

# Permanent Establishments under Italian Tax Law: An Overview

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## 1. Introduction

The permanent establishment (PE) concept is a cornerstone of international taxation. In general terms, the existence of a PE of a non-resident taxpayer in Italy has the following implications:

- the business income derived through the PE is deemed to be derived therefrom;
- the existence of a PE affects the withholding tax applicable on payments attributable to it;
- it may extend Italy's taxing rights to certain items of income not attributable to the PE ("force of attraction" principle);
- it creates an obligation to prepare financial statements to determine the total taxable income of the non-resident and the obligation to file an annual tax return;
- it creates accounting and regulatory obligations; and
- it obliges the non-resident to act as a withholding agent on payments borne by the PE.

This article addresses the PE concept for Italian tax purposes, taking into account domestic law and Italy's tax treaty network. Each section includes the relevant tax

authority pronouncements, while a special section is dedicated to landmark cases.

## 2. Definition of a PE

### 2.1. In general

A PE definition was first introduced into domestic law in 2003, with effect from 1 January 2004.<sup>1</sup> It only applies for income tax and IRAP (regional tax on productive activities) purposes. The treaty definition prevails if more favourable to the taxpayer.

Prior to the introduction of the domestic definition in 2004, the Courts often relied on the Italian Civil Code (ICC) definition of "secondary establishment with permanent representation" contained in Art. 2506 ICC.<sup>2</sup> Subsequently, the same Courts clarified that a secondary establishment with permanent representation is only a type of PE, the PE concept being broader.<sup>3</sup>

Courts and tax authorities also relied heavily on the definition in Art. 5 of the OECD Model Convention (OECD Model).<sup>4</sup> While there is little guidance on the interpretation of the recently introduced definition, several tax authority rulings and Court decisions have considered Art. 5 of the OECD Model and the related Commentary.<sup>5</sup>

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The views expressed in this article are the personal views of the authors and should not be construed in any way as the views of the organizations to which they belong.

1. Legislative Decree No. 344 of 12 December 2003. For a comment on the above-mentioned provision, amongst others, see M. Iavagnillo, "La nozione domestica di stabile organizzazione", *Corriere Tributario* 12 (2004), p. 896; S. Mayr, "Riforma Tremonti: la definizione di stabile organizzazione", *Bollettino Tributario* 18 (2003), p. 1291; L. Perrone, "La stabile organizzazione", in *Rassegna tributaria* 3 (2004), p. 794; E. Della Valle, "La nozione di stabile organizzazione nel nuovo Tuir", *Rassegna Tributaria* 5 (2004), p. 1597.

2. See in this regard Supreme Court decisions No. 3232 of 4 October 1954; No. 3041 of 15 November 1960 and No. 2672 of 9 July 1975.

3. See Supreme Court decision No. 8820 of 27 November 1987.

4. On the PE concept prior to the introduction of a domestic definition, see A. Lovisolo, "Il concetto di stabile organizzazione nel regime convenzionale contro le doppie imposizioni", *Diritto e pratica tributaria* (I) 1983, p. 1127; See M. Del Giudice, "Le stabili organizzazioni", *inserto de Il Fisco* 10 (1983), p. 11; F. Gallo, "Contributo all'elaborazione del concetto di stabile organizzazione secondo il diritto interno", *Rivista di Diritto Finanziario* (I) (1985), p. 385; E. Ceriana, "Stabile organizzazione e imposizione sul reddito", *Diritto e pratica tributaria* 3 (1995), p. 666.

5. See, amongst others, Supreme Court Decision No. 9580 of 19 September 1990 and Circular Letters No. 7/1496 of 20 April 1977 and 9/1496 of 30 April 1977.

The PE definition contained in Italy's tax treaties generally follows the 1963 OECD Model. The following highlights the differences between the domestic definition and that contained in Italy's tax treaties, on the one hand, and between Italy's tax treaties and the current OECD Model definition, on the other hand.

## 2.2. Fixed place of business PE

### 2.2.1. Domestic law

Art. 162(1) of the Income Tax Law (ITL) defines "PE" as a fixed place of business through which the business of the non-resident enterprise is wholly or partly carried on in Italy. Consequently, in order for a PE to be deemed to exist in Italy, there must be: (1) a place of business, (2) which is permanent from a geographical as well as a temporal perspective, (3) which is at the disposal of the enterprise, and (4) through which its business is carried on.

Regarding a fixed place of business PE, the Italian tax authorities issued a ruling stating that a Swiss company maintaining a piece of railway and a railway station in Italy was deemed to have a PE therein. They considered that the railway and the station were used to carry out the company's activities and that all the conditions required to constitute a PE were met.<sup>6</sup>

The Italian tax authorities also held that the mere possession of immovable property in Italy does not *per se* determine the existence of a PE therein since, in order for a PE to exist, it is necessary for it to qualify as a functionally and organizationally independent structure.

In a case concerning a company resident in the Cayman Islands that had purchased commercial real estate in Italy, the Italian tax authorities concluded that there was no PE where the foreign company simply owned the immovable property. If, instead, the foreign company had (1) restructured the building, (2) opened an office to supervise the works carried out by a third-party contractor, or (3) carried on market research in order to profit from the real estate, a PE would have been deemed to exist.<sup>7</sup>

### 2.2.2. Tax treaties

In general terms, Italy's treaties (including recent ones) are based on the 1963 OECD Model. This includes the definition of "fixed place of business" PE. Some treaties use the term "in", while others use the term "through". No material difference should arise from the different wording.

## 2.3. List of examples

### 2.3.1. Domestic law

Art. 162(2) of the ITL contains the following list of examples of an Italian PE: (1) a place of management; (2) a branch; (3) an office; (4) a factory; (5) a workshop; and (6) a mine or an oil or gas well, a quarry or other place for the extraction of natural resources, including areas outside the territorial waters in which, in accordance with

customary international law and the relevant domestic legislation on the exploration and the exploitation of natural resources, Italy can exercise its rights upon the seabed, the subsoil and its natural resources. As confirmed by the tax authorities, the list of examples is not meant to be exhaustive.<sup>8</sup>

This raises an issue as to the nature of the above-mentioned provision. The examples listed in the PE definition in most of Italy's tax treaties and in Art. 5(2) of the 1963 OECD Model, constitute, a priori, a PE, i.e. the conditions required under Art. 5(1) are deemed to be met unless proof to the contrary is given by the taxpayer. This is reflected in the use of the expression "shall include" in Art. 5(2) of the 1963 OECD Model, in contrast to "includes" in the 1977 OECD Model.

Italy's treaties currently in force contain the construction clause in Art. 5(2), as in the 1963 OECD Model. The construction clause was, however, moved to Art. 5(3) in the 1977 OECD Model. Considering that there is a separate paragraph on "construction PEs" under domestic law, it could be argued that Art. 162(2) of the ITL follows the more recent Model Conventions; therefore, proof should always be given of the existence of the elements of Para. 1.

Italy's treaties use the same expression used under Art. 162(2) of the ITL. As a result, it could also be argued that under domestic law the listed examples are deemed to be a priori PEs. It is worth mentioning that, prior to the introduction of the domestic definition, the tax authorities had clarified that their position was in line with the 1963 OECD Model rather than the subsequent versions.

In the authors' view, the examples listed in Art. 162(2) of the ITL also constitute, a priori, a PE given that (1) the Italian translations of the terms "shall include" and "includes" do not differ and that (2) this has been the long-standing Italian treaty negotiation practice. This is also in line with the tax authorities' view that the definition in Art. 162 of the ITL is based on the latest OECD Model and takes into account the observations put forward by Italy in its Commentary<sup>9</sup> (Italy has made an observation to the current OECD Commentary on Art. 5 that provides that even under the current OECD Model, it considers the listed examples as constituting, a priori, a PE).<sup>10</sup>

Finally, it is worth mentioning that on several occasions, in the absence of a domestic definition, the Italian tax authorities have expressed the view that a representative office of a non-resident is deemed to be a PE in Italy.<sup>11</sup>

6. Resolution No. 282 of 11 December 1995. For a comment, M. Leo, F. Monacchi, M. Schiavo, and G. Roxas, *Le imposte sui redditi nel testo unico* (Milan: Giuffrè, 1997), p. 424; G. Borio, "Stabile organizzazione: nozione e soggettività tributaria", *Il Fisco* 45 (1996), p. 10917.

7. See Resolution No. 460196 of 13 December 1989. For a comment, M. Piazza, *Guida alla fiscalità internazionale* (Milan: Il Sole 24 Ore, 2004).

8. See note 7, Resolution No. 282.

9. Circular Letter No. 25 of 16 June 2004.

10. See Para. 43 of the OECD Commentary on Art. 5.

11. See Resolution No. 724 of 18 May 1978, No. 410605 of 6 November 1978 and No. 410827 of 13 November 1978.

### 2.3.2. Tax treaties

The examples contained in Art. 5(2) of Italy's tax treaties are deemed to be, a priori, a PE. This is confirmed by the use of the term "shall include" in most of the treaties, but the same conclusion should also apply to treaties using the term "includes". As mentioned in 2.3.1., this is confirmed by Italy's observation in Para. 43 of the OECD Commentary to Art. 5, wherein Italy does not adhere to the interpretation concerning the list of examples of Para. 2 contained in the Commentary. In its opinion, these examples can always be regarded as constituting a priori PEs.

A mine, an oil or gas well, a quarry or any other place of extraction of natural resources are mentioned as examples of a priori PEs only in the tax treaties with Bangladesh, China (People's Rep.), Ivory Coast, Denmark, Estonia, France, Germany, Greece, India, Indonesia, Kazakhstan, Kenya, Lithuania, Malaysia, Mexico, Norway, New Zealand, United Kingdom, Sri Lanka, Tanzania, Turkey and Vietnam.

The following Italian tax treaties also mention other examples that may constitute, a priori, a PE:

- *Algeria*: a sales outlet;
- *Australia*: an agricultural, pastoral or forestry property;
- *Bangladesh*: a warehouse, in relation to a person providing storage facilities for others;
- *Greece* (protocol): an installation or structure used for the exploration of natural resources only if it exists for more than 6 months;
- *India*: (1) a warehouse, where a person provides storage facilities for others; (2) the use of an installation for the purpose of research and extraction of natural resources; and (3) a premise used as a sales outlet or for receiving or soliciting orders;
- *Ivory Coast*: a fixed place of business used for the purpose of acquiring merchandise;
- *Kazakhstan*: an installation or structure used for the exploration of natural resources, or supervisory services connected therewith, or a drilling rig or ship used for the exploration of natural resources only if such use lasts for more than 12 months, or such services continue for more than 12 months;
- *Malaysia*: extraction of natural resources including timber or other forest produce;
- *Pakistan*: a permanent sales exhibition; and
- *Tanzania*: a farm or a plantation.

## 2.4. Construction clause

### 2.4.1. Domestic law

Art. 162(3) of the ITL extends the concept of PE to include a building site, construction, assembly or installation project or supervisory activities connected therewith, provided such site, project or activities continue for a period of more than three months. This provision closely follows the current Art. 5(3) of the OECD Model, with two main differences: (1) the three-month term and (2) the express reference to supervisory activities. Noth-

ing is stated as regards planning activities and therefore it could be concluded that they are excluded.

It should be noted that before the 2003 modifications to the OECD Commentary on Art. 5, planning and supervisory activities of the erection of a building were covered by Art. 5(3) provided they were carried out by the building contractor. Since the 2003 modifications, the OECD Commentary provides that planning and supervisory activities of the erection of a building are covered by Art. 5(3) if carried out on-site, regardless of who carries them out.<sup>12</sup>

Several issues arise in comparing the domestic provision with the OECD Commentary. The OECD Commentary mentions planning and supervisory activities of the erection of a building, while Art. 162(2) makes a general reference to all construction PEs. In addition, there is an express reference to supervisory activities that would eliminate the uncertainty at the treaty level, at least when this is more favourable to the taxpayer.

### 2.4.2. Tax treaties

Art. 5(2) of all of Italy's treaties contain the construction clause. Generally, it is stated that a building site or a construction or installation project constitutes a PE only if it lasts longer than a certain period of time. The following chart contains an overview of the minimum time periods contained in Italy's treaties.

Treaty	Minimum time period
Albania	12 months
Algeria	3 months
Argentina	9 months
Armenia	36 months
Australia	12 months
Austria	12 months
Bangladesh	183 days
Belarus	36 months
Belgium	12 months
Bosnia and Herzegovina	12 months
Brazil	6 months
Bulgaria	12 months
Canada	12 months
China (People's Rep.)	6 months
Croatia	12 months
Cyprus	6 months
Czech Republic	12 months
Denmark	12 months
Ecuador	12 months
Egypt	6 months
Estonia	9 months
Finland	12 months
France	12 months
Georgia	6 months
Germany	12 months
Greece	9 months/6 months <sup>1</sup>
Hungary	24 months
India	6 months <sup>2</sup>
Indonesia	6 months
Ireland	12 months
Israel	12 months
Ivory Coast	6 months/less than 6 months <sup>2</sup>

12. Para. 17 of the OECD Commentary on Art. 5.

Treaty	Minimum time period
Japan	12 months
Kazakhstan	12 months
Korea (Rep. of)	12 months
Kuwait	6 months
Kyrgyzstan	36 months
Lithuania	9 months
Luxembourg	12 months
Macedonia	6 months
Malaysia	6 months
Malta	12 months
Mauritius	6 months
Mexico	8 months
Morocco	6 months <sup>3</sup>
Mozambique	6 months
Netherlands	12 months
New Zealand	12 months
Norway	12 months
Oman	9 months
Pakistan	6 months
Philippines	6 months
Poland	12 months
Portugal	6 months
Romania	12 months
Russia	12 months
Senegal	6 months
Serbia and Montenegro	12 months
Singapore	6 months
Slovak Republic	12 months
Slovenia	12 months
South Africa	12 months
Spain	12 months
Sri Lanka	183 days
Sweden	12 months
Switzerland	12 months
Tajikistan	36 months
Tanzania	12 months
Trinidad and Tobago	6 months
Tunisia	6 months
Turkey	6 months
Turkmenistan	36 months
Ukraine	12 months
United Arab Emirates	9 months
United Kingdom	12 months
United States	12 months
Uzbekistan	12 months
Venezuela	12 months
Vietnam	6 months
Zambia	9 months

1. an installation or structure used for the exploration of natural resources shall be considered as a PE only if it exists for more than six months.
2. where a temporary chain or activity, following the sale of machinery or equipment, lasts less than 6 months and the expenses incurred for the purpose of such chain or activity exceed 10% of the sales price of the machinery or equipment.
3. there is no minimum time period in the tax treaty with Morocco for a building site.

Some treaties expressly include supervisory activities within the definition of a construction PE. In particular, supervisory activities performed in a state in connection with a building site or construction or installation project fall within the construction clause in the tax treaties concluded with: Algeria, Australia (including an assembly project), China (People's Rep.), Estonia, Indonesia, Israel, Ivory Coast, Kazakhstan, Kenya, Lithuania, Mexico, Pakistan, Philippines (including consultancy activities), South Africa, Turkey and Vietnam.

Finally, the treaties with Indonesia, Israel, Malta, Kazakhstan, Pakistan, Sri Lanka, Turkey and Vietnam contain a provision similar to Art. 5(3)(b) of the UN Model, according to which "the furnishing of services, including consultancy services, by an enterprise through employees or other personnel, where activities of that nature continue for the same or a connected project within the country for a certain period", is deemed to constitute a PE.

## 2.5. Exclusions

### 2.5.1. Domestic law

Art. 162(4) of the ITL states that a fixed place of business does not constitute a PE if its activities are limited to the following:

- (a) the use of an installation solely for the purpose of storage, display or delivery of goods belonging to the enterprise;
- (b) the maintenance of a stock of goods belonging to the enterprise solely for the purpose of storage, display or delivery;
- (c) the maintenance of a stock of goods belonging to the enterprise solely for the purpose of processing by another enterprise;
- (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or collecting information for the enterprise;
- (e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; and
- (f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

The essential feature of these activities is that they are carried out solely for the enterprise and are of a preparatory and/or auxiliary nature.<sup>13</sup>

This is in line with the current OECD Model, but differs from the ordinary Italian tax treaty negotiation practice. In fact, treaties concluded by Italy do not contain a provision similar to (f) regarding a combination of activities.

### 2.5.2. Tax treaties

Following the OECD Model, Italy's tax treaties include a list of business activities that, due to their auxiliary and preparatory character, do not constitute a PE even if carried on through a fixed place of business. As mentioned in 2.5.1., no tax treaty contains a provision similar to letter (f) of Art. 5(4) of the OECD Model. The lack of a provision in the nature of (f) is not material, however, insofar as the overall character of the combined activities remains of a preparatory or auxiliary nature.<sup>14</sup>

13. See also Resolution No. 12/522 of 21 July 1977.

14. For a contrary opinion see S. Mayr, note 1. For a similar opinion see L. Perrone, note 1, p. 802.

This view is reflected in the confirmation by the Italian tax authorities that a fixed place of business in Italy of a UK entity, the purpose of which was only to collect information, carry out market research and advertise for the non-resident enterprise, did not constitute a PE under the relevant tax treaty.<sup>15</sup>

It should be noted that the Italian tax authorities have stated that a Swiss company had a PE in Italy where it maintained therein an office through which it mainly purchased goods. 90% of those goods were transferred directly to the Swiss company, while the remaining 10% were sent to the Swiss company after manufacturing, processing and packaging. The Italian tax authorities determined that the exception contained in Art. 5 of the relevant treaty did not apply because the fixed place of business was also used for purposes other than the mere purchase of goods.<sup>16</sup>

In the following tax treaties entered into by Italy, the listed activities vary from the ones mentioned in the OECD Model:

- *Bulgaria*: the sale of goods displayed at an exhibition after the termination of the exhibition does not constitute a PE;
- *India*: the list of exceptions shall not be applicable where the enterprise maintains any other fixed place of business in the other contracting state for any purposes other than the purposes specified in the list;
- *Indonesia* (1990 protocol): the delivery of goods or merchandise from a storage depot situated in a contracting state to a third country by a person acting as an independent agent to whom Art. 5(6) applies, shall not constitute a PE;
- *Mexico* (1991 protocol): preparation activities relating to the placement of loans do not give rise to a PE if such activities have a preparatory or auxiliary character and if the loans are made with resources that do not arise in that contracting state;
- *Romania*: the sale of goods displayed at an exhibition after the termination of the exhibition does not constitute a PE; and
- *Thailand*: the assembly, or installation or setting up of plant equipment or machinery including construction as necessary for such installation, if it exists for not more than six months.

## 2.6. Electronic equipment

Art. 162(5) of the ITL states that, in addition to what is stated in Para. 4, the disposal of electronic processors and auxiliary equipment that enable the collection and transfer of data and information for the purpose of selling goods and services does not by itself constitute a PE. This provision arguably relates to e-commerce and constitutes a novelty under Italian domestic and treaty law. Although nothing similar is contained in the OECD Model, it seems that this provision is in line with the OECD Commentary on Art. 5. In any event, an analysis of the relevant facts and circumstances is needed to evaluate whether the electronic equipment in Italy is used

for functions that can be considered as preparatory or auxiliary.<sup>17</sup>

The Italian tax authorities recently issued a resolution regarding whether a foreign company's Internet server located in Italy may constitute a permanent establishment.<sup>18</sup> The ruling was requested by a French company that offered online video game services to Italian customers. The French company had installed two servers with an Italian Internet service provider. Their configuration and operation (i.e. software installation and online delivery of the games to the customers) were carried out directly from France. The tax authorities observed that a server may constitute a permanent establishment under specific circumstances, namely when: (1) it is at the disposal of the non-resident enterprise (whether owned, leased, or otherwise); (2) it is located in the same place for a significant period; and (3) it is used to carry out the non-resident enterprise's business. Since the sale of the games was made online and this was part of the main business of the non-resident enterprise (i.e. it could not be considered as an activity of an auxiliary or preparatory character), the business could be deemed to have a permanent establishment in Italy.

## 2.7. Agency PE

### 2.7.1. Domestic law

Art. 162(6) and (7) of the ITL contain the definition of agency PE. Although some differences exist, the definition resembles that of Art. 5(5) and (6) of the 1963 OECD Model. According to Art. 162(6) of the ITL, subject to Para. 7, a resident or non-resident person that habitually concludes contracts in Italy in the name of a non-resident enterprise, different from the purchase of goods, constitutes a permanent establishment in Italy of the non-resident enterprise. Under Art. 162(7) of the ITL, the mere fact that a non-resident enterprise exercises its activity in Italy through a broker, general commission agent, or any other agent of an independent status does not create a PE, provided those persons act in the ordinary course of their business.

Art. 162(6) of the ITL does not require the agent to act on behalf of the non-resident enterprise, nor does it expressly require the agent to have authority to conclude contracts in the name of the enterprise. A notable difference from the OECD Model lies in the fact that, according to Art. 5(5) of the OECD Model, a dependent agent does not give rise to a PE if his activities are of an auxiliary or preparatory nature. According to Italian domestic law, however, the exclusion does not apply to all activ-

15. See Resolution No. 501504 of 7 December 1991.

16. See Resolution No. 533 of 21 July 1983.

17. See also, P. Adonnino, "Il fronte elettronico della stabile organizzazione", *Il Sole 24 Ore*, 12 August 2003.

18. Resolution No. 119 of 28 May 2007. The tax authorities did not, however, give their conclusions on the specific case, stating that a factual analysis was necessary and this was under the jurisdiction of the office for international rulings.

ities that are of a preparatory or auxiliary nature, but only to the purchase of goods.

In the Italian tax literature, the above difference is considered to be substantial, as an agent performing auxiliary or preparatory activities on behalf of the non-resident enterprise (other than the purchase of goods) will constitute a PE under Italian law.<sup>19</sup>

In the authors' view, such a difference should be evaluated taking into account Art. 162(6) as a whole. In fact, while the OECD Model refers to any activity carried on by the agent on behalf of the non-resident enterprise, Italian domestic law limits the definition to the conclusion of contracts in the name of the enterprise, therefore narrowing the scope of the definition. If this holds true, introducing an exception for all activities that are considered to be auxiliary or preparatory would not have any effect, since these activities are already excluded from the definition of agency PE. Consequently, activities carried out by a dependent agent on behalf of the non-resident enterprise, other than the conclusion of contracts in its name, will not be part of the agency PE in any event (and therefore the profits arising therefrom should not be considered attributable to it).<sup>20</sup>

As regards the element of dependence, the Italian tax authorities have issued a resolution regarding the interpretation of the former tax treaty in force with the United States. The tax authorities stated that the fact that an agent only acts on behalf of one principal is a sign of dependence.<sup>21</sup> They have also stated that the exclusion applicable to independent agents acting in the ordinary course of business would not apply where the agent acted as sole representative of the enterprise.<sup>22</sup>

Art. 162(8) of the ITR should also be noted, which contains a unique provision dealing with maritime trade agents. It states that the mere fact that a company carries on business through a maritime agent or maritime mediator having authority with respect to the commercial or operational management of such company's shipping vessels, including on a continuous basis, would not mean that it had a "PE".

### 2.7.2. Tax treaties

Most tax treaties concluded by Italy use wording different from that found in the current Art. 5(5) of the OECD Model. The definition, which is based on the 1963 OECD Model, generally states that:

a person acting in a Contracting State on behalf of an enterprise of the other Contracting State – other than an agent of an independent status as provided for in paragraph [6] – shall be deemed to be a PE in the first-mentioned State if he has, and habitually exercises, in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for that enterprise.

This applies to all of Italy's tax treaties except the treaty with Argentina, which does not contain any exception, and the treaties with Ivory Coast, Oman and Vietnam, which are based on the current OECD Model.

Several treaties, including the treaties with Albania, India, Indonesia, Ivory Coast, Malaysia, Oman, Singapore, Thailand, Turkey and Vietnam, contain a provision that follows the UN Model, according to which a dependent agent is deemed to constitute a PE even if he has no authority to conclude contracts in the name of the enterprise, but habitually maintains in the other state a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

In addition, the tax treaties concluded with India, Lithuania and the Philippines contain a provision based on the UN Model, according to which, if the activities of the agent are wholly or almost wholly on behalf of the enterprise, he would not be considered as acting as an independent agent, provided the transactions between the agent and the enterprise are not at arm's length.

Finally, the following tax treaties contain provisions that differ both from the OECD and the UN Model:

- *Australia*: a dependent agent is deemed to constitute a PE if he manufactures or processes goods or merchandise belonging to that enterprise in the other contracting state. This provision only applies in relation to the goods or merchandise manufactured or processed.
- *Bangladesh*: a dependent agent who habitually secures orders for the sale of goods or merchandise in the other contracting state, wholly or almost wholly for the enterprise itself, or on behalf of the enterprise and another enterprise controlled by it or which has a controlling interest in it.
- *Kuwait*: a dependent agent is deemed to create a PE even if he has no authority to conclude contracts on behalf of the enterprise, but habitually maintains in the other state a stock of goods or merchandise from which he regularly sells goods or merchandise on behalf of the enterprise.
- *India*: a dependent agent is deemed to create a PE even if he habitually secures orders in the first-mentioned state, wholly or almost wholly for the enterprise itself or for the enterprise and another enterprise controlling, controlled by, or subject to the same common control, as that enterprise, or in so acting, manufactures or processes in that state, for the enterprise, goods or merchandise belonging to the enterprise.
- *Senegal*: if the agent maintains a warehouse from which he regularly sells goods for the enterprise, he gives rise to a PE of the enterprise of the other contracting state.

19. See also M. Piazza, note 8, p. 228; S. Mayr, note 1.

20. Note that this is not fully in line with Para. 31 of the OECD Commentary on Art. 5 where it is stated that the changes from the 1963 Model definition (on which the Italian domestic definition is based) to the 1977 Model definition (which is the same as the current definition) are meant to clarify the intention of the 1963 Model provision, without altering its substance, apart from an extension of the excepted activities of the person.

21. See Resolution No. 350300 of 21 January 1957.

22. See note 5, Circular Letter No. 7/1496.

- *Thailand*: a dependent agent who habitually maintains in that contracting state a stock of goods or merchandise belonging to the enterprise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or habitually secures orders in the other contracting state, wholly or almost wholly for the enterprise itself or for the enterprise and another enterprise controlling, controlled by, or subject to the same common control, as that enterprise, is deemed to create a PE.

## 2.8. Group companies

### 2.8.1. Domestic law

Art. 162(9) of the ITL states that the fact that a non-resident enterprise, with or without a PE in Italy, controls or is controlled by a resident enterprise, or that they are both controlled by a third party, shall not of itself result in either enterprise constituting a PE of the other. This provision is generally in line with Art. 5(7) of the OECD Model, although it makes reference to enterprises rather than companies, therefore seeming to have a broader scope.

### 2.8.2. Tax treaties

Tax treaties concluded by Italy generally follow the OECD Model as regards group companies. Accordingly, they generally state that the fact that a company that is a resident of a contracting state controls or is controlled by a company that is a resident of the other contracting state, or which carries on business in that other state (whether through a PE or otherwise), shall not of itself result in either company constituting a PE of the other.

Such a provision is particularly important from an Italian standpoint, in light of both (1) the well-known Supreme Court decision in the *Philip Morris* case and other more recent cases and (2) the observation put forward by Italy in respect of the 2005 changes to the OECD Commentary on Art. 5.<sup>23</sup>

## 2.9. Special provisions for insurance companies

Some Italian tax treaties contain a provision expressly dealing with insurance companies. These provisions are generally based on the UN Model, which states that an insurance company of a contracting state shall be deemed to have a PE in the other contracting state provided that, through a representative, other than one of an independent status, it receives premiums or insures risks in that other state. Treaties with this provision include those with Brazil, Indonesia, Ivory Coast and Mexico. Other treaties, including those with Argentina, Australia, Estonia and New Zealand, contain special provisions dealing with insurance enterprises in Art. 7 or in the relevant protocol.

## 3. Landmark Cases

### 3.1. Possession of immovable property and PEs

In one case, a foreign foundation (a Liechtenstein “Anstalt”) purchased several pieces of land in a tourist

area in the north of Sardinia. The Anstalt was assessed by the Italian tax authorities on the basis that it had carried on business in Italy through a PE situated therein. The case was brought to the Supreme Court, where the taxpayer claimed that the mere ownership of immovable property could not give rise to a PE. The Supreme Court stated that, in principle, immovable property does not give rise to a PE because it is merely a capital asset. The Supreme Court ruled, however, that it could create a PE for the activities that are carried on in Italy as a result of the immovable property being at the disposal of the business, i.e. when the immovable property is instrumental for the carrying on of the business or is the object of the activity itself. After an analysis of the OECD definition, the Court concluded that the Anstalt did have a PE in Italy on the basis that several purchases had been concluded in a short period of time, human and material resources had been used to do so and, due to these facts, the taxpayer was carrying on business in Italy. It also concluded that the activities could not be considered of a preparatory nature due to their direct connection with the business activity carried on in Italy.<sup>24</sup>

### 3.2. Construction activities and PEs

A second case concerned a non-resident company carrying on construction activities in Italy. The (now abolished) Central Tax Court stated that the presence of a building site and of an administrative office within it constitutes a PE in Italy of the non-resident entity. The Court reasoned that, in the absence of an applicable treaty, under the provisions contained in the OECD Model and Italian tax treaties, a building site constitutes a PE if it lasts for more than a certain period of time. Moreover, the Court considered that the presence of the administrative office confirmed that the non-resident had a relevant presence in the Italian territory. Finally, the Court stated that, as provided in the OECD Model, an office for purposes of carrying on a business activity is included in the list of examples that constitute, a priori, a PE.<sup>25</sup>

### 3.3. Group companies and PEs: the *Philip Morris* case

A German company that was a member of the Philip Morris Group (Philip Morris GmbH) received royalties from the Italian Tobacco Administration for the licence to produce and supply cigarettes and tobacco products with the Philip Morris Trademark. An Italian company belonging to the same Philip Morris group (Intertaba Spa) supervised the execution of the contract by the Italian Tobacco Administration and performed agency and promotional activities in relation to sales of Philip Morris products in “duty-free” areas. The main business pur-

23. See Para. 45.10 of the OECD Commentary on Art. 5.

24. Supreme Court Decision No. 8820 of 27 November 1987. For a comment, see M. Medici, “Società ed associazioni estere operanti in Italia e stabile organizzazione”, *Rivista di diritto finanziario e scienza delle finanze* II (1988), p. 105.

25. Central Tax Court Decision No. 1887 of 9 March 1990. For a comment, see S. Mayr, “Società estera con cantiere edile in Italia, vi è stabile organizzazione”, *Corriere Tributario* 33 (1990), p. 2279.

pose of Intertaba Spa was to manufacture and distribute cigarette filters both in Italy and abroad. The tax authorities assessed the Philip Morris Group, claiming that the royalties derived by Philip Morris GmbH were subject to tax in Italy at the ordinary rates, as they were attributable to a disguised PE that the group maintained in Italy. According to the tax authorities, this was demonstrated by a number of factors, including that Intertaba Spa had participated in the negotiations between Philip Morris GmbH and the Italian Tobacco Administration for the conclusion of the licence contract, that Intertaba participated in the business activities of the group without any autonomy and that it incurred costs for the benefit of the group for which no consideration was received. In addition, the tax authorities considered the supervision of the execution of the contract to be essential for the production of income for Philip Morris GmbH. The tax authorities based the above conclusions on legal opinions and other documentation gathered during the investigations, according to which the formation of a subsidiary and the shifting of functions within the group were suggested as means to avoid the existence of a PE in Italy.

The taxpayer appealed the assessment. Both the first and second instance Courts decided in favour of the taxpayer. The Court of second instance quoted Art. 5(7) of the OECD Model in finding that the relationship between Intertaba Spa and the rest of the group could not be the basis for the former being a PE of the latter. It added that the tax authorities had failed to prove that Philip Morris GmbH had a physical space in Italy at its disposal through which its business was carried on or that Intertaba Spa had acted as dependent agent of the German company in concluding the contracts with the Italian Tobacco Administration. The tax authorities successfully appealed the decision to the Supreme Court. The Supreme Court concluded that the decision of the Court of second instance lacked adequate support, did not analytically evaluate the evidence gathered by the tax authorities and misinterpreted the principles contained in the OECD Model and the Italy–Germany tax treaty. In referring the case back to another section of the Court of second instance, the Supreme Court set forth the following principles to be taken into account in deciding the case:

- an Italian company may constitute a multiple PE of foreign companies belonging to the same group and pursuing a common strategy;
- the supervision or control of the performance of a contract between a resident entity and a non-resident entity cannot be considered, in principle, to be an auxiliary activity within the meaning of Art. 5(4) OECD Model and the corresponding article of the Italy–Germany tax treaty;
- the participation of representatives or employees of a resident company in a phase of the conclusion of a contract between a foreign company and another resident entity may fall within the concept of authority to conclude contracts in the name of the foreign company; and

- the fact that the non-resident company entrusted the resident company with the management of some of its business operation makes the latter a PE of the former.<sup>26</sup>

### 3.4. Related companies and PEs

A further case concerned two Italian resident individuals that were shareholders and directors of a Panamanian company. At the same time, they were shareholders and directors of an Italian company. Based on information collected during criminal investigations, the local tax authorities assessed the Panamanian company for VAT purposes, maintaining that it had a PE in Italy and therefore was liable to VAT on the supply of goods (deemed to be) made in the Italian territory.

Specifically, the Italian tax authorities based the assessment on the following elements: (1) bank accounts in Italy pertaining to the Panamanian company, (2) amounts credited to the Panamanian company's bank account, (3) the identity of directors and shareholders of the Italian and Panamanian companies, (4) participation of the Italian company in the negotiations of contracts for the Panamanian company and (5) the fact that the Panamanian company's books and records were kept at the premises of the Italian company.

Although the Court of first instance decided in favour of the taxpayer, the Court of second instance reversed this decision. The Supreme Court rejected the taxpayer's appeal and stated that: (1) the definition of PE must be based on Art. 5 of the OECD Model, integrated by the EC Sixth Directive as interpreted by the European Court of Justice; (2) a separate legal entity may constitute a PE of a foreign taxpayer when the former is entrusted with the management of the business of the latter, since this cannot be considered as an activity of a preparatory or auxiliary character; (3) evidence of the fact that an Italian taxpayer is carrying on business on behalf of a foreign company can be gathered not only from the elements indicated in Art. 5 of the OECD Model, but also from the fact that the persons acting for the Italian company were also acting for the foreign company and were participating in the contractual negotiations, regardless of the lack of formal power of representation. On this point the Court stated that

no decisive relevance may be attributed to the recent modification to the OECD Commentary on Art. 5, according to which the mere fact that a person has participated in negotiations on behalf of a non-resident company cannot constitute the only element to conclude that the person constitutes a PE of the non-resident company. In fact, despite the non-normative value of

26. Supreme Court Decision No. 7862 of 25 May 2002. For a comment on the decision, see A. Ballancin, "La nozione di stabile organizzazione in una recente pronuncia della Suprema Corte di Cassazione", *Il Diritto e Pratica Tributaria Internazionale* (2002), p. 961.; M. Gazzo, "Permanent Establishment through Related Corporations: New Case Law in Italy and its Impact on Multinational Flows", 43 *Bulletin for International Fiscal Documentation* 6 (2003), p. 257. For prior coverage, see C. Romano, "Subsidiaries as Permanent Establishments: The Philip Morris Case", 38 *European Taxation* 9 (1998), p. 315.

the Commentary, which constitutes simply a recommendation to OECD Member States, the Italian government has put forward

an observation according to which Italy cannot ignore the interpretation given by its local judges.<sup>27</sup>

#### 4. Conclusions

Several issues arise in respect of the domestic PE definition and its interaction with Italy's tax treaties. A further issue is the value of the OECD Commentary on Art. 5 in interpreting the definition. The importance of this issue is heightened as a

consequence of the 2005 changes to the Commentary on Art. 5 and the Supreme Court position in this respect. Once a PE is deemed to exist, the issue turns to the calculation of the profits attributable to the PE. This is, however, a topic for a separate article.

27. Supreme Court Decision No. 17206 of 28 July 2006. For a comment, see E. Cacciapuoti, "La società residente quale stabile organizzazione di una società non-residente", forthcoming in *Rassegna Tributaria* (2007).

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