

Master in International Taxation

(University of Hamburg)

Master in Pianificazione Tributaria Internazionale

(Università di Roma Sapienza)

Corso Superiore di Polizia Tributaria

(Guardia di Finanza)

2nd Joint Seminar

**Tax Havens in the Age of Global Standards:
a Comparative Analysis between Germany and Italy
(University of Hamburg, 4th March 2011)**

2. Italian CFC rule

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March 04, 2011

The Italian Tax Legislation

- ✓ Article 167 of Italian Tax Act (i.e. Presidential Decree no. 917 of 22 December 1986)



Summary

- *Introduction*
- *Legislative Evolution*
- *Italian Cfc legislation's objectives*
- *The Legal Framework*
- *Relevant cases*



CFC rules - General

- The CFC rules generally apply to apportion a foreign company's income to the parent company and to subject it to current taxation in the parent company's country without reference to a dividend distribution.
- 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.



Legislative Evolution

- Law no. 342 of 21 November 2000
- Ministerial Decree no. 429 of 21 November 2001
- Ministerial Decree of 21 November 2001
- Legislative Decree no. 344 of 12 December 2003
- Law no. 244 of 24 December 2007
- Law Decree no. 78 of 1 July 2009, converted into Law no. 102 on 3 August 2009
- Revenue Agency Circular no. 51/E of 6 October 2010



Italian Cfc legislation's objectives

- counteract the tax deferral of the profits of the cfc (Stevanato)
 - anti-avoidance purpose (Lupi)
 - both (Leo)
 - avoid the deviation of profits realized through behaviours referable to real interposition (Cordeiro Guerra, ECJ)
 - guarantee equal treatment to taxpayers who generates income abroad and to taxpayers who do so in the Italian territory, namely *capital export neutrality* (Franzè, Ballancin)
- ensure that profits generated abroad are subject to proper taxation.



The Legal Framework

- person subject to CFC rule
- concept of control
- definition of controlled foreign corporation
- identification of tax privileged regimes
- attribution of income to the shareholder of the CFC and elimination of double taxation
- exemptions
- tax ruling



Person subject to CFC rule (art.167, par.1-2, ITC)

- Individuals
- partnerships
- corporations
- public and private entities, which carry out commercial or non-commercial activities.
- excluded italian permanent establishments of foreign entities

Concept of control

Article 167, par. 1, ITC 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*)



Definition of controlled foreign corporation (I)

The notion of entities resident in tax privileged jurisdictions includes:

- enterprises
- partnerships
- corporate entities
- other entities

Also trusts and foreign permanent establishments of non-resident subjects can be considered entities according to the CFC legislation.



Definition of controlled foreign corporation (II)

The Law Decree no. 78/2009 has extended the CFC regime to foreign companies that are not established in black listed jurisdictions, when two tests are met:

- the foreign company is subject to an effective tax in its country of residence which is less than 50 percent of the Italian tax that would apply on its profits, and
- more than 50 percent of the profits of the foreign company are passive income.



Identification of tax privileged regimes

Jurisdictional approach

or

Transactional approach

?



Attribution of income to the shareholder of the CFC (art. 167, par. 6-7, ITC)

- The income of the controlled foreign company is calculated in accordance with the Italian rules governing the taxation of business income.
- 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.
- The shareholders are taxed separately on the cfc income at the average tax rate, which cannot be lower than 27 per cent.
- The double taxation is avoided by a tax credit system

Exemptions

The Italian CFC legislation envisages **two alternative exemptions**

↳ **Active trade or business**

↳ **Effective needs**

After the Law Decree 78/2009 the “active business exception” has been modified:

→ the economic activity of the CFC has to be carried out in the local market of the country in which the CFC is established.

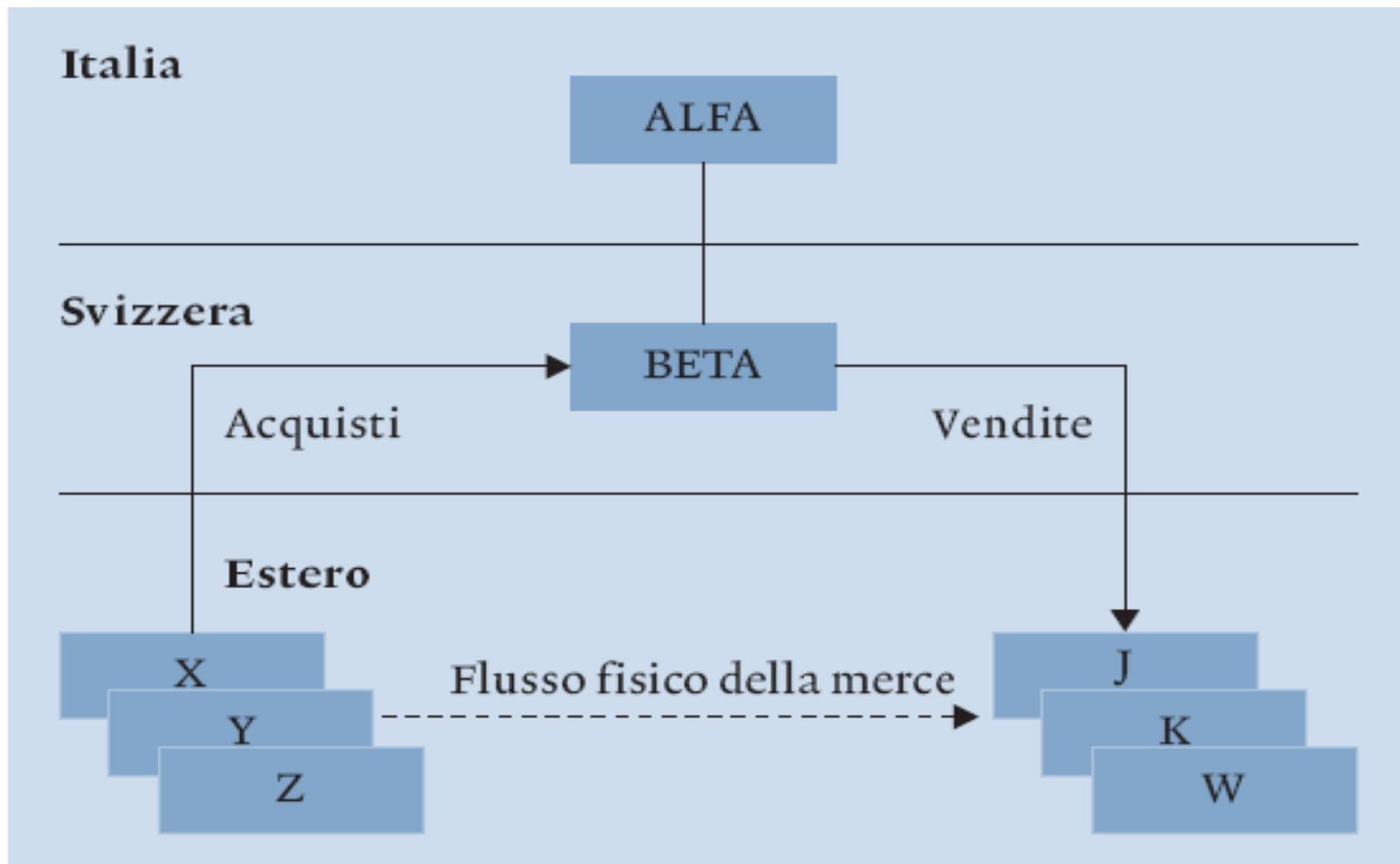
→ the active trade or business exception will not apply to companies more than 50 percent of whose income is passive income

Tax Ruling

- The Italian person who wants to benefit from these exemptions must request a tax ruling and ask for the non-application of the provisions to the tax 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.
- If the ruling is not requested and the requirements of the CFC legislation are fulfilled article 167 will be applied.

Relevant cases (I)

Revenue Agency Resolution no. 427/E of 10 november 2008



Relevant cases (II)

Revenue Agency Resolution no. 165/E of 22 June 2009

