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"INTERNATIONAL TAXATION ASPECTS THAT AFFECT MANAGEMENT OF THE TAX ADMINISTRATIONS"

Subtopic 1.1

"INTERNAL REGULATIONS TO PREVENT INTERNATIONAL TAX EVASION"

Finance Guard

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The topic we are to discuss about is to be examined keeping in mind that is has been analyzed by the OECD – that released several reports on this – and, at the top level, by the G20 meetings, moving from the one held in London in April, 2009.

Thus, a coordinate framework of actions undertaken by the international community appears, aimed both at promoting tax transparency and tackling economic and financial crisis.

Then, no domestic position, regulation or elsewhere is defined in my country disregarding this framework; moreover, the European Union policies and regulations must be considered, too.

Due to all this, my Country, strongly emphasized the fight against tax havens over the last years, which has become one of the main objectives of its economic-fiscal policy.

In view of the above, significant and fast changes occurred in our domestic tax laws, entailing a general enhancement of the legislative system in place against misuse of tax havens, both through:

1. the extension of the scope of already existing rules;
2. the introduction of new rules.

We shall now analyze the two areas as follows.

Now, the first area to be considered is, as I said before, the

1. EXTENSION OF THE SCOPE OF THE ALREADY EXISTING LEGAL RULES ON TAH HAVENS

For starting, I must say what a tax haven is according to Italian legislation.

The Italian tax system draws up **lists of countries**, whose legal and regulatory frameworks can be exploited to commit tax evasion.

In detail, the reference standard is made up of three ministerial decrees in which about **70 foreign legislations** are considered not in line with some our specific tax rules.

The first set of rules that have been updated is related to the so called

a. Participation Exemption - Pex

In conformity with other fiscal legislations of industrialized member Countries, the Italian Government established a tax exemption system for revenues of companies holding stakes in other businesses.

To this end, the so called *participation exemption* – also known as PEX – was introduced. As a result, the capital gains obtained from shares or stakes in companies or other entities, may, if some requirements are met, be deducted from taxable income.

Since 2003 – when this rule entered into force - the rate of exemption of these capital gains changed several times. The current exemption rate is very high, as it arises up to 95% of the value of capital gains.

For obtaining the exemption, a stake – holding company must not resident of a State or territory having a privileged tax system, that is a tax haven.

Furthermore, demonstration must be given that the profits from the stakes have not been placed in States or territories in which they are subjected to privileged tax systems (tax havens, again).

Then, in few words, no benefit (no exemption, in this case) is allowed if any link exists between the stake holder and a tax haven.

An additional aim of this rule should be considered, that is promoting the setting up in Italy of *holding companies*, both foreign and domestic, preventing at the same time, the abuse of off-shore entities.

Our law is now very similar to those already existing in other countries on the same topic of participation exemption.

Eventually, the rule also aimes at avoiding any double taxation of profits from stakes holding, as taxation is only established in respect of the legal person which ontaines the profit, and not in respect of the natural person who transfers the stakes.

The second issue in the area is related to the so called

b. **Controlled Foreign Company (CFC)**

For the purpose of preventing any misuse, whereby a foreign company in which a stake is held, located in tax haven, does not carry out an actual activity but is set up solely for hiding the incomes of a legal or natural person, the Italian legislator provided for the taxation of the incomes of any company, in which a stake is held, having domicile in tax havens.

Such a provision is given in most of tax legislations of the OECD Countries, even if with distinctive features, State by State, according to the taxation approach of the different fiscal systems (“*transactional approach”, “entity approach”, “global approach”).*

Then, according to the Italian law, the incomes of a CFC based in a tax haven are taxed in Italy, and related taxes must be paid by the resident controlling entity.

Obviously, to this end the requirements of the absence of an actual economic activity in the tax haven and of a mere passive utilization of the sources of income (so-called *passive income*) in the foreign State must be met both.

In Italy, the specific CFC legislation provides for the direct allocation to the shareholding entity of the incomes of its own controlled entity, regardless for the actual distribution of such proceeds: this makes useless for fiscal purposes, at the same time, both the foreign corporate screen (so-called *base company*), and the formal fragmentation of the group in legally independent entities.

Art. 13 of Decree-Law 78/2009 furthermore prescribes that, by analogy and harmonization with the provisions already in place in other European systems, in order to prevent undue tax arbitrages, the schemes which may favour disparities of treatment, with particular regard to infra-group operations, must be checked in order to assess whether such transactions are real or fictitious.

Moreover, the law includes in the scope of application of the rule those companies that are located in Countries which, even if not falling within the *black list,* may be deemed to have privileged taxation.

Such extension occurs for the CFCs which benefit from an actual taxation lower for more than half of the Italian one, and profit mostly from passive incomes or which carry out mainly services in favour of companies belonging to the same group.

The third point to be discussed is

c. **The Non-Deductibility Of Costs Scheme**

Italian tax legislation also provides for the non-deductibility of the costs deriving from transactions held between resident businesses and entities based in States or territories outside the European Union and having privileged tax systems.

The aim of the rule is to prevent the erosion of taxable base, implemented through transactions carried out with companies or professionals based in *black list* territories which entail the assignment of costs – and as a result, an undue reduction of taxes - to the Italian taxpayer, whereas the related income would not be taxed in the foreign jurisdiction, or it would be with very low rate.

However, the Italian taxpayers are granted the possibility to "overcome" the related legal presumption if they are able to demonstrate the truthfulness of the activity carried out by the foreign subject with whom business relations have been held.

So, this is a typical case in which the burden of proof is inverted, as no activity must be done by the Tax Administration for tax assessment purposes.

The fourth item is the

d. **ADAPTATION TO OECD DIRECTIVES IN THE FIELD OF TRANSFER PRICES DOCUMENTATION**

A domestic law in 2010 aligned the national legislation in the field of transfer prices documentation to the OECD directives and to the principles of cooperation between taxpayers and financial Administration. In view of this, a rule was included providing, in the cases of adjustment of the normal value of transfer prices practiced in the framework of operations with non-resident entities, the non-applicability of the relevant penalties if the taxpayer, also when a tax audit is on-going, delivers to the Tax Administration documents showing the conformity of the normal price with the transfer prices themselves.
Next topic is

e. **False personal residence**

In our fiscal legislation people are considered resident in the territory of the State when, for the greater part of the tax period, anyone of the three following conditions occurs: entry in the registers of resident population; domicile in the territory of the State under the civil code, or the residence in the territory of the State under the civil code.

On the other hand, the Tax Administration does not need give evidence the of any of the aforementioned conditions in relation to Italian nationals struck off the Registers of resident population and emigrated to a tax haven.

This is due to the fact that, in 1999, the legislator has introduced an inconclusive legal presumption of residence in Italy of such subjects. In this case, the burden of proof is established upon the taxpayer, with whom lies the obligation of proving the truthfulness of the relocation abroad.

This legislative solution has been adopted in order to strengthen the system in place to counter the phenomenon of *relocation abroad of natural persons*, i.e. the fictitious moving of the residence in States with privileged taxation schemes, solely for fiscal saving purposes. It is a rule widely criticized in regard to legitimacy and fairness, also in consideration of the fact that, whereas for persons, also non-nationals, entered in the register of resident population, the registration has the validity of conclusive presumption, for those nationals who entered the Register of Italians Residing Abroad, this presumption has the validity of inconclusive presumption.

The monitoring of the transfers of residence abroad of natural persons forms subject matter of close attention on the part of the Italian legislator; article 83 of decree-law 25 June 2008, n. 112, indeed prescribed the carrying out of control plans in respect of the tax and contributive requirements for non-resident subjects, as well as the obligation for Municipalities to confirm to the competent Revenue Agency Office, within 6 months of the application for inclusion in the register of Italians residing abroad, that the applicant has actually ceased the residence in the national territory; it is also established that for

the three-year period following the aforesaid application, the actuality of the cessation of residence in the national territory is under the surveillance on the part of the Municipalities and the Revenue Agency.

Last topic in this first area I related to

f. **Company fictitious tax residency abroad and trusts**

In the same way as natural persons, also in the field of tax residences for entities and companies, the domestic legislation, continuously evolved, legislator, aimes at tackling the abuse of abroad residency, especially as “fictitious tax residency abroad”. The usual outcome of such a misuse of residency allows the taxpayer to not comply with the domestic tax obligations and, on the other hand, to benefit from a more favourable tax regime than the Italian one.

To this purpose, in the same way as for natural persons, also for entities and companies specific provisions were introduced, establishing several inconclusive presumptions regarding the residence, lying upon the principle known as *substance over form*, regarding particular juridical institutes which, according to the national and international experience have shown that they can be used for the setting up of “fictitious tax residency abroad” schemes.

Reference is firstly made to the *trusts:* Italian law foresees two cases in which an inconclusive legal presumption of residence in Italy can be applied to foreign *trusts* established in countries that do not allow an adequate exchange of information. The first case is the one in which at least one of the transferors and at least one of the beneficiaries are Italian residents; the second one occurs when a resident natural person has arranged, in favour of the *trust*: transfer deeds of the property right on real estate; and: establishment or transfer of real estate rights, also for shares. Such provisions aim at countering possible forms of abuse, with elusive purposes, in the use of these mechanisms of asset segregation, as the expected result is taxation in our country incomes produced in the country itself by trusts established in tax havens.

Now, I am going to explain the second main area of activity of the Italian Government and Parliament, related to the

2. **INTRODUCTION OF NEW LEGAL BASIS**
   The first item is the

a. **Art. 12 of legislative decree 78/2009.**

This rule set up in 2009 an inconclusive presumption according to which the financial investments and activities held in the States or territories with a privileged tax regime (tax havens), in violation of the declaring obligations regarding tax monitoring, are considered established through non-taxed income.

At the same time, harsher penalties for violation of the tax monitoring obligations were introduced.

The rule Art. 12 was adopted with the purpose - explicitly stated by the rule itself – of implementing the understandings reached between the O.E.C.D. concerning the surfacing of economic and financial resources held in Countries having privileged tax systems.

The discovery of investments and financial assets in black list Countries, besides triggering the inconclusive presumption described above, determines the application of doubled penalties compared with those ordinarily decreed for tax offences, and as a result the range of the penalties is between 200% and 480% of due taxes.

Additionally, if the income has been produced abroad, the penalties are furtherly increased by a third.

Furthermore, the deadline for tax assessment is doubled in comparison to the ordinary one, and as a result it extends until the eight year after the one in which the tax declaration was submitted to the Tax Administration (or was to be submitted).

Finally, the penalties established for the violation of the tax monitoring were doubled too, and as a result they must be determined in such cases from 10% up to 50% percent of the amounts not reported in the tax return.

The second point is related to

b. **Communication obligations**

The law foresees that the VAT taxpayers must inform the Tax Administration of all the sales of goods and services rendered and received, registered or subject to registration, to economic traders located, residing or domiciled in countries indicated in the domestic *black list* through a specific form, that must be electronically sent within the last day of the month following the period of reference.

Moreover, recently, the reporting obligation has been extended to some typologies of supplies of services territorially not relevant in the State for VAT purposes, but that are particularly relevant in the prevention and fight against VAT frauds.

Eventually, a Law Decree of the year 2012 removed the obligation to notify the Tax Administration of any transfers of goods and supplies of services done and received, registered or subject to registration, for business operators having office, residence or domicile in privileged taxation Countries, in all cases of operations for amounts lower than 500 Euros.

The very last topic is the

c. **Contractors' blacklist**

In the framework of some recent decisions mad ad international level, and with specific reference to the initiatives adopted by the G20 in the mentioned Summit of July 2009, the national legislator introduced a new legal provision in public contract matters: this provision meets the need to ensure full knowledge of the property and management of entities entitled to take part in the procedures called by the contracting entity in accordance with the national legislation. This also aims at ensuring equal conditions for entities participating in public calls for tenders.

So, the companies having their headquarters, residence or domicile in blacklisted countries are allowed to taking part in public calls for tenders concerning works, services and supplies, but they need a preliminary authorization released by the Ministry of Economics and Finance, based upon an application submitted by the company itself.

Thank you for your kind attention.