

International tax avoidance between norm and fact

ABSTRACT OF THESIS

Taxpayers, exercising their autonomy negotiations, are free to choose the less onerous tax, within the limits of what is allowed by law. Legitimate tax savings, avoidance and evasion are three categories with one goal: saving tax. The first is permitted by law, the latter constitutes abuse, while the third is against the law.

Tax avoidance can be defined as a form of tax savings that is consistent with the letter of the law but not the spirit of tax laws, under which the taxpayer bends the rule, trying to avoid the occurrence of the condition which the law attaches the Birth of the tax and thus circumvents the application of higher taxation.

Evasion, however, consists of a direct violation of tax rules intended to conceal or prevent the prerequisite knowledge of tax.

Until the late eighties, the legislature did not provide any tax of general anti-avoidance provision under income tax.

After several attempts, the legislature enacted Article. 10 Law of 29 December 1990 408, under general anti-avoidance law, which decrees that “Law allows the financial denial of tax benefits obtained in mergers, transformation, demerger, capital reduction, liquidation, valuation of partnerships, transfer of credits and supplies or evaluations of securities carried out without any valid economic reasons for the sole purpose of fraudulently obtaining a tax saving”.

It was a rule with the deterrent effect, especially in a system like ours in which taxation is based on voluntary compliance by taxpayers. The anti-avoidance rule set out a principle, whose validity, however, was limited to a particular sector of the system: mergers, conversions, spin-offs and reductions in capital.

An examination by parliament showed that this rule was an exact reproduction of the amended Article. 9, paragraph 3 of draft Law No 5108 of 1990 on mergers of companies. The rule, therefore, was adapted to a variety of corporate transactions,

although the text was originally designed only for mergers of companies. The new standard soon proved inadequate, thus emerged the opportunity to take a *Generalklausel* that exceeds the stringent anti-avoidance legislation and adopted schemes that give protection to those areas that lacked one.

In 1997, Leg. October 8, 1997, n. 358, art. 7, introduced the art. 37*bis* in DPR Sept. 29, 1973, n. 600, which was to replace the previous provisions of art. 10 law 408/1990. Article. 37*bis*, entitled “Anti-avoidance provisions”, in the first two paragraphs, states that “Are unenforceable financial administration acts, events and legal transactions, also connected, without economic reasons, seeking to circumvent obligations or prohibitions laid down by tax system and get tax reduction or refund, otherwise unfair. The tax authority disregards the tax benefits achieved by the acts, facts and stores referred to in paragraph 1, by applying the tax determined in accordance with the provisions being circumvented, net of taxes payable as a result of the conduct relied administration”.

The provisions will apply only if a transaction occurs among those listed in the third paragraph. It is all those operations usually referred to as "extraordinary" and that, in principle, fall into appropriate strategic designs (mergers, acquisitions, changes, transfers, liquidations).

The wording of paragraph 1, article. 37*bis* corresponds to a potentially positive statement to serve as general anti-avoidance rule. However, the legislature gave the standard two limits in question, having placed in a body of rules relating to the establishment of taxes on income and having limited the scope of operations specifically mentioned in paragraph 3 °.

Article. 37*bis*, certainly has the vocation of the general clause, but this clause is not yet perfect.

Less than ten years of art. 37*bis*, into the emerging interest in an institution already employed in key anti-avoidance by the Court of Justice along with other European systems, particularly the German: the so-called “abuse of law”. The first important definition of abuse law by the Court of Justice was drafted by the ruling of

February 21, 2006, Case C-255/02, (known as *Halifax*) regarded as a genuine leading case on rights abuse.

The judges have applied, for the first time, the abuse of the right to taxation with reference to the guidelines of VAT on objective conditions and the right of deduction of tax, recognized, although implicitly and indirectly the general principle, potentially capable of embracing all matters within the competence of the Community legislature. The Community courts have reaffirmed the existence of a general principle that prohibits individuals to a fraudulent or improper use of Community law, namely to make transactions for the sole purpose to benefit wrongfully obtaining advantages provided for by law, and explained that the prohibition of abuse also applies to VAT.

The misconduct found by the Court is characterized by two elements: first, the transactions at issue, despite the formal application of the conditions specified in the relevant provisions of the Sixth Directive and national legislation that transposes, allows a tax benefit to be obtained in granting would be contrary to the objective pursued by the same rules, and second, must show a set of objective factors that the purpose of the transactions were mainly intended to achieve the above advantage. This approach emphasizes the fact that the transactions undertaken have to be essentially the purpose of obtaining a tax advantage. The sentence speaks of essential purpose of the pursuit of tax advantage, that just as essential and non-exclusive, may coexist with other purposes. In this case the prohibition of abuse is not relevant where the transactions in question may be explained otherwise, by competing economic reasons, unless they are absolutely marginal or irrelevant. It's enough that the purpose is essential.

The anti-abuse principle established by the *Halifax*, and further defined by the European Court of Justice ruling by February 21, 2008, Case C-425/06, refers exclusively to value added tax, resulting in the specific context, failure the right to deduct that improperly obtained. With regard to direct taxation, dominated by national law, it should exclude the application of anti-abuse. However, the Supreme

Court in its Judgement of 29 September 2006 n. 21221, establishes the entry of general anti-abuse principle in our system as a canon of interpretation generally applicable beyond the narrow confines of *Halifax*, in every area of the tax and therefore in direct taxes.

Subsequently, the Supreme Court, with sentences January 16, 2008, n. 8772 and n. 10257 of 2008 (both with respect to taxes on income), confirmed the direct applicability in all areas of our legal system, including income tax, the principle of abuse of law developed by case law (on VAT !) already stated before the judgment n. 21221 in 2006. The definition of abuse made by the Supreme Court is different from the concept set out by the Courts.

The Court of Justice, in particular with the *Halifax*, said that the principle of rights abuse is enshrined in Community law as an unwritten principle inherent in the regulatory system and retractable legal experience of the individual Member States. The abusive conduct was characterized by the necessary presence of two elements: the main purpose of a reduced tax burden and that the transaction, despite compliance with formal conditions set by the relevant provisions, is contrary to the objective pursued by them. In its ruling the Court of Cassation, in fact, no reference to the diversion to the objective pursued by the legislature, that characterizes the abuse.

The Supreme Court stated that “an abuse of the right operations undertaken primarily to achieve a tax advantage, and incumbent on the taxpayer the burden of providing evidence of the existence of alternative economic reasons or competing not merely marginal character or theoretical”.

The Court grants the general principle that “even imposing direct taxation, although they attributed this to the Member States, they must exercise that power in accordance with the principles and fundamental freedoms contained in the European Treaty”.

We agree that Member States must respect, even in matters of income tax, the principles and fundamental freedoms recognized by the EC Treaty, but it is true that the principle of abuse of the right does not fall under the principles established by that

Treaty. Moreover, the Court of Justice said that the principle of interpretation concerning value added tax, but not for taxes of Community origin, nor with respect to taxes on income of only internal matrix.

Subsequently, the Supreme Court, in sections joined in December 2008 with the judgments n. 30055-30056-30057 said that there is a general anti-avoidance principle whose source is not found in case law rather than in the same constitutional principles that inform the Italian tax system and, in particular, that of ability to pay, art. 53 of the Constitution. The highest Judges believes that an anti-abuse principle was present even before the introduction into, by the legislature, article. 10 Law n. 29 December 1990 408, and art. 37*bis*, 29 September 1973 presidential decree n 600, introduced in 1997.

The fact that the legislature wrote the anti-avoidance rule, for reasons of certainty and uniqueness, and then only for certain cases, does not mean that the same could not be implicit in the system. Subsequent anti-avoidance provisions constitute a specification of the anti-avoidance principle inherent in our system, based directly on. 53 Constitution, which establishes the principle of ability to pay and prevented them affiliated to evade obligations to pay contributions through the distorted use of fiscal institutions. The anti-avoidance rules introduced by the legislature must be regarded merely to confirm a principle already deduced and art. 53 Constitution. The imperative to compete for public expenditure is also an expression of the general duty of solidarity (political, economic and social) to art. 2 Constitution, among which also places a duty of contribution, and the principle of equality under article. 3 of the Constitution

The combined effect of articles. 2, 3 and 53 of the Constitution, shows the general duty of imposing contribution to all members of the community to contribute to its maintenance by reason of their actual ability to pay. Therefore the principle is to stop each avoiding unduly necessary contributions.

This approach was subsequently repeated by the Supreme Court in its Judgement January 21, 2009, n 1465. The decision refers to situations not covered by

article. 37 *bis* of DPR 600 of 1973 because it relates to annuities for which the anti-avoidance principle had not yet been codified. In the absence of a written standard, the Court, as it did in December of 2008, affirms the existence of a general anti-abuse principle derived from article. 53 Constitution.

The ruling, contrary to the previous n. 30057 of 2008, assigns a decisive role in articles. 3 e 53 Cost, which canon of interpretation. In this case, it no longer speaks of a direct application of article. 53 Constitution, but the interpretation of substantive provisions in the light of the prohibition of abuse. It is therefore a reasonable constitutionally oriented interpretation of the provisions of the special part. The Supreme Court, in the last four cases cited, has "overcome" the problem of art. 37 *bis* of DPR 600/1973 on paper and got to apply the provisions of article. 37*bis* to cases occurring before its entry into force, because the interpretation of anti-avoidance tax laws based on article. 53, paragraph 1, Constitution.

Our system has developed some tools against international avoidance: transfer pricing, the controlled foreign companies and no tax-deductible costs and other negative components relating to transactions that occurred with firms located in tax havens. With regard to transfer pricing, central analysis is about the article. 110 paragraph 7 of Decree 22 December 1986, n 917 (Consolidated Income Tax, Tuir below). The rule refers to transactions that occur within a transnational group of "non-resident companies within the state" and an "enterprise" resident when, between the two, there is a controlling relationship, in the sense that one controls the other, directly or indirectly, or are both subject to the same subsidiary ("sister"), in which case directly or indirectly, and operations of supply of goods and services provided by non-resident companies on whose behalf the firm resident expressed "sales and procurement of goods or raw materials or manufacturing or processing of products".

The operations consist of supplying goods or services upon payment of a fee that does not match the true value of the goods or service. The components of income from these operations must be evaluated, where such assessment is thereby more Italian income and only exceptionally in the opposite case, when it achieves a

reduction in Italian income, “implementation of the agreements concluded with the competent authorities of foreign states as a result of the special procedures provided for in the friendly bilateral treaties against double taxation on income”, based the normal value of goods and services being exchanged. The discipline of the Controlled Foreign Companies (CFC) was introduced in Italy by Law 21 November 2000 342, art. 1, (in former art. 127-*bis* of Tuir) to counter the localization of incomes in countries with low taxes generated by activities that have their center directors and operating in the State.

Currently, articles. 167 and 168 Tuir governing this particular tax scheme against a resident of Italy who has directly or indirectly, a controlling interest (article 167, supplemented by Decree 21 November 2001, No 429) or link (article. 168, built by DM August 7, 2006, No. 268) in a foreign company located in a tax haven. Generally, income earned by an individual or a company, consisting of income from foreign companies are taxed in Italy, in the tax period in which they are received. Where income is produced by a company resident in a tax haven, then it would be possible to delay taxation on them, through a delay in distribution.

To escape this problem, a system of taxation for transparency was introduced, under which “If a resident of Italy owns, directly or indirectly, including through trust companies or nominees, the control of an enterprise, a company or other entity residing or located in states or territories other than those contained in the Decree of the Minister of Economy and Finance issued under article 168-bis, the income earned by foreign entity defendants are involved, from the financial year or period for managing the foreign entity involved, the residents in proportion to shares held by them, directly or indirectly, regardless of actual perception”.

The CFC rules apply when there is a relationship *ex art.* 2359 cc or link between those involved. The income of non-resident, the resident defendants for transparency, are taxed separately with the average rate charged on the income of the resident.

The taxpayer may avoid the application of CFC rules by submitting the enclosed prior rulings from tax authorities through which to demonstrate either the company or other entity not resident performs effective industrial or commercial activity as its core business in the State or the territory within which they have or that the shares it does not follow the effect of locating the income in states or territories other than those contained in the Decree of the Minister of Economy and Finance issued under article 168-*bis*.

Finally, art. 110, paragraphs 10 and later Tuir rule of the taxation of negative components of income resulting from transactions between resident enterprises and companies domiciled in tax havens, identified in the same way as it is for the application of CFC rules, with the express exclusion of EU member states.

The rule provides that the negative components of income from these transactions are tax non-deductible for the undertaking resident. The underlying purpose is to counteract the shift of tax matters to low-tax countries assuming total or partial untruth of the transactions made.

The provision under review is based on the presumption that firms located in tax havens have been created taxpayers to move from Italian tax matters. This presumption can be rebutted if the taxpayer provides proof that foreign firms have managed a business effectively, or that the transactions entered into in response to a real and appreciable economic interest and that they have effective enforcement. The two conditions are alternatives, so it is sufficient that the taxpayer proves the existence of only one of them to be able to deduct the cost.

Reconstructed under the anti-avoidance rules, one must now see how the problem of burden of proof is posed in this area. The term “burden of proof” should be analyzed in two ways: from objective point of view, as a rule of opinion on the fact that uncertainty allows the judge to reach in any case a decision of acceptance or rejection of the application even if it is still some doubt about the truth of the facts in dispute, therefore, where the evidence is not produced from the documents, the did not test is not legally made (no not *liquet*) subjectively is defined as the allocation of

burdens of proof between the parties, in that each party must prove the facts underlying the claim asserted.

Even in the tax process is applicable to the burden of proof. In particular the use of the rule reviewing of the burden of proof in tax, taking into account the peculiarities of the process which is intended to operate. The burden of proof should be distributed according to the substantive position taken by the parties in court. The prevailing attitude in doctrine and case law lays the burden on the office, the burden of proving the facts constituting his claim, while the taxpayer bears the burden of proving the facts against, modifying or extinguishing it.

On the contrary, if the taxpayer is to make a claim, as if he exercises the right to reimbursement, in proceedings for recovery of, or requiring the approval of a concession or tax exemption, there is a substantial reversal of the position of the parties and will be charged to the taxpayer the burden of proof of the claimed right of association, while the administration will weigh the burden of proving the facts against the repayment or the more favorable tax treatment. Again we apply the general rule of burden of proof on the basis of substantive position taken by the parties in court. This is the rule that presides over the trial that will establish itself in front of the Tax. The rule may be departed from only in exceptional circumstances where the law expressly provides for reversal of the burden of proof. The typical assumption is that the prediction of legal presumption in favor of the tax related items. In this case the office will be sufficient to demonstrate specifically that the conditions prescribed by law for the application of that presumption, and the taxpayer must provide evidence to the contrary.

It's still possible that the evidence produced by the parties is not sufficient to reach a decision, then, the Tax, if deemed necessary to acquire additional evidence, may exercise, for instructors and subject to the facts adduced by the parties, the powers Article provided. 7 of Legislative Decree n. 546 of 1992. Where uncertainty remains regarding the disputed facts will operate the rule of burden of proof in proceedings under which the court must decide unfavorably against the burden of

proof that it has not fulfilled negligently non-existent considering the fact unproven. After examining the burden of proof between taxpayer and tax authorities in the procedural and believe that we must now analyze how attitudes that burden when a transaction is completed elusive.

The anti-avoidance rules are formulated as presumptions of law relating, in which the legislature presumes that a transaction has been put in place with elusive goals, and allows the taxpayer to prove otherwise and demonstrate the authenticity of the work. From the reconstruction of elusive phenomenon it is shown that it does not arise in a very real problem of evidence. The circumvention, in fact, unlike tax evasion, is the result of behaviour that is “sunlight” through lawful means, with behaviour that prevents the occurrence of the conditions or tax less onerous requirements put in place without concealment of tax matters, without simulated acts. The avoidance did not put in place is controversial, to play “cards on the table”, while in processing the taxpayer makes unlawful conduct and is necessary to reconstruct the incident.

Tax avoidance is not an issue of fact for trial, seeking to reconstruct the factual reality. The trial is in fact closely related to the court of law. The first task requires knowledge of character, evidence-based, and aims to ascertain the truth or falsity of the facts at issue, the second one involves an assessment of the legal effects, relating to the identification of the meaning that must be attributed to a rule and the legal consequences arising from the application of the standard case. The first directly involves the parties and the burden sharing of evidence between them, the next assessment is made by hand during the investigation of or the outcome of court proceedings. In tax law the two reviews, one in fact and in law, in fact, affect not only the trial stage, but also procedural of the investigation. The historical reconstruction of the facts and the subsequent assessment underlies both the adoption of the notice of investigation, the delivery of the ruling by the tax court.

Tax avoidance, the fact is not controversial and does not pose particular problems in establishing the facts, but rather for verifying whether the facts alleged

by the office part of the situation-type (or abstract case) as defined by rule. What is important, therefore, is not the *quaestio facti*, but *quaestio iuris*. The legal classification of behaviour is not considered an elusive object test, but a decision. In this sense, is not to say that in disputes about tax avoidance there are questions of fact, because the defence of the taxpayer could be approached to challenge the root of the facts that the financial administration assumes as true and on which it based its finding. The taxpayer may rely on certain factual circumstances to counter the facts established by the office.

But where the taxpayer does not dispute the facts alleged against him, or at least, once they establish the facts, legal issues arise concerning the verification of valid commercial reasons or to fall within the operation carried out among those alleged circumvention by the legislature. As for sound economic reasons, it is true that the taxpayer could cite the facts (which should therefore be tested) in support of their existence, but it is also true that, once those facts are proved, whether you are or not in front of "strong economic case" is a matter of law. As for the international instruments to combat avoidance, however, are of particular importance, in addition to questions of law, matters of fact.

In the framework of transfer pricing, in particular, those are questions of fact relating to the reconstruction operation performed, the determination of normal value and in particular identifying the time and place closer to those transactions or check the identification of sector and the relevant geographic market, or more, that concerning the selection and measurement of results of sample transactions. In the literature, was also shown that the determination of normal value under article. 9, paragraph 3 ° of Tuir could result in an assessment of whether estimated or not estimated in the extreme case where there is a single price list to be considered for the comparison, or a court of law, where, for example, the financial administration contexts taxpayer compliance with the hierarchy of methods covered by that provision.

It is, in fact, question of law to determine the conditions for the applicability of the guidelines, such as checking the subjective condition, represented by a control relationship between the non-resident company and the company resident in the State. Once it found the economic influence of the non-resident company and the company resident in the State is a matter of law to see whether it meets the control condition required by the legislature. As regards the taxation of controlled foreign companies (CFC), the income earned by foreign entity involved shall be posted for transparency from the financial year or period for managing the foreign entity, to the residents, they have a relationship of control or connection, in proportion to their shareholdings to they hold regardless of the actual perception and taxed separately.

The taxpayer may avoid the adverse effects arising from the provisions of Articles. 167 and 168, Tuir a procedure to question, art. 11 Law of 27 July 2000, n. 212, which establish, under article. 167, paragraph 5, that either: a) the corporation or other entity not established effective industrial or commercial activity takes place, as its main activity in the market state or territory within which they have; b) does not result from participations localize the effect of income taxation in states or territories privileged.

The disapplication of the CFC rules implies the resolution of questions of fact and questions of law.

This is largely to resolve issues of fact when it provides evidence of the actual characteristics of the work done by the foreign subsidiary. The first involves extenuating circumstances that the resident must prove that the foreign company, using its own organizational structure (local employees, equipment, etc.), actually carries a trade or business conducted principally in the foreign country in which localized through a stable territorial settlement. The evaluation of the documentation provided by the taxpayer involves mostly questions of law.

The second involves extenuating circumstance, however, a matter of law, in fact, once identified the type of activity should be characterized, it is necessary to conduct an assessment of the activity to see if it was located in that territory to take

advantage of more favorable tax regime, or if there is a real root with the territory, given the presence of a stable organization staff and equipment or the presence of local customers.

Finally, article. 110, paragraph 10 of Tuir provides that the expenses and other negative components of income arising from transactions between companies resident in Italy and companies domiciled in tax countries or territories outside the European Union, with preferential tax regimes are tax non-deductible chief resident in the firm.

The deductions of these components, however, permissible under subsection 11° when the resident enterprise proves that the non-resident company carries on a trade mostly effective, or that the transactions entered into to meet a genuine interest Economic and have effective enforcement. In these circumstances, questions of fact and questions of law arise. In particular, the reconstruction of the actual business carried on primarily involves questions of fact, while the determination of which prompted the subject to the transaction accused of elusiveness requires an evaluation of law.

We then observed that while the finding of Tax avoidance behaviour that have importance only in the national art. 37*bis*, mainly involves questions of law, with regard to international instruments to combat avoidance you have, in addition to questions of law, including questions of fact, when such should be rebuilt to a normal value of a transaction concluded within a group (in transfer pricing) or should be shown the actual substance of economic activity carried out in a tax haven (in CFC and assuming that art. 110, paragraphs 10 and later, Tuir).