of the exploitation of the software itself.
With the patent, however, is protected, provided that there is a technical effect, in terms of logical sequence of steps that is running, whether expressed in logical form or as an algorithm.
In the practice of the companies they fees to make use a software licensed by a foreign company. The payment will pay for a withholding tax only if the compensation is regarded as royalty. If due, the withholding will be provided by the Convention against double taxation signed between Italy and the country of residence of those who concede the software.
In the field, the Ministerial Resolution No 169 / E, 30 July 1997 clarified that, for purposes of qualification of the payment for the exploitation of the software, you need to refer to Article 12 of the OECD Model and its Commentary. Article 12 of the OECD Model defines royalties as "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience"

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[407] To proceed with registration should be filed
- A copy of the program on optical media or similar;
- A statement indicating the title of the program, the author's name, the name and address of the holder of the rights, the date and place of publication; - A description of the program to include the relevant particulars for its identification; - The request for registration made on the form (mod. 349) provided by the SIAE. If the publication was effected by the circulation of media or packaging with labels or frontispieces, must be submitted two copies of the same information which must coincide with those given in the declaration. The SIAE shall assign to programs filed a serial number and date of registration and provide the applicant a certificate of registration. Registration at Public Registry for the software is authentic until proven otherwise, the existence of the program and who wrote it. The data are included in the public and can be accessed by anyone who requests it. The SIAE shall issue certified copies and extracts of all that is filed. Since registration is optional, the registry does not provide a complete list of programs running.

The Model Convention provides that the royalties are subject to tax only in the State of residence of receiver, if he is the beneficial owner. In most of the treaties concluded by Italy, however, is taxing even recognized the State of source may apply a deduction rate on royalties reduced output.
The information and assumptions contained in the Commentary The Commentary provides some interesting details in the field of software, distinguishing the following conduct:
- Transfer of rights to use the software but not the right of ownership;
- Transfer of all rights related to software;
- Purchase of software for personal or professional use.

Transfer of rights to use

In the first case the fees paid were kind of royalty only in certain special cases, such as where a person who transfers the right is the author, or the one that he has acquired the right to distribution or reproduction, and the right is made available to third for the development and commercial exploitation of the software. Basically you can talk about only when the royalty payment is due not to infringe copyright.

Transfer of all rights

In the second case, the remuneration is not comparable to the royalty as represents the amount finally paid for the acquisition of an intangible asset and not a periodic fee for its use.

Purchase of Software

The last case considered, indeed the most frequent in practice, is that buying a license to use the software for personal or business purposes. The consideration paid included in entrepreneurial income of Article 7 or in the training provided for in Article 14 of the Model Convention and does not apply and therefore no deduction in the source country. Falls under the same assumptions the case of compensation paid to acquire the right to make a copy of the program on its own support as a safety copy (backup). The reproduction of the software, in fact, is a mode of use of the program, being absent in this case the commercial exploitation of the intangible asset. Similar considerations apply even when the user makes multiple copies of software to install on the network of their own study or a business. Where due, the tax applicable will be provided by the Convention against double taxation signed with their country of residence of the person who licenses the software. If you there are not signed a treaty with the country of reference, will apply the last paragraph of Article 25 of Presidential Decree no.600 of 1973 under which the fees "paid to non-residents are subject to a withholding tax of 30 per cent on the taxable amount". So if the above fee shall be deemed income of a company will apply the deduction of 30 per cent and if it is classified as self-employment income, then the flat-rate deduction of 25 percent leading to a deduction equal to 22.5 percent. The implementation in our system of EU Directive 2003/49 provided for the abolition of withholding tax on royalties paid to associated companies resident in the EU.

10.8 Software and tax planning methods

If we want to answer to the question about the patentability of tax planning systems, we have to notice that Italian legal system is not ready to accord such kind of protection to that system using Patents.
Is not possible to register as a patent a method of tax planning after its creation by his creator because that method seems not covered by art. 45 and art. 48 of Legislative Decree n. 30 of 2005.
At least we could accord protection to such method through the copyright, but obviously the effect of such protection are completely different and would not reach the purpose of the patentability.
If the Italian system as such is not ready to accord protection to tax planning methods through the patent, we have to notice that is not possible neither to patent the methods, the systems, the plans, created for the aim of the evasion or the avoidance.
Italian legal system cannot protect the methods that have a licit or illicit purpose, but we neither have any kind of provision that made to counter such possibility.
So Italy doesn't have the tools to patent tax planning methods, but nor has not any instrument to deny any protection to the methods that have an illicit purpose, an evading or avoiding aim. We should get to the same result when there is the creation of software intended to give plans for the payment of taxes avoiding or evading them.

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