

PhD program in Business and Tax Law

Coordinator: Chiar.ma Prof. Livia Salvini

XXVIIth edition

**GROUP TAXATION OF CORPORATE INCOME:
A COMPARATIVE ANALYSIS BETWEEN ITALIAN AND
AMERICAN LEGISLATION**

Supervisor:
Chiar.mo Prof. Fabio Marchetti

Ph.D. Candidate:
Dr. Valentino Tamburro

Co-Supervisor:
Chiar.mo Prof. Claudio Sacchetto

Academic Year 2013/2014

**GROUP TAXATION OF CORPORATE INCOME: A COMPARATIVE ANALYSIS
BETWEEN ITALIAN AND AMERICAN LEGISLATION**

Abstract of the paper

In the international and comparative tax law arena, the issue of the group income taxation is crucial. Moreover, the interrelation of this issue with the European Union Law led to a new legislative approach among the Member States to the taxation of cross border dividend context. Under the European Court of Justice's doctrine, it is easier for a MS to adopt the exemption system of taxation of dividends rather than using the credit method. Worldwide taxation supposes the integration of the positive and negative foreign results and the knowledge of the foreign tax law. Indeed, in order to address tax avoidance schemes based on hybrid transaction carried out between two or more States it is necessary to understand the principles of taxation of companies and financial instruments in each foreign country. In this context, the analysis of the foreign tax law should be based on the "law in action" approach rather than on the "law in the book" approach. According to this assumption, the comparative analysis carried out in this thesis takes into account the state of the law, jurisprudence and doctrine of the Italian and American tax systems. Taking into consideration that the American tax system provides the highest tax rate for corporate income tax among the OECD Member countries, the analysis will focus on understanding how this tax system works in practice and the main differences the American system presents in contrast with the Italian system. Finally, the analysis explains how various loopholes in the Italian tax system could be changed by introducing a Us regulation regard-

ing a change in the annual accounting period. Following the introduction presented in Chapter one, an analysis of the Italian tax system (specifically regarding “income group taxation”) is made in Chapter two. Chapter three will include a thorough analysis of the tax system of the United States, while the last Chapter will conclude with a comparative analysis of both the Italian and the American systems. One of the main differences between the Italian and American systems discussed are the criteria used in order to determine the tax residence of a company. While Italian tax law provides three alternative elements: the legal seat, the place of effective management and the corporate purpose, according to the US tax law, the only criterion is the place of incorporation. This approach is mirrored in the double taxation agreement signed by the two respective countries, where the Italian tax policy provides the place of effective management as the tie breaker rule and the US policy usually refers to the place of incorporation, as mentioned previously. The criterion used by the US in order to determine the residence often creates a misalignment with the criteria used in other tax system that can lead to the so called “stateless company”, such as the so-called double Irish case.

The taxation of dividends is also quite different between Italy and the United States. Indeed, while US tax law provides a full taxation system, Italian tax law provides a partial exemption system. Furthermore, the taxation regime of dividends that come from a low tax jurisdiction is more pragmatic in the US than in its Italian counterpart. Indeed, even if the United States had no black list in order to identify tax havens, according to the full taxation system, the dividends that a US company receives from a subsidiary located in a low tax jurisdiction would be fully taxable in the US, thus making it possible to deduct the foreign tax credit.

According to Italian tax law, the existence of a “black list of tax havens” requires that only dividends that derive from these list are fully taxable, while dividends from other countries (for example, Ireland, where the corporate income tax is 12,5%) are taxed as domestic dividends. This substantial difference derives from the necessity of Italian tax law to be in line with the EU law, which strictly prohibits the discrimination of taxation of dividends between foreign and domestic companies. However, US groups can benefit from the tax deferral regime on foreign dividends that is granted by the “check the box” rule. According to the Wall Street Journal, for example, in 2011, the amount of accumulated foreign income of US group was equal to two trillion dollars, notwithstanding the incentives to the repatriation provided under the American Jobs Creation Act.

Under a domestic perspective, the taxation of accumulated income is completely different in the analyzed systems, even if the main goal of these systems is the same. According to the US tax law, the accumulation of income “beyond the reasonable needs of the business” is taxed with a surtax. When that tax is applicable, the whole taxation of the income (once that it is distributed to the individual shareholder) will be close to the 70% threshold. The main goal of this rule is to stimulate the investment of accumulated income in the business activity of the firm, rather than retain that income in order to avoid the double taxation.

According to Italian tax law, the retention of income falls under the allowance for corporate equity regime, which provides a lower taxation of retained income. The main goal of this rule is to stimulate the investment of accumulated income by allowing firms to deduct a notional interest rate on their equity.

In both Italy and the United States, companies may choose to opt for the consolidation system of income in terms of group taxation. Under Italian tax law, the threshold of the minimum shareholding/voting right required in order to join the optional tax system is lower than in the United States. Moreover, while according to Italian tax law each company included in the consolidation system has to file a tax return, in the United States, only the parent company is obligated to file a tax return. After an analysis of the European Court of Justice jurisprudence concerning group taxation, it was discovered that the Italian group consolidation regime is not in line with the principles stated in Joined Cases C-39/13, C-40/13 and C-41/13, where the ECJ stated that a tax system that offers domestic subsidiaries the option of forming a tax entity with each other only when their parent company is also established within national parameters or territories is in direct breach of EU law.

A comparative analysis will also prove useful in order to find new solutions concerning problems in the areas of foreign tax legalities, as well as domestic tax avoidance schemes. One of the main achievements in this context is the possibility to introduce into the Italian tax system the provision contained in Section 482 of the IRC, that states: “If a taxpayer changes his annual accounting period, the new accounting period shall become the taxpayer’s taxable year only if the change is approved by the Secretary”. As explained in this thesis, under Italian tax law the combined use of the participation exemption regime, consortium relief and the “abuse” of the freedom to change the annual accounting period could be exploited by taxpayers in order to avoid the taxation of the business income of a company turning it in a capital gain income, that has a preferential regime of taxa-

tion. Under Italian tax law, the freedom to change the tax period is a loophole that is addressed with weak instruments. As you will read, it should be useful to introduce the provision contained in Section 482 of the IRC in the Italian tax system in order to fill such a gap.

Finally, the analysis of the statistical data of Federal Receipts in the US shows that in both countries, the main fiscal burden falls on the individuals rather than on companies. In this regard, considering the common problem of public finance, the real challenge is not to rebalance the taxation between companies and individuals already residents in a country, but rather to quickly develop a new rule in order to tax non-residents that exploit the digitalization of the economy. Once the OECD will deliver the BEPS project, a loyal cooperation between the States will be necessary in order to introduce in each country the new rules that will address base erosion and profit shifting phenomena. Thus, this will guarantee a more fair apportionment of the taxable income in a global perspective.