Dipartimento di GIURISPRUDENZA
Cattedra di DIRITTO TRIBUTARIO

TITOLO

"The Anti-Tax Avoidance and Tax Cuts and Jobs Act Reforms: an analysis in the light of the BEPS project"

RELATORE
Prof.ssa Livia Salvini

CANDIDATO
Filippo Maria Pietrosanti
Matr. 129923

CORRELATORE
Prof. Giuseppe Melis

ANNO ACCADEMICO 2018/2019

INDEX

INTRODUCTION

The aim of this dissertation is providing the reader with an understanding of the most recent aggressive tax planning schemes adopted by multinational enterprises and the legislative tax law reforms enacted as a response to tax avoidance. More specifically, the thesis will focus on: (1) the OECD issue spotting and recommendations for an organic reform, (2) the EU anti-tax avoidance directive and its implementation in Italy and (3) the 2017 Trump's tax reform with respect to the new international tax measures put into place against global undertakings. Given the vastity of the topic, the study has been narrowed down to four main areas of international tax planning: (1) the use of interest payments and other devices to erode taxable bases and shift profits offshore, (2) the hybrid mismatch arrangements and the unfair tax benefits deriving from this peculiar type of tax arbitrage, (3) the controlled foreign corporation regime and (4) the taxation of the digital economy. The issues mentioned above are described in the first four BEPS Actions published by the OECD which were soon implemented by both the EU and the US. In the conclusions of the dissertation the analysis will focus on a critical evaluation of the reforms. It will provide an answer to the question regarding the effectiveness of the new anti-tax avoidance measures and whether there are possible future arrangements which could still possibly circumvent the newly-enacted rules. Also, the conclusions will briefly analyse the information sharing mechanism currently existing at international level and the necessity of improvement in order to guarantee an adequate tax assessment with respect to aggressive international tax planning.

The topic of this paper was chosen following the author's selection as an LL.M. candidate at American University Washington College of Law (D.C.). The opportunity given by the home university to be part of a dual degree programme paved the way for becoming familiar with a broad range of US law practice areas, including international business taxation. The study of the international tax provisions of the US Internal Revenue Code, many of which were amended by P.L. 115-97, better known as "Tax Cuts and Jobs Act", combined with the home university major in corporate and tax law provided for the necessary tools to draft this comparative analysis. It is interesting to see how the problems reported worldwide are so similar and yet the actual measures enacted at domestic or regional level to deal with them can differ. As a matter of fact, while the general framework of the two reforms is similar, as well as the purposes behind the anti-tax avoidance provisions, the actual implementation and application of the newly introduced regimes varies greatly. Overall, while the EU reform is more inspired by principles of tax cooperation among member states, the US tax law changes only worry about ensuring tax equity for US-based taxpayers even to the detriment of other jurisdictions. The international community has already condemned some of the Tax Cuts and Jobs Act amendments, either because they do not respect the "jurisdiction to tax" generally recognised principle (see GILTI), or since they are not in line with the international obligations agreed upon by the US under the WTO umbrella or in single income tax treaties (see BEAT). However, some criticism must be directed also at some nationally devised measures enacted by some European member states following the EU failure to establish a common digital services tax. As a matter of fact, the withholding tax, initially proposed by the EU Commission and then implemented by some major Eurozone economies, is as aggressive as the GILTI inclusion and the BEAT in terms of unfair tax competition. This tax which applies on web giants revenues can be avoided just by setting up a taxable presence in the market jurisdiction. Basically, this measures strongarms multinational enterprises which make large profits through the internet into creating a permanent establishment which turns out more tax efficient since income taxes allow for the benefit of deductions, while withholding taxes on revenues do not.

The language chosen to draft this thesis was neither the result of a random decision nor due to the vanity of the writer. By contrast, this choice was prompted by an academic consideration and an additional pragmatic aspect. Firstly, international tax law students, lawyers and experts cannot do without being proficient in English. Tax law experts need to share ideas, information and knowledge. It is no surprise that in the scientific community English is the privileged means of communication of this well-known global network. International tax law is no different from other science-based subjects. In everyday cross-border transactions, tax experts and service providers could not help understand the reasons underlying a certain arrangement, but for communicating with their colleagues located in the other interested jurisdiction. A natural feature of this specific branch of tax law is that group-working and information sharing is necessary. In short, isolation is no key to success and could be deemed to be as naive as walking blindfolded on a tightrope.

Secondly, the process of writing a comparative international tax law thesis relied mostly upon a vast majority of sources written in English. Form a practical point of view, the translation of all the documents into the author's native language would have been more burdensome than simply adapting some Italian law concepts and notions to English. The entire first and third chapters are based on foreign sources, while the second one, although dealing with Italian domestic law, sees a predominance of non-Italian sources in respect of the introductory paragraph regarding the two EU anti-tax avoidance directives. Additionally, it needs to be mentioned that some Italian scholars have started writing journal articles in English especially with respect to topics which closely affect foreign investors performing inbound transactions (see for instance the digital services tax article)[1].

Following the explanation of the founding idea of the dissertation and the reasons why it has been written in English, it is necessary to delve into a brief description of the content of each chapter. The first building block of the thesis regards the OECD analysis of the current international tax planning most recurrent schemes. The OECD describes with the utmost precision the various techniques of tax avoidance and then comes up with some innovative solutions to tackle these unfair practices.

The second chapter is focused on the EU anti-tax avoidance directive and its implementation in Italy. The EU has always been concerned with cross-border aspects of taxation law since it directly affects one of the core principles of the Union, namely competition. While for years the EU Commission, the European Council and the European Parliament seemed more inclined towards harmonising indirect taxes only (since they can have disruptive effects upon the single customs union), recently, the problem of direct taxation has become of particular interest. Multinational enterprises have started exploiting differences and loopholes in domestic member states' legislations to reduce their tax bills. By doing so, they took an unfair advantage which distorted

[1] Gabriele Colombaioni, 'Italy Unilaterally Implements the European Commission's Digital Services Tax Proposal' [2019] Rivista di Diritto Tributario Pacini Giuridica.

competition with their nationally-based counterparts subject to a higher tax burden. The result was the enactment of the anti-avoidance directives I and II which laid down some common rules on interest deductions, hybrid mismatch arrangements and controlled foreign corporations' deemed inclusion. Unfortunately, the time was not mature yet to provide member states with a common digital services tax. Nevertheless, the Commission's proposal was followed by some member states, including Italy, which had domestic web taxes enter into force.

The last chapter concerns the revolutionary 2017 Trump's tax reform. Apart from the reduction of the corporate effective tax rate down to 21% and other domestic provisions, the most interesting part of the Tax Cuts and Jobs Act regards international tax law. Unlike prior-law, the newly introduced rules are the outcome of a process which took under close scrutiny the OECD's recommendation and fight fiercely international tax avoidance. Nevertheless, the reform has also extended the reach of the US jurisdiction to tax even to the detriment of other countries and commercial partners. Some provisions are likely to be exposed to WTO challenges or incompatibility with current international income tax treaties. The logic of cooperation and mutual assistance fostered by the OECD is the only principle which the US disregarded and this aspect is reflected in the way some provisions have been designed.

The final remarks of the thesis will contain a critical assessment of the effectiveness of the measures enacted by the two reforms. More specifically, the study will focus on the possible future tax planning strategies which could eventually circumvent the newly introduced anti-tax avoidance provisions. It will also cover the consequences of such tax reforms from a political and diplomatic perspective explaining the roots of the deterioration of the commercial relations between the US and the EU. Lastly, the conclusion will provide an understanding of the current legal framework concerning the exchange of information in tax matters among G20 countries. The different regimes which are applied by the US and EU will cast some doubts as to whether the US is still the leading country in the fight against tax avoidance. Actually, the reader will be confronted by a thought-provoking forecast: the US new international tax law framework is inspired by unfair tax competition policies or protectionist concerns and it is probably turning the US in a new generation tax haven.

Common to all chapters is the practical approach of this thesis. While the study and explanation of the changes in current tax law are important, the analysis does not want to be only theoretical. As the reader will soon realise, this work provides charts, diagrams, mathematical formulas, real cases and examples which facilitate the understanding of how each single provision really works and is applied by the Italian Revenue Agency and the US Internal Revenue Service. Likewise, the first chapter offers a pragmatic insight of international tax planning and explains how certain arrangements and devices are used by multinational enterprises in an attempt to reduce their tax bill.

The hope is that the shift to a more practical style will render the reading smoother, more understandable and more interesting for the reader. Unlike other academic dissertations which have a more theoretical structure, the aim of this paper is to put into practice every rule analysed in the body of the text and to have a more dynamic view of international business taxation. The drafting of tax law is remarked by a great degree of complexity and specificity of its wording. Rephrasing the same very notions which are found in hard law and eventually adding some scholars' opinion is of no benefit, unless cases and examples follow by. This last remarks do not want to extol nor eulogise the content of the dissertation, but simply underlining the view of the writer and his proclivity towards a hands-on experience learning process. Tax law is an extremely practical area of law and concerns every aspect of everyday life of both businesses and individuals. Despite its complexity, the subject matter needs to be put in closer contact with the affected taxpayers and, in order to do so, there are probably no better means than cases and examples.

HARMFUL INTERNATIONAL TAX PLANNING AND THE OECD GUIDELINES

1.1 The Roots of International Tax Planning and the Most Recent Scandals

The law of international taxation started to develop its own legal framework and a certain degree of regulatory autonomy following the second world war. The second industrial revolution and the numerous technological breakthrough had the world shrink and the national economies become more interconnected. However, at the beginning of the twentieth century the problem of taxing business and personal profits derived from foreign investments was relatively easy. As a matter of fact, international economy up until the first half of the nineteen hundreds was based on export and portfolio investments.[2] Domestic companies did not have a multinational dimension and despite trading and selling abroad they did not have a taxable presence in the country of destination of the goods. Also foreign investment was considerably more straightforward than nowadays. Financial holding companies, banks, financial intermediaries and individuals limited their foreign investments to the purchase, holding and sale of stocks or bonds of foreign corporate entities.

This type of international economy made the problem of taxation of profits relatively easy. An active trade or business was taxed on its profits just to the extent all or part of it was attributable to a permanent establishment in the host country. Vice versa, passive investors who did not have a taxable presence in the host country were taxed through a withholding tax on the gross income sourced in the same host country and were exempted from filing the tax return or complying with any other administrative obligation.

Nevertheless, this system based on the binary approach described above became inappropriate after the second world war. The end of the conflict saw the rise of direct foreign investment abroad and the rise of transnational corporation which had an internationally-integrated dimension. The industrial production, once concentrated in a

[2] Sol Picciotto, *International Business Taxation: A Study in the Internationalisation of Business Regulation* (electronic edn, CUP 2013), 1.

single factory according to the doctrine of Taylorism gave way to a fragmented way of producing goods and offering services. Each step of the production was located in one or multiple countries and the final product was the result of a series of transaction between related parties subject to common control. It is clear that the legal framework created for the so called "factory fortress" was not apt for the new global challenges that interconnected production presented.[3]

The first multinational companies had already emerged by 1914, at the outset of the first world war. The second industrial revolution and the end of the American civil war marked the start of the age of steel, electricity, chemical products, oil production and other types of heavy industry businesses. The period between 1865 and 1914 saw the growth of international trade and commerce as well as foreign investments. However, it is estimated that in 1914 the total global international foreign investment amounted to $44 billion and that just a third, roughly $14 billion, consisted of stock ownership.[4] Direct investment was considered a risky activity. The new emerging sectors were all requiring expensive capital contribution which would have bankrupted any investor in case of unsatisfactory returns on the initial bet.

The most common form of investment was the business of lending money to foreign corporations or to foreign governments and financial institutions. Moreover, given the risks associated with lending money to large corporations, lenders were very prone to engage in syndicated loans or sales of loan participations to minimise the risks and diversify the portfolio. This pattern remained virtually unchanged until the economic crash of 1929.[5] The depression and downturn which followed froze international investments and urged national governments to shore up their economies with new protectionist measures which impacted negatively on trade and exports. For almost two decades the situation did not undergo any change and international commerce and investments started over following the second world war.

---

[3] Caryl P Haskins, 'A Factory in a Fortress,' *The New York Times* (Sept 2, 1979).
[4] Sol Picciotto, *International Business Taxation: A Study in the Internationalisation of Business Regulation* (electronic edn, CUP 2013), 2.
[5] Ibid.

The re-emergence of a global economy was facilitated by the stipulation of several tax treaties which allocated the jurisdiction to tax among home country and host country. Instead of apportioning the taxable base between the parent company and the subsidiary (often a fiscally transparent entity) or branch, the first tax treaties were merely concerning with the issue of the jurisdiction to tax. According to the gold standard of the time, a foreign trade or business should be taxed in the host country to the extent the profits are attributable to the taxable presence in the host country. Vice versa, the home country retained the right to tax the worldwide profits of the domestic company allowing a foreign tax credit for the fiscal burden paid to the foreign government. This framework led to stir controversy between industrialised and developing countries. The former wanted to maintain their right to tax the worldwide profits according to the capital export neutrality doctrine, which aims at treating equally domestic and foreign investments. By contrast, the latter stressed the importance of considering the source of the profits and allocating the jurisdiction to tax solely on the basis of income sources. This territorial approach reflected the capital import neutrality doctrine which advocated for striking down any impediment to money flows to developing nations.

Despite being theoretically interested, the issue was outdated in the 1950s and became even more so in the following decades. As a matter of fact, the money invested abroad were simply retained earnings from foreign businesses or money borrowed from banks. The cash flow so despised by the industrialised countries did not take place and simply hid the real problem of international business taxation. Starting from the 1960s, multinational corporations pioneered complex corporate structures and took advantage of offshore financial centres (generally located in rogue-banking countries) to funnel the bulk of their resources to tax havens. The consequence of such unscrupulous business conduct was the emergence of international tax avoidance. This in turn undermined the effectiveness and fairness of domestic taxation and created inequalities which countered the principle of progressive taxation. The largest taxpayers happened to pay less than what they would have if all their economic activities were located in the home country, while the smaller taxpayers were asked to contribute more to finance the public services necessary to guarantee the ongoing integrity of the democratic regime.

Domestic tax authorities responded to multinationals' avoidance schemes by taking unilateral and then internationally coordinated actions in order to claw back into tax the retained earnings located outside the home country. While meeting an initial partial success, these measures encountered technical and political difficulties related to the jurisdictional issues concerning the enforcement of national tax provisions. As of today, international arrangements still assume that the host country is allowed to tax only income which is sourced in the same country and reflects the presence of a genuine trade or business. The residual global profits shall be taxed by the parent country where the company is a resident. Looking more closely at the matter, it is widely acknowledged that there is a complete lack of common international rules regarding the allocation of profits and losses. The current tax regulatory framework is inadequate to face the challenges brought about by globalised economy. Multinational corporations combine strategic decision taken in one country with core business activities and services fragmented in other different jurisdictions. Moreover, their shares are publicly traded in the most prominent capital markets in the world and their ownership is extremely diffuse. Undertakings such as banks and stockbrokers engage in purchasing and selling such shares and other related securities on a daily basis and acquired a significant expertise in exploiting even tiny differences between stock markets in order to accrue great advantages. It is mostly clear that fiscal policies and interventions are not able to keep up with the speed at which business carry on their everyday operations.

Up until 2015, the public opinion's attention to international avoidance tax matters was not fully developed. The triggering events which made everyone conscious of the viciousness of the issue was the long series of decisions taken by the European Commission to sanction certain favourable tax treatments received by multinationals, mostly based in the US. As a matter of fact, within the EU member states are free to set the tax rate they prefer. However, if one or few companies receive a beneficial treatment which allows them to be subject to lower taxation than the effective rate in the host country, then such tax benefits might well be classified as state aids.

One of the core principle of EU law is the supremacy of competition. The main objective set by the Treaty on the Functioning of the European Union (TFEU) is to guarantee the effectiveness of the single common market by pulling down all barriers to completion.

The disciplines splits in two parts: (1) rules which apply to undertakings,[6] and (2) rules against state ids granted by national governments.[7] While the first body of law regulates the lawfulness of arrangements between business so as they do not restrict competition by creating monopolies or oligopolies, the second set of provisions prohibits public authorities and national governments to take any action whose effect is restricting the freedom of access to the common market. Article 107(1) of the TFEU so recites:

> *"[…] any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."*

The literal tenure of the provision clearly states any state intervention which can have even a mere potential negative effect on competition is considered non-compliant with EU law. Also, the article must be read in connection with the case law of the European Court of Justice (ECJ). According to the court's view, the concept of state aid does not embrace only positive aids in the form of subsidies, but also negative aids which mitigate the charges (tax ones included) normally included in the budget of an undertaking.[8]

The European Commission is given power to constantly review state policies affecting the fairness of the market and can propose to the latter the appropriate measures to be taken.[9] In case of findings of deemed state aids the Commission gives prompt notice to the member state so that the latter can submit its observations on the matter and the necessary explanations regarding compliance with EU law. If after reading the member

---

[6] Treaty on the Functioning of the European Union, arts 101 -106.
[7] Treaty on the Functioning of the European Union, arts 107-109.
[8] Case 30/59 *Gezamenlijke Steenkolenmijnen in Limburg* [1961] ECR 1, para 22; Case C-323/82 Intermills v Commission [1984] ECR 3810, para 31; Case C-234/84 Kingdom of Belgium v Commission [1986] ECR 2281, para 13; Case T-129/95 Neue Maxhutte v Commission [1999] ECR-II 21, para 131; Case C-143/99 Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke [2001] ECR-I 8384, para 38; Case C-501/00 Spain v Commission [2004] ECR-I 6721, para 90; Case C-222/04 Cassa di Risparmio di Firenze and Others [2006] ECR-I 325, para 131; Joined Cases C-78/08 to C 80/08 *Paint Graphos and Others* [2011] ECR-I 7641, para 45.
[9] Treaty on the Functioning of the European Union, art 108(1).

state's comments the Commission still finds that there is a violation of article 107(1) TFEU, then it shall issue a final decision allowing some time to abolish or alter the national provision.[10] Should the member state ignore or delay to abide by the Commission's decision, an infringement procedure shall be initiated.[11]

The first country which ended up under close scrutiny of the European Commission was Luxemburg. The investigations started as early as June 2014 led to several decisions to recover state aid from FIAT, Amazon and concerning also McDonald's. The core of the decisions can be summarised by the words of Margrethe Vestager, commissioner for competition policy:

> *"Tax rulings that artificially reduce a company's tax burden are not in line with EU state aid rules. They are illegal. I hope that, with today's decisions, this message will be heard by Member State governments and companies alike. All companies, big or small, multinational or not, should pay their fair share of tax."*[12]

The three multinationals were granted separate tax rulings concerning the tax consequences of intercompany transactions. the rulings concerned the legal issue of transfer pricing, hybrid transactions/entities. The endorsement of a method to calculate the arm's length price which did not reflect economic reality and the consideration given to certain entities or financing transactions allowed to shift profits to low or no tax jurisdictions thus reducing the corporate tax burden and improving their competitiveness.

More specifically, the FIAT group established a financing company in Luxembourg, FIAT Finance and Trade. The core business of this financial subsidiary was lending money to related companies spread across Europe and earning interests. Given that the activities carried out by such company are similar to those of a normal bank, the tax authorities of Luxembourg granted a ruling in favour of FIAT Finance and Trade which calculated the taxable income as a return percentage of the capital deployed by the company for its financing operations. However, the ruling adopted a methodology which is not appropriate for calculating the actual profits of the company. Firstly, the ruling

---

[10] Treaty on the Functioning of the European Union, art 108(2).
[11] Treaty on the Functioning of the European Union, arts 258-259.
[12] Treaty on the Functioning of the European Union, art 107(1).

made some economically unjustifiable assumptions and down-ward adjustments which approximated the capital base available to the company to a much lower amount than in reality. Secondly, the return percentage applied by Luxembourg revealed to be lower than real market conditions and as such it did not reflect the earnings of FIAT Finance and Trade.

Figure 1.1: European Commission, *Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules* (Press Release, 2015).

The Commission concluded for the unlawfulness of the ruling. It clarified that national tax authorities are free to decide whichever method they think fits best in order to calculate the taxable income of a company operating in the single market so long as such methodology reflects market conditions accurately. FIAT Finance and Trade was allowed to reduce significantly the corporate tax burden. Had the estimates of capital and remuneration been in line with the arm's length principle, the taxable profits declared in Luxembourg would have been twenty times higher. Luxembourg was ordered to collect €20-30 million from FIAT Finance and Trade.

With regard to Amazon, the US-based tech giant operated in Europe through two business associations: (1) an operating company headquartered in Luxembourg, Amazon EU, and (2) a holding company chartered as a limited partnership, Amazon Europe Holding technology, which licensed technology to the former. The holding company had patents and other IP rights by virtue of a cost sharing agreement (CSA) with Amazon Inc., based in the US. The royalties earned by the holding company were neither taxed under Luxembourg general tax laws due to its legal form, nor in the US since the partnerships were allowed to defer taxation until repatriation.

The ruling granted by the tax authorities in Luxembourg endorsed the payments of royalties up to 90% of the operating company's profits. This apportionment did not reflect the economic reality nor the general market conditions. As a matter of fact, the operating company was in charge of the all the European retail business activities and employed a large number of employees, while the holding company was a mere empty shell which passed on IP rights.

Figure 1.2: European Commission, *State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million* (Press Release, 2017).

The Commission, following its investigation started in June 2013, found the ruling incompatible with EU competition law and ordered to recover €250 million in order to restore equal treatment with other companies.

While the two cases so far analysed concerned transfer pricing, the Engie and McDonald's case involve hybrid transactions and residence mismatches which granted the two companies significant advantages (although just the Engie scheme was found illegal). The Engie group had two subsidiaries in Luxembourg, an operating and financial companies respectively. The operating company, Engie Supply was financed by the holding company of the group, Engie Holding through a convertible loan arranged through an intermediary. According to the tax ruling granted under Luxembourg law, the borrower was allowed to deduct interest expenses up to 99% of its profits over a decade, but no payment was made to the lender and thus many untaxed profits were parked in Luxembourg. Instead of paying out the debt and being subject to taxes, the lender converted the debt instruments into equity and became the owner of all the untaxed retained earnings. Given that the sale in exchange of stocks is not taxed, Engie group was allowed a deduction not corresponded by an income inclusion. The result was a total exemption on corporate profits.

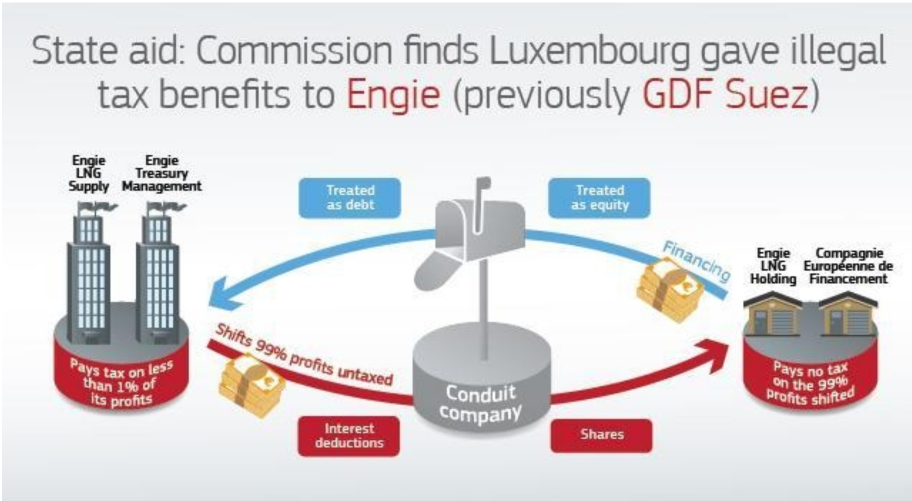


Figure 1.3: European Commission, *State aid: Commission finds Luxembourg gave illegal tax benefits to Engie; has to recover around €120 million* (Press Release, 2018).

The Commission found that the treatment of the same transaction as debt and equity in two different countries constituted state aid following the endorsement of the Luxembourg tax authorities. The member state was ordered to recover €120 million.

The last case concerning Luxembourg is the alleged state aid given to McDonald's following the corporation's request for a tax ruling regarding the application of the Luxembourg-US Double Taxation Treaty. Here, the main issue concerns the treatment of the undertaking's economic presence as permanent establishment under the treaty. The US fast food chain operated in Europe through a subsidiary in Luxembourg which had two branches in Switzerland and the US respectively. In 2009, the company acquired franchise rights in Europe from the US parent company. Nevertheless, the IP rights were allocated internally to the US branch and as such McDonald's asked for and obtained the exemption of such profits from the host state taxation since the same income would have been ultimately subject to US taxation. However, under US tax law the branch was not considered a permanent establishment and, hence, the corporate profits of McDonald's Europe Franchising were granted a double exemption.

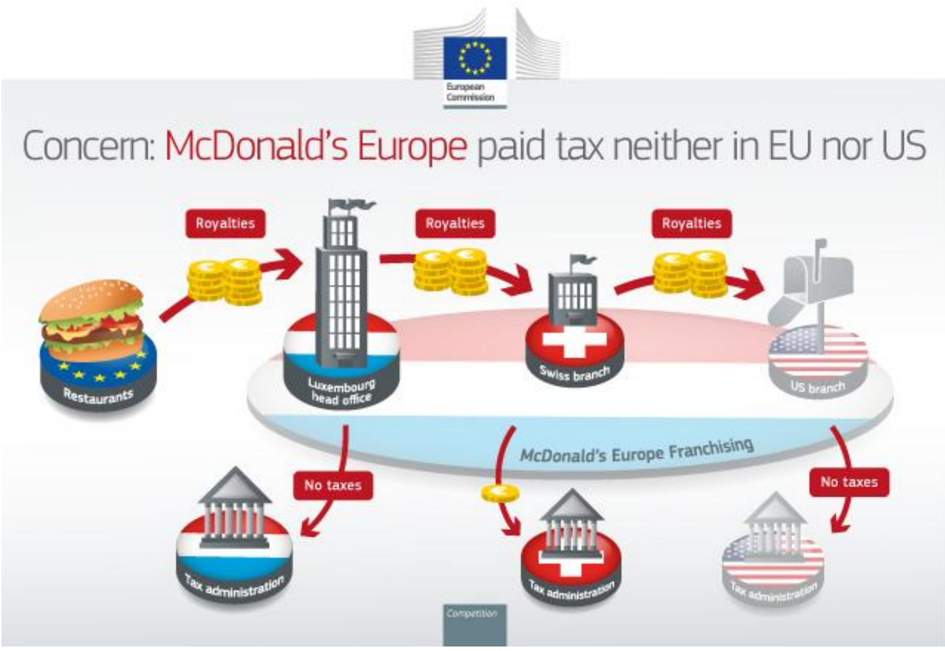


Figure 1.4: European Commission, *State aid: Commission investigation did not find that Luxembourg gave selective tax treatment to McDonald's* (Press Release, 2018).

The Commission found that in this instance there was no state aid granted upon McDonald's since the double exemption was the result of a mismatch between the US and Luxembourg general tax laws. This dispute concerned the use of a hybrid and following this decision Luxembourg amended its laws in order to close the loophole exploited by the multinational in question.

Other two cases which involved transfer pricing were the Starbucks case and the Apple case. Similarly, to what happened with Amazon, the two companies asked for and obtained the issuance of very favourable tax rulings both by the Dutch and Irish tax authorities respectively.
Amazon was allowed to pay an inflated amount of money for coffee beans purchased from a Swiss related company and a higher-than-average royalty price for the technology provided by another related entity based in the UK. Besides, the royalties were neither subject to withholding taxes in the Netherlands nor included in the UK taxable base due to domestic tax treatment of IP-related income incentivising patent boxes.

Figure 1.5: European Commission, *State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million* (Press Release, 2017).

Similarly, Apple group adopted a tax avoidance scheme based on a fictitious internal allocation of profits among different business units on the corporate conglomerate. The Apple group operated in Europe through two subsidiaries: Apple Sales International (ASI) and Apple Operations Europe (AOE). Both companies had a head office with no personnel nor premises which was said to manage all the IP rights of the two Irish-based businesses. After asking the issuance of a ruling centred on the so called "profit split method", the Irish tax authorities agreed to allocate the majority of the profits to the respective head offices which remained untaxed. The allocation was justified upon the assumption that IP rights were the main factor contributing to the creation of value within the Apple group.

Figure 1.6: European Commission, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion* (Press Release, 2016).

In both cases, namely Starbucks and Apple, the Commission found that the selective beneficial tax treatment delivered to the covered transnational companies constituted state aid. The tax savings generated, amounting €250 million and €13 billion respectively (the latter representing the greatest avoidance scheme in history), conferred the two companies an unfair advantage over their competitors and caused a substantial distortion of competition within the single market. The commission ordered the Dutch and Irish governments to collect the unpaid taxes.

Another case in which the European Commission found for the existence of state aid concerns the UK discipline of controlled foreign corporations (CFCs). A CFC is a subsidiary located offshore whose profits have been artificially diverted from the parent country and moved to tax havens. In order to claw back into tax such profits, there is a deemed attribution of the pro rata share of retained earnings back to the resident parent company. This anti-avoidance rule was applied in the UK through two tests: (1) the UK activities test, which taxes offshore financing income to the extent these activities are located in the UK, and (2) the UK connected capital test, which applies to all loans financed through funds or assets derived from capital contributions from the UK. However, the British tax laws provided for an exception if the offshore subsidiary was managed by a foreign financial group which carried out activities in the UK. As such, whether either test was met the CFC discipline did not apply in order to attract foreign financial group to invest in the country.

Figure 1.7: European Commission, *State aid: Commission concludes that part of UK tax scheme gave illegal tax advantages to certain multinational companies; remaining part does not constitute aid* (Press Release, 2019).

The European Commission examined the exception and found the following. The disapplication of the CFC rule in case of UK connected capital does not clash with EU law. The funds are simply channelled through the UK from a foreign company to an offshore subsidiary and so long as there are no UK activities concerned the exemption is lawful. However, with regard to the second exception, when the financing activities are connected with the UK and the earnings are diverted to an offshore subsidiary, the exclusion of foreign financial groups from the application of the CFC regime constitutes a tax disparity which results in a breach of article 107(1) TFEU.[13] Therefore, the Commission found the "Group Financing Exemption" partially illegal under EU law.

The last case to be analysed is the Belgian so called "Excess Profit" tax scheme. This case has some affinities with the issue of income derived from intangibles exploited by multinational companies (see infra digitalised economy and GILTI). Under Belgian general tax laws, all profits recorded from activities performed in Belgium are taxed in that country. Nevertheless, the enactment of the Excess Profit scheme in 2005 assumed that transnational companies' earnings are generated in part because they take part in an international corporate conglomerate which increases the profits of Belgian subsidiaries. This rationale explains why these corporations were allowed to ask for and obtain the issuance of a tax ruling valid for four years and then renewable in order to establish the

[13] Treaty on the Functioning of the European Union, art 107(1).

percentage of Belgian income which was not sourced in Belgium on that grounds that its source was intangible, the participation to a multinational group.[14]

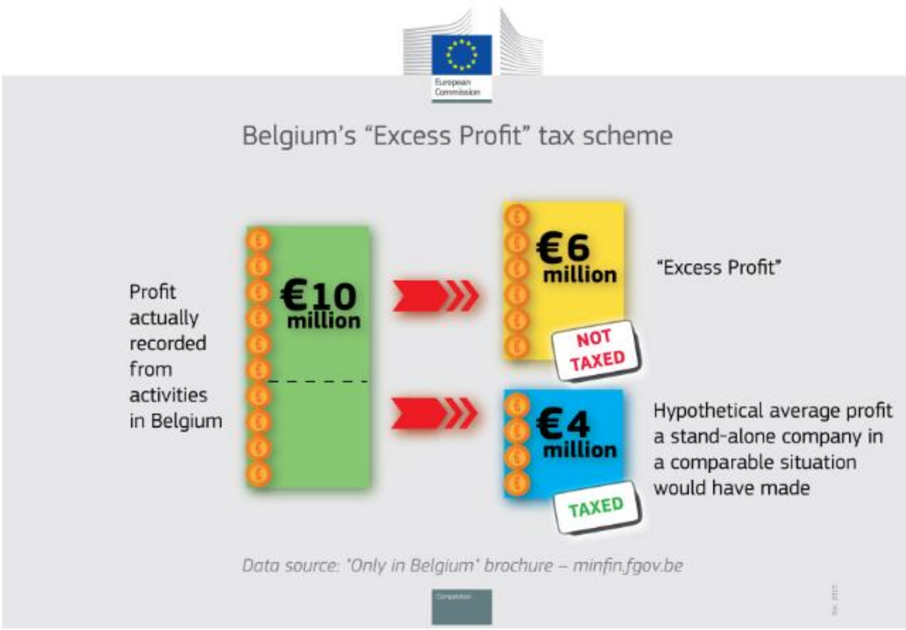


Figure 1.8: European Commission, *State aid: Commission concludes Belgian "Excess Profit" tax scheme illegal; around €700 million to be recovered from 35 multinational companies* (Press Release, 2016).

The European Commission did not agree with Belgium's argument that the scheme was aimed at preventing double taxation and declared the scheme illegal and non-compliant with EU law. The tax benefit applied only to multinationals thus distorting competition. In order to restore market fairness, it ordered the member state to recover €700 million from thirty-five different multinational enterprises.

As underlined in this first paragraph, the complexity of globalised enterprises has posed imminent threats to the functioning of domestic tax systems and to the integrity of national revenues. The European tax scandals prepared the grounds for the G20 Base Erosion and Profit Shifting (BEPS) action plan which tried to approximate international tax law provisions of the most industrialised countries in the globe.

[14] Code des Impôts sur les Revenus/Wetboek Inkomstenbelastingen, art 185 § 2(b).

1.2 An Overview of the OECD BEPS Action Plan

The exploitation of mismatches and legal loopholes by multinational enterprises led to twenty most economically advanced and industrialised countries worldwide to entrust the OECD with developing a common framework to be implemented at national level so that trades and business with a global presence would be restricted in their ability to reduce to the minimum their tax burden. The BEPS project started in September 2013 and it reached its conclusion after only two years. The G20 leaders met at Antalya and publicly endorsed the package of fifteen measures proposed by the OECD in order to tackle the most problematic issues of international business taxation.[15]

Globalisation has opened up new ways for transnational companies to significantly reduce their taxes. By using different corporate structures and legal arrangements, these companies have been able to claim undue deductions or to exempt income from their taxable basis. Moreover, the capacity to minimise the tax burden has been greatly fuelled by the existence of several low or no tax jurisdictions which benefit from the economic presence of multinationals in exchange of favourable tax treatments.

International tax rules have not always kept up with the recent developments and challenges caused by globalisation and the ever-increasing interplay between economies. The recent scandals have also demonstrated that there is a need for coordinated action among countries in order to effectively deal with international tax avoidance. The OECD plan is based on the renovated intent to take multilateral effort in taxing multinationals where their activities are carried out and value is created. While the OCED actions generally concentrated on eliminating double taxation, which is harmful and detrimental to international trade and commerce, the BEPS distinguishes from any previous project. As a matter of fact, real cases have shown how the main focus has shifted from double taxation to double non-taxation.

The aim of the BEPS can be summarised in the words of Angel Gurrìa, OECD Secretary General who spoke at the G20 Ankara Meeting of Finance Ministers and Central Bank Governors on September 5, 2015:

---

[15] OECD, Background Brief: Inclusive Framework on BEPS (OECD Publishing, 2017).

"Let's be crystal clear: What is at stake is to restore the confidence of your people in the fairness of our tax systems."[16]

The driving principle which led the G20 nations to embark upon the ambitious project of reforming the principles of multinational businesses' taxation is fairness. When the largest taxpayers do not contribute enough, or as much as they are supposed to, to the revenues of a country, this undermines the very same concept of democracy. No democratic regime can guarantee the freedom necessary to do business unless its government has the necessary resources to do so. The result of transnational companies' avoidance is the increase of tax burden for small-medium enterprises and households which cannot take advantage of national tax differences due to their solely domestic presence.

The most recent estimates show that the losses in revenues among industrialised countries is somewhat between $100 billion and $240 billion. These numbers represent roughly from 4% to 10% of the global tax revenues levied on businesses worldwide. These practices are extremely dangerous for countries which are becoming more reliant on such revenues to fund their welfare systems. Apart from harming the government and other taxpayers, the base erosion and profit shifting also affects the same trades or businesses which benefit from aggressive tax planning. As a matter of fact, multinationals face a significant reputational risk derived from public attention to their fiscal affairs. For instance, Starbucks, a multinational engaged in delivering the barista experience to customers, agreed to pay £20 million in tax over a two-year period after facing fierce criticism from UK taxpayers.[17]

Even before the implementation of the BEPS some companies have already reshuffled their corporate structure to ensure compliance with the new international guidelines. The first impact of the action plan is to increase coherence at international level. The model

---

[16] OECD, *Policy Brief: Taxing Multinational Enterprises; Base Erosion and Profit Shifting (BEPS)* (OECD Publishing, 2015).

[17] Simon Neville and Jill Treanor, "Starbucks to pay £20m in tax over the next two years after customer revolt: Starbucks UK says it will pay corporation tax over next two years after consumer anger comes across 'loud and clear'," The Guardian, December 6, 2012, >https://www.theguardian.com/business/2012/dec/06/starbucks-to-pay-10m-corporation-tax>.

has been shaped to lay down some minimum standards to be followed and level the playground in fiscal affairs. The crackdown on treaty shopping, aggressive tax planning and the introduction of the country-by-country reporting will redesign domestic tax policies taking into account what happens beyond any nation's borders. Most importantly. The BEPS focused on neutralising hybrid mismatches which allow a great deal of profits go untaxed. At the same level, it undertook an effort to strengthen the effectiveness of CFC rules and limit the exploitation of passive interests to benefit from taxable base deductions.

The OECD took notice of the great complexities which are involved in the taxation of intangibles. The issue is controversial both in terms of transfer pricing and digitalisation of the economy. With regard to the first area, the transfer of IP from a source country to a low or no tax jurisdiction poses the problem of evaluation. It is hard to attribute a monetary value to the transfer of intangibles abroad and this makes the application of exit taxes even more uncertain. Also, the digitalisation of businesses has created an interaction between the country of management and the market countries. Social media companies acquire and build their value by increasing their user base. The more people use an online platform the more the company owning it has the possibility to make revenues by advertising products and selling data to third parties. In short, the OECD's position is conscious that personal "information is the oil of the twenty-first century and analytics is the combustion engine". [18] Hence, market countries which contribute to the creation of value by virtue of their population should be able to tax some of the profits made and so far, taxed only offshore.

Lastly, it was acknowledged that an effective international tax system cannot work without a real effort to cooperation internationally. Countries need to share information about taxpayers, rulings and enact common disclosure requirements to enhance transparency and simplify administrative controls. Domestic tax systems need not to be designed to increase to the maximum national revenues to the detriment of other countries. Unfair tax competition among states is not the key to success. By contrast,

[18] Peter Sondergaard, SVP Gartner, 2011.

OECD members are highly advised to cooperate and devise arbitration mechanism in case of clashes between different tax authorities.

The G20 BEPS action plan confirms the renovated goal of the OECD to set common standards to approximate national laws and regulations internationally. The forerunner of the OECD was the Organisation for European Economic Co-operation (OEEC) in charge of managing the Marshall Plan for the reconstruction of Europe, completely destroyed by the second world conflict. Ever since its creation in 1961, the OECD has been expanding reaching as of today a membership of thirty-six countries and pushing forward tax policies aimed at the fairness of the global tax system. The BEPS action plan represents the greatest effort in the OECD's history to deliver a comprehensive vision and legal framework of the latest issues of international business taxation.

1.3 Tax Issues Related to Hybrid Mismatch Arrangements

The growth of international trade which has been experienced over the past few decades has been paralleled by an increased level of sophistication in structuring cross-border transactions. The word "hybrid" simply refers to the situation in which a taxpayer exploits the differences between two countries in order to achieve a tax benefit. The avoidance generated by hybrids is substantial. In 2009, New Zealand settled a case against four large banks for a sum exceeding NZD 2,2 billion (€1,3 billion).[19] Likewise, Italy reported that it settled tax disputes concerning hybrids for €1,5 billion, while the US estimates that hybrid transactions generating foreign tax credit amount to $3,5 billion.[20]

The use of hybrid mismatch arrangements can generally make use of one or more of the following elements:

---

[19] OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012), para 5; the document refers to the following link: <http://www.ird.govt.nz/aboutir/media-centre/media-releases/2009/media-release-2009-12-23.html>.

[20] Mark W Everson, Letter from the Commissioner of Internal Revenue to the Honourable Charles E Grassley, Chairman of the Senate Committee on Finance, May 19, 2019.

1. Hybrid entities: these are entities which are, for tax purposes, transparent in one country and treated as a corporation in another country. When the order is inverted the entity is called a "reverse hybrid" (treated like a corporation in one country and fiscally transparent in the other);
2. Dual residence entities: these are entities which are resident for tax purposes in two different countries. This paper will analyse the consequences of dual residency further on.
3. Hybrid instruments: these are financial instruments treated differently in two countries, generally as debt and equity respectively.
4. Hybrid transfers: these are arrangements which are considered a transfer of ownership in one country, but not in the other (commonly, a collateralised loan falls in this category).

In terms of legal effects created by hybrid mismatch arrangements, the results can be shortly classified as follows:

1. Double deduction schemes: arrangements where a deduction (typically for interest expenses) is claimed in two different countries;
2. Deduction/no inclusion schemes: arrangements which allow to claim a deduction in one country without having an income inclusion in the taxable income registered in the other country;
3. Foreign tax generator schemes: arrangements which allow to claim a foreign tax credit which is either not due, not totally due or not due unless the taxpayer corresponds more taxable foreign income.

The focus of this dissertation will now shift to provide an explanation of how hybrid mismatch arrangements work and what are the main features of certain transactions which are carefully crafted by professionals hired by multinationals.

Suppose that a multinational group has the parent company in country A (A co) which is also the indirect owner of an operating company in country B (B co). The ownership is indirect since between A co and B co the group interposed a hybrid entity which owns all the stock of B co and is in turn controlled by the parent company A co. The hybrid entity borrows money from a third party and uses such money to make a capital contribution to B co (or to buy all of its shares if the company was already existing, so called leveraged buyout). The hybrid entity is allowed to claim a deduction for the passive interest rate it has to correspond to the lender.

Figure 1. "Double deduction" with hybrid entity

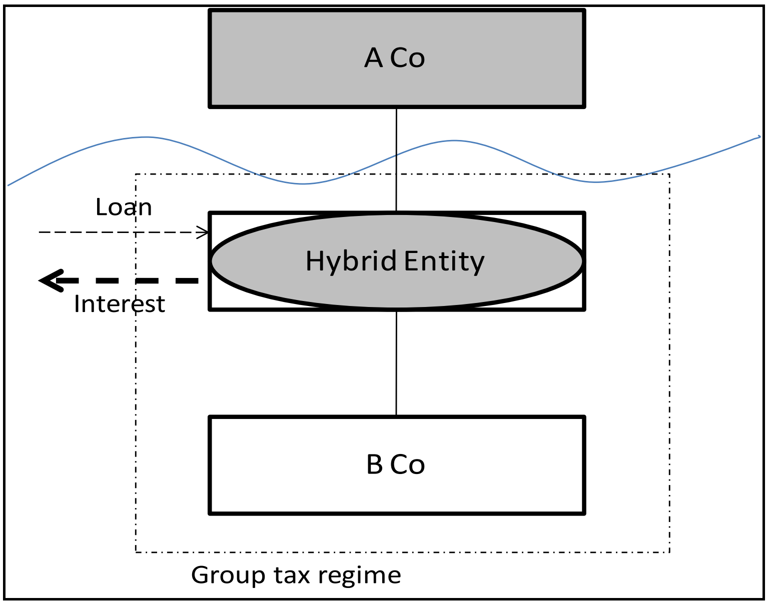


Figure 1.9: OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012).

The result of such operation is a double deduction. In country B, the hybrid entity is treated like a corporation and as such it can claim a deduction for interest expenses paid to the lender in order to offset the income earned through dividends and other sources. However, in country A, the hybrid entity is flow through and its income and related expenses are directly allocated to the parent company A co. As such, the interest expense can be deducted also in country A and offset the income earned by A co.

The result of the double deduction arrangement is to use the same expense to offset income in two different countries. The interest deduction is claimed in both countries due to the different treatment given to the interposed entity. Another scheme to obtain the same result is the use of a dual resident company. When a company is a resident for tax purposes in one country it is likely that it can benefit from group relief or tax consolidation at national level. By doing so the income and losses of all the corporate residents in one country are summed and the corporate conglomerate is treated as a stand-alone taxpayer instead of separate corporations.

However, if a company is resident in country A and country B and benefits from tax consolidations systems in both countries, then the same losses can offset the income generated by two national groups located in country A and B. This avoidance scheme is known as "double dip" and it is extremely beneficial if the dual resident company's losses exceed its income. The situation of dual residency is created because of differences between countries' general tax laws. For example, in the US states any corporation incorporate in the US (no matter what state) is considered a domestic corporation.[21] In Australia and the UK, a company is considered a resident only if the corporate management resides within their borders regardless of the place of incorporations.[22] Therefore, supposing a US-incorporated corporation moves its board of directors to the UK or Australia, the business association is considered a resident in both countries (dual residency).

The second scheme put in place in order to minimise a multinational tax burden is the deduction/no inclusion. Suppose a company resident in country A (A co) lends funds to a company resident in country B (B co) with an instrument which is considered equity in country A and debt in country B. The result is that all payments corresponded under the instrument are considered deductible interest in country B, but are exempt in country A. it is necessary to clarify why the payments are exempt under the general tax laws of country A. Many countries minimise the effect of double taxation on corporate conglomerates by exempting the dividends or gains obtained by a corporate shareholder when holding or selling some stock it owns. Indeed, the income so generated has been already taxed at corporate level in the lower tier company and shall be taxed at personal level upon distribution to individual shareholders. In short, a chain of corporations pays taxes only at the lowest tier (corporate rate) and upon distribution (individual tax rate, generally through withholding taxes). However, this mechanism allows to claim undue tax benefits in case of repurchase agreements.

[21] Internal Revenue Code 1986, 26 USC § 7701(a)(30).
[22] Income Tax Assessment Act 1936 § 6(1); *Bullock v Unit Construction Company* [1960] AC 455, 738.

Figure 2. "Deduction / no inclusion" with hybrid instrument

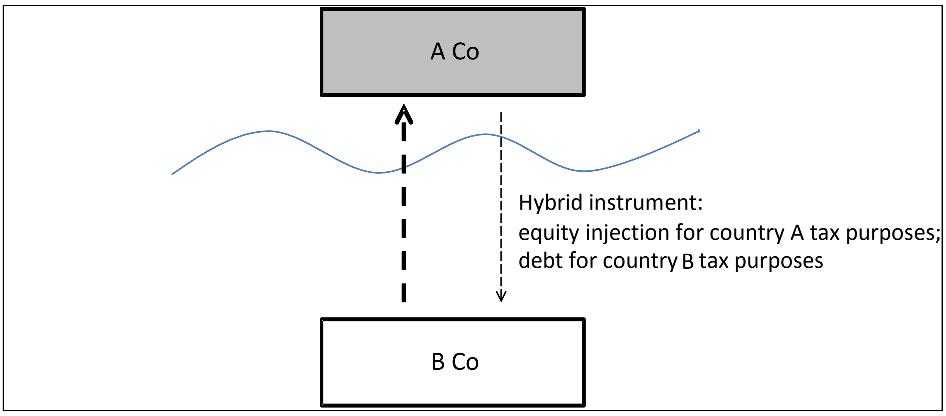


Figure 1.11: OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012).

A common type of transaction which combine the benefits of deduction and exemption is the commonly known repurchase agreement. This transaction can be seen as a financing operation backed by shares of the borrower. However, a more formalistic approach might consider this transaction as the purchase and resale of securities. If the two countries involved in the arrangement consider the transaction under a formalistic and substance-over-form approaches respectively, the group can obtain a double benefit.

If country A adopts a formalistic approach the resale of the asset and the gains it generated fall into the application of the participation exemption rule explained above and there is no inclusion in the taxable income of A co. Conversely, if, at the same time, country B adopts the substance over form principle, then, the transaction is seen as a collateralised loan and the payments made under the instruments are deductible. The exploitation of such differences of treatment by related parties can accrue a considerable tax advantage to the detriment of the tax revenues of both country A and B.

Another possible structuring of a hybrid arrangement which allows the benefit of a deduction/no inclusion is the use of a hybrid entity in country B. Any payment made by such entity is deductible in country B (for the entity is treated like a corporation) and not included in country A since the cash flow is simply considered a remittance from a foreign branch (the hybrid is indeed transparent in country A). A classic example is a loan from A co to B hybrid. The movement of money are considered internal payments by country

A and, hence, fiscally disregarded, while country B sees the transaction as a loan whose interest is fully deductible.

The last type of hybrid mismatch arrangement is the so-called foreign tax credit generator. This kind of transaction is based upon the use of a hybrid transfer of an equity instrument by virtue of a repurchase agreement between related parties.

Suppose that in country A, the parent company (A co) owns a special purpose vehicle (SPV) headquartered in country A as well. A co agrees with a financing company in country B (B co) upon selling the preferred stock of the SPV in exchange for money and repurchasing the same stock at a later date. The agreement gives also B co the right to perceive dividends distributed by the SPV during the period within which the agreement is in force. It is assumed that the SPV will earn some income subject to country A's taxation, later distributed to B co.

Figure 3. "FTC generator" with hybrid transfer

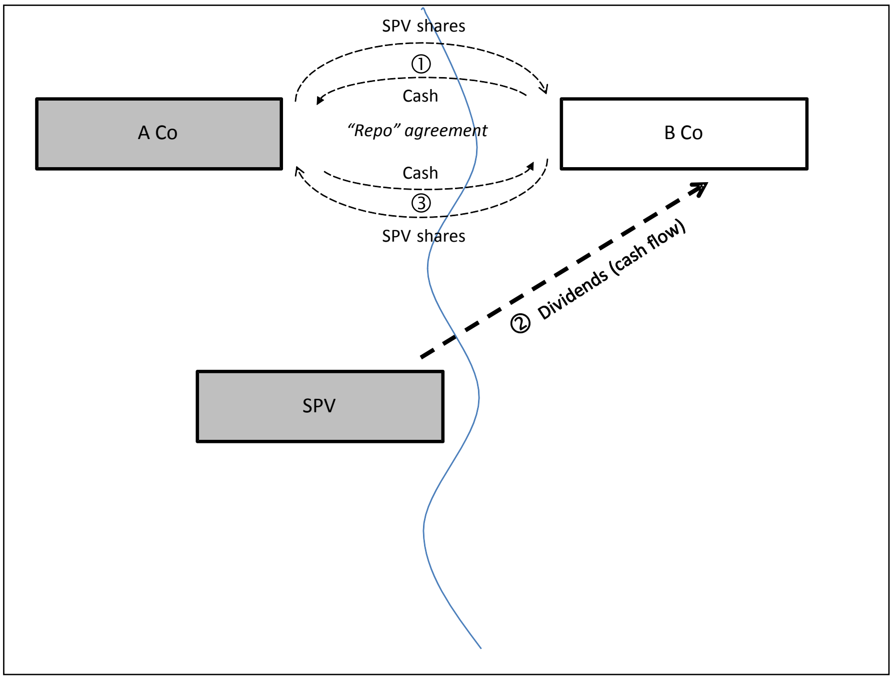


Figure 1.12: OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012).

In country B the repurchase agreement is treated like a purchase and resale of stock under a formalistic approach. Thus, B co will be treated like the owner of the SPV shares and will be entitled to claim a foreign tax credit for any foreign taxes paid by the SPV in country A upon dividend distribution. Vice versa, in country A, under the substance over from principle, the repurchase agreement is treated like a collateralised loan in which the lender agrees to extend funds to the borrower because of the assets backing the lending facility. Accordingly, A co will be allowed to claim a deduction for the interest paid upon the loan (which is the difference between purchase and resale price) and shall be considered still the owner of the shares of the SPV.

The effect of the overall scheme is to provide for a deduction in country A coupled with taxation in country B which is, however, offset by the foreign tax credit for taxes paid by the SPV in country A. Therefore, while country B's revenues receive only the positive difference (if any) between country A and its tax rate, country A's revenues are generated at first by the taxes levied on the SPV, but then offset by the deduction allowed to A co. The net result is the total or virtually total avoidance of tax-raising powers in both countries.

The OECD has highlighted the great risks connected with the abuse of hybrid mismatch arrangements. These transactions are difficult to detect and are lethal to the fairness of the overall tax system. Banks and other financial institutions carry on these operations either on their own account or on behalf of multinational enterprises when designing sophisticated schemes of business financing. The number of operations concluded daily is enormous and the possibility to deal with even a considerable part of them is hard for any tax administration. The general effect of hybrids is diminishing the tax revenues available to each country's Treasury. Moreover, multinational enterprises which are able to minimise their tax burden find themselves at a competitive advantage over their business counterparties.

Given the compelling policy reasons to fight against these instruments, the OECD has suggested two rules to put an end to the abuses performed by multinationals. The primary rule is that countries where the payor is resident should deny the deduction from the taxable income of the company if the payment is not included in the taxable income of the recipient or if another deduction is granted in the other country. However, if the recommended primary rule is not applied, then the counterparty jurisdiction is allowed to enforce a defensive rule by either requiring the recipient entity to include the payment in its taxable income or denying the second deduction which the same business association might eventually benefit from.

1.4 Recommendations on a More Effective CFC Regime

The most prominent and studied body of law in international tax law is by far the treatment of controlled foreign corporations (CFCs). The enactment of CFC rules goes back as early as 1962 and is now broadly adopted worldwide. The analysis if the OECD follows an analytical framework separating CFC rules in five building blocks and an additional final consideration: (1) defining a CFC, (2) exemptions and threshold requirements, (3) defining CFC income, (4) computing such income, (5) income attribution rules and (6) preventing double taxation.[23]

When a jurisdiction decides to apply the CFC rules upon a company it must first decide whether such entity is a CFC. The classification should pay attention to the type of entity in question and to the degree of control exercised by the parent company over the subsidiary located abroad. Apart from entities which are not fiscally transparent and, hence, benefit from deferral (unless CFC regimes apply), also flow through entities and permanent establishments should be included in the definition of CFC if they earn income which raises so called BEPS concern. Additionally, it is also necessary to include a hybrid mismatch rule to prevent corporate groups from avoiding CFC inclusion.

Partnerships, trusts and estates are all pass through entities which generally speaking see their income allocated directly to the interest holders. However, there might be some cases (like the example of a blind trust) in which such income is not attributed directly as set out above and in this case CFC rules could apply if the underlying income raises BEPS concerns. Also, permanent establishments set up by a CFC in a third country shall be subject to CFC rules if the country of incorporation of the CFC has a territorial tax system and the branch profits in the third country are not included in the taxable base of the CFC.

---

[23] OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).

Lastly, if a hybrid arrangement takes place between two countries separate from the parent company's jurisdiction, the income of the lower tier CFC would not be included in the income of the upper tier CFC thereby avoiding taxation even in the parent corporation's country. As shown in the figure below, A co owns 100% of B co which owns in turn 100% of C co. Under the law of country A, C co is a disregarded entity and the interest payment to B co is considered a mere remittance. The payment is, then, neither included in B co's income nor taxed according to CFC rules. Given that the hybrid mismatch takes place aborad it is necessary to include this type of arrangement among the situations in which CFC taxation still applies.

Figure 2.1 Modified hybrid mismatch rule

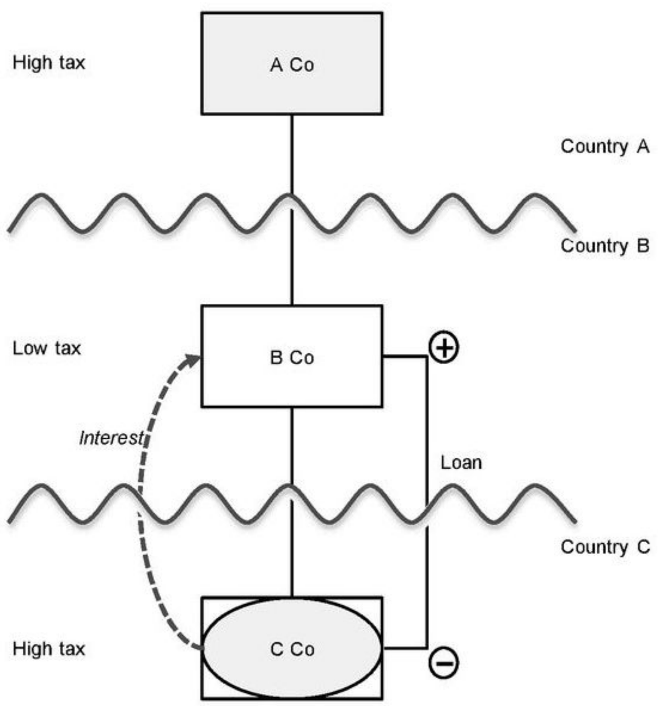


Figure 1.13: OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).

Falling into the category of entities covered by the CFC rules does not suffice to apply the income inclusion. The covered entity must also be subject to a certain degree of control by the parent company. The control exerted over the CFC and other lower tier CFC can be based upon: (1) legal control, which focuses on voting right and rights to elect the board of directors, (2) economic control, which looks at the rights over the profits and assets of the CFC, (3) de facto control, which focuses on ability to direct the CFC taking the day-to-day and most important decisions, or (4) consolidation, which applies accounting standards to determine control (e.g. IFRS 10).

Generally speaking, the threshold to establish control is owning at least more than 50% of the foreign company, although in a minority of jurisdictions even the mere 50% is enough. This test must be applied carefully since there are several ways to avoid exceeding the threshold. If two unrelated companies having less than 50% are acting in concert to control a foreign company, then, CFC rules apply on their pro rata share. Likewise, related parties controlled by a common parent company can own together more than 50% of the stock of the foreign company. In such case, their stocks are added. Lastly, direct control could be diluted in lower tiers of CFC when the parent company controls another company with less than 100% and this controlled corporation controls another with less than 100%. The multiplication between the two ownership percentages could fall below 50% and yet there is still control. These situations are exemplified below.

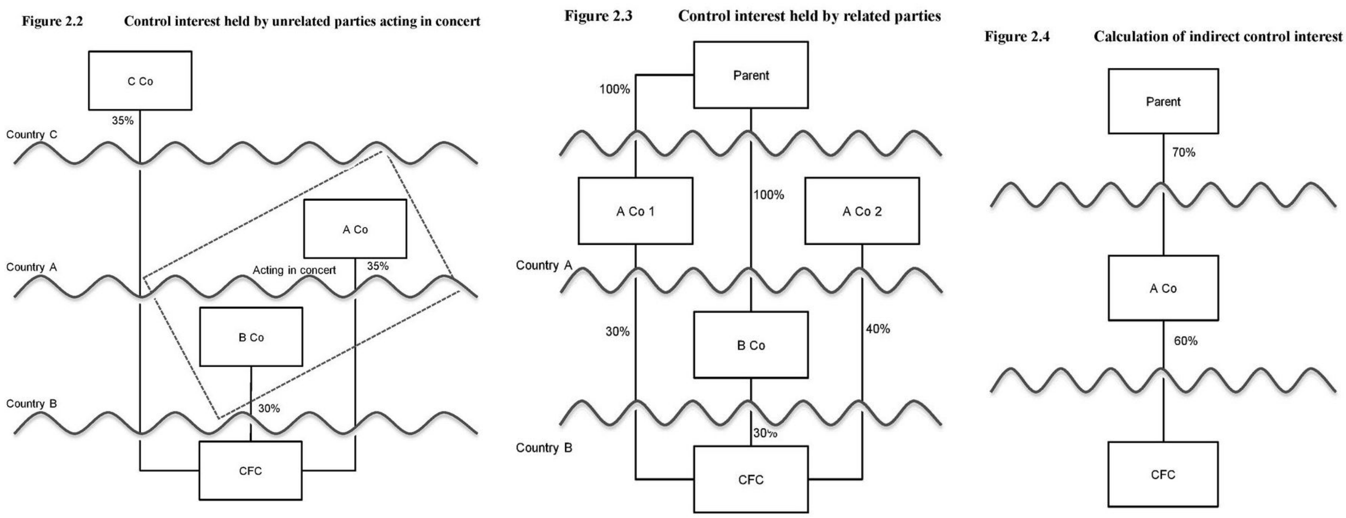


Figure 1.14: OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).

The application of CFC rules needs to be narrowed down in cases where there is little chance of base erosion or profits shifting. As a matter of fact, the application of this rules gives rise to high administrative costs which are not worth bearing if the amount subjected to taxation following a successful assessment is not much. Therefore, tax administrations should enforce reporting requirements which simplify the identification of those companies which most likely are the real targets of the CFC regime. The OECD suggestions are establishing a de minimis threshold of income, a meaningfully below tax rate which triggers the income inclusion and, eventually, the combined application of a white list containing all the jurisdictions which are not CFC countries of incorporation.

The enactment of a de minimis provision (the best hypothesis is the greater of: no more than 5% of the parent company's income or €1 million) has to be applied carefully. The parent company could decide to fragment the activities carried out by the single CFCs so that they all fall into the application of the exception. However, an anti-abuse rule which requires to consider the aggregate of all exempted CFCs might be introduced to avoid higher portions of income to go untaxed. The drawback of this anti-avoidance provision in the increase of administrative costs for national tax administrations.

The other all-or-nothing rule to be examined is the recommended introduction of a tax rate exemption (also called high-tax kick out). Most CFC laws include an exception for those companies incorporated abroad which are subject to a level of taxation which is nearly as high as the one applied in the parent company's country. The tax rate exemption can be applied either by nominal tax rate or by effective tax rate. The OECD suggests the application of the latter since tax systems are full of deductions and exemptions which might apply in one jurisdiction and not in another. Therefore, the parent company has to calculate the net income taxed in the foreign country divided by the income which would be taxed in its country multiplied by the applicable tax rate.

$$\frac{foreign\ taxable\ income}{domestic\ taxable\ income} \times foreign\ tax\ rate \geq tax\ exemption\ rate$$

The third building block of CFC taxation is the definition of CFC income. The OECD approach is to give flexibility to each country to design the income inclusion the way fits the best. However, it also stresses the importance of taking into account types of income which raise BEPS concerns. The analysis can be either: (1) categorical, (2) based on economic substance, (3) focused on excess profits, or (4) by entity and/or transaction involved.

The categorical analysis treats income earned by a CFC as included income depending on one of the following three factors: the legal classification of income, its source, or the relatedness of the parties. The legal classification highlights the risks connected with particular types of passive income. Dividends are passive income and as such can be easily shifted from one country to another by setting up a foreign base company. However, in the case of a CFC if the underlying income (which is the income earned by the CFC) is active, then, it is recommended to look through and consider the income active instead of passive (hence, there would be no inclusion).

Interest income is also very much frowned upon. A parent company could easily form a foreign base company with large amounts of capital and use it to lend to related affiliates. The interest would be deductible in high tax jurisdictions and subject to little tax or no tax offshore. If the CFC is overcapitalised, it lends mostly to related parties (hence, it does not carry a properly active financing business) and to persons outside the country of incorporation of the CFC, the interest shall be included in the CFC income. Likewise, insurance income is also rather concerning. Indeed, profits could be shifted away from the countries were risks are actually located. Generally speaking, if the CFC is overcapitalised, the policy holder/beneficiary resides outside the CFC's country of incorporation, or the contract was agreed upon by related parties, the income so derived shall be included in the parent company's gross income.

Another type of income which presents several complexities is the combination of royalties and IP income. Intangibles are valuable assets of a company which can be easily moved from one jurisdiction to another under many different legal arrangements. Additionally, IP is hard to value since there is a lack of comparable transactions to determine their real value and its capacity to produce future income. IP income can be easily manipulated and it is almost impossible to separate the value of products and services sold from the underlying technology used to deliver them.

Lastly, sales and services income is also particularly tedious. Apart from IP income which can be easily shifted to foreign base companies, another kind of CFC which causes profit shifting is the invoicing company. In this scenario, a parent company sells goods or services by using the CFC as reseller or agent. The mark-up price or commission taken by the CFC shall be included in the gross income of the parent company if there is no substantial contribution or transformation to the product or service by the CFC. As a matter of fact, the arrangement simply diverts income to a foreign country.

The other two factors to be taken into account for the categorical analysis are the relatedness of the parties and the source of income. The first factor considers income generated through intercompany transactions as CFC income. Some jurisdictions have applied this test which is quite straightforward, but might lead to an excessively broad extension of the CFC inclusion. The other factor is the source of income. This test looks at whether the real source of the income has been artificially stripped from the parent country to a foreign country. The policy basis of this factor is centred on fairness and aims at respecting the jurisdictional powers to tax of every country, however, the application of the source of income factor is rendered extremely difficult by its indefiniteness.

Apart from the categorical analysis just dealt with so far, the OECD has taken into account other views. Under the substance analysis the parent company is taxed upon income which does not reflect the economic reality of its productive line. In simpler terms, the tax administration looks at whether the employees, assets, premises and risks of the CFC are adequate to the amount of income produced. If the human and capital investment does not reflect the apportionment of income, the excess is clawed back into tax. In a similar fashion, the excess profits analysis simply establishes a normal return that any CFC in a particular situation is entitled to earn. Any excess profit must be included in the parent company's gross income. The normal return can be a set percentage of the risk-inclusive rate or the eligible equity invested.

Lastly, the remaining analysis is the entity or transactional one. Under the entity view, if a foreign company is considered a CFC all of its income is attributed to the parent company no matter the classification of its income nor the arrangements it engaged in. this system greatly simplifies and reduces administrative burdens and costs, but does not always reveal to be an accurate assessment. By contrast, the transactional analysis puts emphasis on the type of arrangement the CFC engaged in the taxes the related income if BEPS concerns arise. Surely, it is the most complex and costly, but does not do sweeping generalisations as its counterparty method does.

Once it has been established that a foreign company is a CFC and that some of its income is includible, it is necessary to calculate the exact amount to be subjected to the parent company's tax rate. In doing so, the OECD reminded that two countries and two tax laws are involved: the home and host jurisdictions. According the its recommendations, the system of the home country should be privileged in computing the income which should be taxed. However, the operating result of any CFC might be a profit or a loss. The OECD suggested that in order to avoid abuses the CFC regime should place limitation on the attribution of excess losses to the parent company. As a matter of fact, losses will be carried forward in the foreign country instead of being deducted and then recaptured years later. The loss limitation can be either designed on the grounds of nominal operating results, or on the types of income earned by the parent company and the CFC by singling out separate baskets for active and passive income.

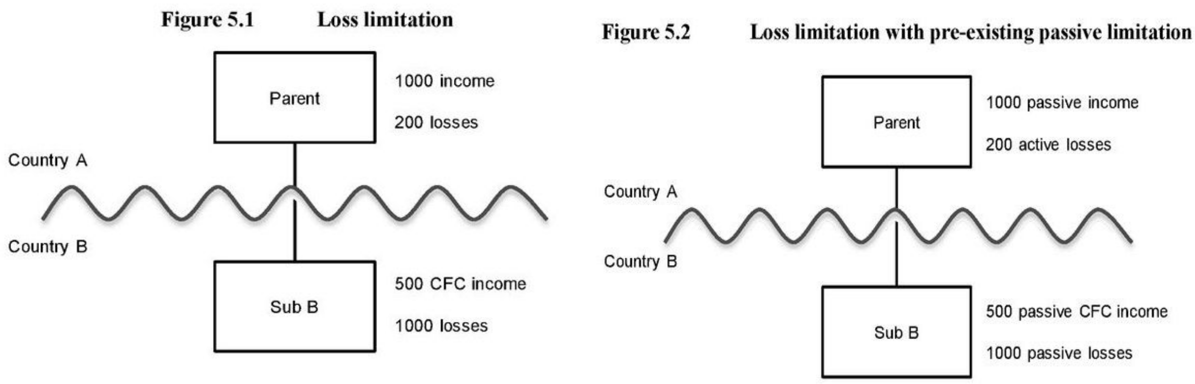


Figure 1.14: OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).

The last building block of CFC rules consists of the attribution of income to the interest holder in the CFC. This operation requires several consecutive steps in order to finally tax income at shareholders' level.

The interest holder might need to exceed a certain ownership threshold to be attributed the income of the CFC (e.g. 10% of the stock) or else it might be necessary that they exercise actual control. If the taxpayer has met this requirement the amount of income to be included in the pro rata share of income earned by the CFC reduced by any day during the tax year in which the foreign company has not met the requirements to be treated as a CFC.

$$ownership\ interest \times CFC'income \times \frac{CFC\ qualified\ period}{365\ days}$$

Such income shall generally be included in the taxpayer's taxable years in which the accounting period of the CFC ends. The income might be treated either as a deemed dividend inclusion (hence, indirect foreign tax credit and other related rules), or as a flow through attribution (by applying the framework for transparent entities). Finally, it is necessary to apply a tax rate. The parent company's jurisdiction can decide to subject the CFC's income to a so called "top-up tax", which is a lower-than-average rate resembling the alternative minimum tax for individuals, or the normal rate generally applied to domestic business associations.

The BEPS Action 3 on CFCs concludes the illustration of the topic by making a final consideration on the possibilities of double taxation which might arise from the application of such regime. The OECD specifically refers to situations in which the foreign company pays foreign taxes, distributed dividends and to the scenario in which more than one jurisdiction apply CFC rules.

In the case of foreign corporate taxes paid by the CFC of the double application by different countries of CFC's rules, the OECD suggests that states recognise a foreign tax credit up to the amount of taxes paid abroad. If the CFC paid income taxes upon its income, when the income is attributed to the parent company a foreign tax credit must be recognised in order to prevent distortions on international investments and commerce. Likewise, if there is a chain of CFCs located in different countries which also rely on CFC rules, then the taxes paid by lower and upper tier CFCs must be credited against the parent company's overall taxes.

Figure 7.1 Interaction of CFC rules

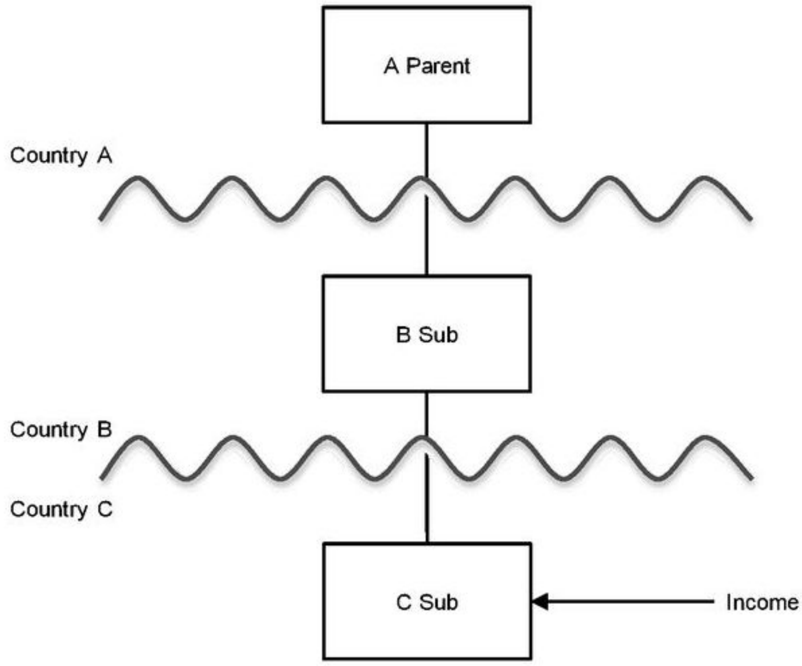


Figure 1.14: OECD, *Action 3 - 2015 Final Report: Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).

The other situation which might give rise to double taxation is the actual distribution of income already taxed upon deemed inclusion/transparency. Previously taxed income shall be distributed under a total exemption regime up to the amount taxed so far. The same rule shall apply on gains realised on the sale of stock in a CFC. The price received in exchange for the sale of stock shall be exempt up to the initial value of the stock plus all the deemed dividends not already distributed (any eventual excess paid by the incoming stockholder shall be taxed according to CFC rules).

1.5 The Problems Related to the Digitalised Economy

Ever since the dot-com boom (and also bubble) took place, the global economy has become increasingly reliant upon digital assets as means to do business.[24] The implication

[24] Cockfield, Arthur J and Hellerstein, Walter and Millar, Rebecca and Waerzeggers, Christophe, 'Taxing Global Digital Commerce' [2013] Wolters Kluwer Law & Business 3; Reimar Pinkernell, 'Internationale Steuergestaltung im Electronic Commerce', (2014) 494.

of internet in the production line transformed completely the way undertakings deal with customers, sell and market their product and services, and relate to other enterprises. Additionally, as in every other industrial sector of the economy, the digital world has seen the sudden rise of prominent multinationals such as Google, Amazon, Facebook, Microsoft, Apple and the like.

The changes brought about by new technologies showed the shortcomings of traditional tax principles when applied to new firms and to a revolutionary way of doing business. The G20 Finance Ministers mandated the Task Force on the Digital Economy to continue to monitor the developments with respect to digitalisation even following the publication of the OECD's BEPS package.[25] As a matter of fact the many multinational enterprises started the reshuffling of their corporate structure in order to apparently comply with the OCED's guidelines and yet still be able to shift the majority of their profits abroad to low tax jurisdictions.[26]

The tax challenges relating to the allocation of taxing rights among the different jurisdictions in which digital companies operate in can be summarised in three main characteristics: (1) scale without mass, (2) heavy reliance on intangible assets and (3) data and user participation. The term scale without mass refers the rapidity of internet-based companies to expand very rapidly without the need of localised and identifiable investments in a particular jurisdiction. In other terms, the growth of digital corporation is mostly ethereal. The dependence on intangibles which characterises the digital economy strains the traditional rules of profit allocation between countries. The high degree of technological content of patents and other IP rights makes it difficult to find a comparable arrangement to assess correctly the creation of value of each transaction. Given that in the majority of cases, the products (and sometimes even the services) sold have an embedded technological quality, it is also extremely hard to separate the value contribution of the intangible and tangible assets. Moreover, IP rights are easily movable between countries under a vast array of methods which renders the monitoring of profit

[25] OECD, *Action 1 - 2015 Final Report; Addressing the Challenges of the Digital Economy* (OECD Publishing, 2015).
[26] OECD, *Public Consultation Document – Addressing the Tax Challenges of the Digitalisation of the Economy* (OCED Publishing, 2019).

shifting compliance virtually impossible. Lastly, the data and user participation poses challenges to the traditional nexus principle which empowers a country with the jurisdiction to tax a trade or business.

The digitalised economy makes large amounts of revenues either by selling products or services through online platforms or by gathering data from individuals and entities around the world and then sell such personal information, mostly bundled-up in packages, to other businesses. The capacity to act remotely by using a simple server located in one jurisdiction while the destination country or data-source jurisdiction are elsewhere results in the avoidance of any taxable presence in the place where the real effects of the transaction take place.

In order to understand how internet multinational enterprises have been so successful at avoiding high tax burden it is necessary to show and explain some examples of tax planning. Following the examination of the following scenarios, the dissertation will provide the possible answers which the OECD suggested in its reports.

The general framework of internet companies' planning tries to avoid a taxable presence in the market country operating remotely. If the taxable presence cannot be avoided, the vast majority of profits are shifted away through trading structures or by maximising the deductions in that country. Additionally, the corporate entity tries to avoid withholding taxes or to be subject to low withholding taxes. In the case of treaty countries, the distribution of dividends has a preferential withholding tax rate (which can be as low as 5% on gross income if the controlling entity has at least 25% ownership in the controlled corporation).[27] The recipient and parent company is subjected to low or no taxation when receiving income from the business association located in the market country. This result can be achieved either by selecting a low tax jurisdiction, or opting for preferential regimes, or hybrid mismatch arrangement to avoid income inclusion. Lastly, the ultimate parent company, which is at the top of the corporate group does not tax the low-taxed profits funnelled into the low tax jurisdiction.

[27] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 10(2(a)(b).

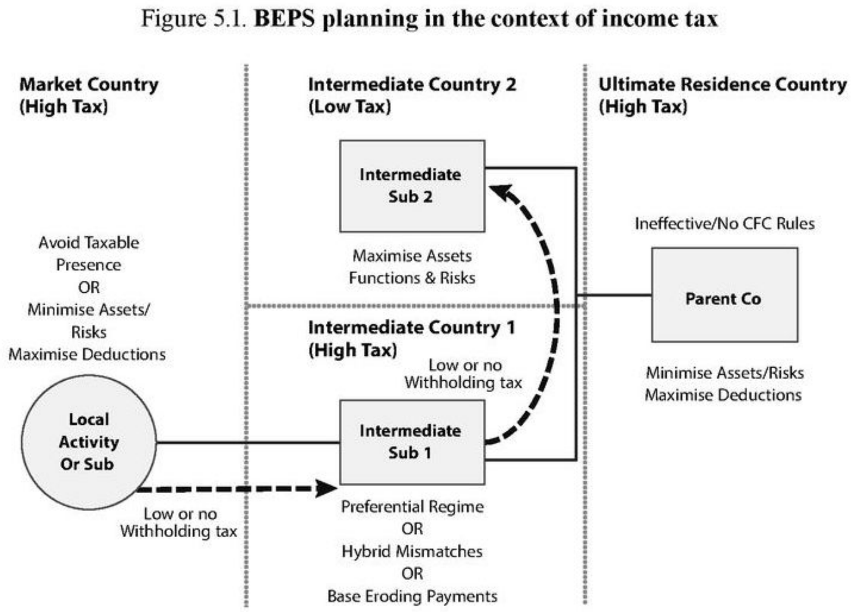


Figure 1.15: OECD, *BEPS Action 1 – 2015 Final Report: Addressing the Tax Challenges of the digital economy* (OECD Publishing, 2015).

The one analysed above is the general avoidance scheme used by internet multinationals. However, online retailers adopt a slightly different version from what it has been already shown. Given the great expansion of e-commerce over the last few years, it seems necessary to highlight some of the most interesting features of tax planning structures in respect of this new industry.

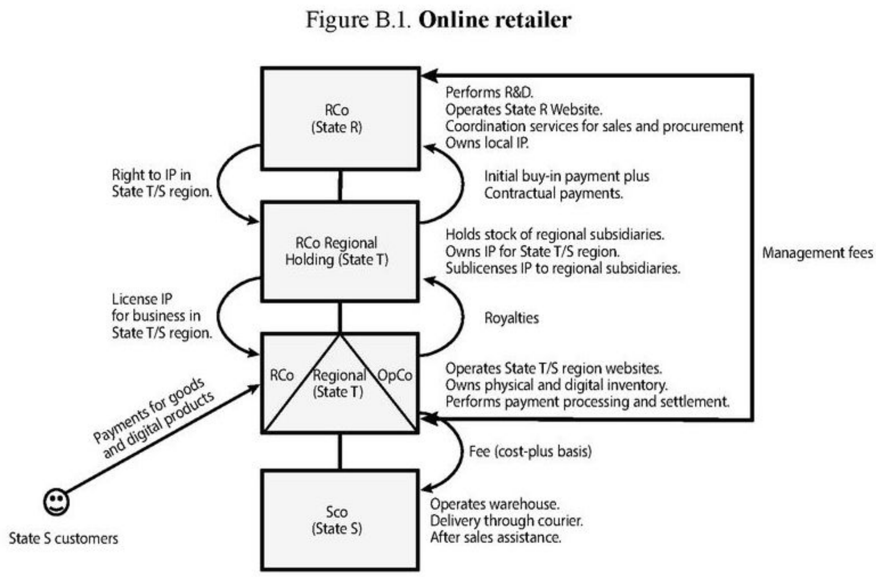


Figure 1.16: OECD, *BEPS Action 1 – 2015 Final Report: Addressing the Tax Challenges of the digital economy* (OECD Publishing, 2015).

The parent company is generally the one which performs research and development and owns all the rights to IP within the group. It also operates a website in the country of incorporation where customers can browse and order goods and services. Finally, it handles the coordination of services for sales and procurement by managing warehouses (which fall into preparatory or ancillary activities not considered permanent establishments)[28] or hires independent agents (which do not constitute permanent establishment too).[29] The lower tier company is incorporated in a different state and has the right to manage IP owned by the parent company in specified region by virtue of a buy-in payment under a cost sharing agreements. Cost sharing agreements are contribution helpful to move IP rights from one country to another. It also owns other regional subsidiaries (one within the same state) to which it licenses the same IP rights in exchange for royalties. The third subsidiary is an operating company which handles the inventory, processes payments. This company is also a hybrid which means that the managing fees paid to the parent company are deductible in its country and non-includible in the country of destination. Lastly, the second operating subsidiary, incorporated in a third jurisdiction, handles the warehouse, delivery services and sales assistance.

By availing themselves of similar schemes, e-commerce giants can save a great deal of taxes in high tax jurisdictions where they concentrate all the deductions and shift their profits in low/no tax countries or where they are granted a preferential tax treatment. As it was illustrated at the outset of the dissertation, tax authorities can give preferential tax treatments in the form of tax rulings which endorse a mechanism to determine the taxable base of undertakings in a manner which allows the majority of profits go untaxed.

Moreover, it is also necessary to briefly mention how the digitalised economy was able to avoid indirect taxation too. The value added tax (VAT) or goods and services tax (GST) is generally levied at international level according to the destination principle. As such, the exporter will sell the good or service without charging the VAT/GST and will be

[28] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 5(4)(e).
[29] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 5(5).

entitled to obtain a tax refund by the national revenue for the input tax paid (if any) to its suppliers. By contrast, the importer will charge the VAT/GST to the following purchaser and remit the tax to the local tax authorities. However, the way this tax works in respect of cross-border transaction is not that straightforward. With regard to goods sales, the administrative burden to levy the VAT/GST prompted G20 countries to enact de minimis threshold below which no tax is effectively charged (since the costs to assess and collect the taxes due would exceed the actual revenues so obtained). With regard to services, the transaction could take place as a B2B or a B2C purchase. While the first scenario does not present difficulties since the buying business is able to self-assess the tax due once it sells the service again (through a reverse charge mechanism), the second fact pattern has more complexities. Customers are not so reliable when it comes to self-assessing the VAT/GST. Sometimes, the tax will be levied under the origin principle (so the supplier's jurisdiction will charge the export). However, the OECD's recommendation is to have the non-resident service supplier pay the tax to the customer's jurisdiction.

It is possible to provide the reader with two hypothetical examples of how VAT/GST can be totally or mostly avoided by internet-based businesses.[30] Suppose a business sells low value goods online to local customers. Being a resident taxpayer, it shall have to collect and remit indirect taxes upon the sale of goods. However, if the resident taxpayer set up a company offshore and shipped the low value goods from abroad, it would qualify for the de minimis threshold exemption and would not be subject to any indirect tax. Additionally, if the chosen foreign country were a low tax jurisdiction, there would be also considerable tax savings in respect of direct income taxes. The second fact pattern concerns a service supplier. Suppose a resident business provides local customers with streaming digital content online (e.g. films, TV shows and the like). Given that the service provider is a resident taxpayer of the jurisdiction where its customers use the online streaming facilities, it is subject to the VAT/GST collection and remittance. However, should the taxpayer carry on its business through a newly incorporated foreign base company, the outcome could be twofold. If the tax is levied under the origin principle, choosing a no/low VAT/GST jurisdiction would result in a great tax advantage. If the tax

[30] OECD, *BEPS Action 1 – 2015 Final Report: Addressing the Tax Challenges of the digital economy* (OECD Publishing, 2015), paras 311, 315-316.

is levied under the destination principle, the foreign taxpayer could decide to willingly not pay the indirect taxes due and without an effective enforcement mechanism the market country could end up without no recourse against the foreign debtor.

The impressive ability of digitalised businesses to avoid both direct and indirect taxes prompted G20 countries to take action. The solutions advanced by the OECD to tackle these issues are mainly three: (1) the “user participation” proposal, (2) the “marketing intangibles” proposal and (3) the “significant economic presence proposal”. All the three proposals have a common aim which is expanding the taxing rights of the user or market jurisdiction.

The first proposal is based on the idea that highly digitalised businesses create value not only through traditional processes, but also by developing a large user base from which they benefit greatly. Soliciting a sustained engagement and active participation of users is key to developing an undertaking and being more competitive. Social media platforms (especially Instagram) are populated by user-generated content. The information gathered by these online platforms is essential to advertise certain products to groups of targeted customers. The revenues of such companies are created by the active participation of users. Additionally, the same growth of the participation base is actually due to users. By interacting with each other, current users persuade non-users to join the platform and being more connected to their community. Likewise, search engines make revenues by virtue of advertising. Much of the content delivered is produced by the same users which contribute to the information it can provide with. Additionally, the search engine tailors the experience to any single customer by gathering information about his or her preferences and attitudes. Apart from improving the engine itself and its effectiveness, the collected data are also sold to third parties and result in profits for the business. Lastly, online marketplaces are also very much dependent upon the extent of their user base. All the products found for sale are offered by the same user willing to sell. By contrast, those willing to buy will be more easily persuaded that the platform meets their needs and expectation if the array of goods offered is as large as possible. Moreover, users are convinced to take an active role in the online marketplace by providing comments and make money themselves. The subtle technique of having the platform user feel empowered is the core of any highly digitalised business.

Despite the user base contribution to value creating, user jurisdiction has little or no taxing rights over online platforms. The OECD proposal would suggest modifying the nexus and allocation rules proportionately to the contribution that the user base in market countries make. To do so there are four steps:

1. Calculating the residual or non-routine profits of the business;
2. Separating the portion of residual profits attributable to the user base from the one attributable to other factors (e.g. IP rights. etc.);
3. Allocating the user-based profits among the jurisdictions in which the business has users;
4. Giving those countries the right to tax such profits regardless of whether there is a permanent establishment or not.

While theoretically the proposal is sound, it might be very difficult to agree upon a common set of rules to calculate the allocation of profits and taxing rights according to the user base contribution.

Another proposal discussed by the OECD is the marketing intangible proposal. Like the user participation one, it would change the allocation of profits and the nexus rule for the distribution of taxing rights. However, the application of this proposal would reflect a wider scope and not only would highly digitalised businesses fall into the category taxed, but also all trades or business part of the so called digital economy. The policy behind this view of profit-split is centred on the idea that there is a link between intangible assets and users in market jurisdictions. Brands, trademarks, trade names, franchises, patents and the like are more likely to generate profits if they reflect more favourable attitudes in the minds of customers. Secondly, the data gathered through digital interface are stored and analysed (sometimes even sold) to improve the intangibles and make them even more attractive in the eyes of the beholders.

Taking into account the link between users and intangibles (not the company itself as in the former proposal), the profits generated should be subjected to the taxing rights of the market jurisdiction even in the absence of a traditional taxable presence. As a matter of fact, by operating remotely, such presence can be easily avoided or limited to its minimum. The proposal follows the same steps already explained above, however, the profits derived from marketing intangibles can be calculated even if a company (especially related) owns no legal title over the IP and benefits from its use through licensing agreements. The effect of this proposal is to claw back into tax the revenues of both highly digitalised businesses and more traditional ones which have started making profits in a similar fashion.

The last proposal put forward is the "significant economic presence". Significant economic presence means establishing a nexus with a market jurisdiction based on objective and sustained factors throughout a tax year. If a company sells to or makes revenues from a market country remotely and its profits are substantial, it will be possible for that country to tax the portion of gross income connected with its territory, undertakings and population. In other words, a non-resident can be found to have a digital presence (a modified version of a permanent establishment) if: (1) it has a user base in that jurisdiction, (2) the volume of data thereby derived is consistent, (3) it bills and collect money in local currency, (4) it maintains a website or webpage in local language, (5) it is responsible for the final delivery of goods or support-services, (6) it carries on sustained marketing and sales promotion activities to attract local customers. These are just some of the main factors to be looked at, although the list is not fully comprehensive.

The calculation of the tax burden to be paid to each jurisdiction would follow a three-step procedure:

1. Defining the global taxable base to be divided;
2. Allocating the taxable base among different jurisdictions on the grounds of several factors resulting in a profit-split;
3. Weighting these factors to determine the extent to which each country can exercise its taxing rights.

The OECD finally suggested three ways of designing laws to subject such income to taxation. Such regulatory improvements aim at preventing base erosion in particular instances and therefore should all be enacted. CFC rules have demonstrated to be very effective in facing the issue of profits shifting, the OECD encourages states to change the current CFC rules in order to extend their application to subsidiaries offshore. Another solution, which can apply in the absence of a controlling company in the jurisdiction at stake, is to revise the profit-split transfer pricing rules in order to claw back into tax all profits shifted abroad. This can be extremely beneficial for high-tax countries where multinational enterprises concentrate all their deductions. Lastly, the OECD put forward the enactment of a withholding tax on gross revenues for countries where there is either no taxable presence or a light presence. In these circumstances, both the application of CFC rules and profit-split is excluded and the only way to share some of the profit is through a withholding operating specifically for e-commerce and data gathering.

1.6 The Erosion and Shifting of Taxable Bases

The last instrument of tax planning highly adopted by multinational enterprises is the use of interest deduction expenses to manipulate the taxable income reported in each jurisdiction. The advantage of such practice is twofold: firstly, the corporate group does not need to inject additional equity into a subsidiary or related party, secondly, the interest expense can be allocated in high tax jurisdictions by borrowing from third parties directly or borrowing form unrelated lenders and making a loan to an affiliate. The second option allows to transfer the deduction from one company to another and earn the spread between the initial interest rate charged by banks or financial institutions and the interest rate actually paid by the targeted affiliate.

In order to fully understand the OECD's guidelines on the issue of interest (and related payments) deduction, it is advisable to provide the reader with all the steps which will be followed.

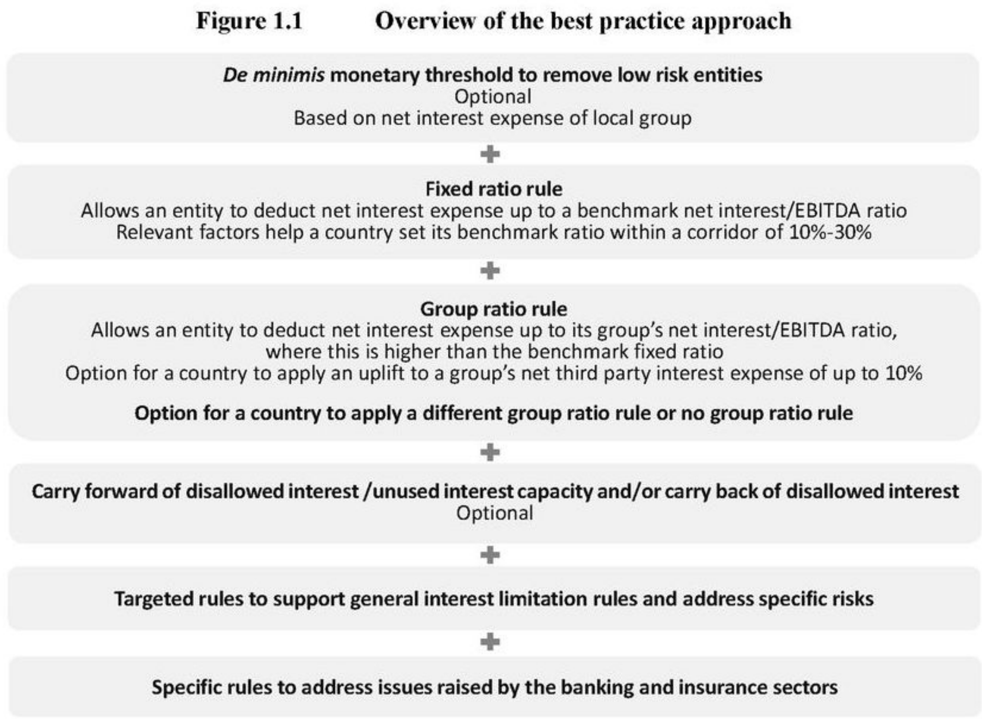


Figure 1.17: OECD, *BEPS Action 4 – 2015 Final Report: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD Publishing 2015).

The OECD simply defines the term "interest" as the cost of borrowing money to finance business operations. Given the sophistication of multinational enterprises, it would be naïve to merely consider as interest the additional cost charged by banks and financial institution in exchange for loans. Indeed, the capacity to structure new arrangements equivalent to borrowing, but with different legal effects should, nonetheless, be treated likewise for tax purposes. The limitation should, therefore, apply to all forms of indebtness, to payments economically equivalent to interests and any expense incurred in connection with financing schemes.

The list should reasonably include: payments under participating loans, convertible bonds, zero coupon bonds, Islamic finance, finance lease payments, capitalised interest added to the value of corporate assets, amortisation of capitalised interest, derivative instruments or hedging arrangements related to an entity's borrowings, guarantee fees, and the like. Vice versa, the list should not include: foreign exchange gains and losses, different derivatives or hedging arrangements, operating lease payments, royalties and interests related to pension plans.

After defining what interest actually means, it is important to understand which undertakings are subject to the interest deduction limitation and to what extent. According to the OECD, the limitation should apply to multinational groups, domestic groups and standalone entities. Multinational enterprises have different corporations in various countries. In order to effectively prevent the interest deduction by allowing them to relend money to another related party, all countries in which multinationals operate should have an interest deduction limitation. Vice versa, all the indebtness would be concentrated in the only countries where the loophole has not been closed yet. Domestic groups (sometimes also part of a multinational group) are subject to the same tax authority and the limitation might be applied on a consolidated basis or per single entity. The OECD considered the first option more appropriate, but affirmed that both measures are equally effective. Lastly, it comes to standalone entities which are not part of a group. In many cases these businesses are small and do not raise BEPS concerns. However, it might be that they are owned by complex holding structures involving trusts or partnerships. In these circumstances, the base erosion likelihood is equivalent to multinational groups

In order to simplify the administrative burden of the G20 countries' tax authorities the OCED suggested the introduction of a de minimis threshold which would exclude all companies which due to their dimension do not raise BEPS concerns. The threshold should be based upon the net interest deduction of the entity or group. By doing so, it would be possible to narrow down controls just over the companies which benefit mostly from being highly-leveraged.

The approach to followed when limiting the interest expense allowed as a deduction should take into account several factors. Firstly, both the earnings and the interest paid by the entity or group vary throughout the tax year and cannot be said to be constant. According to the OECD, it would be advisable to look at the average of interest expense burden of the company over the average EBITDA (earnings before interest, taxes, depreciation and amortisation). The reflects the operating cash that the company has and is a better reflection of the financial situation of businesses than EBIT (earnings before interest and taxes). Moreover, when calculating the interest expense there are two available options: the gross interest expense and the net interest expense. The gross interest expense takes into account only the passive interests paid to affiliates or third parties. Vice versa, the net interest expense allows to offset the passive interest amount with the interest income earned by the company. Just the difference between active and passive interests is subject to the limitation corridor which the OECD suggest be between 10% and 30% of the EBITDA.

It should be noticed that another possible benchmark for interest deduction is the asset value of each company in the group. The benefit of assets is that they are certainly not as volatile as earnings which can be shifted more easily by the controlling entity of the group. However, given that the economies of the G20 countries are always less and less reliant upon heavy industrial sectors, the use of an earning-based fixed ratio rule seems to better adapt to all sectors.

Another non-negligible factor is the interest expense incurred in the case of project financing. Certain public-benefit projects are naturally performed by highly leveraged corporations. This is not due to tax planning reasons, but simply to the industry in question. An eventual lack of an exception for public projects finance would seriously strike a blow to the entire industry and have a negative impact over the possibility of banks and other financial institutions to earn revenues.

The OECD, as mentioned above, envisaged the introduction of a fixed ratio rule in all tax systems aimed at limiting net interest deductions. The main objective pursued through this rule is ensuring that a percentage of the taxable income earned and produced in the target jurisdiction is subject to tax. The corridor suggested by the OECD ranges from 10% to 30% while the rest of income cannot be offset by the surplus in passive interests. Eventually, the excess disallowed deduction can be either carried forward or carried back in accordance with the tax rules of the jurisdiction where the entity is incorporated or runs its daily business operations. The limitation can either apply at entity level or at group level. The first approach produces a stricter outcome since it does not allow to merge all incomes and ratios of the other companies of the group located in the same country to calculate the net interest expense which can be deducted. By contrast, allowing all domestic companies to mingle their ratios creates more flexibility in terms of economic choices of the enterprises. In any case, the domestic group should be subjected to administrative requirements to file reports regarding the financial situation of each company in order to guarantee transparency when calculating the net interest expense allowed as a deduction.

The introduction of the fixed ratio rule could be avoided by putting into place arrangements which would escape the application of the limitation. The OECD recommended the provision of so called “targeted rules” which would minimise the abuses put into practice by multinational enterprises. For instance, an entity with a high net interest expense could enter into an arrangement to reduce it and fall below the threshold of the fixed ratio rule by converting the interest expense into a different kind of deductible expenditure, or by converting taxable income into a form equivalent to interest. If the fixed ratio applies at group level by taking into account only related parties’ payments, it might be possible to increase the indebtness towards third parties and be allowed the entire deduction. Lastly, in countries where the rule does not apply to standalone entities, a group could restructure its organisation and create a transparent holding company to separate the different corporations and avoid the application of the fixed group ratio.

The last recommendation of the OECD in respect of the limitation on interest deduction is the exemption of the business of banking and insurance. Given the social importance of banks and insurance companies, subjecting these two industries to the interest expense limitation would be counterproductive. Moreover, such rule would probably not be effective in tackling the base erosion and profit shifting of financial institutions. As a matter of fact, banks take deposits from customers and lend this money to trades or businesses. Even in cases in which banks issue bonds to finance their operations, the money so collected would be lent again at a higher interest rate. In short, banks would certainly have positive interest income higher than negative one. The high regulatory burden already imposed upon banks and insurances (including the obligation to keep adequate buffers of regulatory capital to mitigate risk exposure) suggests the exemption of these two sectors from the application of the fixed ratio rule.

1.7 Could the BEPS Action Plan Lead to Tax Protectionism?

The widespread practices of base erosion and profit shifting adopted by multinational enterprises over the last few years have shown the necessity to change and rethink the actual international tax law system. The G20 BEPS Action Plan is a clear answer to the burning issues which countries' tax systems and revenues have faced for decades. However, the OECD pointed out that the enactment of this new anti-abuse measures might reveal to be counterproductive and limit international trade if there is a lack of coordination among countries in order to avoid double taxation.

The current framework of bilateral treaties dates back to the 1920s and to the first Model Tax Law Convention issued by the League of Nations. Despite the updates brought to this model by the OECD and the United Nations, globalisation has clearly exacerbated the gaps and frictions among different tax systems. The BEPS action's aim is to counter double exemption and avoidance schemes which are straining democratic systems by reducing the necessary resources to guarantee the effectiveness of human social, economic and political rights. However, measures such as the CFC regime or the hybrid rules or the taxation on digital economy as well as strict deduction limitation could result in an effective double taxation of trades and businesses if countries do not agree to coordinate their policies.

The concerns raised by the OECD are also aggravated by the recent slowdown in global economy. History has shown that economic crises lead to protectionism and the rise of new measures aimed at shoring up domestic economies and decrease imports from rival countries. In short, the changes can be summarised in the sentence "beggar thy neighbour".[31] For instance, both the breakout of the 1997 Asian financial crisis and the 2008 subprime mortgage crisis did raise concerns regarding protectionism and led to a bigger shrink in the global GDP than expected.[32]

---

[31] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (W Strahan and T Cadell, 1776).

[32] Barbara Barone and Roberto Bendini, 'Protectionism in the G20' (Directorate General for External Policy Department Publishing, 2015).

Protectionism and barriers to trade can take several forms. As a matter of fact, apart from actual ban from import and high tariffs on goods and services coming from aboard, international trade has seen the emergence of the so called "behind-the-border" measures which consist of regulatory or technical requirements as well as subsidies which have greatly restricted liberalised commerce and competition among industrialised nations.

The entrance of Mr. Donald J Trump on the international political stage and his policies have again showed that the majority of people fear globalisation.[33] There is a widespread belief that apart from multinationals and large undertakings, common people have received more pain than gain. Likewise, the European continent has witnessed the rise of anti-establishment political stars too who have proposed similar political measures based upon an extension of national taxing rights aboard and lowering income taxes domestically.

From a technical perspective, CFC rules are the ones whose application can result in the most negative impact upon trade and commerce as well as foreign investments. When a foreign corporation is subject to the control of a parent company, the income earned abroad is deemed distributed to the parent company if the overall foreign tax burden is too little. To avoid double taxation and harsh treatment of outbound transactions, general tax law recognises a foreign tax credit for the taxes paid aboard. However, the taxable income taken into account for the purposes of CFC regime might well differ from the taxable income declared in the foreign country. In other words, the deductions and exemptions which a government might grant upon a company investing there can turn out to be more generous than the ones applied by the country of incorporation of the parent corporation.

Other issues, which are additional to the foreign tax credit and the difference in the taxable income computation, are the application of CFC rules by more than one country and the tax treatment of previously taxed income when distributed through dividends or earned in the form of capital gains. The subject matter has been already dealt with when

[33] Katie Allen, 'Trump's economic policies: protectionism, low taxes and coal mines', The Guardian (Noveber 9, 2016), < https://www.theguardian.com/us-news/2016/nov/09/trumps-economic-policies-protectionism-low-taxes-and-coal-mines >.

explaining the OECD's recommendation on an effective CFC regime and it would be unnecessary to repeat the same conclusions here. Nonetheless, it is pivotal to point out that the BEPS Action Plan opened the possibility for politicians and national governments to exploit the BEPS project to protect domestic economies. Instead of labelling protectionist measures as such, there might be the likely risk of justifying any similar intervention as an anti-abuse or anti-avoidance scheme to prevent multinationals from avoiding taxes and not contributing enough.

The recommendation of this last paragraph is to design anti-avoidance measures in a manner which is consistent with free trade and competition among states. Technicians should not give in to political guidelines in order to use the analysed suggestions for reasons which go beyond the real scope to be pursued. As we will analyse further, the US have enacted a new CFC tax regime called Global Intangible Low-Taxed Income (GILTI) which has some protectionist features. It is a top-up tax which allows a credit up to 80% instead of the total of the foreign taxes actually paid abroad.[34] Additionally, the tax credit basket for GILTI is separate from the other basket and cannot be mingled with other income basket to maximise the benefits of cross-crediting.[35]

[34] Internal Revenue Code 1986, 26 USC § 961(d).
[35] Internal Revenue Code 1986, 26 USC § 904(d)(1)(A).

THE TRANSPOSITION OF THE BEPS ACTION PLAN IN THE EU CONTEXT AND THE "ANTI-TAX AVOIDANCE DIRECTIVE" IMPLEMENTATION IN ITALY

2.1 The EU Answer to the BEPS Action Plan and the ATAD Directive

The BEPS Action plan gave final proof that the current international tax law framework is believed to be outdated and unable to respond to the challenges brought up by the integration of modern economies and the advancement of globalisation.[36] Among the various actors who took part in the development of the anti-avoidance package, the EU member states are a considerable majority. The increased sophistication of aggressive tax planning strategies threw into crisis all the major economies on the global stage, although it stroke a blow especially to European countries since the freedom guaranteed by the single market have paved the way for abuses of the freedom of establishment in terms of tax saving strategies.

The long path of the ATAD I and II began on January 28 2016, when the European Commission published the anti-avoidance package for a fairer, simpler and more effective corporate taxation within the EU area.[37] As a matter of fact, the exploitation of general tax law differences among member states can impact negatively on competition. The EU firmly believed that leaving the implementation of the BEPS Action plan to each national law-maker would have been counterproductive. Without a common set of rules, member states could fall into the trap of increasing the number of loopholes and incoherencies between jurisdictions, thus, giving even more leeway to multinational enterprises for successful tax saving arrangements.

The purposes of the ATAD package are well explained in the words of Valdis Dombrovski, Vice-President of the European Commission, responsible for the Euro and Social Dialogue:

[36] OECD, 'Explanatory Statement 2015 Final Reports', (OECD, Publishing 2011).
[37] European Commission, *Fair Taxation: Commission presents new measures against corporate tax avoidance*, (Press Release, 2016).

> "*Today we are taking another step to strengthen confidence in the entire tax system, making it fairer and more efficient. People have to trust that the tax rules apply equally to all individuals and businesses. Companies must pay their fair share of taxes, where their actual economic activity is taking place. Europe can be a global leader in tackling tax avoidance. This requires coordinated European action, avoiding a situation of 28 different approaches in 28 Member States".*

As highlighted by the brief reported above, the goals of the proposal submitted to the European Council is to ensure effective taxation in the EU, increase tax transparency, secure a levelled playing field and put forward legally binding measures to block the most common methods used by multinational companies to avoid paying their fair share of taxes.[38]

After an initial postponement,[39] the European Council reached an agreement on the draft of the anti-tax avoidance directive on June 21, 2016,[40] and formally adopted ATAD I on July 12 of the same year.[41] The provision thereby included regarded the following main aspects: a general limitation on passive interest deductibility (as in BEPS Action 4), rules concerning the taxation of controlled foreign corporations (as in BEPS Action 3), a new regulatory framework addressing the issues which arise from hybrid mismatch arrangements (as in BEPS Action 2). Also, the ATAD I included some provisions which are not derived from the BEPS Action plan, but from the proposal of a common consolidated corporate tax base (CCCTB). The proposal did not come into force due to the aversion showed by several member states which strongly condemned such measures

[38] Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, No 5936/16); Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, 6788/16).
[39] Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, 9342/16).
[40] General Secretariat of the Council FISC 104 ECOFIN 628 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] EN 10426/16.
[41] Council Directive (EU) 2016/1164 of 12 July laying down rule against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193/1 [hereinafter ATAD I].

as an undue interference over EU countries sovereignty in the field of direct taxation. These provisions are the exit tax and the general anti-avoidance clause (GAAR), which aim at broadening the reform of EU taxation beyond the scope of the OECD's suggestions.

Despite the quantum leap that ATAD I represented for the innovation of EU general tax laws, the European Commission issued a proposal prompting the amendment of the anti-tax avoidance directive on October 26, 2016.[42] The proposed changes concerned the treatment of hybrid mismatches with regard to arrangements with third countries outside the EU. As of December 6, 2016, the draft submitted to the European Council met a broad consensus on the amendments put forward to improve the mechanism to counter hybrid mismatches. The ministers of the member states agreed on every provision, but for the limited exceptions allowed and the implementation date.[43] The formal adoption of the ATAD II occurred on May 29, 2017 and introduced new rules to tackle hybrid mismatches with the tax system of countries outside the EU which must be implemented by January 1, 2020.[44]

The anti-avoidance package enacted by the EU at supranational level represents an unusual legislative intervention of the Union on member states fiscal policies. As a matter of fact, the EU has always been reluctant to harmonise direct tax law since it is considered the core of member states' sovereignty and, thus, a very sensitive area of law. Looking at the other intervention of the EU in terms of direct taxation, it is unsurprising that only five corporate tax directives have been enacted before the ATAD: (1) the Parent-

[42] General Secretariat of the Council FISC 173 Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2016] EN 13733/16.
[43] Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, No 15205/16).
[44] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L 144/1 [hereinafter ATAD II].

Subsidiary Directive,[45] (2) the EU Merger Directive,[46] (3) the EU Interest and Royalties Directive,[47] (4) the EU Recovery Directive,[48] and (5) the Directive on Administrative Cooperation in Tax Matters.[49] Therefore, the adoption of the ATAD represents a new achievement in the harmonisation of tax policy within the single market and constitutes an opportunity for the future.

The purpose of the ATAD is to counter any taxpayer's abusive practice. The drafting of the anti-avoidance package takes into account the decisions of the Court of Justice of the EU (CJEU) in order to strike a balance between fair taxation and other fundamental freedoms.

The notion of abuse of law in the field of tax law was established by the CJEU in the Cadbury Schweppes case.[50] The Cadbury Schweppes group established two subsidiaries in Ireland whose profits were solely derived from lending activities to foreign affiliates. The income so shifted could then benefit from a more favourable tax regime granted under the Irish Tax Code. The UK government tried to claw back into tax the eroded taxable base through the application of CFC rules, but the company claimed this violated the freedom of establishment provided for under articles 43 and 49 TFEU.[51] In its preliminary ruling the CJEU changed its longstanding case law in favour of the absolute freedom of establishment and wrote:

---

[45] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L 345/8.

[46] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfer of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L 310/34.

[47] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L 157/49.

[48] Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L 84/1.

[49] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L 64/1.

[50] Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031.

[51] Consolidated version of the Treaty on the Functioning of the European Union OJ C 326/47, artt 43, 49.

> *"It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory".*[52]

Overall, the CJEU ruled that the absence of economic substance does not prevent member states from reacting to abusive practices. Moreover, corporate taxpayers cannot avail themselves of any of the economic freedoms granted by the EU treaties if the only objective of their arrangements is the achievement of an undue tax saving. The Cadbury Schweppes case represents a pivotal shift from absolute freedom of establishment to a relative one.

Following an initial historical and theoretical overview of the ATAD, it is necessary to dive into the specific provisions of the anti-avoidance package and understand how the EU decided to implement the recommendation set forth by the OECD in its BEPS Action plan.

The ATAD is applicable to all taxpayers which are subject to corporate tax in one or more member states, including permanent establishments in one or more member states of entities resident in a third country for tax purposes.[53] As a general rule, transparent entities fall outside the scope of application of the anti-tax avoidance directive, but the rules set forth for reverse hybrid mismatches (companies which are treated like corporations in their country of incorporation and flow through abroad) do apply also to pass through entities.[54]

The formula adopted by the European law-maker leaves member states a great deal of freedom in interpreting and implementing the notions of "taxpayer" and "corporate

[52] C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031, para 55.
[53] ATAD I, art 1, ATAD II, art 1(1).
[54] ATAD II, art 1(1.2), 9(a).

tax".[55] The prospective ambiguity in the initial provision of the anti-avoidance package stems from the fact that in other provisions it refers to the concept of entity which entails a much broader category of taxpayers. Estates, trusts and partnerships are not always, depending on the domestic tax laws of each member state, included in the array of taxpayers which are subject to corporate tax. Another issue which might stir controversy regards the treatment of withholding taxes and whether these are considered to fall into the category of corporate taxes. Again, this loophole will be left to member states and they will have the final say as to whether such form of taxation will or will not be included within the meaning of "corporate taxation".

Another aspect to be taken into account when assessing the effectiveness of the newly enacted directive are the limits imposed upon the scope of application of the anti-avoidance framework. Firstly, the enactment of this body of law will not interfere with the corporate taxation system of any member states, whether they adopted a classical or imputation tax treatment of dividends.[56] Just to be clear, classical taxation subjects to tax profits both at corporate level and then at shareholders' level, thus, creating double taxation. By contrast, an imputation tax system taxes corporate profits first according to a pre-established rate and then, when dividends are distributed, stockholders are given a tax credit for the taxes already paid by the corporate entity. The result is an eventual rebate of the excess tax or an additional adjustment fee depending on the tax bracket the individual taxpayer falls into.

The second limitation affecting the scope of ATAD is the relationship with other directives with regard to hybrid mismatches. Where the provisions of another EU source of law lead to the neutralisation of the negative effects of a hybrid mismatch arrangement, the tax outcome so obtained shall not be modified any further by the application of the ATAD I and II rules.[57] Finally, the anti-avoidance rules concerning hybrids face another limitation posed by the tax treatment granted under a double income taxation treaty concluded by a member state. Again, despite being the anti-hybrid rules applicable, the

---

[55] Riguat Aloys, 'Anti-Tax Avoidance directive (2016/1164): New EU Policy Horizons' (2016) 56 European Taxation, 497.
[56] ATAD II, Preamble, para 24.
[57] ATAD II, Preamble, para 30.

result shall not be affected insofar as it is in compliance with the provisions set forth under the tax treaty.[58] In short, the rules contained in double income taxation treaties have the power to override the application of hybrid mismatch arrangements provisions.

The ATAD, as already mentioned, aims at the harmonisation of international tax law within the single market. Its enactment was mainly due to the scandals and abuses which multinational enterprises took part in and which shocked the general public. In accordance with this ratio, the anti-avoidance package sets a minimum standard which shall apply to all member states. However, the ATAD does not "preclude the application of domestic or agreed-based provisions aimed at safeguarding a higher level of protection for domestic and corporate tax bases".[59]

The first anti-tax avoidance measure put forward under the ATAD is the interest is the interest limitation rule, which mirrors the BEPS Action Plan number 4.[60] As a matter of fact, the directive follows the best practice pointed out by the OECD and allows to deduct net interest expenses up to 30% EBITDA in accordance with a fixed ratio rule.[61] The ATAD does not mention the word "net interest", but exceeding borrowing costs.[62] However, under the definition included under article 2, exceeding borrowing costs means the "amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues […] according to national law".[63] Also, the definition of borrowing costs is very broad and entails interest expenses on all forms of debt and any other expenses or fees contracted in connection with the raising of finances.[64] The directive gives also a list of the most common financing arrangements and sates expressly that this list is non-exhaustive.[65]

58 ATAD II, art 1(4.5).
59 ATAD I, art 3.
60 Guglielmo Ginevra, 'The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU Level' (2017) 45 Intertax, 121.
61 ATAD I, art 4(1).
62 Ibid.
63 ATAD I, art 2(2).
64 ATAD I, art 2(1).
65 Ibid.

The ATAD also gives the possibility to domestic groups to calculate their deductible exceeding borrowing costs on an overall basis.[66] For the purposes of the application of this group fixed ratio, the election for the optional taxation as a consolidated group is not necessary.[67]

To simplify the administrative burden imposed upon member states' tax administrations, the directive sets forth some exceptions which excludes from the application of the fixed ratio all taxpayers which do not raise BEPS concerns:

1. All taxpayers whose exceeding borrowing costs are up to €3 million (so called de minimis threshold);[68]
2. All taxpayers which are standalone entities;[69]
3. All loans which either were concluded before the enactment of the ATAD or are agreed upon for the financing of long-term public infrastructure projects may be exempted by member states (so called grandfathering provision)[70]

Also, if the taxpayer is a member of a consolidated group for financial accounting purposes, member states can give the possibility to fully deduct the exceeding borrowing costs, if it can demonstrate that the taxpayer's equity over its total assets is equal or higher to the groups same ratio (so called group equity escape clause).[71] The following formula will help clarify the exception.

$$\frac{Taxpayer's\ equity}{Taxpayer's\ assets} \geq \frac{Group's\ equity}{Group's\ assets}$$

It is important to mention that the EU approach is consistent with the OECD's recommendation in providing for a de minimis threshold and public project financing exceptions. Nevertheless, the OECD also advised to be wary of standalone entities which in some cases might raise BEPS concerns too (when the ownership interest is owned by

[66] ATAD I, art 4(1).
[67] ATAD I, art 4(1)(a)(b).
[68] ATAD I, art 4(3)(a).
[69] ATAD I, art 4(3)(b).
[70] ATAD I, art 4(4)(a)(b).
[71] ATAD I, art 4(5).

estates or trusts). In this regard, the EU showed to be naïve and totally exempted entities which are not tied to other business associations.

The last provision worthy of analysis is the exclusion of financial undertakings from the application of the interest limitation cap.[72] In full accordance with the OECD position, the EU recognised the social importance and uniqueness of the banking and insurance industry. Considering that a great part of the business of banking and insurance is represented by acting as intermediaries (borrowing from another bank or from the public though notes and then relending or concluding an insurance with a client and then being reinsured by another institution) in order to hedge the risks of each transaction, the tax treatment of such arrangements had to take into account the specific reasons lying behind these transactions. An eventual lack of such provision would have had disruptive effects upon such a core business of the economy.

The second anti-tax avoidance measures provided for under the ATAD is the exit taxation.[73] The interesting fact about this newly enacted rule is that it does not derive its origin from the BEPS Action plan of the OECD. As a matter of fact, the initial plan of the European Commission was the creation of a common consolidated corporate tax base (CCCTB) which would have harmonised the computation of the income and losses of all EU undertakings at European level.[74] In short, the effect of the proposal would have been the possibility to file a single tax return valid for all member states' tax administrations, followed by the mere application of nationally-set domestic corporate tax rates. Apart from improving the freedom of establishment, the CCCTB project would have helped to fight tax avoidance, resolve double taxation disputes within the single market and address hybrid mismatches with non-EU countries.[75] Nevertheless, the hostility shown by some member states against this project led to its non-implementation. As a result, the ATAD included a provision which derives its scope and character from the CCTB.

---

[72] ATAD I, art 4(7).
[73] ATAD I, art 5.
[74] European Commission, *Commission proposes major corporate tax reform for the EU* (Press Release, 2016).
[75] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) [2011] EN 121/4.

The underlying rationale of the exit tax is to subject to taxation the unrealised profits of assets which, despite being transferred out of the home country to another one, are still under the economic control of the same taxpayer. Within the EU the ECJ case law has moved from an absolute prohibition for member states to do so, to backing this taxing power in order to prevent tax avoidance and distortions of the competition within the single market. In the Laysterie du Saillant case,[76] an individual taxpayer wanted to transfer the tax residence outside France. The French Ministry of Economy assessed a tax bill due to the Treasury because of the appreciation of the share of the company. The ECJ was asked whether such exit tax was compliant with the freedom of establishment granted under the TFEU. It was held that the French government action was unlawful.

This trend was subsequently changed in the *N* case.[77] The case concerned a Dutch individual taxpayer who had substantial interests in Dutch companies. He decided to move to the UK and move the place of effective management of the companies to the Dutch Antilles. Again, the Dutch government moved for the application of an exit tax on the unrealised value of the securities held by the individual. Here, the court was vested with the power to decide another time on the lawfulness of such measure. Contrarily to its previous decision, the ECJ ruled that the measure pursued an objective in the public interest appropriately.[78] Hence, the exit tax was upheld. Other two similar cases involving the transfer of tax residency, from the Netherlands to the UK and from Germany to Austria respectively, were again decided in favour of the lawfulness of the exit tax provisions.[79] Hence, the case law of the ECJ had, long before the enactment of the ATAD, paved the way for member states to establish anti-base erosion measures.

---

[76] Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2431.
[77] Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-7445.
[78] Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-7445, para 47.
[79] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273; Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] (CFI, 23 January 2014).

The exit taxation, as provided for under the anti-avoidance package, subjects any taxpayer to tax when there is a transfer of corporate assets out of the country where these assets are located.[80] The taxable base is the difference between the market value of the assets at the time of the transfer and the value recorded for tax purposes. In short, the unrealised capital gain, which is difference between the purchase cost and the current value when the asset is transferred. The exit tax applies when the transfer occurs between the head office in a member state and the permanent establishment in another member state or third country or vice versa.[81] It also applies if the taxpayer transfers its tax residence to another member state or third country except for those assets which remain effectively connected with the home member state.[82] The last scenario of application is triggered when the taxpayers transfers the business carried on by a permanent establishment to another member state or third country so long as the home member state loses taxing rights over the transferred assets.[83]

The payment of the exit tax can be deferred by paying in instalments over a period of time not exceeding five years in accordance with the legislation of each member state if the transfer takes place in connection with another EU/EEA country.[84] This benefit is countered by the eventual application of an interest rate set by each member state.[85] Moreover, if the member state has reason to doubt about the solvency of the taxpayer the deferral can be conditioned upon providing appropriate guarantee to cover non-recovery risks.[86] However, the deferral regime is considered terminated if one of the following events takes place:[87]

1. The transferred assets are sold or otherwise disposed of by the taxpayer;
2. The taxpayer's assets, tax residence, or business carried on through a permanent establishment are subsequently transferred to a third country (which is non-EU/EEA);

[80] ATAD I, art 5(1).
[81] ATAD I, art 5(1)(a)(b).
[82] ATAD I, art 5(1)(c).
[83] ATAD I, art 5(1)(d).
[84] ATAD I, art 5(2).
[85] ATAD I, art 5(3).
[86] Ibid.
[87] ATAD I, art 5(4).

3. The taxpayer goes bankrupt or is wound up.

The possibility of obtaining a deferral of the exit tax was explained by the European Commission as necessary for being in compliance with the freedom of establishment and the case law of the ECJ analysed above.[88] The possibility of paying the tax bill in instalments over a five-year period does not constitute a barrier to the fundamental freedoms which are the bedrock for the creation of a competitive single market.

The exit taxation provisions do not apply to assets which are transferred either within a period of 12 months, or as collateral for the raising of finances, or in order to meet prudential capital requirements, or for the purpose of liquidity management.[89] Also, any transfer between a subsidiary and its parent company or vice versa falls outside the scope of the exit tax. As a matter of fact, given that the two companies are separate entities, the necessary price paid for the transfer is subject to tax in the transferor's member state and it is adjusted in the event of transfer pricing issues.

The following innovation of the ATAD is the introduction of a general anti-abuse rule (GAAR) at European level.[90] The main purpose of the GAAR is to prevent that taxpayers can put in place tax-avoidance arrangements which are not covered by specific anti-abuse rules and as such are lawful. As a matter of fact, new avoidance schemes develop extremely rapidly in the current economic scenario and law-makers cannot keep up with all the innovations in the field of aggressive tax planning. The GAAR is a tremendous asset to close any gaps in the general tax laws of member states and allows national tax administrations to fight tax avoidance more consistently.

The literal tenure of article 6 ATAD allows member states to ignore the tax effects of an arrangements or a series of arrangements when their main purpose or one of them is the achievement of a tax saving which defeats the object and purpose of the applicable tax law, so long as the overall schemes is non-genuine in respect of all the facts and

[88] European Commission, Proposal for a Council Directive laying down rules against tx avoidance practices that directly affect the functioning of the internal market [2016] EN 026/16.
[89] ATAD I, art 5(7).
[90] ATAD I, art 6.

circumstances.[91] The follow-up of this rule specifies the meaning of "non-genuine". An arrangement or a series of arrangements shall be regarded as such insofar as they are concluded for no valid commercial reasons which do not reflect economic reality.[92]

Form the analysis of the first two paragraphs of article 6 of the ATAD, it is evident that there are four requirements in order for a national tax administration to prove the tax-avoidance purpose of a certain scheme: (1) the conclusion of an arrangement or a series of arrangements which have legal effects, (2) the achievement of a tax saving, (3) the defeat of the object and purpose of the applicable tax rule and (4) the absence of any worthy business reasons. The GAAR provision has been harshly criticised due to its lack of clarity and specificity. The rule lacks actual definitions of what constitutes an abusive practice. Nevertheless, the wording of the GAAR takes after the CJEU case law and should not be frowned upon for this reason.

The CJEU has set out the concept of abusive scheme in the area of tax law in the Halifax case concerning the value added tax (VAT).[93] Halifax plc, a banking company, designed a tax planning stricture to deduct input tax on building costs which were for the main part non recoverable. The court used a two-prong test to identify the existence of an abuse. First, there must be an advantage contrary to the object and purpose of the applicable rule. Secondly, the tax benefit has to be the main reason to engage in such arrangement. Likewise, the CJEU also clarified the concept of legal abuse in the context of direct taxation. In the Kofoed case,[94] two shareholders of a Danish company made a tax free exchange of their shares in a newly incorporated Irish company according to article 11 of the Merger Directive.[95] Shortly after the transfer, the Irish company distributed dividends to the shareholders and the Danish tax authority reclassified the transaction as a taxable event. The CJEU in its preliminary ruling allowed member states to interpret EU law

[91] ATAD I, art 6(1).
[92] ATAD I, art 6(2).
[93] Case C-255/02 *Halifax plc and Others v Commissioners of Customs and Excise* [2006] ECR I-1655.
[94] Case C-321/05 *Hans Markus Kofoed v Skatterministeriet* [2007] ECR I-5818.
[95] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfer of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L 310/34, art 11.

sources in accordance with their general anti-abuse provisions if the scheme put in place has the unique purpose of gaining a tax advantage.

As described above, the text of the GAAR was necessarily drafted in general terms in order to accommodate the rule to a vast array of cases. The difference between a lawful and an abusive arrangement lies in a judgment concerning the facts and circumstances of the case. The case law of the CJEU does not provide further clarification since its decisions are written in general and abstract terms too. Tax law experts shall face the reality that the concept of general abuse of tax law is flexible and is decided on a case by case basis.

Before moving on to the analysis of the CFC regime, it is pivotal to refer to the Italian experience in respect of the GAAR. As a matter of fact, given that the country enacted a GAAR which mirrors article 6 of the ATAD some years before and the tax reform did not make any amendment, the dissertation will not provide a separate paragraph for the analysis of this issue.[96]

The long history of the elaboration of a GAAR in Italy dates back to the late 80' when Italian courts started considering abusive tax practices unlawful under article 1344 of the civil code, titled "contracts against public policy".[97] However, the Italian Supreme Court of Cassation ruled that, whenever a contract is concluded for the main purpose of tax avoidance, it cannot be voided on the grounds that such arrangement is against public policy.[98] Accordingly, tax law does not prohibit certain arrangements, but can simply disregard the tax saving which results from the aggressive tax planning activity.[99]

In 1990, the Italian law-maker introduced for the first time a GAAR which, however, had its scope of application limited to direct taxation. The rule allowed the tax administration to ignore the tax benefit and claw back into tax the avoided payment.[100] Few years later, the GAAR was replaced by another provision which not only did allow to disregard all

---

[96] Law No 212/2000, art 10-bis.
[97] Italian civil code, art 1344.
[98] Cass Civ Sez V, 3 settembre 2001, No 11351.
[99] S Cipollina, 'La legge civile la legge fiscale. Il problema dell'elusione fiscale' [1992] CEDAM, 149; P Tabellini, 'L'elusione della norma tributaria' [2007] Giuffrè, 214.
[100] Law No 408/1990, art 10.

arrangements with no economic substance and aimed at obtaining a tax benefit, but every scheme directed to avoid the application of any tax rule.[101] Despite its broader application, the possibility to use this rule was conditioned upon the realisation of a scheme which included one of the enumerated operations which, for the most part, involved corporate reshuffling.[102]

Contrary to the literal tenure of the new GAAR, the Italian Supreme Court of Cassation adopted a broad interpretation of the anti-avoidance clause and ruled that the legal system provided for a general principle against any legal abuse in respect of tax law. This case law was derived from two decision of the Court of Cassation in the case of dividend washing (when a mutual fund sold shares before receiving the dividend so that the capital gain would be exempt and the buyer could receive the dividend tax free and sell the shares at a lower price claiming a deduction)[103] or dividend stripping (when a non-resident foreign company gave shares to an Italian taxpayers under an usufruct agreement so that the foreign tax credit, unavailable to non-residents, could be claimed).[104] Following the Halifax decision of the CJEU,[105] the Court of Cassation strengthen the prohibition upon abusive practices by claiming it applied not only to harmonised taxes, but also to non-harmonised ones.

However, this line of interpretation created a great deal of uncertainty. Therefore, the United Sections of the Italian Supreme Court (which decide when there are different interpretations among single sections), in an attempt to clarify the applicable law, stated that the principle of prohibition upon tax abusive practices is derived from EU law for harmonised taxes and from article 53 of the Italian Constitution for non-harmonised taxes.[106] Despite the different rationale of the decision, the result of the holding did not change.

[101] D.P.R. 600/1973, art 37-bis.
[102] D.P.R. 600/1973, art 37-bis(3).
[103] Cass Civ Sez V, 21 ottobre 2005, No 20398.
[104] Cass Civ Sez V, 14 novembre 2005, No 22932.
[105] Case C-255/02 *Halifax plc and Others v Commissioners of Customs and Excise* [2006] ECR I-1655.
[106] Cass Civ SU, 23 dicembre 2008, No 30055-57.

The messy succession of contradictory judicial decisions led the Italian law-maker to intervene by delegating the government to reform the GAAR and bring to an end the controversy stirred by the purposive (far from being literal!) interpretation of courts.[107] The Italian government introduced article 10-bis into the so called "taxpayers' bill of rights" which anticipated the position taken by the EU in the ATAD.[108]

The next anti-avoidance measure enacted under the ATAD is the CFC regime, which is most probably the most important rule in order to fight aggressive tax planning.[109] A comprehensive and understandable analysis of this provision must be separated into three building blocks: (1) identifying a CFC, (2) ascertaining the existence of CFC income and (3) computing such income.

According to the ATAD, a CFC is a company or permanent establishment having tax residence outside the member state of its parent company, the profits of which are either exempt or not subject to tax in the member state of the parent company so long as two other conditions are met:

1. The parent company owns more than 50% of vote, value or profit-share of the foreign company or permanent establishment;
2. The corporate tax rate paid abroad is lower than the difference between the corporate tax rate in the member state of the parent company's incorporation and the foreign tax rate. The following formula and figure will help to clarify the application of this second requirement.

$$foreign\ tax\ rate < Member\ State's\ tax\ rate - foreign\ tax\ rate$$

[107] Law No 23/2014, art 5.
[108] Law No 212/2000, art 10-bis.
[109] ATAD I, arts 7-8.

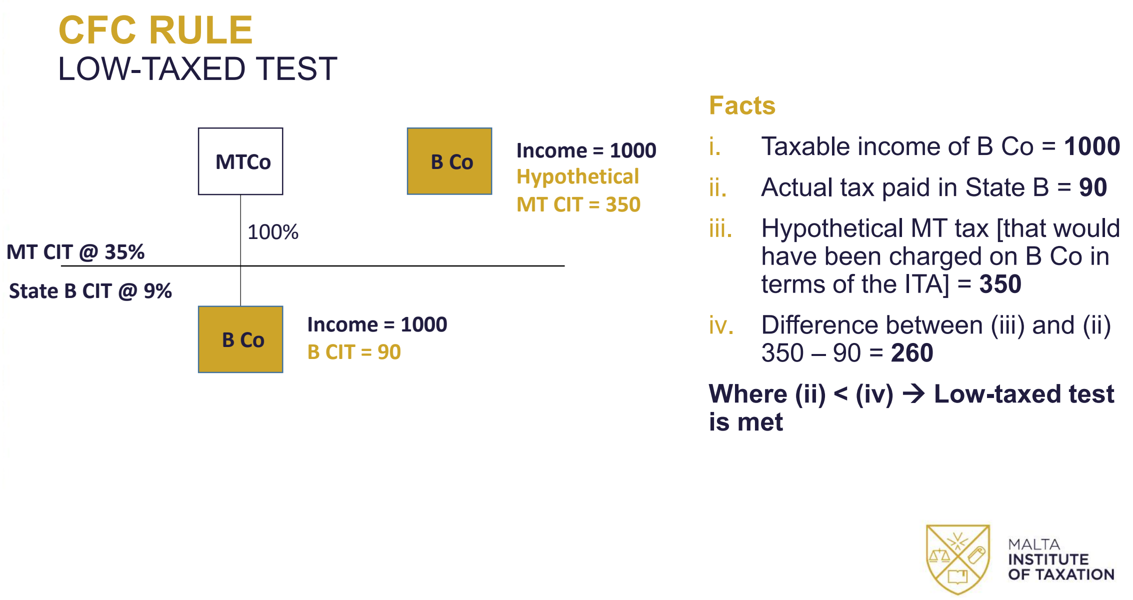


Figure 2.1: Nadiia Onyshchuk, 'EU Directives on Direct Taxation Part II' [2018] Malta Institute of Taxation.

If the foreign company falls into the definition of CFC in accordance with the rules so far set out, it is then necessary to make sure whether the foreign company earns some BEPS income. The ATAD allows member states to pick one out of two methods to do so: (1) the categorical approach, or (2) the substantive approach.

Under the first method, the member state of the parent company shall include in the tax base of the resident taxpayer the undistributed income which is derived from: interests, rents, royalties, dividends, banking and insurance income and income form invoicing companies (which are foreign base companies earning income from purchasing and reselling goods and services from the member state to third countries).[110] However, if the foreign company carries on a substantial economic activity abroad, the deemed inclusion shall not operate (e.g. the goods and services are sold not only to third countries, but also to customers within the foreign country of incorporation).[111] Member states can refrain from applying this exception if the country of incorporation is not a EU/EEA country.[112] If a member states opts for using the categorical approach, it can grant a de minimis

[110] ATAD I, art 7(2)(a).
[111] Ibid.
[112] Ibid.

exception when the BEPS income is one-third or less than the total income earned by the CFC.[113]

Alternatively, the ATAD provides for the substantial approach which prescribes to include in the tax base of the parent company the undistributed income of the CFC derived from "an arrangement or a series thereof […] regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income".[114] If a member states opts for using the substantial approach, it can grant a de minimis exception when: (1) the accounting profits do not exceed €750,000 and the non-trading income does not exceed €75,000, or (2) the accounting profits do not exceed 10% of the operating costs recorded in the covered tax year.[115]

Finally, the last building block of the CFC under the ATAD is the computation of the income which raised BEPS concerns according to one of the two methods just analysed. The ATAD leaves member states to decide the calculation of the actual tax base to which the national corporate tax rate should be applied.[116] However, the income included in the parent company's tax base shall be the pro rata share of the undistributed earnings and profits.[117] The inclusion shall be made during the tax year of the parent company in which the tax period of the controlled foreign entity ends.[118] Moreover, in order to avoid the double taxation of previously taxed income, the actual distribution of dividends and the capital gains realised upon the sale of the stock in the CFC shall be treated as tax-free income.[119] Also, the member state shall recognise a deduction (and not a tax credit) for the foreign taxes paid by the CFC to its country of incorporation or location.[120] This policy choice is controversial since the deduction for foreign taxes is less advantageous than the

---

[113] ATAD I, art 7(3).
[114] ATAD I, art 7(2)(b).
[115] ATAD I, art 7(4).
[116] ATAD I, art 8(1)(2).
[117] ATAD I, art 8(3).
[118] ATAD I, art 8(4).
[119] ATAD I, art 8(5)(6).
[120] ATAD I, art 8(7).

foreign tax credit. The EU has probably decided to impose a sort of penalty upon those undertakings which exploit low tax jurisdictions in order to shift profits. As a matter of fact, whenever the foreign tax rate is at least half of the tax rate applied in the member state of incorporation of the parent company, the CFC regime just explained will not be triggered (so called "tax-rate kick-out").

The last anti-avoidance measure to be analysed within the ATAD package is the one addressing the issue of hybrid mismatches. Following the BEPS Action 2, the EU laid down rules regarding hybrids mismatches in order to address these concerns. The regulatory framework initially enacted under ATAD I had to be revised and improved by means of ATAD II since the first measures adopted proved to be ineffective in order to fight the sophistication of multinational enterprises and the willingness of non-EU/EEA countries to keep granting favourable tax regimes. The dissertation will first explain the regime under the first directive and then proceed to explain the changes brought about under the second piece of legislation.

Under ATAD I, a hybrid mismatch is defined as a situation in which a taxpayer in one member state and an associated enterprise in another member state structure an arrangement allowing both undertakings to claim a deduction against their respective taxable incomes (so called double deduction), or allowing a deduction for one enterprise only without a corresponding inclusion in the gross income of the associated entity (so called deduction without inclusion).[121] The directive provides also for a definition of associated enterprise. It can be either an entity in which the taxpayer holds at least 25% by vote, capital or profit share, or an individual or an entity which holds at least 25% by vote, capital or profit share of the taxpayer.[122] However, the percentage required is increased up to 50% if the mismatch involves the use of a hybrid entity.[123]

If the factual situation between the taxpayer and the associated enterprise fell into the definitions provided for above, the deduction should have been granted just to the payor

[121] ATAD I, art 2(9)(a)(b).
[122] ATAD I, art 2(4)(a)(b).
[123] ATAD I, art 2(4).

in case of double deduction,[124] while the deduction should have been denied to the payor in case of deduction without inclusion.[125]

The ATAD I was very unsatisfactory and did not put an end to the phenomenon of hybrid mismatches. Firstly, its application was limited among member states. This resulted in possible abuses by using a hybrid arrangement with third countries. Secondly, the targets of the anti-avoidance measure were limited to associated entities and eventually individuals holding stocks in these entities. As such, any transaction between the head office in a member state and a permanent establishment located in another member state would not have been covered by the provision. In the light of these considerations, a second legislative intervention revealed to be necessary in order to better harmonise and improve the response to hybrid mismatches within the single market.

The ATAD II provides for a new and broader definition of hybrid mismatches. Firstly, it includes financial instruments which give rise to a deduction without an inclusion in the taxable income of the payee within a reasonable period of time which is statutorily set at twelve months or a longer period which can be expected to be agreed upon by non-associated enterprises.[126] Secondly, it provides that constitutes a hybrid mismatch any payment which gives rise to a deduction without inclusion in the taxable income of the payee due to the differences in the allocation of payments under the laws of the countries involved, if such payment:

1. Takes place between associated entities;[127]
2. Takes place between the head office and the permanent establishment;[128]
3. Is directed to a disregarded permanent establishment;[129]
4. Is disregarded under the laws of the payee jurisdiction (exemption or no subjection to tax) and eventually it also involves the head office and a permanent establishment or two or more permanent establishments.[130]

---

[124] ATAD I, art 9(1).
[125] ATAD I, art 9(2).
[126] ATAD II, art 1(2)(b)(9)(a).
[127] ATAD II, art 1(2)(b)(9)(b).
[128] ATAD II, art 1(2)(b)(9)(c).
[129] ATAD II, art 1(2)(b)(9)(d).
[130] ATAD II, art 1(2)(b)(9)(e)(f).

Lastly, the directive, in line with the ATAD I, includes within the definition of hybrid mismatch the double deduction outcome.[131] Also, the definition of associated enterprise is expanded by including other three scenarios: (1) when two legal persons are acting in concert their stock in terms of vote, value, or profits share is added, (2) when an entity is part of the same consolidated group for financial accounting purposes, it is considered an associated enterprise and (3) when the taxpayer can exercise significant influence over the management of the entity of vice versa.[132]

The ATAD II brought some changes also in terms of neutralisation of the effects of hybrids mismatches. As a matter of fact, while the primary measure to be put in place remains the allowance of deduction just for the payor in case of double deduction and the denial of such deduction for the payor in case of deduction without inclusion, the directive sets a secondary measure should the obligated jurisdiction fail to act.[133] Following the OECD recommendation in the BEPS Action 2, the secondary measures are the denial of the deduction for the payor and the inclusion of the payment in the payee's income in the case of double deduction and deduction without inclusion respectively.[134]

The ATAD II also deals with reverse hybrid mismatches. These arrangements involve an entity which is treated as a corporation in the country where the parent company is incorporated and is considered flow through in the in a host member state.[135] The directive imposes every member state to tax the flow through entity to the extent its income is not subject to taxation in the parent company's country of incorporation.[136] However, collective investment vehicles (mutual funds and the like) are exempted from the application of reverse hybrid rules.[137]

The last amendment introduced by the second directive to the hybrid mismatches framework concerns the dual residency mismatches. If a taxpayer is considered resident for tax purposes both in a third country and in a member state, the member state shall

[131] ATAD II, art 1(2)(b)(9)(g).
[132] ATAD II, art 1(2)(a).
[133] ATAD II, art 1(4)1(a), art 1(4)2(a).
[134] ATAD II, art 1(4)1(b), art 1(4)2(b)
[135] ATAD II, art 1(5)(1) 'article 9a'.
[136] Ibid.
[137] ATAD II, art 1(5)(2) 'article 9a'.

deny the deduction insofar as the expense is allowed to set off the income of the taxpayer in the third country.[138] If the taxpayer is a dual resident of two member states, the deduction is allowed just in the member state where the tax residency is established under the rules set forth in the double income taxation treaty agreed upon between the two member states.[139]

It is noteworthy to mention that the ATAD II rules also apply to imported mismatches.[140] An imported mismatch is a type of arrangement which exploits the different treatment under the laws of two other third countries and which, nonetheless, creates an undue tax advantage even in the country where the taxpayer is located.

Suppose a company in country A (A co) owns all the shares of a company in country B (B co) and concludes a repurchase agreement with B co, whereby A co lends money backed by B co shares and B co agrees to pay off the loan by buying back the same shares at a future date. If, as explained in chapter one, country A considers the transaction as an equity purchase to which it applies the participation exemption and country B considers the arrangement a simple collateralised loan which can be deducted, the effect is a deduction without inclusion. Assuming that the same money is lent again to a corporate borrower resident for tax purposes in a member state (MS co) which is totally owned by either A co or B co, the interest can be deducted for MS co and it is used to offset the former loss for B co. Hence, country A has a non-inclusion, country B cannot levy taxes since the previous interest deduction offsets the subsequent interest income, and the member states grants a deduction. The ATAD II takes into account the possibility to structure arrangements so that by using non-EU/EEA countries hybrid mismatches can be imported into the single market and distort competition.

[138] ATAD II, art 1(5) ‘article 9b’.
[139] Ibid.
[140] ATAD II, Preamble, para 7-8, 25.

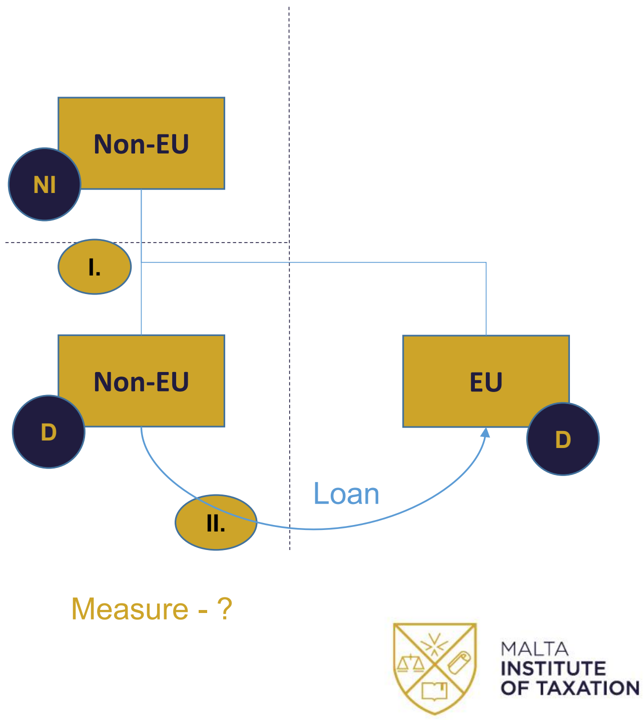


Figure 2.2: Nadiia Onyshchuk, 'EU Directives on Direct Taxation Part II' [2018] Malta Institute of Taxation.

In order to avoid the effectiveness of this tax planning scheme, the taxpayer resident in the member state is obliged to disregard the deduction and the corporate group is halted from obtaining a double benefit. The scheme explained above works also in the case of double deduction obtained by interposing a hybrid entity between two companies residing in different countries. The hybrid entity borrows from a third party and lends to the only related party which does not consider the hybrid fiscally transparent. The deduction is allowed for both the hybrid entity and the corporate borrower. If the money were lent again to a related party located in a member state, the mismatch could be imported. However, ATAD II would prevent this from happening.

If one gave a critical look at the ATAD II, it would be evident that the directive has it shortcomings, although it followed the recommendation of the BEPS Action 2. The hybrid mismatches provisions merely give a solution to the consequences of the problem. Once the differences between two or more member states arise, the rules mentioned above come into action to neutralise the effects of the arrangements causing tax avoidance. In order to intervene to the roots of the problem, some have proposed the adoption of the "symmetrical classification" which is used in the Swedish legal system.[141] In short, the foreign legal entity is given the same treatment granted by its country of incorporation. The benefit of this plan is to eliminate the possibility of any mismatch from arising at least when dealing with hybrid entities (not for hybrid transactions). However, the proposal faces issue of compatibility with EU law since a discrimination could arise between domestic and foreign taxpayers which could possibility impact negatively upon competition.[142] For instance, an entity which would be considered a hybrid under the laws of a member state will be recognised as such even in all other member states, but if the same type of business association were incorporated initially in another member state it could be classified as a non-hybrid in the rest of the Eurozone. This might prompt investors to engage in forum shopping in terms of certificate of incorporations.

2.2 Measures to Tackle Base Erosion Transactions and the Exit Tax

Italy is part of the EU and as such is bound by the directives issues by this supranational organisation. With regard to direct taxation, together with Germany and France, the Italian government prompts the EU to take more decisive action in terms of harmonisation of fiscal policies. Being the third largest economy in the Eurozone and the second largest manufacturing country in the single market,[143] Italy hopes that the EU will reshape the current taxation system of the Eurozone and make it fairer for those countries where corporate tax rates are higher and production activities are effectively located.

The Legislative Decree No 142/2018, approved on November 29, 2018 and published on the Official Journal on December 28 2018, implemented at national level the ATAD I and ATAD II provisions and kept domestic legislation up with the most recent developments in the field of international business taxation.[144] In this paragraph the

[141] Redactionele Aantekening, 'Hybride mimastches en hybride leningen' [2017].
[142] G K Fibbe, 'Hybride mismatches onder de ATAD; symptoombestrijdiing is geen oplossing' [2016] Weekblad Fiscaal Recht.
[143] Monya Longo, 'Il paradosso dell'Italia: terza economia in UE, penultima sui mercati' [2019] Il Sole 24ore; Paolo Bricco, 'Il sorpasso della Francia (che non c'è). Perché l'Italian rimane la seconda manifattura europea' [2019] Il Sole 24ore.
[144] Legislative Decree No 142/2018.

analysis will focus upon the implementation of the limits upon passive interest deductibility and the exit tax provision.

It is preliminary to say that the first rule limiting the deduction of passive interests dates back to 1973 when undertakings could deduct only the ratio of passive interests which was equal to the percentage obtained by dividing the business income by the total income earned.[145] The sophistication of the Italian law-maker with regard to tax issues needs to be stressed in order to fully understand its willingness to be ahead of the changes and problems posed by the enormous advancement and transformation of the economy.

The reform of the passive interest deduction limitation is put forward under article 1 of the ATAD decree and completely rewrites former article 96 of the Income Tax Code except for the fixed ratio of deductibility which remain the 30% EBITDA margin.[146] The amendments have brought relevant changes both on the subjective and objective scopes of application of the rule.[147] The taxpayers covered by the reform are all corporate taxpayers also known as IRES taxpayers in Italy. For sole proprietorships and individual taxpayers, the discipline of the deductibility of passive interest remains regulated under article 61 of the Italian Tax Code which still makes the deductibility of passive interests be dependent upon whether the expense pertaining to the business activity is within the ratio obtained by dividing the business income by the overall personal income.[148] Also, undertakings operating in the banking and insurance industry as well as all financial intermediaries are excluded from the application of the interest deduction limitation rule. This legislative choice is in line with the previous text of article 96 of the Italian Tax Code, the BEPS Action 2 and the ATAD I.

The previous text of article 96 excluded from the application of the interest limitation an array of companies due to the social relevance of their business activities: (1) consortiums among companies for the execution of public works, (2) special purpose vehicles incorporated after the assignment of a public project and (3) companies set up for the

---

145 D.P.R. 597/1973, art 74(2).
146 Legislative Decree No 142/2018, art 1; D.P.R. 917/1986 [TUIR], art 96.
147 Alessandra Serena, Sophia Pavetto, 'Il recepimento della Direttiva ATAD in materia di interessi passivi' (2019) 2 Bilancio e reddito d'impresa 5.
148 TUIR, art 61.

construction of fright villages. The new article 96 has repealed the exemption for the abovementioned business associations, but it still grants a beneficial treatment if these companies comply with the objective requirements set forth under the new objective scope of application.[149] This legislative choice is in compliance with the BEPS Action 2 which prompted the OECD's countries to allow a more lax regulation for those undertakings which, in the light of the project financing activities which they carry on, need to borrow large sums of money in order to perform the construction of long-term, infrastructures in the public interest. However, this exemption applies so long as the undertaking in charge of the public project and the capital equipment used to complete its construction are located within the EU.

It is also important to mention that initially the ATAD decree had repealed article 14(36) of the Law No 244/2007, which was, however, reintroduced under the Finance Act 2019.[150] The decree had stricken down the exclusion form the interest deduction limitation for real estate companies which tend to borrow large sums of money from institutional lenders using their real estate assets as collateral. However, the exemption from the limits has been reinstated under the Finance Act 2019 in consideration of the particular type of business carried on by real estate companies and the potential difference between the treatment of sole proprietorships under art 61 and corporate taxpayers under art 96.

Following the explanation of the changes regarding the subjective scope of the new article 96, it is necessary to move on with the analysis of the objective scope of application. Firstly, the ATAD decree gives a new definition of passive and active interests and well as financial charges and proceeds which must be taken into account for the purposes of the deduction limitation. These interests must be classified as such under the accounting principles chosen by the enterprise. Also, the same qualification shall be confirmed under the general tax law rules in the field of balance sheets having regard to the so called "enhanced principle of derivation".[151] Lastly, the interests shall arise out of an operation

[149] TUIR, art 96.
[150] Legislative Decree No 142/2018, art 14; Law No 244/2007, art 1(36); Law No 145/2018, art 1(7).
[151] Ministerial Decree No 49/2009; Ministerial Decree 8 June 2011; Ministerial Decree 3 August 2017.

having financial nature or a contractual arrangement bearing a relevant financial element. The requirement that the interest is so defined under the relevant tax regime has its consequences. For instance, a repurchase agreement concerning shares or similar financial instruments are irrelevant with regard to the enhanced principle of derivation.[152] However, differently from the previous regime, interests arising out of relevant business debts can now be limited up to the maximum percentage allowed.[153] Lastly, it is important to mention that the ATAD decree repealed article 32(13) of the Law Decree No 83/2012 which allowed to deduct entirely and without limitations the expense for the collocation of debt securities and similar financial instruments regardless of their recording in the balance sheets. From now on, even these costs will be subject to the interest deduction limitation.[154]

Another relevant amendment caused by the ATAD decree is the carry-forward mechanism designed for active interests. Prior to the reform, if during a tax year the active interests were more than the passive one, this positive difference could not be carried forward to absorb the eventual future interest losses generated in the years ahead. As a matter of fact, the government explanatory report attached to the ATAD decree refers to the example of the 'one-day profit'.[155] This scenario occurs any time an undertaking can raise finances at an interest rate which is below the market value and then records in the balance sheets the market value which is higher than the one effectively paid. Each year this mechanism could generate an active interest which can be used to offset an eventual financial loss.

The ATAD decree also changed the method of computation of the EBITDA of each corporate taxpayer. Prior to the reform, the EBITDA referred to was the one arising out of the application of the accounting principles and as such the so called civil EBITDA. The tax reform takes now into account the adjusted tax value of each component of the EBITDA having, thus, great consequences on the result of the computation.[156] For instance, the expense borne for buying and using a corporate car will be fiscally relevant

[152] Ministerial Decree No 48/2009, art 3; TUIR, art 44.
[153] International Financial Reporting Standard 15.
[154] Legislative Decree No 142/2018, art 14; Law Decree No 83/2012, art 32(13).
[155] Government Explanatory Report to the Legislative Decree No 142/2018.
[156] TUIR, art 96(4).

at either 70% or 20% depending on whether the vehicle is used by the employees or not. The telephone bills will be accounted for just up to 80% and the costs for food and lodging up to 75%.

It is also important to mention that the change from a civil to a tax adjusted EBITDA must be coordinated with the rules which exclude certain portion of income from the tax base of a corporate taxpayer. However, the new fixed ration rule does not provide clarifications on this issue. It is probably the best interpretation that in order to account such quota correctly one must make a difference between the deductions allowed which do not have a link with the income statement and the ones which do. For instance, the 'Patent Box' regime or the 'Branch Exemption' will be subtracted from the total EBITDA, while the 'ACE' benefit (a tax credit granted for equity injection instead of debt financing) will be added to the EBITDA. Despite the proposed interpretation, it is undeniable that the calculation of the tax adjusted EBITDA will lead to burdensome disputes.

The interest expense allowed as a deduction each year is equal to 30% of the tax adjusted EBITDA. The excess interest expense shall be allowed to be carried forward for a maximum period of five years according the 'first-in, first-out' ratio (the carry-forward mechanism operates first for the oldest debt to the most recent one). According to the ATAD decree, the new fixed ratio rule will start applying form January 1, 2019 for all corporate taxpayers except for the exclusions mentioned above.[157] Nevertheless, for the debt contracted before 2019 the carry-forward mechanism keeps being granted with no time limitation.

The new fixed ratio rule is extremely complicated and can result in a difficult coordination with other rules contained in the income tax code and other general tax laws.[158] This increased difficulty can definitely lead corporate taxpayers to make mistakes and for this reason it is predictable that there will be more litigation in tax courts. Further, the limitation of the carry-forward mechanism up to five years can be almost considered a tax penalty upon enterprises. The only real benefit introduced under the ATAD decree

---

[157] Legislative Decree No 142/2018, art 13.
[158] Alessandra Serena, Sophia Pavetto, 'Il recepimento della Direttiva ATAD in materia di interessi passivi' (2019) 2 Bilancio e reddito d'impresa, 5.

regarding this issue is the possibility to carry forward the active interest to offset future financial losses.

Given the complexity of new article 96 of the income tax code, it is useful and beneficial to provide the reader with an example showing how the ATAD Decree changed the practical application of the fixed ratio rule. Suppose that a company has the following income statement: €1 million profits, €800,000 costs, and €50,000 depreciation of both tangible and intangible property. These numbers are adopted for both the tax year ending on December 31, 2018 (prior to the fixed ratio tax reform) and for the one ending on December 31, 2019 (following the enactment of the ATAD Decree).

Tavola 1 - Valori di bilancio al 31 dicembre 2018

A) Valore della produzione	euro 1.000.000
B) Costi della produzione	euro 800.000
8) Canoni locazione finanziaria di beni strumentali	euro 0
10a) Ammortamento immobilizzazioni immateriali	euro 15.000
10b) Ammortamento immobilizzazioni materiali	euro 35.000

Tavola 2 - Valori di bilancio al 31 dicembre 2019

A) Valore della produzione	euro 1.000.000
B) Costi della produzione	euro 800.000
8) Canoni locazione finanziaria di beni strumentali	euro 0
10a) Ammortamento immobilizzazioni immateriali	euro 15.000
10b) Ammortamento immobilizzazioni materiali	euro 35.000

Figure 2.3: Mauro Sebastianelli, Nicola Cardinali, 'NUOVE REGOLE DI DEDUCIBILITÀ DEGLI INTERESSI PASSIVI PER I SOGGETTI IRES' (2019) 2 Amministrazione & Finanza 35.

However, while in 2018 the EBITDA was calculated by taking into account the accounting value as recorded in the financial statements of the company, the tax reform requires corporate taxpayers to consider the deductible expense having regard to the tax adjusted value. Therefore, not all of the €800,000 costs are fully deductible according to the tax adjusted value. As shown in the chart below, the €1,000 phone costs are deductible up to 80% (€800), the €2,500 car expenses are deductible up to 20% (€500), while the €50,000 compensation given to the board of directors is non-deductible at all. Hence, while calculating the EBITDA margin the corporate taxpayer shall add back the non-deductible portion of income before applying the 30% fixed ratio rule. In the case at stake, the EBITDA shall be increased by €52,200 (€50,000 + €200 + €2,000). The chart below will provide a clear overview of the initial accounting value, the tax adjusted percentage, the value to take into consideration and, lastly, the EBTDA increase which shall be added back.

Tavola 3 - Valori fiscalmente rilevanti al 31 dicembre 2019

Voce di bilancio	**Importo**	**Deducibilità**	**Valore fiscale**	**Variazione in aumento**
Spese telefoniche	euro 1.000	80%	euro 800	euro 200
Spese autovettura	euro 2.500	20%	euro 500	euro 2.000
Compensi amministratori non pagati	euro 50.000	0%	euro 0	euro 50.000

Figure 2.4: Mauro Sebastianelli, Nicola Cardinali, 'NUOVE REGOLE DI DEDUCIBILITÀ DEGLI INTERESSI PASSIVI PER I SOGGETTI IRES' (2019) 2 Amministrazione & Finanza 35.

It is now possible to show the reader the EBITDA for both tax years. Despite the additional complexity brought by the reform, the tax adjusted value increases the EBITDA margin and thus also the deductible amount for interest expenses.

$$2018\ EBITDA = 1{,}000{,}000 - (800{,}000 - 15{,}000 - 35{,}000)$$

$$2018\ EBITDA = 1{,}000{,}000 - 750{,}000$$

$$2018\ EBITDA = 250{,}000 \rightarrow 30\% = 75{,}000$$

$$2019\ EBITDA = 1{,}000{,}000 - (800{,}000 - 15{,}000 - 35{,}000 - 52{,}200)$$

$$2019\ EBITDA = 1{,}000{,}000 - 697{,}800$$

$$2019\ EBITDA = 302{,}200 \rightarrow 30\% = 90{,}660$$

The other anti-base erosion measure which the ATAD decree modified following the issuance of the EU directive is the exit taxation framework. Once again, the Italian tax system introduced the first exit tax rule as early as 1995 and modified its discipline several times.[159] It is important to mention that the Italian tax code applies the exit tax whenever an undertaking ceases to be resident for tax purposes within the Italian territory. Resident entities are those who have their head office, tax residence or carry their core business in

[159] Law Decree No 41/1995, art 30.

Italy.[160] At the same level, foreign holding companies which have shares in entities resident in Italy are presumed to be tax residents if their effective place of management is found to be in Italy (the so called corporate inversion).[161] As a matter of fact, if a resident taxpayer becomes a non-resident taxpayer, it shall still be subject to worldwide taxation,[162] if a corporate inversion scheme is uncovered, or it will be subject to exit tax on unrealised capital gains if the operation is genuine.

Following the overview of exit taxation and corporate inversion, it is necessary to analyse the changes brought by the tax reform. The new article 166 of the Italian tax code covers a larger array of cases where the exit tax applies.[163] Firstly, whenever an enterprise which is a tax resident of the country moves its residence for tax purposes abroad, the unrealised capital gains shall be subject to tax. The capital gains are the difference between the market value of the assets and the purchase cost fiscally deducted upon acquisition. However, the exit tax does not apply if the tax residence of the undertaking is moved abroad, but all the assets remain in a permanent establishment located Italy. This rule is necessary to guarantee full freedom of establishment within the single market. One of the most recent examples of this exception is the Fiat Chrysler Automobile (FCA) transfer of headquarter to the Netherlands and transfer of tax residence to the UK.[164] The company did not have to pay any hefty tax bill to the Italian Revenue since all the assets located in the peninsula were left there incorporated in an Italian business association.

Secondly, the exit taxation applies whenever a tax resident transfer some of its assets to a permanent establishment located outside the territory of the country. Again, the difference between the market value and the purchase cost fiscally recognised shall be taxed. It is pivotal to mention that the so called ‘internationalisation decree’ gave the possibility to all tax residents to consider exempt the profits and losses from permanent

[160] TUIR, art 73(3).
[161] TUIR, art 73(5-bis).
[162] TUIR, art 121.
[163] TUIR, art 166.
[164] Alessandro Rigatto, ‘Fiat Chrysler Automobiles, perché non serve l’exit tax’ [2014] Wired.it.

establishment located abroad.[165] As such, once the exit tax has been paid, the permanent establishment will not influence the tax bill of the head office any longer.

Thirdly, if the taxpayer is a foreign tax resident, but owns a permanent establishment in the country, any transfer of either the entire taxable presence or some assets from the domestic permanent establishment to the head office or to another permanent establishment shall be subject to the exit taxation regime. The computation of the unrealised capital gains will follow the same procedure explained above.

Lastly, if the transfer of all or some assets takes place as a result of an M&A transaction, the assets transferred abroad shall be again subject to exit taxation. In this case the valuation of the assets is the market value attributed to all of them just before the completion of the M&A transaction. However, if following the transaction all the assets are simply in the hands of a permanent establishment resident in Italy for tax purposes, then, the exit taxation is excluded.[166]

The ATAD decree adopted the wording ‘market value’ to replace the former ‘standard value’ used under the former art 166 of the tax code. The meaning of this change is simply to link the computation of unrealised gains to the discipline concerning transfer pricing. In other words, the valuation of the assets shall mirror the purchase price which would be established at arm’s length between unrelated taxpayers.[167]

The decree clarifies the regulatory framework concerning funds and capital buffers which have been set aside in order to meet future unforeseeable losses.[168] As a matter of fact, these funds are subject to tax deferral up until the non-realisation of the unforeseen event. More specifically, this provision applies in the case of transfer of the tax residence abroad or in the case of M&A transactions, insofar as this funds and capital buffers are not retained by a domestic permanent establishment. In all the other scenarios, the foreign resident taxpayer shall pay taxes on these funds and capital buffers just if they transfer

[165] TUIR, art 168-ter.
[166] TUIR, art 179(6).
[167] TUIR, art 110(7); Law Decree No 50/2017; Ministerial Decree 14 May 2018.
[168] TUIR, art 166(2).

the entire permanent establishment abroad. In brief, the exit tax applies just to the extent these funds are moved to foreign head offices or permanent establishments.

The ATAD decree modifies the treatment of losses too. The result differs according to which corporate reorganisation is designed by the taxpayer.[169] Firstly, if the taxpayer moves entirely all its activity to a foreign country without leaving a permanent establishment in Italy, all the losses recorded at the end of the last tax year are offset, without the limitations under article 84(1) of the tax code (which limits the carry-forward mechanism to 80% of previous tax years' losses)[170], against the income attributable to the last tax year in which the taxpayer is resident in the country and, if there is an exceeding loss, against the unrealised capital gains which shall be subject to the exit tax (without the application of the 80% carry-forward limitation under article 84(1) of the tax code). Secondly, if the taxpayer's reshuffling leaves a permanent establishment within the country, all the losses recorded at the end of the last tax year are offset, this time subject to the 80% carry forward limitation, against the income attributable to the last tax year and, if there is an exceeding loss, against the unrealised capital gains which should be subjected to the exit tax within the limits of the net worth of the permanent establishment,[171] but without the application of the 80% carry forward limitation. Lastly, in the event of an M&A transaction the effects will be the same mentioned above depending on whether the corporate reshuffling will leave a permanent establishment within the country or not.

The ATAD decree clarifies the point in time when the income is attributed to the taxpayer.[172] When the taxpayer moves its residence abroad, the unrealised capital gains are deemed to be realised during the last tax year in which the taxpayer must file the tax return. In all other cases, the unrealised capital gains are attributed when the arrangements are executed. Following this watershed, any capital loss or capital gain eventually realised does not influence the computation of the income to be subject to the exit tax.[173]

---

[169] TUIR, art 166(2-bis).
[170] TUIR, art 84(1).
[171] TUIR, art 181, 172(7).
[172] TUIR, art 166(7).
[173] TUIR, art 166(8).

The tax reform modified the former tax deferral mechanism under the guidelines of the ATAD I.[174] The prior regime allowed all companies which transferred their tax residence to a EU country or to an EEA country (which had concluded a tax treaty with Italy for the mutual assistance in the collection of tax bills) to defer the exit tax up until the moment the capital gain was effectively realised.[175] The new article 166(9) of the tax code allows any taxpayer to pay the exit tax by a one-time payment or in five instalments over a five-year period (instead of six instalments as of before the tax reform).[176] However, the payment in instalments is conditioned upon adequate guarantee of solvency which is disciplined according to a ruling issued by the Director General of the Revenues and Collection Agency. Moreover, this beneficial regime is allowed only if the tax residence is moved to a EU country or to a EEA country insofar as it consents to an adequate exchange of information and has agreed upon a treaty with Italy for the mutual assistance in the collection of tax bills. Apart from the first instalment, all the other payments are subject to an interest rate for the deferral.[177] The new article 166 of the tax code provides for a list of cases in which the benefit of the instalment payments is revoked by law.[178] Accordingly, the taxpayer has to pay the residual amount of the whole exit tax due to the Treasury within the next instalment date.

Following the analysis of the new regulatory framework in respect of the exit tax payment, it is necessary to understand whether its enactment is compatible with EU law and more specifically with the freedom of establishment as set under article 49 of the TFEU.[179] Before delving into a detailed study of the CJEU case law and its evolution over the time, it is preliminary to inform the reader that the repeal of the tax deferral and the provision of an option to pay the exit tax either right upon transfer of tax residence or

[174] ATAD I, art 7.
[175] Former TUIR, art 166(4-quarter).
[176] Ministerial Decree 2 July 2014.
[177] Legislative Decree No 241/1997, art 20.
[178] TUIR, art 166(12).
[179] Consolidated version of the Treaty on the Functioning of the European Union OJ C 326/47, art 49.

over a five-year window is perfectly compliant with EU law. In the *DMC* case, the same CJEU expressly stated at paragraph 62 and 64:[180]

> *"[62] In that context, in the light of the fact that the risk of non-recovery increases with the passing of time, the ability to spread payment of the tax owing before the capital gains are actually realised **over a period of five years** constitutes a satisfactory and proportionate measure for the attainment of the objective of preserving the balanced allocation of the power to impose taxes between Member States. […] [64] Accordingly, by giving the tax payer the choice between immediate recovery or recovery spread **over a period of five years**, the legislation at issue in the main action does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States."*

Accordingly, the choice given to any transferring taxpayer by both the ATAD I under article 5(2) and new section 166(9) of the Italian income tax code is compliant with EU law and is not likely to face any further challenge before the CJEU.

The *DMC* decision took place in 2014 following a long series of cases (firstly, involving individual taxpayers and then corporate ones) which were decided somewhat incoherently. The first time the CJEU was charged with a preliminary ruling concerning a member state's exit tax provision was the *Lasteyrie* case (2004).[181] A French national decided to move its tax residence to Belgium and the French tax administration assessed a built-in capital gain in respect of the increase in value of shares owned in a domestic company. The tax had to be collected immediately upon transfer of tax residence, unless

---

[180] Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] (CFI, 23 January 2014), paras 62, 64.

[181] Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2431.

the taxpayer could nominate a representative which could guarantee the effective payment of the tax. The court decided that such provision restricted the freedom of establishment and discriminated among taxpayers who move out of France of those who remain.[182]

Similarly, in the *N* case, a Dutch national decided to move its tax residence to the UK and shifted the place of effective management of some companies it owned to the Dutch Antilles (2006).[183] Under Dutch law the disposal of "substantial shareholding" (5% or more) in a company formed part of the individual's taxable income and the transfer of tax residence abroad triggered a deemed disposal of all the taxpayer's taxable assets. The unrealized capital gains had to be paid immediately unless due guarantee was given in accordance with a specified agreement with the tax administration. Again, the CJEU found that the tax deferral conditioned upon due guarantee limited the freedom of establishment.[184]

The last case concerning exit taxation of individual taxpayers was triggered following an infringement procedure started by the European Commission against the Kingdom of Spain. More specifically, the Spanish law-maker passed a law allowing the tax administration to tax and immediately collect all the untaxed income of resident taxpayers who were about to lose such status and move abroad. The tax was levied and collected before the tax bill of resident taxpayers was due, thus, discriminating among those who were moving abroad and those who were staying in Spain. The CJEU found that such diversified treatment constituted a discriminatory practice and a limitation of the freedom of establishment of Spanish taxpayers.[185]

The stance of the CJEU started to change when it dealt with exit taxation provisions which were structured in a more lenient manner and affected corporate taxpayers. In the

---

[182] Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2431, para 46.
[183] Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-7445.
[184] Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-7445, para 55.
[185] Case C-269/09 *European Commission v Kingdom of Spain* [2012] (CFI, 12 July 2012), para 57.

National Grid Indus case,[186] National Grid Indus BV, a Dutch company, had an outstanding claim in pound sterling against National Grid Indus plc, a UK based affiliated entity. Following a rise of the pound sterling against the Dutch guilder, the Dutch company decided to move its place of effective management to the UK thereby losing the status of Dutch taxpayer. The tax administration moved for the immediate taxation of the built-in capital gain deriving from the currency claim appreciation. The court stated that member states have the right to enact exit tax rules since it safeguards the correct apportionment of taxing rights among different member states when cross-border transfers of residence occur.[187] However, the CJEU also stated that immediate collection of exit taxes upon transfer limits the freedom of establishment since it deteriorates the cash flow position of companies moving abroad in comparison with those which remain resident taxpayers.[188] As such, national law should give the option between immediate taxation and tax deferral eventually with an interest rate charge and the possibility of some debt guarantees.[189]

Following the *National Grid Indus* decision, another case concerning corporate taxpayers was brought before the CJEU in connection with an infringement procedure started by the European Commission against the Portuguese Republic. The Portuguese law-maker enacted a tax provision which subjected to immediate exit taxation all the gains and untaxed business assets of a corporate taxpayer moving abroad so long as these business assets did not from part of a permanent establishment in Portugal.[190] As such, the national legislation was discriminating among taxpayers and called for immediate taxation of unrealised capital gains only to the extent that the specified business assets were actually moved out of the country. Again, the court found that the lack of any provision giving the taxpayer the choice between immediate taxation and tax deferral with an interest charge was incompatible under EU law. The same findings were confirmed in a subsequent

---

[186] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273.
[187] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273, para 64.
[188] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273, para 37.
[189] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273, paras 73-74.
[190] Case C-38/10 *European Commission v Portuguese Republic* [2012], para 28.

decision of the court which followed the infringement procedure started by the European Commission against the Netherlands for the very same reasons explained above with regard to Portugal.[191]

After having explained the evolution of the CJEU case-law, it is now possible to appreciate the conclusions reached by the court in the initially mentioned *DMC* case. The court has framed the boundaries within which member states and European institutions can move when passing tax legislation affecting taxpayers moving their tax residence abroad. More specifically, the *National Grid Indus* and *DMC* decisions contrast with the *Lasteyrie du Saillant* case.[192] At first, the CJEU considered the request of adequate guarantees for grating the tax deferral unlawful when it was vested with the jurisdiction to decide the issue. However, its stance has changed over the years and acknowledged the member states' right to impose an interest rate charge and certain debt guarantees in respect of exit taxation. Furthermore, the court also limited the tax deferral period which, while initially thought as unlimited, it can now be limited to no less than five years. In short, the EU case law moved from a more restrictive approach to a tax policy theory inspired by public interests and anti-tax avoidance instances.[193] In the light of these considerations, the ATAD I and the ATAD decree both match with the latest developments in the CJEU decisions and mirror its new balance between fundamental freedoms and limiting aggressive tax planning.

Going back to more general considerations, it can be said that, unlike the reform of the interest deduction limitation, the new exit taxation regime is a valid measure to tackle anti-tax avoidance practices.[194] The rule is complex, but its application is clear,

---

[191] Case C-301/11 *European Commission v Kingdom of the Netherlands* [2013] (CFI, 19 March 2013), para 16.
[192] Shane Wallace, Shane Muprhy, 'Exit Taxes: Where to Now? After National Grid Indus BV' (2012) 2 Deloitte 80, 84.
[193] Prof. Gerard Meusen, 'EJTN Judicial Training on EU Direct Taxation' (Radboud University Nijmegen, The Netherlands, 21 April 2016) < http://www.ejtn.eu/Documents/About%20EJTN/Administrative%20Law%202016/AD201602%20Tax%20Law%20Thessaloniki%2021-22%20April/Gerard_Meussen_WS1_AD201602_Thessaloniki.pdf >.
[194] Antonella Della Rovere, Francesca Pecorari and Piergiorgio Valente, 'Nuova disciplina dell'exit tax: estensione dell'ambito applicativo e richiamo al valore di mercato' (2019) 4 Il Fisco 357.

straightforward and does not show inconsistences with other tax laws such as the corporate inversion. The aim of this rule is the prevention of arrangements to exploit the increasing freedom of movement between member states and third countries outside the EU to erode the tax bases. International tax avoidance is one of the main causes of the drop of the consistency of domestic tax revenues and it is believed that the impact of aggressive tax planning is generating fiscal losses between 4% and 10% of the entire corporate income per country.[195] The provisions so enacted place Italy in line with the most advanced standard in international taxation and anti-avoidance regimes. The elimination of the complete tax deferral on unrealised capital gains will assure the Italian Treasury more revenues and simplify the collection of the tax. The problem of international tax avoidance affects many aspects of everyday life and takes away the resources which should be poured into development and growth.

2.3 The CFC Regime in Italy

The ATAD decree, which as mentioned above was enacted to ensure the implementation at domestic level of the ATAD I and II provisions,[196] had an impact on the controlled foreign company (CFC) regime as well.[197] It is noteworthy to point out that the Italian tax legislation had already introduced its first form of CFC legislation back in 2000 giving evidence of the government attention to the anti-tax avoidance phenomenon.[198] This initial CFC regime was based upon the identification of a list of countries which were considered tax havens or tax shelters and as such included in the "black list" to be drafted by the Ministry of Economy and Finance.[199] In other words, Italy had adopted a jurisdictional approach which limited the application of the deemed inclusion of controlled foreign companies' income to the countries they were operating in. As highlighted in the first chapter, any jurisdictional approach has its limits. As a matter of fact, there is no distinction between activities carried out for business purposes and mere

---

195 Audizione dell'Agenzia delle entrate, VI Commissione Finanze e Tesoro del Senato, 10 ottobre 2018.
196 ATAD I, artt 7-8.
197 Legislative Decree No 142/2018, art 4.
198 T.U.I.R., art 127-bis introduced under Law No 342/2000.
199 Ministerial Decree 21 November 2001 and following amendments.

financial ones. Moreover, the existence of a list requires the same economic branch of the government to update that list, possibly every year, in order to ascertain whether some countries should be excluded from and some added to the black list.

The black list system was partially abandoned in 2004 when the new articles 167 (the CFC regime was indeed moved away from article 127-bis) and 168 of the tax code allowed to tax income earned by foreign affiliated companies (the threshold to be considered an affiliate is considerably lower than to be a foreign controlled company under article 2359 of the civil code).[200]

Following the already mentioned Cadbury Schweppes decision issued by the CJEU,[201] another tax reform amended the CFC regime in order to avoid issues of compliance with EU law. The deemed inclusion was extended to EU countries as well, insofar as the only income attributed to the resident parent company was "passive".[202] Lastly, the 2015 tax reform completely abandoned the black list system and introduced two possibilities to claw back into tax the income earned by controlled foreign corporations: (1) if the company was located outside the EU, the CFC inclusion would apply so long as the "nominal" tax rate applied abroad was less than 50% of the Italian tax rate, (2) if the company earned passive foreign income, regardless of its geographical headquarter, the CFC inclusion would apply so long as the "effective" tax rate applied abroad was less

---

[200] Italian Civil Code, art 2359; according to article 2359 of the civil code a company is an affiliate if another entity can exercise a meaningful influence over its operations. There is a rebuttable presumption of affiliation if the other company own 20% of the stock of the affiliate or 10% if the affiliate is a publicly-traded corporation. Vice versa, the definition of control is met just if:

1. The parent company owns 51% of the shares of the controlled company (legal control);
2. The parent company has enough voting rights to exercise a dominating influence over the management of the controlled company (managerial control);
3. The controlling company can exercise a dominating influence given the existence of meaningful and specific obligations arising from a contract which determine, according to the facts and circumstances (factual control).

When the control is established under the numbers 1 and 2, the computation includes all voting rights held directly or indirectly through other entities or trustees.

[201] Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031.

[202] The definition of passive income comprises: dividends, interests, rents, royalties, annuities and capital gains from the sale of non-business assets.

than 50% of the Italian tax rate.[203] Nevertheless, the taxpayer was granted the possibility to ask the tax administration for a ruling concerning the lawfulness of its foreign operations and the disapplication of the CFC regime.[204]

Following an historical introduction of the Italian CFC legislation, it is now necessary to analyse the changes which were brought about by the ATAD Decree. The Decree implemented articles 7 and 8 of ATAD I (as well as the BEPS Action 3) and applies to all resident investors (both companies and individuals) including the permanent establishments of non-resident taxpayers. The new CFC test does not make differences based upon the residence of the controlled taxpayer. Hence, whether the controlled foreign corporation is located within the EU/EEA or not, it shall not influence the outcome of the tax bill due.

The ATAD I gave member states the possibility to opt either for the "transactional" approach and thus tax the controlled foreign company's income which would fall into the definition of passive income,[205] or for the "jurisdictional" method thereby taxing all income earned by the controlled foreign taxpayers if the arrangement is non-genuine and the only reason why the company was set up in the foreign country was the achievement of a tax saving by virtue of the preferential tax treatment granted by the foreign host-country.[206] The explanatory report to the ATAD Decree confirmed the government's intention to strike a balance between the two approaches and use both in order to be more effective in facing the technicalities of new tax avoidance arrangements.[207]

Firstly, it is preliminary to say that the new CFC regime applies to virtually all kinds of resident taxpayers. Individual taxpayers as well as business entities which are fiscally transparent and thus disregarded for tax purposes are both included in the list.[208] Also, all resident corporate business entities and other entities which predominantly carry on business activity fall into the scope of the CFC rules and in some circumstances the

[203] Raffaele Rizzardi, 'La disciplina CFC: un punto fermo dopo la Direttiva ATAD?' (2019) 3 Corriere Tributario, 283; .U.I.R., art 167(4)(8-bis) [*prior to the ATAD Decree].
[204] T.U.I.R., art 167(8-quinquies) [*prior to the ATAD Decree].
[205] ATAD I, art 7(2)(a).
[206] ATAD I, art 7(2)(b).
[207] Presidency of the Ministers' Council, *Explanatory Report* (2018).
[208] T.U.I.R., art 5.

regime takes into account non-business associations and trusts which are resident in Italy for tax purposes.[209] Finally, the new article 167 of the tax code applies to permanent establishments set up in Italy which are controlled by non-resident entities or individuals, but control another taxpayer which is a resident of a third country (thus, middle-tier permanent establishments now become taxable and is treated as an Italian corporation which controls another foreign corporation).[210] The reform extended the application of the CFC rules to Italian permanent establishments of non-resident taxpayers which were not included in the previous regulatory framework, unless the establishments were indirectly controlled by a resident of the country.[211]

The other element to be clarified concerns the array of foreign taxpayers which are considered controlled foreign entities and, as such, whose retained earnings and profits are included in the income of the controlling resident taxpayer. The new discipline contained under article 167 of the tax code applies to all entities whose stock is owned by a resident taxpayer. This definition tends to include: (1) foreign undertakings, companies and entities, (2) foreign permanent establishments whether owned by controlled foreign entities or by resident taxpayers which opted for the branch exemption regime.[212] This modification adopted by the Italian law-maker is perfectly in line with the preamble of the ATAD I which prompted member states to stretch the application of the CFC regimes to all sorts of corporate structures which might lead to tax avoidance.[213] The new phrasing of article 167 is a quantum leap from its former wording. Prior to the reform, a great deal of emphasis was put on the actual business location of the foreign entity (if the host country was granting a preferential tax treatment), while the new text goes beyond the mere definition of corporate entity and treats even foreign branches of non-resident controlled taxpayers or exempt branches as corporations. The same Revenue and Collection Agency clarified that the term "entity" must be interpreted in the sense of any corporate arrangement which does not fall within the legal definition of business association.[214] Therefore, it is a residual category which comprises every possible form

---

[209] T.U.I.R., art 73(1)(a)(b)(c).
[210] T.U.I.R., art 167(1).
[211] Ministerial Decree No 429/2001.
[212] T.U.I.R., art 167.
[213] ATAD I, Preamble, para 12.
[214] Revenue and Collection Agency, *Explanatory Statement No 23/E* (May 26, 2011).

of enterprise. Interestingly, the CFC regime applies to foreign flow through entities too. Under article 73 of the tax code, pass through foreign entities (e.g. partnerships) are considered corporate taxpayers for domestic purposes and as such the CFC rules shall apply as if the entity had a proper corporate veil in terms of tax burden.[215] In sum, the ATAD Decree now applies the deemed inclusion to any of the following directly or indirectly controlled foreign taxpayers: (1) undertakings, companies and non-resident entities, (2) foreign permanent establishments controlled by controlled foreign entities and (3) foreign permanent establishments controlled by resident taxpayers if they opted for the so called "branch exemption" regime.

After the analysis of the two first building blocks of the CFC regime, the next issue regards the notion of control. The Italian law-maker uses a double definition of control which is based upon article 2359 of the civil code. Firstly, a foreign entity is deemed as a controlled foreign company if it is subject to a certain "operational control" exercised by the parent company. In this first category, it is possible to identify three types of operational control:[216]

1. Legal control: the parent company owns, directly or indirectly, more than 50% of the voting rights of the controlled foreign company;
2. Factual control: the parent company owns, directly or indirectly, a percentage of voting rights which is sufficient to exercise dominating influence over the controlled foreign company;
3. Contractual control: the controlled foreign company has agreed upon some contractual obligations which allow another company to exercise a dominating influence.

The second type of control is economic. It exists when the parent company owns, directly or indirectly through one or more controlled entities or trustees, more than 50% of the dividend rights.[217] This approach is in line with the same very notion of economic control

---

[215] T.U.I.R., artt 73(1)(d), 165; Revenue and Collection Agency, *Explanatory Statement No 9/E* (March 5, 2015).
[216] Italian Civil Code, art 2359(1).
[217] T.U.I.R., art 167(2)(b).

set forth in the BEPS Action Plan 3.[218] The outcome of this new wording of article 167 of the tax code is the denial of any beneficial effects to those companies which, as it happened frequently in the past, used to separate the voting rights from the pro-rata share of the earnings and profits of the controlled foreign corporation.[219]

However, it is pivotal to pay attention to the difference between the Italian notion of control and the ATAD I definition when lower tiers of CFCs are taken into account. As a matter of fact, according to the Italian law-maker the pro rata participation in lower tier CFCs by means of an upper tier non-CFC is equal to the multiplication between the ownership in tier[1] and tier[2].

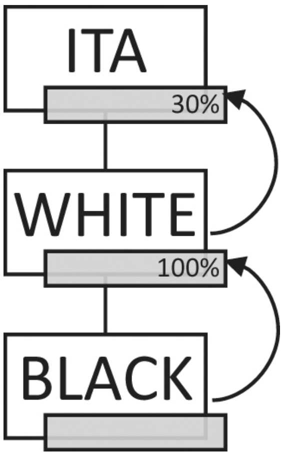


Figure 2.5: Alessandro Furlan, Luca Sormani, 'Interrelazioni tra disciplina CFC e dividendi da società estere alla luce delle modifiche introdotte dal decreto ATAD: casi pratici' (2019) 4 Fiscalità e Commercio Internazionale, 15.

As clearly shown in the chart above, if the Italian parent company owns 30% in a foreign company named 'white' and white owns 100% of a foreign company named 'black', the Italian company will not include the income earned by black in its income. Only if the country of incorporation of white provides for CFC rules, then, white shall include in its tax base the retained earnings and profits of black.

By contrast, the EU law treatment of lower tier CFCs differs completely since the ATAD I refers to indirect control (at least 50% by vote or stock) through foreign affiliates.[220] An

[218] OECD, *Action 3 - 2015 Final Report: Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015), para 35.
[219] Marco Piazza, 'Partecipazione agli utili oltre il 50% per il controllo della società estera' in Il Sole 24ore (2019) 5 Norme e Tributi Focus, 8.
[220] ATAD I, art 7(1)(a).

affiliate is a company owned by another at least by 25% of its stock. This means that any time one or more than one affiliate own more than 50% of a controlled foreign corporation, the interposed affiliate or affiliates do not prevent the inclusion of the CFC's income in the parent company's tax base. Given the supremacy of EU law, article 2359 of the Italian civil code must be interpreted in the sense of the EU directive and as such interposed affiliates do not limit the scope of application of the CFC regime. Hence, in the example shown above, the company named 'black' shall be considered a CFC of the Italian company regardless of whether the interposed affiliate is.

The fact that a resident taxpayer controls a foreign entity does not imply an automatic application of the CFC regime. As a matter of fact, the OECD recommendation prompted the G20 countries to apply the deemed inclusion only to those CFC's which raised BEPS concerns. The ATAD decree repealed the former territorial distinction between "black list" countries (tax havens outside the EU) and "white list" jurisdictions (EU countries granting a preferential tax treatment) and provided taxpayers with a broader and more general approach.[221]

The controlled foreign company shall be subject to the CFC rules only if: (1) the effective tax rate to which it is subject in the foreign jurisdiction is lower than 50% of the tax rate it would have been subject to, had it been a resident taxpayer, (2) more than one third of the total income earned by the controlled foreign corporation is passive.[222] The Revenue and Collection Agency clarified during the event called "Telefisco 2019" that the effective tax rate shall be calculated taking into account just the Italian corporate tax rate (IRES) regardless of the regional tax on production activities (IRAP).[223] Moreover, it is possible to consider applicable the prior definition of effective tax rate according the formula laid down in the 2016 ruling of the Commissioner of the Agency:

$$\frac{foreign\ tax\ paid}{foreign\ gross\ income} \leq 50\% \frac{hypothetical\ Italian\ tax\ to\ be\ paid}{foreign\ gross\ income\ under\ Italian\ law}$$

[221] Diego Avolio, Paolo Ruggiero, 'Il recepimento della Direttiva ATAD e le nuove disposizioni in materia di CFC' (2019) 3 Il Fisco 253, 254.
[222] T.U.I.R., art 167(4)(a)(b).
[223] Revenue and Collection Agency, *Explanatory Statement No 35/E* (August 4, 2016); Commissioner's Ruling No 143239 of 16 September 2016.

the other notion to be clarified is the actual meaning of passive income. The definition shall apply to: (1) interests and any other income generated by financial assets, (2) rents and royalties of any kind, (3) income derived from rent-to-own agreements, (4) income from banking, financial and insurance business, (5) capital gains released from the sale of assets between related or affiliated entities insofar as the value added during these transactions in none or negligible and (6) income from services supplied to related or affiliated entities insofar as the value added during these transactions in none or negligible.[224] The criteria to establish when the added value is none or minimal when the goods or services are supplied between related or affiliated entities are laid down by Ministerial Decree to be issued by the Ministry of Economy and Finance.[225] The Decree defines as such those services which: are auxiliary, do not belong to the core business of the multinational enterprise, do not require the use of non-fungible assets and do not require the assumption of great risks in terms of liabilities. This approach is coherent with the OECD transfer pricing guidelines.[226]

Also, with regard to passive income the Italian law-maker did not avail itself of the exemption option for financial undertakings which have the majority of their profits deriving from intercompany financing. The ATAD I under article 7 granted such possibility in order to exempt companies in the business of banking from being penalised although the majority of their activities was carried out in respect of affiliated entities.[227] The choice is reasonable from a policy perspective. A great part of the BEPS concerns raised by the OECD is related to company financing means. Multinational enterprises have enough cash in hand to set up a financial subsidiary which could be used as an industrial bank making loans to cash-hungry affiliates. The possibility which the directive gives to member states goes against the very purpose of the OECD's recommendation and proves that EU institutions have always shown an irrational bias for financial institutions. The course of action taken by the Italian law-maker is more respectful of and adherent to the BEPS Action guidelines.

---

[224] T.U.I.R., art 167(4)(b)(1-7).
[225] Ministerial Decree 14 May 2018, art 7.
[226] OECD, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax' (OECD Publishing, 2017), Chapter VII, Section D.1, para 7.45.
[227] ATAD I, art 7(3).

The CFC regime provides for an exception to the deemed inclusion if a controlled foreign entity meets the so called "active business test".[228] The aim of the CFC rules is to prevent that passive income, which can be easily moved away from high-tax to low-tax jurisdictions, benefits from a preferential tax treatment. However, if a company sets up a subsidiary or an exempt permanent establishment in a foreign country for genuine business purposes, the general tax laws of the parent company's country of incorporation should not hinder such economic expansion abroad. It is for these reasons that the anti-tax avoidance provision does not apply to all those circumstances in which the controlled foreign company carries on a substantial business activity in its country of incorporation by hiring employees and deploying assets, capital equipment and other related investments in the host country.

The interpretation of this concept becomes extremely controversial when the controlled foreign company works as or performs the functions of a holding company. Both the Italian Supreme Court of Cassation[229] and the CJEU[230] have issued some judicial decisions about the application of the business active test to financial holding companies and the relationship with the issue of corporate inversion. The nature of a holding company is to own and manage the subsidiaries it controls or merely participates in. The definition of genuine active business here cannot resemble the traditional meaning of active business of manufacturing or services supply. Therefore, the distinction lies between dynamic and static holding companies. The former, takes its own decisions and it is not controlled remotely from another jurisdiction where the management really is, while the latter is simply a fictitious holding company with no autonomy and decision-making powers. It is recommendable to either exempt holding companies from the CFC regime and use the corporate inversions instead for static holdings (hence, every static holding company would be considered resident in the country where the actual management is and would be subject to worldwide taxation), or apply the CFC rules to holding companies without treating differently dynamic and static ones. The Italian tax administration has not taken a position yet and it is advisable that they do in order to avoid

[228] T.U.I.R., art 167(5).
[229] Cass Sez V, 28 December 2016, Nos 27112-13 and 27115-16.
[230] Case C-6/16 *Eqiom SAS, ex Holcim France SAS and Enka SA v Ministre des Finances at des Comptes publics* (CFI, 7 September 2017).

more cases from being filed and give investors a clear picture about the application of the tax reform.[231]

The taxpayer can pass the active business test also by making an inquiry to the tax administration asking for a ruling. In the Italian tax law framework, the ruling is simply an answer of the tax administration to a tax law question asked by the taxpayer.[232] The reply from the tax law administration is not binding, but if the taxpayer adheres to it then the tax administration cannot file it with a notice of assessment, unless it had previously notified that its position about the issue had changed.[233] Thus, if the taxpayer has reason to believe its situation falls into the application of the active business test exemption, it can ask the tax administration whether they agree with the taxpayer's opinion. Despite this possibility, the taxpayer has no duty to file such inquiry and if it did not, before filing a notice of assessment, the Revenue and Collection Agency must provide the taxpayer with ninety days to explain its reasons not to apply the CFC regime.[234] If the tax administration is not persuaded it shall explain in details why the taxpayer should have applied the anti-tax avoidance rule in the notice of assessment.[235] If the taxpayer asked for a ruling and the Revenue and Collection Agency agreed it fell into the exemption, there are no further demonstration of its compliance with article 167 of the tax code, but the Agency can still verify whether the information and evidence provided were truthful and complete.[236]

Finally, it is necessary to explain what the tax outcome is if the CFC regime applies to a certain non-resident taxpayer according to everything analysed so far. If the foreign controlled entity is subject to the anti-tax avoidance measure, the pro rata share of its retained earnings and profits shall be included in the tax base of the controlling resident taxpayer.[237] If the stock ownership is indirect (which means through a series of CFCs) the pro rata share is calculated by multiplying the ownership percentage of tier[1] with the

---

[231] Giuseppe Mazzarella, Andrea Tempestini, 'Esimenti disallineate con le CFC' [2018] Il Sole 24ore, in Norme e Tributi.
[232] Law No 212/2000, art 11.
[233] Ibid.
[234] T.U.I.R., art 167(5).
[235] Ibid.
[236] T.U.I.R., art 167(12).
[237] T.U.I.R., art 167(7).

ownership percentage of tier2. The determination of the income attribution follows the rules set by the income tax code for pass through entities with the exception of the following rules which shall not be applied: (1) rules regarding shell companies and net operating loss shells, (2) tax gap estimates and studies, (3) the ACE (“aiuto alla crescita economica” meaning “aid to economic growth. It is a tax credit for opting to finance a company through equity instead of debt), (4) rule concerning the instalment payment of capital gains.

The income so calculated is then attributed to the parent company. However, such income is not mingled with the one from domestic sources and it shall be taxed on a standalone basis.[238] The applicable tax rate will be the average rate paid over the tax years taken into account if the rate has been amended and in any circumstance it shall not be lower than the corporate tax rate in force when the tax bill is due. the foreign taxes paid abroad allow the taxpayer to claim a euro-for-euro tax credit against the domestic liability.[239] This mechanism guarantees the fairness of the CFC regime and prevents any scenario of double taxation.

The tax reform of the CFC regime entered into force on January 1, 2019.[240] Overall, the new CFC rules have modernised the Italian tax law framework and got rid of the difference made between black and white list countries. The previous preferential treatment in favour of subsidiaries set up in EU countries did not respect the purpose and aim of the deemed inclusion mechanism. Hence, the abrogation of this dual standard and the simplification of the rule should be praised. However, as the dissertation mentioned above the Revenue and Collection Agency should operate to provide taxpayers with immediate clarifications about some terms which really need to be better defined. While there is no controversy that the meaning of passive income is settled both at domestic and international level, the notion of effective tax rate needs to be specified further in order to avoid misleading resident companies with foreign investments. Moreover, when it comes to foreign holding companies the debate becomes even more controversial. Still there are no clues as to whether they should be considered as falling into the active

[238] T.U.I.R., art 167(8).
[239] T.U.I.R., art 165(1).
[240] Legislative Decree No 142/2018, art 13(1).

business test exception (so long as they are not managed by a foreign-base entity and possess decision-making autonomy) or they should simply be regulated under the tax inversion regime.[241]

The ATAD Decree seems to have brought the Italian taxation of controlled foreign companies from a previously jurisdictional approach to a newly transactional one. It is pivotal to inform the reader that such a sharp change is not the reality of the current general tax law framework. Indeed, the taxation of controlled or affiliated foreign entities is still very much carved upon a jurisdictional method. Firstly, whenever a foreign company is controlled by an Italian corporate entity and has at least one-third of its income deriving from passive sources, the whole income is deemed included in the tax base of the resident taxpayer.[242] In other words, unlike other countries (like the US), the Italian law-maker has decided to include also the portion of active income produced by the foreign company so long as at least one-third of the whole profits are passive. This overall deemed inclusion is clearly based on a jurisdictional view of international taxation. A purely transactional approach should merely include in the tax base of the resident taxpayer just income which raises BEPS concerns (thus, income from passive sources).

Secondly, despite having formally abandoned the black list system, the Italian law-maker introduced a new generation black list based upon a general definition of low tax jurisdiction under new article 47-bis of the income tax code.[243] The ATAD Decree inserted the new article by defining tax havens or shelter in broader and more general terms, without naming a list of single countries.[244] Before the analysis of the new definition of low tax jurisdiction, it is necessary to outline the tax framework for dividends from and sales of shares of foreign entities, once the CFC legislation does not apply. If a company is not subject to any control by a resident taxpayer or is subject to its control, but does not exceed the passive income threshold (one third of the total income) set under article 167, the dividend distributions and gains from the sale of shares receive

[241] T.U.I.R., art 73(5-bis).
[242] Diego Avolio, ‘Chiarimenti per Paesi a fiscalità privilgiata e transfer pricing’ (2019) 9 Il Fisco 852.
[243] T.U.I.R., art 47-bis(1).
[244] Legislative Decree No 142/2018, art 5(1)(b).

a beneficial treatment. Corporate taxpayers can benefit from a 95% dividend received deduction which allows to credit foreign taxes against the 5% income which remains taxable in Italy, while the rest of the income is substantially exempt from domestic corporate tax.[245] The same participation exemption applies in case of gains derived from the sales of shares since the appreciation of the shares is simply the amount of built-in dividend yet to be distributed.[246] The rationale of the 95% exemption on corporate dividends and gains from the sale of stock banks upon the fact that the lower tier foreign company has already paid foreign corporate taxes in the country where it is organised. As such, the Italian legislator, in order to foster the presence of holding companies at domestic level, reduces to a marginal 5% its taxing rights and avoids the issue of double corporate taxation (which could have also been avoided through a tax credit system. However, it generally results in higher taxation).

For individual taxpayers the generally applicable tax laws differ from corporate entities. As a matter of fact, there is no risk of double corporate taxation when a dividend or a gain from the sale of stock is taxed at individual level once again. However, instead of taxing dividends and capital gains on stock at graduated rates and mingle such income with income from other sources, the Italian law-maker allows another preferential treatment. The dividends and gains from stock are subject to a 26% withholding tax levied by the payor company which is a resident of the country or the financial intermediary which is a resident if the payor corporate entity is a foreign company.[247] Once the withholding tax has been levied, the dividend or gain is not included in the tax return of the taxpayer since no further taxes shall be paid upon such income. Considering that the highest applicable tax rate is statutorily set at 43% for all income exceeding €75,000,[248] the withholding tax provision constitutes a considerable tax break for individual taxpayers.

As the dissertation has pointed out above, there is an interplay between the non-application of the preferential tax rules explained so far and the fact that the payor company is located in a low tax jurisdiction.[249] Basically, whenever the foreign entity

[245] T.U.I.R., art 89.
[246] T.U.I.R., art 87.
[247] D.P.R. 600/1973 No, art 27(1).
[248] T.U.I.R., art 11(1)(e).
[249] T.U.I.R., art 47-bis(1).

distributing dividends or whose stock was sold at a gain is resident in a low tax jurisdiction, the dividend received deduction (or participation exemption) and the preferential withholding tax do not apply and the income is deemed included even though dividends have not been distributed yet.[250]

Under article 47-bis, all non-EU/EEA countries can be considered low tax jurisdictions and, thus, be subject to the deemed inclusion of retained earnings and profits if they meet the one of the two tests set forth by the provision. If the resident taxpayer has a controlling interest in the foreign entity, the country is a low tax jurisdiction if the effective tax rate (ETR) is lower than 50% of the corporate taxes to be paid in Italy.[251] If the resident taxpayer does not have a controlling interest in the foreign company, the country is a low tax jurisdiction if the nominal tax rate (NTR) is lower than 50% of the one applicable in Italy.[252] Unlike article 167, this new regime applicable to all companies set up in non-EU/EEA countries does not take into account whether the income is active or passive. So long as the taxation either effective or nominal is lower than the statutorily set one, the deemed inclusion is triggered. However, there are two exceptions which reduce the purely jurisdictional character of article 47-bis: (1) the "active business test" and (2) the "cash parking test". Under the first exception, the taxpayer can demonstrate to the Italian tax administration that the foreign company carries out an effective trade or business in the country where it is organised and thus avoid the deemed inclusion. Under the second test, the resident taxpayer is allowed to demonstrate that the holding of stock in the foreign entity does not result in pooling cash in the low tax jurisdiction. Additionally, the resident taxpayer can also ask the tax administration for a preliminary ruling upon one of the two exceptions so that it can avoid being notified future tax assessment concerning eventual deemed inclusion not filed within the resident taxpayer's tax return.[253]

It needs to be mentioned that, although one of the two exceptions is met and the tax administration agrees with the taxpayer that article 47-bis does not apply, the deemed inclusion is not totally avoided. More specifically, the "cash parking test" fully exempts

[250] T.U.I.R., artt 47(4), 68(4), 89(3), 87(1)(c).
[251] T.U.I.R., art 47-bis(1)(a).
[252] T.U.I.R., art 47-bis(1)(b).
[253] T.U.I.R., artt 47-bis(3), Law No 212/2000, art 11(1)(b).

the resident taxpayer form the application of article 47-bis and for this reason it will benefit again from the dividend received deduction (or participation exemption) for corporate taxpayers or the reduced withholding tax rate for individuals. By contrast, the "active business test" produces the same effects only up to 50% of the income derived from the foreign based company.[254] Therefore, corporate taxpayers will benefit from the dividend received deduction (or participation exemption) only for half of the income received, while the rest of the income will be subject to the 24% corporate income tax with the possibility to claim a euro-per-euro tax credit for taxes paid abroad.[255] Likewise, individual taxpayers can benefit from the 26% withholding tax upon dividend distribution or sale of stock only for half of the income, while the rest of it will be deemed included at graduated rates after being mingled with income from other sources.[256]

The second set of rules regarding the deemed inclusion of foreign derived income might create some confusion to the reader. It is now necessary to understand how CFC rules and article 47-bis coexist and are effectively used by the tax administration. As we have seen, the CFC regime aims at clawing back into tax the retained earnings and profits which the controlling shareholder of a foreign entity can park abroad deferring taxes on dividends indefinitely. By contrast, article 47-bis can be defined a "capital export neutrality" (CEN) tax imposed upon both controlling and non-controlling shareholders when they take advantage of jurisdictions which engage in unfair tax competition practices. Aside from the different purposes of the two regimes, the CFC rules apply to controlled foreign companies irrespective of their geographical location. Article 167 does not make any difference between foreign companies located within the EU/EEA and those which are not. Conversely, the CEN regime applies only to non-EU/EEA based foreign companies. Therefore, while there can be no interpretative issues with regard to foreign companies set up within the single market, both articles 167 and 47-bis can apply to business associations outside the customs union. More specifically, the overlap between CFC and CEN taxation can happen only with regard to controlling resident taxpayers of non-EU/EEA foreign companies. To simplify even further, the current tax law framework can divide foreign business associations in three categories: (1) controlled foreign companies

[254] Law No 205/2017, art 1(1009).
[255] T.U.I.R., artt 77, 165.
[256] D.P.R. 600/1973 No, art 27(1); T.U.I.R., art 47(4).

based in the EU/EEA which are subject only to the CFC regime, (2) non-controlled foreign companies based outside the single market which are subject only to the CEN regime and (3) controlled foreign companies based outside the single market which are subject to both the CFC and CEN regimes.

Despite the lack of clarity provided by the newly enacted rules, whenever a controlled foreign company can be subject to both the CFC and CEN regimes, article 167 of the income tax code shall be applied first to the exclusion of article 47-bis.[257] As a matter of fact, with regard to individual taxpayers which are controlling shareholders of non-EU/EEA foreign companies, the code expressly states that the application of CFC taxation shall exclude any double levy arising out of the CEN regime.[258] No such provision can be found in respect of corporate taxpayers, but an organic interpretation of the general framework tends to assimilate the tax outcome and excludes the subjection to CFC and CEN taxes. After having clarified that article 167 takes priority over CEN rules with regard to non-EU/EEA controlled foreign companies, it is necessary to see whether article 47-bis can still apply if the stricter requirements for CFC taxation are not met. Assuming that a foreign controlled company outside the single market benefits from low tax rates, but produces only active income (thus, article 167 cannot be applied), the Revenue and Collection Agency can still claw back into tax the retained earnings and profits under CEN rules (unless the resident taxpayer can demonstrate that one of the two exceptions applies).[259] Hence, the Italian law-maker wanted to eradicate all possibilities that outbound investments abroad could result in unfair tax competition with regard to foreign jurisdictions in which the ATAD I and II do not apply. The tax administration is provided with an alternative mechanism to tax profits parked outside the EU/EEA so long as they are produced by virtue of foreign companies (controlled or non-controlled) based offshore in low tax countries.

[257] Alessandra Serena, Sophia Pavetto, 'Modifiche alla disciplina CFC e alla tassazione dei dividendi e delle plusvalenze black list' (2019) 3 Bilancio e reddito d'impresa 17, 22.
[258] T.U.I.R., artt 47(4).
[259] Alessandra Serena, Sophia Pavetto, 'Modifiche alla disciplina CFC e alla tassazione dei dividendi e delle plusvalenze black list' (2019) 3 Bilancio e reddito d'impresa 17, 22.

Following the study of both CFC and CEN rules, it can be concluded that the Italian system of taxation concerning foreign subsidiaries and affiliates located abroad is "quasi-transactional". As a matter of fact, new article 167 is definitely more inspired by a transactional approach, although once the rule is triggered also the active income portion is deemed included in the resident taxpayer's tax base. A foreign entity is required to (1) be subject to control by an Italian taxpayer, (2) earn at least one-third of its income from passive sources meticulously identified by the law-maker and (3) benefit from a low tax rate in the foreign jurisdiction. The list of requirements is in compliance with the OECD BEPS Action 3 guidelines and it targets just the controlled foreign companies which engage in certain transactions and at the same time benefit from low tax rates in the jurisdiction where they are organised.[260] Moreover, the code provides for the active business income exception which fully exempts the foreign company from the deemed inclusion in consideration of the genuine purpose of the activities carried out abroad. However, article 47-bis is merely a new generation "black list" which, instead of listing a series of countries, provides a general definition of low tax jurisdiction and taxes all income thereby produced irrespective of whether the come from active or passive sources. The "active business" and the "non-cash parking" exceptions limit the rigidity of the CEN rules, but do not change the nature of article 47-bis which is inspired by a purely jurisdictional approach. The combination of an intra-EU/EEA transactional approach with an extra-EU/EEA jurisdictional one gave rise to the "quasi-transactional" framework mentioned at the outset of the paragraph. Whether or not the legislative choice made by the Italian law-maker is fair to countries which are not part of the single market goes beyond the scope of this thesis. However, this hard-hitting approach surely results in an expansion of the Italian jurisdiction to tax which might be detrimental to other jurisdictions. From a technical point of view, the CFC and CEN rules lay down a very complex body of law. Nevertheless, the ATAD Decree simplified prior law and eliminated the black and white list regimes previously in force.[261] The reform can surely

[260] OECD, *Action 3 - 2015 Final Report: Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).
[261] Dott. Giovanni Turri, 'FISCALITÀ FINANZIARIA: TASSAZIONE DEI DIVIDENDI E DELLE PLUVALENZE' (2019) 3 Diritto e Pratica Tributaria 989; Marco Piazza, Antonio della Carità, Elia Biaggio, 'CFC e tassazione dei dividendi esteri: breve guida al self-assessment' (2019) 5 Fiscalità e Commercio Internazionale 40.

be said to be more effective in fighting tax avoidance and more easily applicable to practical situations.

The last issue which comes to the attention with regard to controlled foreign companies is the tax treatment of corporate inversions (or foreign relocation). In some cases tax inversion is used by the Revenue and Collection Agency for the same purpose, levying taxes on foreign derived income, but through a different type of assessment of the taxpayer's position. The CFC rules are laid down to claw back into tax all the undistributed profits made abroad by foreign subsidiaries. However, if a taxpayer decides not to apply the deemed inclusion, the tax administration cannot immediately file a notice of assessment without having first asked for a preliminary explanation.[262] As a matter of fact, should the Revenue and Collection Agency not follow the procedure, the following notice of assessment would be void and thus ineffective.[263] The tax inversion or foreign relocation regime becomes a shortcut to achieve the same result and the tax administration will often try to intervene under this simplified umbrella first.

Article 73 of the tax code applies to foreign holding companies which are either directly or indirectly owned by resident taxpayers or managed by a resident board of directors or similar executive body.[264] The effect of this rule consists of considering the foreign entity as a tax resident of the country and thus subjects its income to worldwide taxation. The definition concerning the body in charge of the foreign company is in perfect compliance with the OECD notion of "effective place of management" which can be found under article 4 of the model convention.[265] However, the Italian tax administration clarified that the tax residency of an entity can be just one (this is to avoid the so called double dip).[266] Therefore, if a dispute concerning the residency of a company is triggered and two states

---

[262] T.U.I.R., art 165(8-quarter).
[263] Ibid.
[264] T.U.I.R., art 73(5-bis).
[265] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 4.
[266] Revenue and Collection Agency, *Resolution No 471/E* (December 3, 2008).

which ratified an income tax treaty are at stake, then, the respective tax authorities should undertake the mutual agreement procedure and come to a reasonable conclusion.[267]

A case of national interest which stirred a great deal of controversy concerned the famous fashion house "Dolce & Gabbana".[268] For the purposes of this dissertation, the issue will be dealt with just from the tax law perspective without delving into the analysis of the criminal charges brought against the two stylists. Like many other companies whose value is largely determined by intangibles, the two stylists decided to opt for a corporate reshuffling and transfer their personally-owned brands ("D&G" and "Dolce & Gabbana") and other royalty-generating assets to Luxembourg. More specifically, the group was formed by two Italian companies 'D&G s.r.l' (the holding company) and 'Dolce & Gabbana s.r.l.' (the operating company and licensee of the intangibles). The Italian holding controlled a Luxembourg company 'Dolce & Gabbana Luxembourg' which in turn wholly owned 'Gado S.a.r.l.' (which became the new owner of the intangible assets). The Italian tax authorities became suspicious for three main reasons: (1) the corporate structure had a long-standing Italian tradition and was suddenly moved to Luxembourg, (2) the employees were not immediately hired by Gado and (3) the effective place of management and all the decision-making powers were vested in the Italian holding company. Therefore, it seemed obvious that the only purpose of the corporate reshuffling was to avoid the 45% income taxes on royalties in order to benefit from a 4% rate granted in Luxembourg.[269] However, under the application of article 73 of the tax code, the first instance and appeal tax courts ruled against the two stylists and concluded that since there was an abusive tax relocation, Gado S.a.r.l. would be considered a resident taxpayer thus subject to Italian taxation on its worldwide profits. In order to simply the understanding of the arrangement, a chart is provided below.

[267] Revenue and Collection Agency, *Explanatory Statement No 21/E* (June 5, 2012), § 4.2.2.
[268] Scarlett Conlon, 'Dolce & Gabbana Case Officially Closed' [2016] British Vogue.
[269] Morena Vassalo, 'Esterovestizione e reato di omessa dichiarazione: l'assoluzione Dolce & Gabbana' [2015] Altalex.

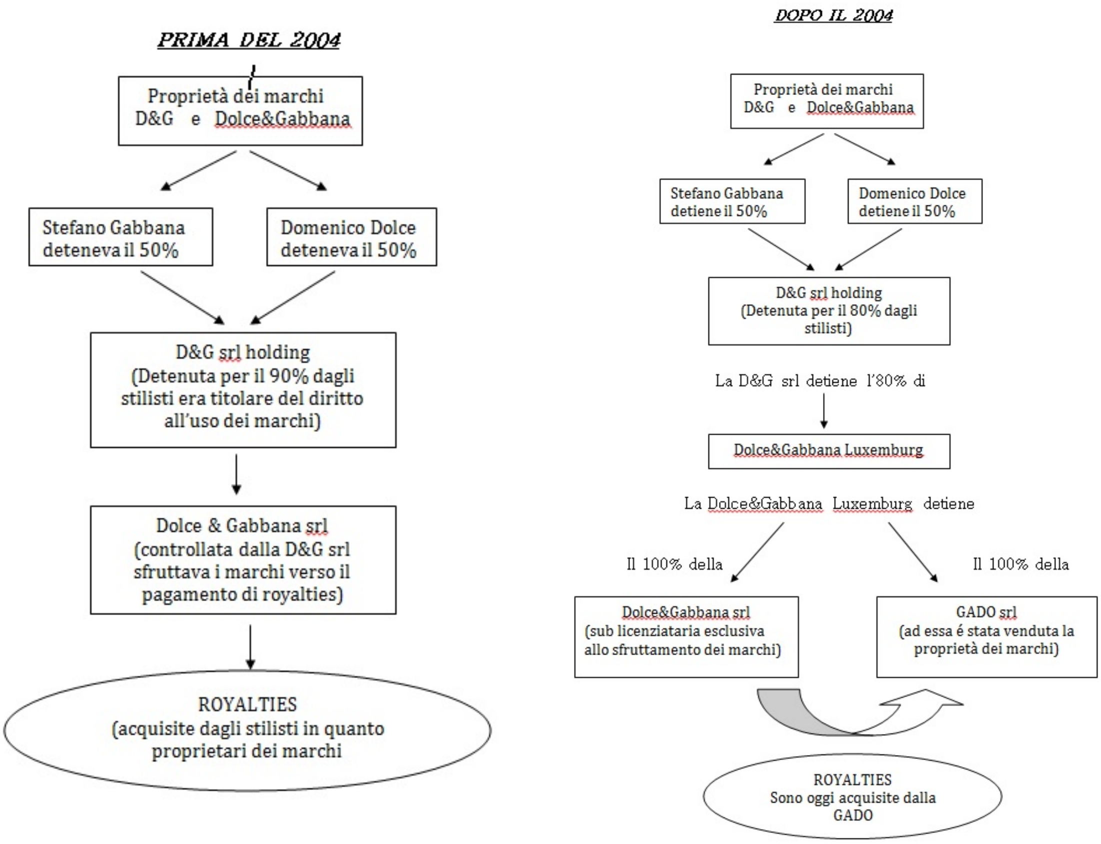


Figure 2.6: Morena Vassalo, 'Esterovestizione e reato di omessa dichiarazione: l'assoluzione Dolce & Gabbana' [2015] Altalex.

Before 2004, the two stylists controlled D&G which, in turn, owned Dolce & Gabbana. The operating company was the licensee of the intangibles and paid royalties directly to the two stylists for the licensing agreement which allowed the company to exploit the brand with third parties. Following 2004, the two stylists controlled D&G which, in turn, owned Dolce & Gabbana Luxembourg. The Luxembourg holding then controlled both Gado, the new owner of the intangibles, and Dolce & Gabbana, now the licensee of Gado (not the two stylists), which paid hefty royalties for the use of the brand.

The Italian Supreme Court of Cassation overturned the decision of the tax courts of first instance and appeal by enumerating several factors.[270] The corporate restructuring was upheld and not considered abusive since the transfer of the brand into a new company could ensure a better management than a 50-50 ownership by the two stylists. Secondly,

[270] Cass Sez V, 21 December 2018, No 33234.

the transfer of the brand in a Luxembourg company was based upon the imminent initial public offering (IPO) of the shares of the company on the Luxembourgish stock market, which is well-known for being particularly appealing to foreign investors. The Supreme Court stance is in line with the teachings of the CJEU concerning the freedom of establishment.[271] Tax savings cannot be considered abusive when an undertaking takes advantage of the lawful opportunities offered by the single market or by member states' preferential tax treatments, unless the operation results in a wholly artificial arrangement not prompted by genuine economic purposes.[272]

Despite the outcome of this decision and thus the impossibility to consider the foreign company a resident taxpayer, it will not come unobserved that the Luxembourgish company owning the intangibles can still fall into the definition of controlled foreign company. As a matter of fact, it is subject to the indirect legal control of the Italian holding company and is likely to earn more than a third of its income from passive sources, specifically royalties. It is therefore striking the connection between articles 167 (eventually 47-bis) and 73 of the tax code and the necessity to always consider them both when dealing with a foreign holding company.

The Dolce & Gabbana case took place several years ago, but still draws a lot of interest due to the complexity of the case. Given that tax relocation is not the only measure which the tax administration can avail itself of, it would be interesting to prospect how this case would be decided if it occurred nowadays. Ruling out the possibility to claw back into tax the foreign shifted income by means of article 73 of the income tax code, the Revenue and Collection Agency could assess the taxpayer's position under new article 167. As a matter of fact, also article 47-bis shall be disregarded since CEN rules apply only to non-EU/EEA countries while Luxembourg is a member states of the EU.

Under article 167, the resident taxpayer is D&G holding which owns 80% of Dolce & Gabbana Luxembourg, which in turn owns 100% of Gado, the new owner of the intangible property. Both Dolce & Gabbana Luxembourg and Gado are controlled foreign

---

271 Case C-108/99 *Commissioners of Customs and Excise v Cantor Fitzgerald International* (CFI, 9 October 2001), para 33.
272 C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031, para 55.

companies for two reasons: (1) the Italian holding company exercises legal control according to article 2359 of the civil code and (2) the control can be both direct and indirect by means of interposed entities.[273] Gado is a lower tier foreign company which is 80% indirectly controlled since the ownership level shall be obtained by multiplying the ownership level in tier^{1} by the one in tier^{2}. Moreover, the interpretation of lower tier ownership provided for under the ATAD I strengthens the supposition of indirect comtrol over Gado (under EU law whenever a 25%-or-more-owned non-residnet affiliate controls more than 50% of another foreign company, the resident affiliate shall be considered a controlling shareholder).[274]

Now that it has been established that Gado is a CFC it needs to be seen whether it meets the passive income test. Gado, as the new owner of the intangibles, received hefty royalties from related parties in consideration of the commercial exploitation of the D&G and Dolce & Gabbana brands. Under article 167, the notion of passive income included royalties and other payments due for the use of intellectual property.[275] The passive income test is met if more than one-third of the overall income is derived from passive sources. As such, Gado obtained most of its income from royalties and thus it meets the passive income test.

The last requirement is that the controlled froeign company be subject to an effective income tax rate lower than 50% of the one which would be applied in Italy.[276] Gado was subject to 4% tax rate on royalties which was a beneficial treatment granted by Luxembourg general tax laws. By contrast, the applicable tax rate which would have been applied in Italy is 24%.[277] The income earned by resident corporate entity is presumed to be business income regardless of its source and is subject to the IRES, the corporate income taxes.[278] Therefore, Gado would meet even the low income tax test and thus be

[273] T.U.I.R., art 167(2)(a); the provision refers expressly to article 2359 of the Italian Civil Code.
[274] ATAD I, art 7(1)(a).
[275] T.U.I.R., art 167(4)(b)(2).
[276] T.U.I.R., art 167(4)(a).
[277] T.U.I.R., art 77.
[278] T.U.I.R., art 75(2).

subject to a pro rata deemed inclusion of its income under article 167 with the possibility to credit foreign taxes paid abroad.[279]

It seems that under current law Gado's retained earnings and profits would be subject to the CFC deemed inclusion. However, the resident taxpayer, D&G holding, can still demonstrate that Gado is carrying on a genuine business activity. In order to do so, it would need to show the tax administration that there is sufficient personnel hired through employment contracts, that the company owns or rents premises where the employees work on a daily basis and, most of all, that Gado carries out actual economic activity which concerns the development and promotion of the brands and the necessary research for being considered an IP-producing company. All these considerations must be made taking into account all the facts and circumstances of the case. Moreover, the subjective view of the court and its personal sensitivities would certainly play an important role in deciding whether such exception could apply or not. The purpose of this dissertation does not involve giving a precise answer to this case, but aims at providing the reader with the necessary tools to analyse and efficiently structure similar fact patterns and situations. In other words, the hypothetical just prospected simply wants to focus the reader's attention on the list of factors to consider when advising similar corporate reshuffling so that the tax planning arrangement remains lawful and does not become abusive.

2.4 The New Rules on Hybrid Mismatch Arrangements

The ATAD I did not cover in a sufficient manner the phenomenon of hybrid mismatch arrangements and it is for this reason that the EU institutions decided to take action a second time and give an adequate response to the issue.[280] The enactment of the second directive made the obligations upon each member states more straightforward and specific and led to a more coherent harmonisation of the entire discipline. It is noteworthy to mention that ATAD I completely missed the regulation of reverse hybrids and the entire discipline was laid down under ATAD II.

[279] T.U.I.R., art 167(6)-(9).
[280] ATAD I, artt 2, 9; ATAD II, art 1.

Contrary to what the dissertation has pointed out at the beginning of each chapter, this time the Italian tax system did not have a previous specific discipline addressing hybrid mismatch arrangements. The recommendations of the OECD on the subject matter were entirely implemented through EU law. Nevertheless, it would be unfair to say that courts and tax law experts did not take into account the problem. As the thesis will analyse further on, these particular types of arrangements were questioned banking upon the general anti-abuse rule (GAAR) which the Italian law-maker has enforced for about three decades.[281] This consideration does not diminish the importance of the implementation at national level of a specific discipline for hybrid mismatches which was fundamental to tackle with major strength the aggressive tax planning scheme. Moreover, the treatment of hybrid entities and transactions are inevitably a cross-border issue which could not be adequately dealt with unless the EU law-maker would step in assuming a proactive role.

The ATAD decree dedicates an entire section, composed of articles from 6 to 11, to hybrid mismatch arrangements and follows with utmost precision the regulatory framework derived from EU law.[282] Under article 6, the Italian law-maker lays down a long list of definitions which aim at clarifying the meaning of certain terms.[283] It also depicts the different patterns of arrangements which can generate an undue tax saving.[284]Article 7, titled "jurisdiction of the Italian state", states when Italy is either the payor's country, the investor's country or the beneficiary's country,[285] and together with article 8 provides for the adequate countermeasure to put in place in each situation to neutralise the hybrid.[286] Articles 9 and 10 regulate reverse hybrids and residence hybrids respectively, thus, complying with the broader set of rules which were enacted under the ATAD II.[287] Lastly, article 11 provides for rules imposed upon the tax administration when it investigates abusive practices and eventually files a notice of assessment.[288]

---

[281] Law No 408/1990, art 10; D.P.R. 600/1973, art 37-bis; Law No 212/200, art 10-bis.
[282] Legislative Decree No 142/2018, artt 6-11.
[283] Legislative Decree No 142/2018, art 6(a)-(z).
[284] Legislative Decree No 142/2018, art 6(1)(r)(1)-(8).
[285] Legislative Decree No 142/2018, art 7(1)-(3).
[286] Legislative Decree No 142/2018, art 8(1)-(5).
[287] Legislative Decree No 142/2018, arty 9, 10.
[288] Legislative Decree No 142/2018, art 11.

The section concerning hybrid mismatch arrangements begins with a long list of definitions which helps understand and clarify the meaning of certain terms. The main legal terms will be explained in details. The decree explains the notions of "double deduction" by referring to the situation in which the same negative income element is deducted against the taxable bases of two associated taxpayers both in the jurisdiction of the payor and of the investor.[289] Vice versa, the "deduction no inclusion" scenario is defined as the circumstance in which the same negative income element is deducted against the taxable base of the taxpayer in the jurisdiction of the payor and is not included in the gross income of an associated taxpayer in the jurisdiction of the investor.[290] A "financial instrument" is described as any arrangement which gives rise to a positive income element in relation to the raising of finances or to a capital contribution and is subject to the tax rules concerning debt/equity instruments or derivatives according to the laws of the beneficiary's or payor's jurisdiction.[291] The terms "structured arrangement" stands for any contractual agreement or business transaction which gives rise to a hybrid mismatch and was aimed at producing such effect, unless the taxpayer was not aware of the mismatch and the tax saving.[292] A "hybrid entity" is considered to be any entity which is subject to corporate taxation in the host jurisdiction and is a flow through entity in the parent company country.[293] A "disregarded permanent establishment" is any business activity carried out in the host jurisdiction which is considered a permanent establishment only in the investor's country, while the host state does not deem the activity a taxable presence.[294] the following chart will provide a better understanding of the statutory definitions.

[289] Legislative Decree No 142/2018, art 6(1)(b).
[290] Legislative Decree No 142/2018, art 6(1)(c).
[291] Legislative Decree No 142/2018, art 6(1)(l).
[292] Legislative Decree No 142/2018, art 6(1)(q).
[293] Legislative Decree No 142/2018, art 6(1)(i).
[294] Legislative Decree No 142/2018, art 6(1)(p).

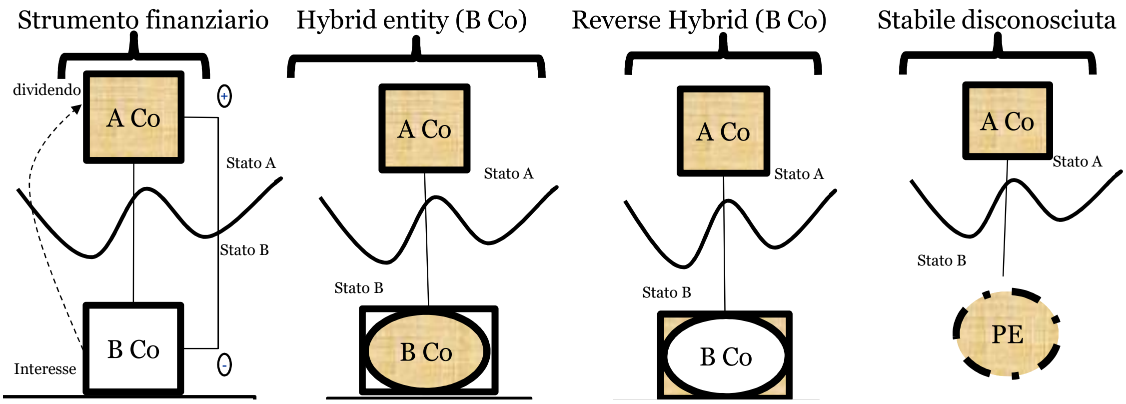


Figure 2.7: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

Starting from the left, A co finances B co through a repurchase agreements. The interest expense is deductible for B co, while the capital gains realised by A co when giving back the shares is exempted due to the participation exemption rule. The two corporate structures in the middle represent a hybrid entity and a reverse hybrid respectively. B co is once considered flow through for state A and a corporation for state B and vice versa in the case of a reverse hybrid entity. Lastly, ATAD II and the ATAD decree also take into account the scenario regarding the disregarded permanent establishment. While the permanent establishment is considered as such in state A, it is not deemed a taxable presence in state B. Assuming that PE benefits from the branch exemption (which taxes a branch as if it were a company) all the profits generated would not be taxed in any of the two jurisdictions thereby giving rise to a "double exemption" case.

The ATAD decree, under article 6 letter -r, provides a definition of hybrid mismatch by enumerating several fact patterns which might occur when multinational enterprises make some structured arrangements. Firstly, it pays attention to arrangements which cause a deduction/no inclusion though the use of either financial instruments, hybrid or reverse hybrid entities, or branches. Secondly, it concentrates on double deduction arrangements by means of consolidated hybrid entities or consolidated foreign branches. As we have shown above and in the first chapter, the repurchase agreement is a classic example of hybrid transfer which is often used in financing operations since it results in a deduction/no inclusion. The return payment of the loan, generally higher the initial funds lent, is deductible for the borrower and exempt for the lender.[295] However, some

[295] Legislative Decree No 142/2018, art 6(1)(r)(1)(2).

complications might arise if the financial instrument is sold to a third party (basically, a new lender) and the original lender cashes in a "substitute payment". A coherent interpretation of the ATAD decree leads to consider the anti-avoidance rules applicable even to substitute payments which are received upon the sale or transfer of hybrid financial instruments. The chart below will illustrate the classic repurchase agreement and the debt assignment agreement which triggers the substitute payment.

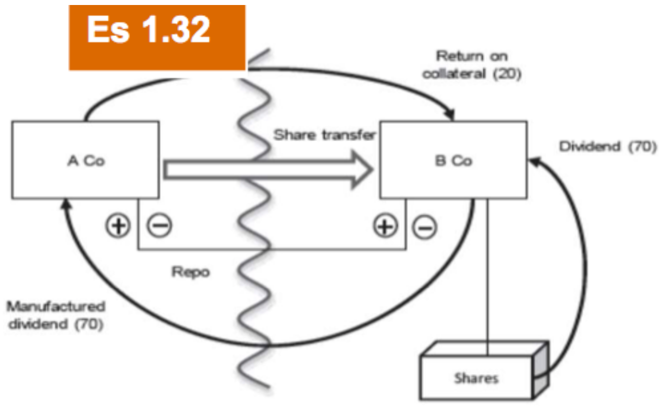


Figure 2.8: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

As it clearly shown in the second example, B co sells a loan participation amounting to half of the initial lending facility to A co in exchange for the purchase price plus a premium. Assuming that the loan is secured by shares, the premium price is exempt, while the interest due to both A co and B co can be deducted against the income of C co. Thus, substitute payments can generate the same consequences of hybrid instruments and the ATAD decree takes them into account for the first time. This innovation puts the Italian tax framework ahead of the pack of G20 countries in the fight against tax avoidance.

The ATAD decree also exemplifies the deduction/no inclusion scheme which can be easily put in place through hybrid entities or reverse hybrid entities.[296] Briefly, any payments to a reverse hybrid or from a hybrid entity can benefit from a deduction/no inclusion if the structured arrangement is based upon a debt instruments. A loan from a reverse hybrid to a foreign company is deductible for the borrower, but considered as a remittance for the lender. Vice versa, a loan to a hybrid entity is deductible for such entity,

[296] Legislative Decree No 142/2018, art 6(1)(r)(3)(6).

but it is not includible in the income of the lender since it is seen as a remittance from a branch. The figure below will help clarify the tax planning scheme.

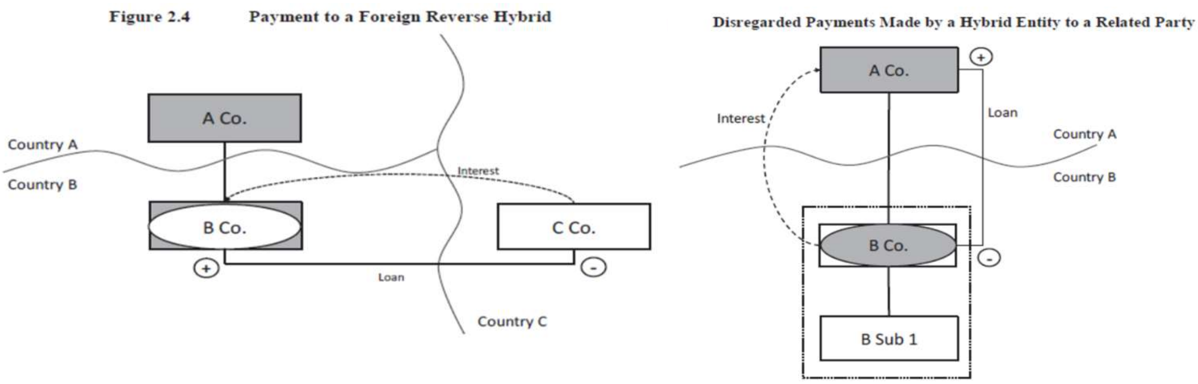


Figure 2.9: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

In the first example, B co is a reverse hybrid, which means treated as a corporation in country C, but as a flow through entity in country B. B co lends funds to C co. The interest payment of the lending facility is deductible for C co, but it does not become part of the gross income of B co since it is considered a branch of C co in country B. Therefore, generally speaking, a payment to a reverse hybrid generates a deduction/no inclusion. In the second example, the fact pattern is simply the other side of the coin. This time, B co is a hybrid entity, taxpayer in country B and flow through in country A, and is the borrower. Hence, the interest payment is deductible for B co, but it is not included in the gross income of A co which treats such money wire as a remittance. Again, it is possible to claim that, overall, a payment from a hybrid entity generates a deduction/no inclusion.

The other type of tax planning which the ATAD decree tries to codify concerns the use of branches.[297] Operating foreign branches are not a separate entity and thus all the income earned is then attributed to the head office, unless the home country adopted a territorial taxation system thereby creating an exempt branch. Moreover, any payment made from the branch to the head office and vice versa does not generate income since the money wire constitutes a mere remittance. The first type of arrangement is a three-party scheme where the head office of the parent company makes a loan to a subsidiary set up in another country which, in turn, pays the interest rate to the foreign branch of the

[297] Legislative Decree No 142/2018, art 6(1)(r)(4)(5)(7).

parent company located in a third country. The foreign branch can either be untaxed on the earnings derived from the interest payments due to the laws of the host country, or it can be a disregarded branch and thus a non-taxable presence. Hence, the deduction sustained by the borrower is not included in the gross income of the lender's foreign branch. An illustration is provided below.

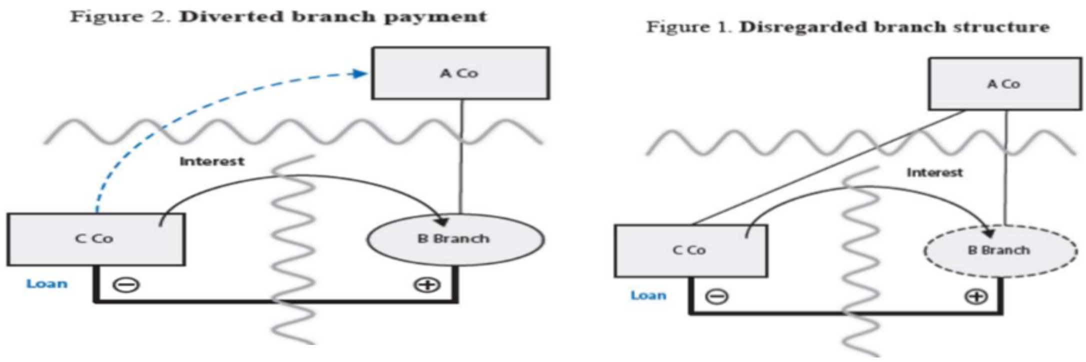


Figure 2.10: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

As shown in the chart above, A co is always the lender and C co the borrower, although the effective recipient of the interest payment is the foreign branch of A co. In the first, scenario, the deduction/no inclusion is due to the laws of country B which does not tax the interest rate earned by B branch. It is possible to assume that the earnings and profit are subject to a mere tax deferral since the source country is actually country A. By contrast, in the second case B branch is disregarded and thus given that it is not a taxable presence in country B there is no inclusion in the gross income of the foreign branch either due to a tax deferral or a foreign branch exemption or a territorial taxation system. While the earnings are not taxed, the costs borne by C co are deductible as interest rates.

Aside from diverted and disregarded branches, another tax planning instruments is the arrangement of exempt branches combined with royalty-like payments. The head office grants the foreign branch the use of patents, licenses and other IP intangible assets in exchange for royalties. The income generated abroad is for the most part absorbed by royalty payments to the head office. However, when the profits derived from the foreign branch are exempt or simply all foreign-sourced income is untaxed, such scheme erodes the foreign taxable base and does not include such income in the tax base of the head office.

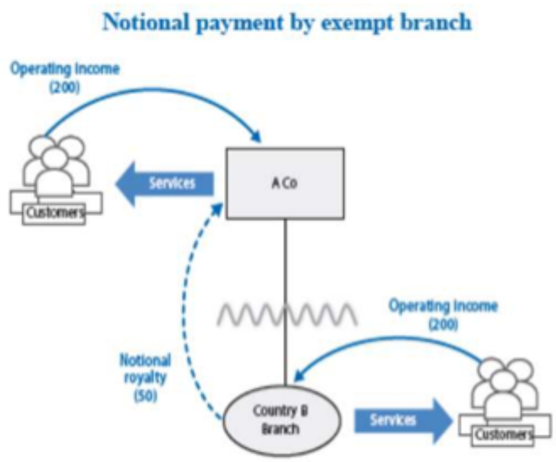


Figure 2.11: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

The chart shows how part of the operating income of the foreign branch is absorbed by the payment of royalties to A co, the head office. However, the income so earned goes untaxed either because of an option branch exemption regime, or the territorial tax system which country A adopted, thus, exempting all foreign source income.

The last case of hybrid mismatch concerns the double deduction obtained through the use of third-party financing combined with a consolidated hybrid entity or foreign branch.[298] The parents company sets up a hybrid entity or a branch in a foreign country which are consolidated with either a second subsidiary founded in the same foreign country. The hybrid or branch takes a loan from a bank and then deducts the interest payment both with the other nationally-consolidated entities which operate in the same foreign country and with the parent company which, according to the laws of the investor's jurisdiction, considers the entity or branch fiscally transparent. Again, a graphic demonstration of the case will be provided.

[298] Legislative Decree No 142/2018, art 6(1)(r)(8).

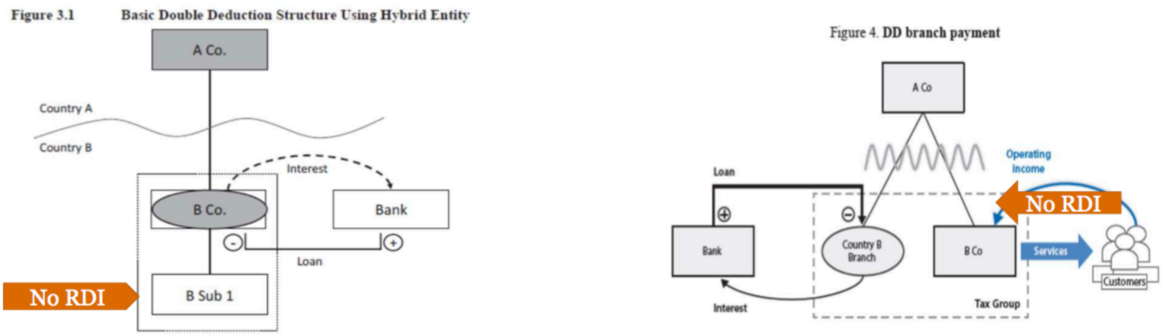


Figure 2.12: Dario Sencar, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti.

A co sets up a hybrid entity or a branch in country B. Both the branch and the hybrid are transparent for the laws of country A, thus, attributing any net operating loss to A co directly. Moreover, the hybrid or branch is consolidated with other controlled entities established in country B thereby allowing to mingle the losses sustained. Once, the entity or branch takes a loan from an unrelated bank, the interest payment deduction is dually claimed against the income of both to A co and B sub 1/B co. The combination of a consolidated hybrid entity or foreign branch with debt financing gives rise to a double deduction mismatch.

The double deduction can also be obtained through an entity which is for tax purposes dually resident and a party of a tax consolidation in two different countries. By doing so, the same deductible expense can be used to offset the income earned by the other consolidated undertakings twice. Article 10 of the ATAD decree prohibits the use of the so called "double dipping" regardless of whether the dual resident is also a resident of another EU/EEA country or not.[299] The deduction is thus denied in the resident taxpayer's country so long as the other foreign country allows the same expense to be deducted against its tax base.

Following the analysis of this complex article 6 of the ATAD decree, it is necessary to give a look at the other statutory provisions which clarify the response to neutralise hybrid mismatch arrangements. Under article 7, Italy can be either: (1) the payor's country, (2) the investor's jurisdiction or (3) the payee's state.[300] When the deductible expense is

[299] Legislative Decree No 142/2018, art 10.
[300] Legislative Decree No 142/2018, art 7.

borne by a resident taxpayer, Italy is the payor's country (e.g. deduction/no inclusion). When the deductible expense is borne by a foreign permanent establishment of a resident taxpayer or by a non-resident taxpayer and yet the expense is deductible by the resident taxpayer, Italy is the investor's jurisdiction (e.g. double deduction). When the resident taxpayer is the beneficiary of a deductible payment borne elsewhere, Italy is the payee's country.

The role played by Italy within the structured arrangement is pivotal to identify the right course of action which the tax administration must follow to neutralise the mismatch. In case of a double deduction, the tax administration shall deny the deduction claimed by the resident taxpayer if Italy is either the payor or investor's jurisdiction.[301] In case of a deduction/no inclusion, the tax administration shall: (1) deny the deduction claimed by the resident taxpayer if Italy is either the payor or investor's jurisdiction, or (2) include the payment in the gross income of the resident taxpayer if Italy is the payee's country.[302] However, the deduction denial shall be withdrawn if the foreign state subjects to tax the stream of income within twelve months from the payment.[303] Finally, if the hybrid mismatch is due to the use of a disregarded permanent establishment (generally, this situation refers to a deduction/no inclusion), the payment shall be subject to tax as if the payee was the resident taxpayer's head office.[304] However, this provision can apply only to the extent that it does not clash with a treaty clause which legitimises the exemption.

All the rules and provisions so far analysed apply to a broad category of taxpayers. Firstly, the new anti-hybrid law hits both entities and individuals.[305] Secondly the entity must be an associated enterprise. The ATAD decree defines an associated enterprise as any entity in which another entity or individuals holds 50% or more by vote, value or profit-share.[306] Apart from this mathematical test, the decree goes on and states that any entity which is subject to control or dominating influence under article 2359 of the civil code (the

[301] Legislative Decree No 142/2018, art 8(1).
[302] Legislative Decree No 142/2018, art 8(2).
[303] Legislative Decree No 142/2018, art 8(2)(c).
[304] Legislative Decree No 142/2018, art 8(4).
[305] Legislative Decree No 142/2018, art 6(1)(h).
[306] Legislative Decree No 142/2018, art 6(1)(u)(1).

explanation of both notions has been given above when dealing with the CFC regime)[307] is also an associated undertaking.[308] Lastly, the decree applies the hybrid rules also to any entity which is part of a tax consolidation with other entities regardless of the decree of control or ownership at stake.[309] The definition is extremely broad and can go beyond the recommendation of the OECD and the EU legislative action. Nevertheless, both supranational institutions wanted to set a bottom line for the anti-avoidance measures to be implemented by the G20 countries. The fact that the ATAD decree has set the bar higher is certainly not in contrast with BEPS Action plan and the EU hopes. However, the definition of associated enterprise is narrowed down to the mathematical test only when reverse hybrid entities come into consideration.[310]

The last provision of the ATAD decree concerning hybrids is about the guarantees in favour of taxpayers when the tax administration has doubts whether hybrid mismatch arrangements have been used to accrue an undue tax saving. The rule is exactly the same laid down for the application of the CFC regime. Before filing a notice of assessment, the tax authorities shall ask for explanations and clarifications to the taxpayer within sixty days.[311] If the tax administration still thinks the taxpayer has avoided taxes, it can file the

---

[307] according to article 2359 of the civil code a company is an affiliate if another entity can exercise a meaningful influence over its operations. There is a rebuttable presumption of affiliation if the other company own 20% of the stock of the affiliate or 10% if the affiliate is a publicly-traded corporation. Vice versa, the definition of control is met just if:

1. The parent company owns 51% of the shares of the controlled company (legal control);
2. The parent company has enough voting rights to exercise a dominating influence over the management of the controlled company (managerial control);
3. The controlling company can exercise a dominating influence given the existence of meaningful and specific obligations arising from a contract which determine, according to the facts and circumstances (factual control).

When the control is established under the numbers 1 and 2, the computation includes all voting rights held directly or indirectly through other entities or trustees.

[308] Legislative Decree No 142/2018, art 6(1)(u)(4)(5).

[309] Legislative Decree No 142/2018, art 6(1)(u)(3).

[310] Legislative Decree No 142/2018, art 9.

[311] Legislative Decree No 142/2018, art 11(1).

notice of assessment within additional sixty days from the reply or the expiry of the first deadline.[312]

The enactment of the anti-hybrid-abuse discipline at national level modernised the Italian tax law framework and guarantees a higher threshold of tax equity. Nevertheless, this dissertation posed the question concerning whether the general anti-abuse rule (GAAR) was not enough in order to fight against this particular phenomenon of tax avoidance, especially in the light of the possible evolutions of both domestic and EU case law. As a matter of fact, both the actual formulation of the GAAR and its predecessor can well adapt to situations where there are no genuine economic interests at stake and the only scope is represented by an undue tax advantage.[313] However, tax law experts were quite critic about the possibility to use the GAAR in order to tackle a phenomenon which had cross-border character and, mostly, was justified by actual economic reasons which, however, were structured to exploit loopholes in national legislations.[314] Moreover, the hybrid phenomenon could not well match the approach of domestic anti-abuse rules which were geared for the "effective beneficiary" of each business transaction.[315]

Despite the space now covered by the new anti-hybrid provision, it is possible to assume that the GAAR would apply to every situation which will not fall into the application of the framework so far explained and yet cause the same effects.[316] With regard to the reinforced notice of assessment procedure, the legislative solution can be explained banking upon two main reasons. Firstly, when dealing with hybrids there is a great necessity of coordination which imposes the possibility to explain the taxpayer's situation in the other country in which it operates. Secondly, the same CJEU stressed the

[312] Legislative Decree No 142/2018, art 11(2).
[313] Law No 212/2000, art 10-bis; former D.P.R. 600/1973, art 27-bis.
[314] Assonime, *Explanatory Note No 21/2016* (August 4, 2016), 21: *"Actually, the domestic definition of tax abuse under the Legislative Decree No 128/2015 does not seem appropriate to neutralise the aggressive tax planning schemes realised through international tax arbitrage, while it appears aimed at contrasting unlawful domestic tax advantages"*.
[315] D.P.R. 600/1973, art 26-quater.
[316] Duilio Luburdi, Luca Nobile, 'Norme sul disallineamento da ibridi: gli aspetti procedimentali' (2019) 1 Il Fisco 58.

importance to guarantee the right of defence and fair trial even in the field of tax law.[317] In the specific case, the CJEU prevented the French government from denying the application of the participation exemption on the dividends distributed to a Luxembourgish parent company as provided for under the Parent-Subsidiary Directive.[318] As a matter of fact, the Luxembourgish company was owned by a Cypriot company in turn controlled by a Swiss holding. The French authorities denied the exemption on the basis that the only purpose to interpose a EU-based shell company was to take advantage of the exemption. The decision stressed that in the absence of an adequate fact-finding procedure the freedom of establishment could not be restricted by domestic anti-abuse provisions. The holding in the Equiom case is also in line with the scepticism of some Italian tax law expert regarding the possibility to use the GAAR for cross-border tax arbitrage schemes.

However, it needs to be pointed out that the EU stance on the issue of hybrids is not always coherent. As a matter of fact, two mismatch cases have been decided with opposite conclusions. On the one hand the CJEU held the Danish anti-abuse provision preventing double dipping compliant with EU law.[319] In the case mentioned, a merger between a Danish company and two Swedish companies produced a negative outcome and was claimed as a deduction in the consolidated tax return. The Danish tax administration denied the deduction since it could have been claimed in Sweden too. The Danish decision was upheld.

On the other hand, the McDonald's state aid case, which concerned a double exemption hybrid, was decided in favour of the multinational enterprise.[320] Following the 2009 corporate reshuffling of the group, the IP rights for Europe, Ukraine and Russia were transferred to a Luxembourgish subsidiary which in turn gave the economic exploitation rights to its US Franchise branch. The US Franchise branch then gave the sub-license to

[317] Charter of the Fundamental Rights of the European Union [2000] OJ C 364/01, artt 47, 48.
[318] Case C-6/16 *Eqiom SAS, ex Holcim France SAS and Enka SA v Ministre des Finances at des Comptes publics* (CFI, 7 September 2017).
[319] C-28/17 *NN A/S v Skatteministeriet* (CFI, 4 July 2018).
[320] Tamara Gasparri, 'Un caso di struttura ibrida "scudata" dalla Convenzione tra Lussemburgo e USA' (2019) 1 Il Fisco 49.

the Swiss Service branch of the same Luxembourgish subsidiary which in turn sub-licensed to all franchisees in each European country. According to US domestic tax laws, the US Franchise branch was a disregarded branch and thus exempt from US taxation since it was not a taxable presence. However, under the Luxembourg-US tax treaty, Luxembourg considered the branch an exempt branch. In brief, all the royalties went completely untaxed. The EU commission concluded that the preferential tax treatment was not selective and specific to one company, since it could well be applicable to any company taking advantage of the treaty. In the end, the Luxembourgish government decided to change its income tax code and put an end to the mismatch.

The two decisions and their strikingly different outcomes signal how dangerous income tax treaties can be to the neutralisation of hybrids. This episodes are probably predicting that the tax planning issues related to hybrid will not be sorted out as easily as the drafters of ATAD I and II thought.

2.5 The Digital Economy and the Digital Services Tax

The last topic of international taxation left to analyse in this chapter concerns the Italian response to the crisis generated by the growth of the digital economy. As the dissertation pointed out at the beginning of the chapter, both ATAD I and II did not take into account the issue of digital services economy. The lack of a supranational response from the EU left single member states to provide themselves with national measures aimed at taxing a portion of the profits which internet-based multinational enterprises make every year. As a matter of fact, the Directive proposal issued by the European Commission did not meet the approval and agreement of the majority of the member states and thus did not achieve the goal of a common approach to digital economy revenues.[321] However, Italy took after the proposal and introduced its own digital services tax, which is based upon the OECD's recommendation to have a withholding tax into force which is specifically designed for online advertisements, data selling and e-commerce.[322] However, given that the digital

[321] European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues from the provision of certain services [2018] EN 0073/18.
[322] OECD, *Action 1 - 2015 Final Report; Addressing the Challenges of the Digital Economy* (OECD Publishing, 2015); OECD, *Public Consultation Document –*

services tax needs an implementing ministerial decree issued by the Ministry of Economy and Finance, which has not been published yet, the tax has remained just ink on paper.[323]

Together with other European countries, namely the UK, France, Spain and Romania, Italy has shown its intention to follow-up the European Commission's proposal.[324] One of the greatest innovation of the tax reform enacted by the 5-Star-League government is the enactment, for the first time in the Italian legal system, of the tax on digital economy. The rapid growth and expansion of internet giants such as Google, Amazon, Facebok and the like has shown developed nations how complicated taxing the profits of such entities can be. The prominent issue related to digital services is that the entire transaction is deemed to take place and, hence, taxed in the host country (where the server is located) instead of the source country (where the buyer resides).

The growing concerns expressed by political parties, media and civil society worldwide have put the aggressive tax planning activities of multinational enterprises, leaders in the digital economy, under the spotlight. As a matter of fact, tech giants have been able to shift their profit to low tax jurisdictions by installing their servers in these countries. The immediate result of such installation is that any transaction, whether domestic or cross-border, is considered to take place in the country where the server is placed. Moreover, despite the presence of multinational subsidiaries in the source country, the current definition of permanent establishment found in international income tax treaties or in domestic tax codes does not accurately reflect how digital economy operates in real world. Generally speaking, the notion of permanent establishment does not cover the use of facilities or fixed places of business maintained solely for the purpose of storage, display, delivery of goods or merchandise, collecting information or carrying on activities of a preparatory or auxiliary character.[325] However, the Finance Act 2019 repealed the former digital services tax introduced a year earlier with the exception of article 1(1010)

Addressing the Tax Challenges of the Digitalisation of the Economy (OCED Publishing, 2019).
[323] Law No 148/2019, art 1(47); Edoardo Frattola, 'La web tax scomparsa' [2019] Osservatorio Conti Pubblici Italiani.
[324] 'Digital services tax Europe' (2019) Grant Thorton.
[325] US Model Income Tax Convention, art 5(4); D.P.R. No 917/1986 (T.U.I.R.), art 162(4).

of Law No 205/2017 which modified article 162 of the income tax code by introducing the concept of "significant and continuous economic presence".[326]

The Italian law maker has enacted the tax on digital services to follow the recommendation of the OECD.[327] The digital tax is levied on resident and non-resident taxpayers who supply services and have an overall revenue equal to or higher than €750 million when a sum of at least €5.5 million is effectively connected income to digital services performed within the Italian territory.[328] The digital tax consists of a withholding tax of 3% on gross revenues and must be paid to the Italian Treasury within the month following each trimester.[329] Among with the introduction of the new tax on digital services, the Italian Parliament has repealed the former tax on digital transactions which should have come into force from January 1, 2019.[330] The new digital tax applies to all resident and non-resident persons carrying on a business or trade, regardless of the legal form used, depending on whether the overall yearly revenues exceed the threshold established by law.[331] Thus, the tax incises on sole proprietorships, unlimited business entities and limited business associations.[332]

The digital services which fall into the field of application of the new tax are strictly defined under the Finance Act 2019. The following services are subject to the newly introduced tax regime:

1. the diffusion of advertisements by means of digital interface to users of such platform (online advertising);
2. the provision of any digital interface allowing its users to interact and keep the lines of communication also in order to facilitate the direct supply of goods and services to such users (e-commerce);

---

[326] Law No 145/2018, art 1(49); Law No 205/2017, art 1(1010); T.U.I.R., art 162(2)(f-bis).
[327] Law No 145/2018, art 1 (35).
[328] Law No 145/2018, art 1 (35-50).
[329] Ibid.
[330] Ibid.
[331] Law No 145/2018, art 1 (36).
[332] Ibid.

3. the transmission of data and information gathered from users and generated by the use of the digital interface (data selling).

Despite the subjective inclusion laid down in paragraph thirty-six, the Finance Act 2019 establishes that the tax on digital services does not apply for services performed in favour of persons which, pursuant to the definition included in article 2359 of the civil code,[333] are subject to common control or exercise any form of control over related entities.[334] The purpose of such provision is limiting the application of the newly enacted tax to consumers (B2C transactions) and unrelated businesses (B2B transactions).[335] The absence of such specification would have had a negative impact on intragroup transactions and rendered the structuring of investments more difficult and costly.

The tax on digital services is computed based on gross receipts.[336] This means that the costs borne by any enterprise for rendering services cannot be deducted when applying the 3% tax rate to the taxable base (as such, the 3% is calculated on the sum of profits and costs, namely on revenues).[337] However, the tax shall be levied net of any VAT amount or any other indirect tax applicable to the transaction concluded.[338] Roughly speaking, the digital tax is merely passed on to the consumer which will be the effective payor of the tax in economic terms.

The tax year of the tax on digital service coincides with the solar year.[339] Moreover, the profits made are deemed taxable in a certain tax year so long as the beneficiary of the taxable service is located within the Italian territory during the tax year.[340] A beneficiary of a taxable service is considered to be located within the Italian territory during the tax year if one of the following localisation criteria is met:

---

[333] Italian Civil Code, art 2359.
[334] Law No 145/2018, art 1(38).
[335] Antonio Tomassini, Andrea Di Dio, 'Web tax sui servizi digitali: soluzione transitoria in attesa delle decisioni dell'OCSE' (2019) 4 Il Fisco 344.
[336] Law No 145/2018, art 1(39).
[337] Ibid.
[338] Ibid.
[339] Law No 145/2018, art 1(40).
[340] Ibid.

1. in the case of services diffusing targeted advertising on digital interfaces, such advertisement appears on the user's device when the device is used within the Italian territory during the tax year taken into account;
2. in the case of services providing multilateral digital interfaces which allow its users to interact and keep the lines of communication also in order to facilitate the direct supply of goods and services to such users, if such service either:
    a) allows a customer who is using the device within the Italian territory during the tax year considered to conclude a transaction by means of the digital interface during the covered period within the Italian territory;
    b) consists of a different type of digital interface from the one mentioned above and the user can access a checking account linked to the interface for the entire tax year considered, or for most of it, and the checking account was opened by means of a device used within the Italian territory.
3. In the case of services for transmission of data and information gathered from users and generated by the use of the digital interface, when such data and information have been generated by using a device within the Italian territory during the covered period or any prior tax year and have been transmitted during the covered period.

The following paragraph of the Tax Act clarifies the computational method to be used when calculating the right amount due to the Treasury.[341] The reform sets the amount of the tax rate at 3% and specifies that the amount is obtaining by applying the tax rate to the taxable revenues generated during each trimester of the tax year.[342]

The Finance Act 2019 goes further in showing the administrative obligations each person subject to the tax payment must comply with.[343] Once the taxpayer has rightly computed the amount to be paid, the actual payment shall be made within the month following each trimester of the tax year considered.[344] However, the tax return is still to be filed annually, although it will include the amount of taxable services which have been performed during

[341] Law No 145/2018, art 1(41).
[342] Ibid.
[343] Law No 145/2018, art 1(42).
[344] Ibid.

the last four months from the end of the tax year considered.[345] Also, the Tax Act delegates the government to enact by decree an optional regime by which corporate conglomerates can elect to nominate one corporation to take on the burden to assess, liquidate and pay the tax on digital services owed to the Treasury by all the other corporate entities belonging to the same group.[346]

The new tax on digital services applies also to persons who are non-resident in the country for tax purposes and do not have either a permanent establishment in Italy or a VAT registration number, if they meet the requirements for the application of the digital tax.[347] If this is the case, the taxpayer shall ask the Revenues and Collection Agency for an identification number to be issued solely for the purposes of such tax.[348] The application for the ID number shall be made in accordance with the means established by administrative act as adopted by the Director General of the Revenues and Collection Agency.[349] When non-resident taxpayers belong to the same corporate conglomerate of resident taxpayers, for the purposes of the digital tax, both resident and non-resident taxpayers are jointly and severally liable for the payment deriving from the enactment of the new tax.[350] This provision is compliant with the OECD recommendation in respect of digital B2C transactions given that the customer's self-assessment of indirect taxes is not deemed as reliable as having the non-resident suppliers comply with the necessary filings.[351]

The legal regime related to tax assessment and collection of taxes due with regard to the digital tax shall follow the same rules set forth under the VAT provisions, so long as these

---

345 Ibid.
346 Law No 145/2018, art 1(45).
347 Law No 145/2018, art 1(43).
348 Ibid.
349 Ibid.
350 Ibid.
351 OECD, *Action 1 - 2015 Final Report; Addressing the Challenges of the Digital Economy* (OECD Publishing, 2015); OECD, *Public Consultation Document – Addressing the Tax Challenges of the Digitalisation of the Economy* (OCED Publishing, 2019), para 317: *"The OECD's E-commerce Guidelines (OECD, 2003) therefore recommend a mechanism that requires the non-resident supplier to register, collect and remit VAT according to the rules of the jurisdiction in which the consumer is resident"*.

rules are compatible.[352] Therefore, it is reasonable to interpret the provision so that in B2B transactions the digital services tax (like the VAT/GST) is not charged by the non-resident digital supplier, but is paid directly by the resident importer which shall self-bills the purchase and pays the web tax by withholding 3% of the payment.[353] By contrast, with regard to B2C transactions, non-resident digital suppliers shall, under art 1(43) of Law No 148/2015, ask for a VAT number to the tax administration and pay the digital services tax themselves. The chart below will provide a better understanding of the process.

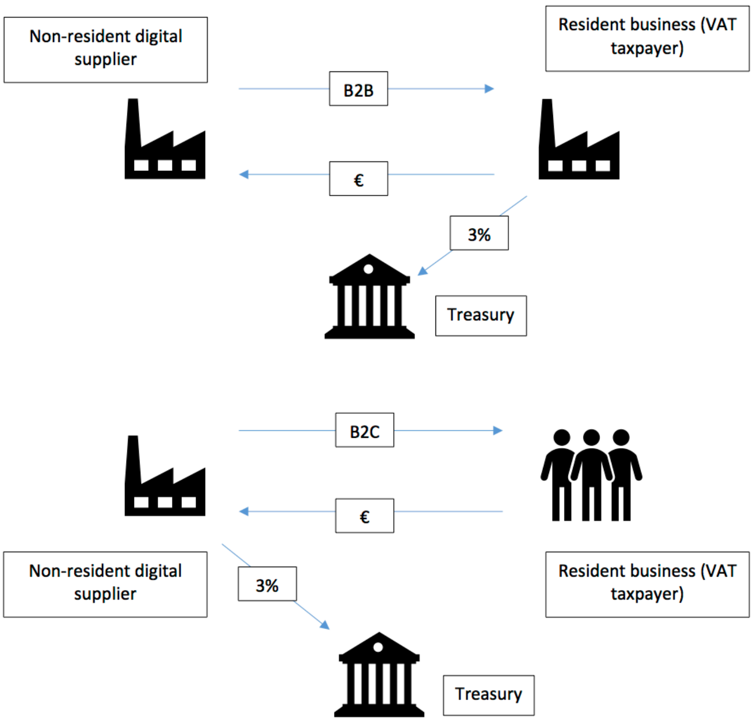


Figure 2.13: This chart was designed by the author of the dissertation.

With regard to the effective application of the tax on digital services, its entrance into force shall take place sixty days following the publication on the Official Journal of the implementing decree issued by the Ministry of Economy and Finance.[354] So far, no implementing decree has been already issued by the Ministry and the new digital service tax remained just a written piece of paper with no effective application more than two

352 Law No 145/2018, art 1(46).
353 D.P.R. No 633/1973, art 17(2).
354 Law No 145/2018, art 1(47).

months after the initial deadline set under the Finance Act 2019.[355] Without the implementation of this newly introduced tax, the Italian government will lose €150 million tax revenues in 2019 and €600 million the following year.[356]

The Finance Act 2019 contains the so called “financial invariance clause”.[357] The enactment of the tax on digital services shall not place any new or additional financial burden on the Italian Treasury.[358] As a consequence, the agencies in charge of the application and enforcement of the new tax shall comply with their duties by virtue of the current human resources, capital equipment and budgetary means.[359]

According to paragraph forty-nine of the tax reform, the Minister of Economy and Finance shall submit to the House of Deputies and to the Senate an annual report concerning the state of implementation, the outcome and the economic results deriving from the provisions enacted under the Act.[360] In the update to the Economic and Financial Document (in Italian “nota di aggiornamento al Documento di Economia e Finannza (DEF)”), the Department of Finance of the Ministry of Economy and Finance shall submit a report regarding the implementation of the newly introduced tax for the purposes of updating the financial effect brought about.[361]

Paragraph fifty of the Finance Act 2019 repeals paragraphs from 1011 to 1019 of the Finance Act 2018 which discipline the “tax on digital transactions and related services supply by electronic means” which should have entered into force on January 1, 2019, but never did.[362] The former digital tax had the same 3% tax rate imposed upon the single transaction net of VAT.[363] However, it was applied only to persons concluding at least three thousand transactions during the tax year.[364] Any service supply in favour of a

---

355 ‘Web tax non parte: rischio mini-buco per le casse dello stato da 150 milioni nel 2019’ [2019] Teleborsa.
356 Ibid.
357 Law No 145/2018, art 1(48).
358 Ibid.
359 Ibid.
360 Law No 145/2018, art 1(49).
361 Ibid.
362 Law No 145/2018, art 1(50).
363 Law No 205/2017, art 1(1011-1019).
364 Ibid.

contractor was excluded from computation if the contractor had elected to be taxed according to the flat tax rate for small VAT taxpayers.[365] The tax was levied, at the time of payment, by the contractor who had legal recourse against the supplier to ensure the collection of the tax.[366] The existence of a business-to-business transaction ("B2B") related to the supply of services by means of electronic devices was a mandatory requirement for the application of the previous digital tax.[367] Therefore, all the transactions concerning goods and those pertaining to services to customers ("B2C") were excluded from the Finance Act 2018 application.[368] By contrast, the new digital services tax, as already mentioned, applies to both business-to-business and business-to-customers.

The former digital tax was applicable to all undertakings, both sole proprietorships and business associations, which were carrying on a trade or business by supplying digital services. However, all undertakings electing to be taxed according to a lower flat tax rate for small VAT taxpayers, or subject to the preferential treatment for young entrepreneurs and workers benefiting from unemployment insurance were excluded from the digital tax application.[369]

The objective field of application of the previous tax on digital services was to be determined by virtue of a ministerial decree which should have set forth the implementing regulatory framework, including tax return filing requirements, tax payment and eventual exemptions.[370] The former government never enacted such decree and during the question time number 5-01007 held in the Finance Committee meeting on November 28, 2018 it referred that such decree was still under scrutiny due to the regulatory developments taking place at European level. As a matter of fact, the Council of the European Union was discussing the proposal of an EU Directive concerning a tax on profits deriving from the supply of certain digital services.

365 Ibid.
366 Ibid.
367 Ibid.
368 Ibid.
369 Ibid.
370 Ibid.

After having described the functioning of the so called "web tax" in Italy it is necessary to highlight some problematic profiles of the reform and stress what the legal solutions can be. Given that the digital services tax is levied on revenues, this might trigger the issue of double taxation if the taxpayer is also a resident of the country and thus subject to income taxes. However, a logical interpretation of the Finance Act 2019 and the income tax code leads to consider the withholding taxes paid on digital services deductible from the corporate income since, under article 99 of the income tax code, whenever an indirect tax is not creditable (like the VAT which, in the majority of cases, is passed on to consumers and credited against the VAT already paid on the purchase) such expense shall be deducted from the tax base.[371] By contrast, in the absence of an explicit law provision in the Finance Act 2019, the digital services tax should not be creditable against corporate income taxes due. This mechanism seems in line with the law-maker's will to design the new web tax as an indirect tax on gross returns.

Lastly, the web tax seems to be compatible with both international income tax treaties and EU law. Firstly, bearing an indirect nature, the digital service tax is not included in the scope of double taxation treaties ratified by Italy. As such, there can be no interference between the international obligations arising from these international agreements and domestic law. With regard to EU law, the web tax is compatible with the VAT Directive since, as pointed out by the European Commission, it does not bear all the hallmarks of the VAT.[372] The VAT is the only allowed "turnover tax" within the single market and has four main characteristics which should be all present to raise issues of compatibility with EU law: (1) it applies to any transaction related to goods and services, (2) it is proportional to the price charged by the supplier, (3) it is charged at each stage of the production and distribution process and (4) the amounts paid during all the previous stages are credited against the tax due to the member state resulting in an actual tax proportional to the added value at each stage and economically borne just by the final consumer.[373]

[371] T.U.I.R., art 99.
[372] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1.
[373] Gabriele Colombaioni, 'Italy Unilaterally Implements the European Commission's Digital Services Tax Proposal' [2019] Rivista di Diritto Tributario Pacini Giuridica.

The analysis of the digital services tax is inevitably linked with a topic of international taxation which was firstly dealt with as early as 1923. The Report on Double Taxation issued by the League of Nations highlighted the problems concerning the interaction between taxation based upon residence and source taxation.[374] Whenever a multinational enterprise makes a cross border transaction, it triggers tax consequences in two different countries: (1) the country where the income is produced, (2) the country where the income is repatriated. Generally speaking, it is possible to draw a distinction between active and passive income derived from one jurisdiction and directed to another.[375] Given that active income is taxed on a net basis (thus, allowing deductions against the taxable base before applying the national tax rate) the tax effectively applied by the source country is generally high. By contrast, when passive income is generated the tax applied is lower since it is applied against the gross income produced thereby not giving any consideration to deductions and other expenses. However, the situation is turned upside down in the residence jurisdiction. The resident taxpayer which invested outbound is taxed lightly when it repatriates active income generated abroad and is taxed more heavily upon passive income derived from interests, rents, royalties and capital gains. The chart below will summarise the structure explained so far.

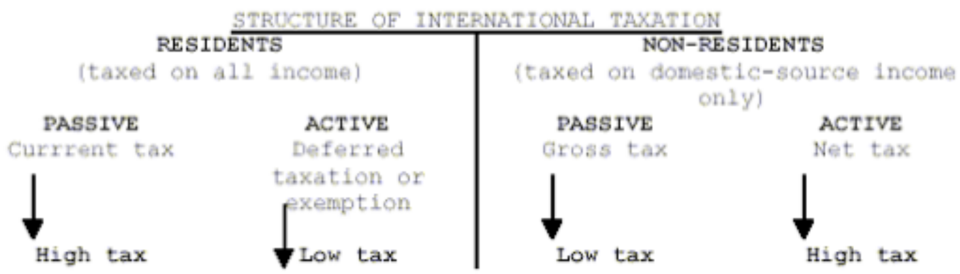


Figure 2.14: Pierpaolo Rossi Maccanico, 'Giustificazione del sistema internazionale di tassazione dei redditi' (2002) 40 Il Fisco 6389.

This trend is confirmed also by the OECD Model Treaty against double taxation which subjects passive income to low or no tax in the source country and exempts active income

[374] Financial Committee, *Report on Double Taxation* (Economic and Financial Commission of the League of Nations Publishing, 1923).
[375] Pierpaolo Rossi Maccanico, 'Giustificazione del sistema internazionale di tassazione dei redditi' (2002) 40 Il Fisco 6389.

generated through a permanent establishment from taxation in the residence country.[376] The core purpose of such treaty provisions is to encourage international trade and cross-border investments. The OECD Model Convention strikes a balance between the instances of the host country, which desires to raise revenues for the exploitation of its market and natural resources, and the investors' jurisdiction which needs to tax profits arising from outbound transactions to ensure capital export neutrality.

The concept of capital export neutrality is pivotal in developed jurisdictions tax systems. As a matter of fact, without the worldwide taxation principle there would be two negative consequences for industrialised nations. Firstly, resident taxpayers would be discriminated according to the source of their income despite earning the same amount of money. For instance, if a taxpayer derived most of its income from abroad, the absence of residence-based taxation could result in a lower tax rate if the source country is a low tax jurisdiction. Conversely, the other resident taxpayer which earned all its income from nationally-located activities would pay a higher tax bill. The consequence would be a blatant breach of the "ability-to-pay taxation principle" (which is constitutionally set under article 53 of the Italian Constitution)[377] which would, in turn, result in the disregard of tax equity. Secondly, the residence jurisdiction is better able to ascertain the ability-to-pay of each taxpayers. Given that all the worldwide derived income are mingled and then taxed, the residence country is in the position of evaluating whether a foreign loss in a certain country should offset foreign income produced in another. By contrast, the source country can merely have access to tax information limited to the business or portfolio activities carried out within its boundaries.

The dispute between residence and source taxation needs to be limited to the really problematic issues to be dealt with. Practically speaking, not all taxpayers are involved by the conflict of sovereign rights to tax the same flow of income. Individual taxpayers

[376] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, artt 7(1), 10-13; business profits are subject to tax exclusively in the jurisdiction where the trade or business activities are carried on, while dividends, interests, royalties and capital gains benefit from preferential tax rates.
[377] Italian Constitution, art 53; this article establishes that the Italian taxes are levied according to a progressive system and taking into due consideration the ability-to-pay of each taxpayer. As such, two taxpayers earning roughly the same amount of income shall not be treated differently solely upon the source where such income is derived from.

generally carry on their activities in the same country of their residence and as such have no double taxation issues (also, frontier workers are simply taxed according to the place of performance rule and, thus, eventual problems could arise only between neighbouring countries with no tax treaty).[378] Also, domestic undertakings are again not involved in the issue between residence and source taxation since the place of their activities and their effective residence coincide. In brief, only multinational enterprises are heavily affected by eventual changes in the international tax system which sees a predominance of residence taxation over source taxation or vice versa.

Despite the reflection upon the ability-to-pay and tax equity principles, which prompt for the repeal of source taxation, the international tax scenario shows a very different reality. The reason for source taxation to be still in force is basically twofold. On the one hand, the residence of multinational corporations (especially publicly traded ones) can be subject to manipulation and occur to be in tax-havens or low or no tax jurisdictions which would thereby exempt their worldwide profits. On the other hand, residence taxation would help industrialised economies to develop even further, while developing nations would still lag behind without possibly benefiting from the presence of multinationals within their country. From a global welfare perspective, source taxation helps with the distribution of wealth from economically advanced jurisdictions to developing ones.

The topic becomes even more complex when only digital multinationals are taken into considerations. The global economy turned from a one-dimension system to a two-dimension reality during the twentieth century. However, the birth of the internet added a third dimension which is immaterial and somewhat extraneous to taxation.[379] When both investments and activities were located in one country only, taxes were levied exclusively within that jurisdiction and no problems of double taxation were at stake. Once international trade and commerce became predominant, investors' and host jurisdiction had to come to terms and establish a common toolbox to distribute sovereign rights to tax. The OECD Model Convention and its bifurcation between active income

[378] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 15.
[379] Carlo Garbarino, 'Nuove dimensione della transnazionalità dell'imposizione' (2002) 3 Rassegna Tributaria 864.

derived from a permanent establishment and passive income proposed an ideal solution which worked up until internet was born. As explained in the first chapter, web giants can operate remotely through the mere use of an Internet Service Provider (ISP) in the market jurisdiction. The definition of permanent establishment under article 5 of the OECD Model Convention does not entail ISPs which simply allow for the advertisement of certain products or services.[380]

The use of digital technology created the phenomenon of "disappearing taxpayers", those taxpayers which had no residence in either the host or investors' jurisdictions.[381] The host country taxes were avoided by arranging transactions without an effective taxable presence in the market jurisdiction. By contrast, the residence country taxes were considerably reduced by inter-country transactions with other affiliates located in low or no tax jurisdictions. The result was an action against aggressive tax planning arrangements put in place by internet-based multinational enterprises. However, while the US (a technology exporter) prefers residence taxation, the EU (a technology importer) is now moving towards a source taxation system. It is somewhat ironic that an entire continent which for years prompted a residence taxation system is now aligning its stance with developing countries. It should not shock the reader that all European countries are lagging behind in term of digital development and could be defined "internet developing countries". All the web giants are headquartered in the US and the EU's attempt to introduce a single-market digital services tax is a clear example of a desperate effort to fill the competitive gap between the two sides of the Atlantic Ocean. Nevertheless, it must be mentioned that the EU countries' enactment of the web tax targets both resident and non-resident taxpayers. The aim of such tax was creating a taxable base for those companies which do not have a permanent establishment within the market jurisdiction. The extension of such tax to resident taxpayer is against the inspiring principles lying behind its enactment. As a matter of fact, resident taxpayers engaged in the digital business already pay their fair share of taxes. Non-resident digital businesses are at a competitive advantage against resident ones since they can reduce their tax bill by

[380] OECD Articles of the Model Convention with respect to Taxes on Income and Capital, art 5.
[381] Carlo Garbarino, 'Nuove dimensione della transnazionalità dell'imposizione' (2002) 3 Rassegna Tributaria 864.

arranging remote selling strategies. The digital services tax should fill this gap, but the fact that it shall be levied on resident digital taxpayers contradicts its main purpose. Additionally, putting on EU digital businesses another economic burden will certainly not help with the development of digitalised economy within the single market. It is therefore, advisable that the Italian government would structure this tax differently. On the one hand, the targeting of non-resident or non-EU/EEA businesses only should be framed in a manner compliant with international trade law obligations. On the other hand, resident undertakings should be exempted from this additional economic expense since they are already subject to income taxes and VAT.

From a legal point of view, the dispute between the two systems is simply the economic reflection of the extent of development of a country either overall or in a certain industry.[382] The digital service tax enacted by Italy and other European countries imposes a withholding tax on revenues produced by internet based multinationals with a "significant economic presence" within that jurisdiction. The term significant economic presence is merely the tax law translation of the so-called third dimension of current global economy. Although a company has no permanent establishment, the source country can still apply a low tax on revenues to share the profits generated by virtue of its national market. The other option left to the investor is setting up a permanent establishment which would immediately trigger ordinary taxation on a net basis. This second alternative would again reduce the tax complexity by eliminating the third dimension (remote selling) and simply call for the straightforward application of tax treaties already in force designed for two dimensions only. Nevertheless, setting up a permanent establishment such as a subsidiary (not a branch since the revenue test would, in this case, be certainly met) would not avoid the application of the digital services tax with regard to unrelated parties if the "significant economic presence" test is met.

The approach adopted by the US is completely different. As it will be explained more in details in the following chapter, the new GILTI inclusion is a tax imposed upon controlled foreign corporations which are directly or indirectly owned by a resident taxpayer within the US. As such, the US is adopting a residence-based taxation system by expanding the

[382] Carlo Garbarino, 'La tassazione del reddito transazionale: nozione e principi generali' (2002) 14 Correire Tributario 1275.

reach of its sovereign rights to tax. The selected target is any controlled foreign company which does not distribute its retained (deemed intangible) earnings and profits parked in low or no tax jurisdictions. Surprisingly enough, the web tax debate is simply a new generation debate upon residence ad source taxation and the related instances made by (web) developed and (web) developing countries.

THE TAX CUTS AND JOBS ACT AND THE US APPRAOCH TO THE BEPS ACTION PLAN

3.1 An Overview of the US Efforts to Deal with Harmful Tax Practices

President Donald J. Trump signed into law the Tax Cuts and Jobs Act, Public Law 115-97, on December 22, 2017. The tax reform changes dramatically the federal tax system both at domestic and international level.[383] The legislative history of the Act goes back to October 2017 when the House and the Senate agreed to a budget resolution for the federal year 2018.[384] Both the House Committee on the Ways and Means and the Senate Committee on Finance were instructed to draft legislation within their law-making powers which would increase the budget by no more than $1.5 trillion over a ten-year period.

The agreement triggered the budget reconciliation procedure which is an expedited law-making process. The reconciliation process was created in 1974 and designed to allow for a speedy consideration of certain tax, spending and budgetary bills.[385] Following an initial budget resolution, both chambers of Congress lay down the instructions to be followed by the appointed committees to take charge of the process. The two committees are given wide discretion to draft legislation within the framework set by the joint resolution. However, if further changes are proposed, the conciliation procedure becomes of extreme importance. As a matter of fact, generally speaking, the Senate rules grant the possibility of unlimited debate and other obstacles when discussing issues concerning the amendments of a certain bill.

The reconciliation procedure limits the debate in the Senate to a maximum cap of twenty hours, thus, preventing filibusters to halt the passage of the budgetary piece of legislation. The time limitation does not mean that further amendments cannot be proposed. Nevertheless, these are considered without any possibility for an extended debate on each

---

[383] Molly F Sherlock, Donald J Marples, 'The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law' [2018] Congressional Research Service.
[384] House Concurrent Resolution No 71 (115th Congress).
[385] Congressional Budget Act 1974, 2 USC §§ 305-1027.

one. This process is also known as “vote-a-rama”.[386] The additional advantage of the expedited procedure is that the bill, apart from being dealt with quickly, can be passed with only a simple majority.

The conciliation procedure has also its own limitations. Firstly, it can be used only up to three times per year on budget resolutions. Secondly, the main restriction is the so called Byrd rule, named after Senator Robert Byrd, which allows opposing senators to block the insertion of provisions in the bill which are unrelated to budgetary changes to current legislation. In short, the majority is prevented from taking advantage of the expedited procedure for including a vast array of extraneous provisions which should, instead, be subject to parliamentary debate. Once all these hurdles have been overcome, the final package is submitted to both chambers of the Congress and, in case of positive outcome, the bill is then sent to the President for being signed into law.

The 2017 tax reform was estimated to decrease the federal budget revenues by $1,456 billion between 2018 and 2027, which is the ten-year window allotted by the joint resolution referred to above. The largest part of revenues decrease is due to levying less taxes on individuals ($ 1,126.6 billion), while the business tax reform accounts for a third of the total federal revenues decrease ($ 653.8 billion). Interestingly enough, it is the international tax reform which raises the federal tax revenues by $324.4 billion over ten years. As already mentioned in the earlier chapters, this dissertation is focusing exclusively on the international tax provisions which were triggered by the OECD’s recommendation and, thus, in the following paragraphs a better legal understanding of the new tax burden imposed by the US on multinational enterprises and cross-border transactions will be provided. The chart below summarises the information given so far and shows how the initial decrease in revenues diminishes over the ten year window. The tax proceeds increase over the same period has the same downward trend and this can be easily explained by the enactment of the new section 965 which provides for a mandatory

[386] Jake Lestok, ‘How the Congressional Reconciliation Process Works’ [2017] The NCLS Blog.

repatriation of all foreign cash and non-cash assets which form part of the post 1986-retained earnings and profits of controlled foreign corporations.[387]

Table 1. Estimated Budget Effects of the Conference Agreement for H.R. 1

Billions of Dollars

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-2027
Individual	-75.3	-188.8	-171.9	-156.3	-150.8	-144.0	-140.9	-139.2	-41.4	83.0	-1,126.6
Business	-129.3	-133.8	-112.9	-92.5	-50.4	-16.4	-15.9	-24.1	-28.4	-49.4	-653.8
International	68.9	42.6	26.0	28.0	22.9	22.5	36.7	48.7	29.1	-0.8	324.4
Total	-135.7	-280.0	-258.8	-220.8	-178.3	-137.9	-120.1	-114.6	-40.6	32.9	-1,456.0

Figure 3.1: Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. 1* (December 18, 2017).

Aside from the more strictly economic considerations which marked the political propaganda of the Trump's tax reform, the Tax Cuts and Jobs Act is clearly a response to the OCED BEPS Action plan.[388] Subtitle D of the tax Act deals exclusively with international tax provision and is split in two parts: (1) outbound transactions (concerning US taxpayers investing overseas) and (2) inbound transactions (regarding foreign taxpayers ploughing their financial means in the US economy). More specifically, the reform deals with hybrid mismatch arrangements, anti-deferral regimes for CFC income, limitation on interest deductibility, a reduced tax on domestic intangible income and the introduction of the BEAT.

The similarities between the OECD package and the US tax reform are striking. New section 267A aims at the neutralization of hybrid mismatches according to the recommendation set forth by the BEPS Action 2.[389] It also allows the IRS to draft implementing regulations to identify further situations in which the tax benefits accrued by the taxpayer should be deemed abusive. The Revenue Act of 1962 introduced for the first time in the US and worldwide the CFC taxation regime, which is known under the

[387] Internal Revenue Code 1986, 26 USC § 965.

[388] Jessica Silbering-Meyer, 'Tax Cuts and Jobs Act: A Response to BEPS' (2018) 29 Journal of International Taxation 40.

[389] Internal Revenue Code 1986, 26 USC § 267A; OECD, *Action 2 – 2015 Final Report; Neutralising the Effects of Hybrid Mismatch Arrangements* (OECD Publishing 2015).

name of "subpart F income" in the US due to its collocation in the Internal Revenue Code.[390] The anti-deferral regime was revised following the OECD's recommendation and the US expanded the CFC regime not only to passive income, but also to low-taxed intangible income earned abroad by virtue of the newly enacted GILTI provisions.[391] The new tax is certainly derived from the BEPS Action 1 proposal to extend the application of existing CFC regimes to the digitalized economy in order to claw back into tax all profits derived from the use of intangibles abroad which receive a preferential tax regime (the other two proposed methods, analyzed in the first chapter, were: (1) a broad application of the profit split method, (2) the enactment of a withholding tax on e-advertisement, e-commerce and data selling).[392] The Tax Cuts and Jobs Act also takes after the BEPS Action 3 on interest deduction limitation in revising existing section 163(j) and introducing the new Base Erosion Anti-Abuse Tax (BEAT).[393] While new section 163(j) adopts the recommended fixed ratio rule on interest payment deductions, the BEAT designs a complex alternative minimum tax on a modified taxable base which disregards any related party base eroding payment.[394]

The 2017 tax reform also introduces the foreign derived intangible income deduction which resembles some patent box regimes enacted in other countries (Italy included), but differs in that it allows a deduction which extends to income derived from export.[395] It is necessary to wait for the World Trade Organisation, if ever invested with a related dispute, to decide on the compatibility of such preferential tax treatment with the international trade law framework.

The Tax Cuts and Jobs Act, as it will be shown further, will have a tremendous impact on future tax planning of US corporations and their corporate strategies, especially in the mergers and acquisitions context. The effects on the newly-enacted provisions will tend to avoid the application of the GILTI inclusions and, contrary to what used to happen

[390] Revenue Act 1962, 26 USC 1.
[391] Internal Revenue Code 1986, 26 USC § 951A.
[392] OECD, *BEPS Action 1 – 2015 Final Report: Addressing the Tax Challenges of the digital economy* (OECD Publishing, 2015).
[393] OECD, *BEPS Action 4 – 2015 Final Report: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD Publishing, 2015).
[394] Internal Revenue Code 1986, 26 USC §§ 163(j), 59A.
[395] Internal Revenue Code 1986, 26 USC § 250.

before 2018, trigger the subpart F inclusion in order to claim a full foreign tax credit and preserve the possibility of unlimited carryforward of exceeding amounts of foreign tax credits.

It is interesting to point the that the International Monetary Fund (IMF) has published an evaluation paper of the Tax Cuts and Jobs Act which considers positively the efforts of the US government to modernize its tax system.[396] More specifically, among the other several changes, the US moved from a worldwide taxation system to a quasi-territorial system which has restored the US capacity to compete with other industrialised countries and has brought US firms on equal tax terms with their foreign counterparts. The term "quasi-territorial" means that the dividends repatriated from specified 10%-owned foreign subsidiaries are exempted from US tax so long as the company is not a controlled foreign corporation or a passive foreign investment company (PFIC) and thus subject to the anti-deferral regimes which will be looked at further on.[397] The exemption applies only to corporations and not to individual shareholders which are simply entitled to a tax deferral unless the anti-deferral rules apply to them too.[398] The exclusion of individual taxpayers from the foreign dividends deduction under new section 245A does not allow to define the US tax system as "fully-territorial".

The shift from the former worldwide taxation system is accompanied by a transition tax which mandatorily applies to all foreign cash and non-cash assets which have been deferred since 1986 and are still parked overseas.[399] The transition tax was not expected to create any disruptive effects on the foreign currency market since it applies whether the assets are effectively repatriated or not. Basically, this tax provision aims at starting over with a clean slate and abandons the ineffective deferral policy which showed to be clearly unsuccessful.

The IMF also pays attention to the new intangible-derived income taxation. As a matter of fact, the combination of GILTI on foreign profits and FDII at domestic level renders

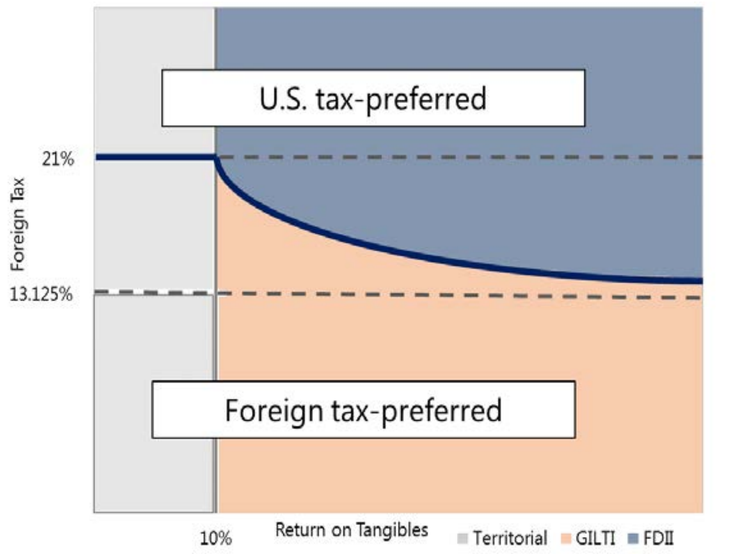
[396] Nigel Chalk, Michael Keen and Victoria Perry, *IMF Working Paper: The Tax Cust and Jobs Act: An Appraisal* (IMF Publishing, 2018).
[397] Internal Revenue Code 1986, 26 USC § 245A.
[398] Internal Revenue Code 1986, 26 USC § 245A(a).
[399] Internal Revenue Code 1986, 26 USC § 965.

the taxation of US firms' income which exceeds the ten percent return on tangible assets equal (both rates are 13.125% up until 2025 and 16.406% following December 31, 2025).[400] In other words, GILTI is a minimum tax on profits of controlled foreign corporations' deemed intangible income whose objective is to neutralise the tax benefits accrued by setting up foreign entities in low-tax jurisdictions. By contrast, the FDII deduction aims at lowering the tax burden on domestic corporations which have deemed-intangible income derived from the sale of goods or services abroad and for foreign use. Thus, for a US investor the choice between locating its production activities in the US or abroad becomes irrelevant. The IMF itself expressed some concerns with the compatibility of the FDII provisions with the prohibition on export subsidies established under the WTO umbrella. Also, the FDII may be in breach of the G20 OECD BEPS Action Plan which aims at countering all measures offering preferential tax treatment on business activities not tied to the country concerned (thus, export since it is directed to foreign markets).

In order to fully understand the interplay between GILTI and FDII and the effects on other jurisdictions, it is useful to pay attention to different fact patterns. If a company has a return on its tangible assets which is below 10% or is slightly above such threshold, both GILTI and FDII considerations become immaterial and the investor will prefer a jurisdiction simply according to its effective tax rate. In simpler terms, if a foreign country offers a tax rate lower than 21%, it will probably attract US investors. The scenario gets more complex if a company has a return on tangible assets which consistently exceeds the 10% threshold. In this case, the tax differences on the 10% return becomes immaterial and what matters are the tax consequences on the deemed intangible tax return. Given that the investor will always be taxed at 13.125% on its deemed-intangible income whether it locates its activities in the US or abroad, it is likely that the former jurisdiction will be preferred. This is also due to a strictly legal reason, namely the fact that a GILTI excess foreign tax credit does not allow any carry-forward or carry-back mechanism thus resulting in a foreign loss. The boundary between locating at home or overseas is shown in the chart below.

[400] Internal Revenue Code 1986, 26 USC § 250, 951A.

Figure 5. Tax-Efficient Investment Location Given Territoriality, GILTI and FDII



Note: The bold line shows combinations of the foreign tax rate (T_F) and pre-tax return on tangibles (r) at which the after-tax reruns from investing in the U.S. and abroad are equal, given a domestic tax rate of 21 percent in the latter. For $r > 0.1$ tis is defined by

$$rT_F + \max\{(r - 0.1), 0\} = (0.21)[r - 0.375(r - 0.1)],$$

the term on the left being tax payable under GILTI< that on the right being tax payable under FDII.

Figure 3.2: Nigel Chalk, Michael Keen and Victoria Perry, *IMF Working Paper: The Tax Cust and Jobs Act: An Appraisal* (IMF Publishing, 2018), 27.

The considerations which tax planners should take care of are many and must be consistent with the extent of tangible investments which the management of the company is planning. High investment in tangible property apart from allowing amortisation and depreciation which reduces the tax base, increases the 10% return on qualified business assets and thus renders investing aboard more cost-efficient. Vice versa, low levels of tangible investments and a preference for research and developments guarantees a better treatment under the new FDII provisions.

The analysis proposed here shows how the US tax reform started to be designed according to the recommendations of the OECD, but drifted away from the core principles of international cooperation and mutual recognition of taxing rights.[401] As a matter of fact, the same BEAT provisions are subject to criticism by foreign scholars. Unlike the BEPS Action 4,[402] the base erosion anti-abuse tax applies to all large companies and to the financial sectors too.[403] Also, the new tax is arguably in violation of both international tax treaty law and the WTO obligations.[404] To begin with, the US Model Income Tax Convention provides for a non-discrimination clause under article 24 which prohibits the IRS from treating domestic entities on more favourable terms than their foreign counterparts headquartered in a treaty partner jurisdiction.[405] However, the BEAT imposes a minimum tax on a modified taxable income which disallows deductions generated by intercompany transactions with foreign affiliates. The discrimination consists of denying a deduction just with regard to foreign related entities instead of covering all deductible expenses as provided for under new section 163(j).[406]

The other aspect of BEAT which is frowned upon by the international community regards the compatibly with the WTO Subsidies and Countervailing Measures Agreement.[407] Under this treaty, a subsidy is a financial contribution which: (1) is given by the government and confers a benefit, (2) is selectively provided to specific enterprises, trades, businesses or undertakings. Firstly, the BEAT recalculates the taxable base by adding back the deductions allowed for foreign depreciable property,[408] thus creating an implicit subsidy in favour of domestic depreciable property. Secondly, the provisions applies only to foreign affiliated entities of domestic taxpayers satisfying the selective treatment requirement. However, there is wide scepticism as to whether the BEAT

[401] Vieri Ceriani, 'Riflessioni sul coordinamento internazionale della fiscalità d'impresa' (2019) 1 Rassegna Tributaria 30.
[402] OECD, *BEPS Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD Publishing, 2015).
[403] Internal Revenue Code 1986, 26 USC § 59A.
[404] Alexander Davis, 'Does the BEAT Violate International Law?' [2018] Columbia Journal od Transnational Law.
[405] United States Model Income Tax Convention, art 24.
[406] Cfr. Internal Revenue Code 1986, 26 USC § 59A, 163(j): the field of application of the two rules is different. Although both rules aim at preventing base erosion payments from shifting profits overseas, the way the BEAT was designed by the 2017 tax reform raises concerns of compatibility with current US obligations under income tax treaties.
[407] Agreement on Subsidies and Countervailing Measures [1994] 1869 UNTS 14.
[408] Internal Revenue Code 1986, 26 USC § 59(d)2.

confers an actual subsidy. Some commentators have argued that the application limited to depreciable property might be insufficient to warrant WTO challenges. Also, the BEAT excludes from the tax base recalculation the cost of goods sold unless the multinational corporation has recently inverted and shifted its tax residence to a foreign jurisdiction.

The BEAT has also raised concerns in respect of the BEPS Actions 8-10 regarding Transfer Pricing which bank on the arm's length principle to evaluate the fairness of intercompany transactions.[409] The BEAT does not take into account the compatibility of the price charged by the foreign associated entity, but excludes all payments which fall into the scope of application of the newly-enacted provision. Also, the new tax is non-compliant with the BEPS Action 15 which calls for G20 countries to sit at the round table and sign a multilateral instrument for the cooperation in modifying existing income tax treaties so as to modernise and render these conventions in line with the latest developments put under the spotlight by the OECD's hard work.[410]

This first overview of the effects of the Tax Cuts and Jobs Act enacted by the Trump administration is pivotal to clarify the starting point of the reform and the following developments of the legislative project. The combination of protectionist measures and the lack of respect for other jurisdictions' taxing rights has somewhat created a reform characterised by a controversial and twofold assessment. On the one hand, the 2017 Act follows the OECD's recommendations and results in effective tax avoidance measures which highlight the meticulous attention of the US in the fight against multinational enterprises' abusive tax planning schemes. On the other hand, the statute extends the reach of US taxing rights well beyond the standard notion of "jurisdiction to tax" and does not try to achieve a mutually agreed solution with other commercial partners. The clear intent of the reform is to counter international tax avoidance and render the US more

[409] OECD, *BEPS Actions 8-10 – Aligning Transfer Pricing Outcomes with Value Creation* (OECD Publishing, 2015).
[410] OECD, *BEPS Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* (OECD Publishing, 2015).

attractive to domestic and foreign investments to the detriment of other countries (so called "beggar thy neighbour" doctrine).[411]

3.2 The Base Erosion Anti-Abuse Tax and Other Corporate Financing Provisions

This paragraph of the dissertation will focus on the measures put in place by the Trump administration to counter the phenomenon of base erosion and profit shifting through the manipulations of interest payments and other deductible expenses. The analysis will focus firstly on the newly enacted base erosion anti-abuse tax (BEAT) which is a new tax introduced under the Tax Cuts and Jobs Act and one of the most interesting provisions the tax reform.[412] Secondly, new section 163(j) will be taken into account stressing the amendments regarding the interest deduction limitation and the similarities with the OECD's recommendation.[413] Lastly, the attention wills shift to section 365 which, before the changes to the interest limitation deduction, was used by the IRS to recharacterise debt financing as equity injection, thus, disallowing the interest payment deduction in favour of foreign lenders.[414]

New section 59A imposes a sort of alternative minimum tax on certain large taxpayers by applying a lower tax rate to a modified taxable income which does not take into account some so called base eroding payments. The tax is applied by comparing the taxpayer's regular tax liability with the 10%-rate on the modified corporate tax base. If the result of the second calculation is greater than the standard liability, the surplus is due to the Treasury. To understand how the BEAT works it is necessary to analyse the separate building blocks of the new tax: (1) the applicable taxpayer, (2) the base erosion payment, (3) the bare erosion tax benefit, (4) the base erosion percentage, (5) the calculation of the alternative tax liability and (6) the reporting requirements and other applicable special rules.

---

[411] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (W Strahan and T Cadell, 1776).
[412] Internal Revenue Code 1986, 26 USC § 59A.
[413] Internal Revenue Code 1986, 26 USC § 163(j).
[414] Internal Revenue Code 1986, 26 USC § 365.

The BEAT applies, with respect to any taxable year, to any taxpayer which is a corporation other than a regulated investment company, a real estate investment trust and an S corporation (a per se corporation which benefits from pass through treatment upon election of its management and satisfaction of the necessary requirements to be eligible for such treatment).[415] Also the corporation must be a "large taxpayer" which means that its gross receipts must be over \$500 million and it must have a base erosion percentage of at least 3% or higher.[416] Section 59A provides for an aggregation rule. All persons treated as a single employer under section 52(a) are aggregated and considered as a single taxpayer for the purposes of meeting the gross receipts tests (over \$500 million) and for the calculation of the base erosion percentage.[417] When the taxpayer taken into account is a foreign person, then the gross receipt amount is calculated only taking into account the gross income which is effectively connected with a US trade or business.[418] This rule has implications in practical terms. If a foreign person has a permanent establishment in the US and a foreign branch in another country, the foreign branch's income is not considered, vice versa, if a US taxpayer has a foreign branch its foreign gross receipts are taken into consideration.

Following to the clarification of the covered taxpayers, the dissertation will explain the types of payments which fall into the application of section 59A. A base erosion payment is defined as any amount paid or accrued by a taxpayer to a foreign person that is a related party and with respect to which a deduction is allowable.[419] More specifically, base erosion payments consist of any amount that is a reduction in gross receipts with respect to: (1) the purchase or depreciable property (or property subject to amortisation) from a related party, (2) the premiums paid for reinsurance contracts to related parties, (3) an amount paid or accrued to a surrogate foreign corporation which is a related party or to a member of the expanded affiliated group of the surrogate entity.[420] A surrogate entity is simply a foreign entity which following a reorganisation owns all the assets of a domestic

---

[415] Internal Revenue Code 1986, 26 USC § 59A(e)1A.
[416] Internal Revenue Code 1986, 26 USC § 59A(e)1B-C.
[417] Internal Revenue Code 1986, 26 USC § 59A(e)3.
[418] Internal Revenue Code 1986, 26 USC § 59A(e)2A.
[419] Internal Revenue Code 1986, 26 USC § 59A(d)1.
[420] Internal Revenue Code 1986, 26 USC § 59A(d)2-4.

corporation or partnership when at least 60% of its stock is still in the hands of the former domestic entity's shareholders.[421]

As mentioned above, the taxpayer to which the payment is directed must be a foreign related party. A taxpayer is foreign when it is not a US citizen , a US resident or a domestic business association.[422] The term related means any 25% owner of the domestic taxpayer or any other person which is related to the taxpayer according to the broad concept adopted for the purposes of ascertaining transfer pricing.[423]

There are some exceptions to the definition base erosion payments. Firstly, it is not considered a base erosion payment any amount paid or accrued with respect to the supply of services, if the price charged is in compliance with the "service cost method" laid down under the transfer pricing regulations issued by the IRS and there is no mark-up component.[424] Secondly, any amount paid for the cost of goods sold or any qualified derivative payments are excluded from the base erosion.[425] The qualified derivative payment is exempted from the application of the BEAT if the gain or loss is treated as ordinary income and it derives from a contract whose outcome is determined by reference to other financial items.[426]

The aggregate of all the base erosion payments which are not covered by the exemption just mentioned consist of the base erosion tax benefits which the domestic entity accrued by reducing its tax base in the US.[427] However, the reduction in the taxable base does not form part of the tax benefits if any tax or withholding tax has been imposed upon the payment to the related entity.[428] The payment is totally disregarded if a 30% withholding tax is levied according to the FDAP (fixed, determinable, annual, periodical) income rules (FDAP withholding is levied upon all those foreign taxpayers which receive passive income sourced in the US and have no trade or business which is taxable within the US.

[421] Internal Revenue Code 1986, 26 USC § 7874(a)2B.
[422] Internal Revenue Code 1986, 26 USC § 7701(a)30.
[423] Internal Revenue Code 1986, 26 USC § 59A(g).
[424] Internal Revenue Code 1896, 26 USC § 59A(d)4.
[425] Internal Revenue Code 1986, 26 USC § 59A(h).
[426] Internal Revenue Code 1986, 26 USC § 59A(h)2A, -4A.
[427] Internal Revenue Code 1986, 26 USC § 59A(c)2A.
[428] Internal Revenue Code 1986, 26 USC § 59A(c)2B.

Basically, the payor is obliged to withhold a portion of the gross income to ensure tax compliance of non-resident foreign taxpayers). If under any treaty the 30% withholding tax is reduced or waived, the untaxed portion of the base erosion payment is added back to the aggregate of tax benefits.

It is important to mention how the coordination with section 163(j) works. Since the interest limitation rule imposes a fixed ratio on all deductible payments to foreign entities (also non-related parties), the reduction in the interest amount which can be deducted during a tax year is first allocated to unrelated parties and then to related entities. By doing so, the IRS can hit the taxpayer twice by disregarding interest-like payments to foreign third parties and apply the BEAT on the other related-party transactions. This mechanism allows to maximise the combined effects of both provisions and restrict the base erosion and profit shifting concerns.

As mentioned above, the BEAT applies only to large taxpayers if they have a base erosion percentage which is higher than 3%. The calculation of this percentage is the result of the aggregate amount of the base erosion tax benefits divided by the sum of all the deductions allowed to the taxpayers (erosion tax benefits included):[429]

$$Base\ Erosion\ Percentage = \frac{Base\ Erosion\ Tax\ Benefits}{Total\ Amount\ of\ Deductions\ Claimed}$$

The base erosion tax benefits are also important for the calculation of another important factor, namely the modified taxable income. The modified taxable income is calculated by adding back to the net income all the base erosion tax benefits and the result of the net operating losses multiplied by the base erosion percentage.[430] Again, the formula will help clarify the notion:

$$Modified\ Taxable\ Income = B.E. Tax\ Benefits + (B.E.\% \times NOL)$$

Once all these hurdles have been sorted out, the BEAT owed to the Treasury consist of the excess, if any, of 10% of the modified taxable income over the regular tax liability

[429] Internal Revenue Code 1986, 26 USC § 59A(c)4.
[430] Internal Revenue Code 1986, 26 USC § 59A(c)1.

reduced (but not below zero) by some tax credits statutorily taken into account for the purposes of calculating this minimum tax.[431]

$$BEAT = 10\%\ Modified\ Taxable\ Income > 21\% Taxable\ Income$$

Following the explanation of the rules generally applicable to large taxpayers, it is necessary to mention some special rules which affect certain aspects of the BEAT. Firstly, the applicable tax rate was 5% for the taxable year beginning in 2018, it was raised to 10% for the following year up until 2025 and will be further increased up to 12.5% after December 31, 2025.[432] Secondly, if the taxpayer is a member of an affiliated group which includes a bank or a duly registered securities dealer, it will be subject to a BEAT rate which is one percentage point higher than the standard rate and the base erosion percentage requirement is lowered to 2% (instead of the generally required 3%).[433]

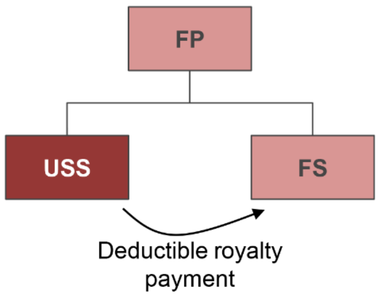
The Tax Cuts and Jobs Act also prescribed new reporting obligations upon all taxpayers which are related to foreign companies as defined under section 59A(e).[434] The underlying reason for this reporting requirement is ensuring compliance with the BEAT. Therefore, all domestic corporations which are related by a 25% stock ownership to another foreign entity shall report to the IRS the following information: (1) the name, principal place of business and country or countries or incorporation or residence of each related party to the domestic taxpayer which had a transaction with the reporting corporation, (2) the manner of relation between the two entities and (3) the transactions effectively occurred between the reporting corporation and each related foreign person.[435]

In order to understand how the BEAT works, let's assume a foreign parent company (FP) owns both a US and a foreign subsidiaries (USS and FS respectively). USS has \$300 income and \$200 deduction, \$180 of which are base eroding payments to related parties. The regular tax liability is 21% of \$100 which is \$21. The BEAT liability is the 10% of the modified taxable income which is obtained by adding back the base eroding tax

[431] Internal Revenue Code 1986, 26 USC § 59A(b)1.
[432] Internal Revenue Code 1986, 26 USC § 59A(b)2.
[433] Internal Revenue Code 1986, 26 USC § 59A(b)3.
[434] Internal Revenue Code 1986, 26 USC § 6038A(a).
[435] Internal Revenue Code 1986, 26 USC § 6038A(b).

benefits (10% of $100+$180=$28). Thus, the BEAT is simply the difference between the regular tax liability and the eventual excess of BEAT which, in this case, is $7. This plain vanilla example is shown in the chart below.

Figure 2: BEMTA Computation



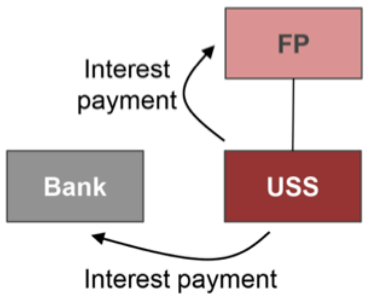
- Assume that US Subsidiary (USS), a subsidiary of Foreign Parent (FP), has:
  - $300 of gross income
  - $200 of deductions, including a $180 royalty payment to a foreign affiliate, Foreign Subsidiary (FS), that is not subject to US withholding tax
  - $0 of tax credits
  - $21 of regular tax liability
- USS has $180 of base erosion payments
- USS has $180 of base erosion tax benefits
- USS' modified taxable income is $280 ($100 + $180)
- USS' adjusted regular tax liability is $21 ($21 – $0)
- Assuming a BEAT rate of 10%, USS' BEMTA is $7 ($280 x 10% – $21)

Figure 3.3: Latham&Watkins, 'Following the BEAT: IRS Issues Proposed Regulations on Application of Base Erosion and Anti-Abuse Tax' (2019) Client Alert Cometary No 2433.

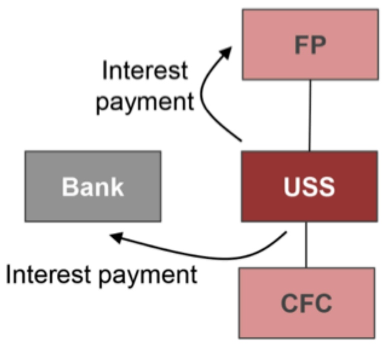
Following this straightforward fact pattern of BEAT application, it is useful to provide a second and last example which demonstrates the interplay between the BEAT, the fixed ratio rule on interest deduction limitation under section 163(j) and GILTI (which will be analysed further in the anti-deferral regime chapter). As we mentioned before, the interest limitation deduction applies first to foreign unrelated party interest and just then to related party's. In this way, all or part of the interest allowed as a deduction for the current taxable year can be added back in the modified taxable income calculation. As a matter of fact, if the interest allowed as a deduction was derived from arrangements with unrelated parties, it could not be added back. With regard to GILTI, it is necessary to mention that it increases the foreign tax credit upon deemed distributed income and thus it reduces the US tax liability by raising the likelihood of BEAT application. In other words, the more GILTI (or subpart F income) is produced, the more likely it is that the BEAT will apply. The following example will help clarify this complex interaction between rules.

Let's assume that a foreign parent company (FP) owns a US subsidiary (USS) which has $300 income and $200 deductions ($20 from operating expenses, $100 from related party base eroding payments and $80 from interest due to an unrelated bank). Under section 163(j) only $84 of the total $180 interest paid is deductible for the tax year. Thus, the taxable income is $196 ($300-$20-$84). The US tax liability is the 21% of $196 which is $41 minus a tax credit of $15 which gives $26 of effective US tax. The BEAT is obtained by adding back the base eroding payment allowed as a deduction for the taxable year, namely $84 (which as explained is first attributed to related party interest expense and then to unrelated party's) and multiplying by 10%. The result is $28 of minimum tax and hence $2 of BEAT (10% of $280 minus $26). Assuming that USS has a CFC and that there is a $100 GILTI inclusion which throws off an additional $10 of tax credit, the US tax liability becomes $16 and the BEAT to be paid $12. The chart below exemplifies graphically what said so far.

Figure 6: Interaction With GILTI



- Assume that USS has:
  - $300 of gross income
  - $200 of deductions, including $100 of business interest paid to a foreign related party and $80 of business interest paid to an unrelated party
  - $84 of allowable business interest expense under Section 163(j)
  - $41 of regular tax liability*
  - $15 of tax credits
- Applying the ordering rules above, all of USS' $84 of allowable business interest expense is treated as foreign related party business expense and is thereby a base erosion tax benefit
- USS' modified taxable income is $280 ($196 + $84)
- USS' adjusted regular tax liability is $26 ($41 – $15)
- Assuming a BEAT rate of 10%, USS' BEMTA is $2 ($280 x 10% – $26)



- Assume the same facts as the example above, except that USS now has:
  - $300 of gross income, $100 of which constitutes GILTI inclusion attributable to its ownership of a CFC
  - $25 of tax credits, including $10 of FTCs associated with GILTI inclusion
- USS' modified taxable income is unchanged from the example above ($280), but USS' adjusted regular tax liability is now $16, since USS is required to also reduce its regular tax liability by the FTCs associated with its GILTI inclusion ($41 – $15 – $10)
- Assuming a BEAT rate of 10%, USS' BEMTA is now $12 ($280 x 10% – $16)

*$41 regular tax liability is a stated assumption for the examples in this Figure 6

Figure 3.4: Latham&Watkins, 'Following the BEAT: IRS Issues Proposed Regulations on Application of Base Erosion and Anti-Abuse Tax' (2019) Client Alert Cometary No 2433.

This last example gives an idea of how complex the application of the BEAT can be especially in respect of the other international tax provisions either amended or introduced under the Tax Cuts and Jobs Act. Following the comprehensive analysis of the BEAT, it is necessary to look at the changes that the 2017 tax reform made to section 163(j) and how the new rules has been carved in accordance to the recommendation of the OECD in the BEPS Action 4.[436]

Under prior law, the interest paid or accrued by a US taxpayer was deductible in the computation of the taxable income subject to some limitations.[437] The taxpayer's selected method of accounting was important (cash method or accrual method) to determine when the interest was due and thus deductible. In case of issuance of debt instruments (like bonds, debentures and more broadly corporate notes) with an original issue discount, the deduction was allowed over the life of the debt instrument upon a yield to maturity basis.[438] Moreover, former section 163 provided two methods to limit the interest deduction: (1) the investment interest expense and (2) the earnings stripping rule. In the case of any taxpayer other than a corporation, the interest deduction limitation was based upon the investment interest expense, which is the interest paid upon indebtness allocable to property held for investment.[439] The deduction was limited to the "net investment income" which consisted of the gross investment income derived from property held for investment minus all the expenses other than the interest connected with the production of such income.

For all corporate taxpayers, the rule governing the interest deduction was the previous earnings stripping rule. Old section 163(j) allowed to IRS to disallow a deduction for any "disqualified interest" paid or accrued if the two threshold test was satisfied: (1) the payor's debt-equity ratio exceeded 1.5 to 1.0 and (2) the payors net interest expense

[436] OECD, *BEPS Action 4 – 2015 Final Report: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD Publishing, 2015).
[437] Internal Revenue Code 1986, 26 USC § 163(a).
[438] Internal Revenue Code 1986, 26 USC § 163(e).
[439] Internal Revenue Code 1986, 26 USC § 163(d).

(which takes into account the excess of interest losses over interest income) exceeded 50% of the adjusted taxable income of the taxpayer. The term disqualified interest included: (1) interest paid or accrued to related parties when no federal income tax is paid, (2) interest paid or accrued to unrelated parties when a related party guarantees the debt and (3) interest paid or accrued to a real estate investment trust (REIT) by another REIT which is its subsidiary.[440] The amount disallowed benefited from an unlimited carry-forward and could not exceed the amount by which the net interest expense exceeded 50% of the taxpayer's adjusted taxable income.[441] Additionally, the taxpayer was allowed to carry forward the excess, if any, of 50% of its prior adjusted taxable income for three years in order to increase the allowable deduction amount.[442]

The Tax Cuts and Jobs Act changed the deduction allowed for corporate taxpayers thereby leaving the rest of section 163 unaltered. Under new section 163(j), the deduction for business interest paid by corporations is limited to the sum of: (1) the business interest income for the taxable year, (2) 30% of the adjusted taxable income of the taxpayer for the same year and (3) the floor plan financing interest of the taxpayer during the same taxable year. Business interest means any interest paid or accrued on indebtness allocable to a US trade or business. Both investment interest and investment income within the meaning of section 163(d) do not fall within the meaning of business interest nor business interest income. Floor plan financing stands for any line of credit used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the same property acquired (e.g. loans for car dealerships to purchase inventory). By doing so, the rule allows to fully deduct interest up to the business interest income and the floor plan financing interest, while the eventual exceeding interest expense is limited up to 30% of the adjusted taxable income.

Like prior law, new section 163(j) is intended to apply following the applications of provisions which subject the interest expense to deferral, capitalisation or other limitations (see the interplay with the BEAT explained above). The business interest excess is allowed an unlimited carry-forward as business interest paid or accrued in the

[440] Internal Revenue Code 1986, 26 USC § 163(j)3, -5B.
[441] Internal Revenue Code 1986, 26 USC § 163(j)1A-B.
[442] Internal Revenue Code 1986, 26 USC § 163(j)2B(ii).

following taxable years. When the taxpayer is a partnership, the fixed ratio rule is applied at the partnership level instead of the shareholder's.[443] The use of a flow through entity can be subject to certain abuses and accordingly there are three additional limitations to avoid the accrual of a double benefit which would render section 163(j) ineffective.

First, the double counting rule does not take into account the partner's distributive share when calculating the adjusted taxable income to which the 30% fixed ratio must be applied.[444] For instance, suppose ABC is a 50-50 partnership with XYZ corporation and an individual as partners.[445] ABC has $200 income and $60 business interest expense. Under the 30% fixed ration rule all the $60 interest expense is deductible. The partners' distributive share is $70 each ($200-$60 divided by 2). If XYZ corp has an additional $25 interest expense, the $70 distributive share cannot be taken into account a second time to deduct the partner's interest expense. In the absence of such rule, XYZ corp could deduct $21 (30% of $70) and carry forward $4.

Secondly, section 163(j) provides for an additional limitation rule which increases the excess taxable income of the partnership with regard to the partner's distributive share when the partnership interest expense has not exhausted the entire limitation.[446] In the absence of such rule, the partner could use the pro rata share of its income and the unused partnership interest limitation to deduct more interest. For example, suppose ABC is a 50-50 partnership with XYZ corporation and an individual as partners.[447] ABC has $200 income and $40 business interest expense. Under the 30% fixed ration rule all the $40 interest expense is deductible and there is still an exceeding $20 allowed as a deduction. the excess business income is calculated as follows: $20/$60x$200=$66.67. XYZ corp has a pro rata share excess taxable income which is $33.33 and, thus, it can deduct an additional 30% of this sum which is $10. Assuming XYZ corp has an additional $25 interest expense, it can deduct up to $10 and carry forward $15.

---

[443] Internal Revenue Code 1986, 26 USC § 163(j)4A(i).
[444] Internal Revenue Code 1986, 26 USC § 163(j)4A(ii)(I).
[445] Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. I* (December 18, 2017).
[446] Internal Revenue Code 1986, 26 USC § 163(j)4A(ii)(II).
[447] Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. I* (December 18, 2017).

Thirdly, in the case of a partnership the entity level carry-forward rule does not apply, since the excess business interest expense is carried forward only at partner's level.[448] However, the 30% fixed ratio rule shall apply to the partners too when deducting excess interest expense from the partnership's previous taxable years. For instance, assume a partner has $100 of disallowed business interest expense from a partnership in year 1.[449] In year 2, the partner is allocated $100 of excess taxable income and $10 of excess business interest income both derived from the partnership, while he also has $200 from other income sources. Accordingly, the partner can deduct $40 (30% of $100 plus $10) and the remaining $60 can be carried forward to year 3 and following.

The section 163(j) limitations explained so far do not apply to small taxpayers which meet the $25 million gross receipts test as laid down under section 448(c).[450] The aggregation rules apply in order to establish whether the taxpayer is artificially trying to avoid exceeding the $25 million gross receipts test. However, unlike prior law, the interest deduction limitation applies to all taxpayers regardless of whether the base erosion payment is paid to a related or unrelated party.

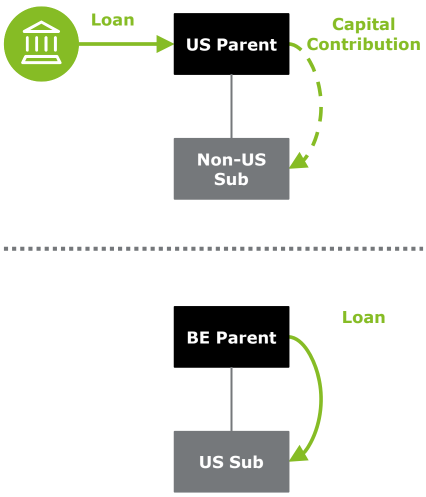


Figure 3.5: Deloitte, 'US Tax Reform: Major US Tax Reform Impacts' [2018].

[448] Internal Revenue Code 1986, 26 USC § 163(j)4B.
[449] Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. 1* (December 18, 2017).
[450] Internal Revenue Code 1986, 26 USC § 163(j)3.

As show in the chart above, the 2017 tax reform extended the application of section 163(j) to both loans from unrelated banking institutions and related corporate entities belonging to the same group.

The last provision of the US tax code which aims at preventing base erosion and tax avoidance is section 385. This rule is a significantly important instrument in the toolbox of the IRS which allows the tax administration to recharacterise certain transactions from debt to equity.[451] Basically, the IRS is given the power to treat certain debt instruments issued by US corporations as stock, thus, disallowing the deduction claimed upon the covered indebtness. The recharacterisation must take into account several factors to correctly determine whether a creditor-debtor or a corporation-shareholder relationship exists: (1) the existence of a written unconditional promise to pay, (2) the subordination to or preference over any other indebtness, (3) the debt-equity ratio, (4) the convertibility, if any, into stock of the corporation, (5) the relationship between the holdings of stock and the holdings of interest in the US issuers.[452] While the characterisation by the issuer shall be binding on both the issuer and the holder of the instrument, the IRS is not bound and is also granted the power to issue regulations to specifically regulate the subject matter.[453]

On October 13, 2016, the US Department of the Treasury and the IRS issued the final regulations of section 385. The documents maintains the framework laid down in the temporary regulations issued in April 2016 with some minor changes. To highlight the content of the document, the regulations provide for a "general rule" and a "funding rule" which specify the kind of tainted intercompany debt transactions which are to be recharacterised as stock (the "bifurcation rule" which was in the temporary regulations and allowed the partial recognition as debt and equity has been eliminated). The section 385 regulations are limited to US issuers of debt and any reclassification operates for all federal income tax purposes.

[451] Internal Revenue Code 1986, 26 USC § 385(a).
[452] Internal Revenue Code 1986, 26 USC § 385(b).
[453] Internal Revenue Code 1986, 26 USC § 385(c)1, -3.

According to the general rule, a debt instruments is reclassified as stock if it is issued: (1) in a distribution, (2) to acquire the stock of a member of the issuer's expanded group and (3) as consideration in certain internal asset reorganisations. In the first case, a US subsidiary issues a note to the foreign parent instead of an actual distribution. By doing so, the dividends which should have been distributed are replaced by a tradeable loan which generates an interest deduction. To avoid such scheme, the note in reclassified as a capital contribution in exchange for stock by means of debt remittance. In the second scenario, the US subsidiary and the foreign parent engage in a leveraged-buyout of a third entity belonging to the same extended group. The loan to the acquiring US subsidiary is reclassified as stock since the previous owner of the other subsidiary was the same foreign parent. The last case can cover a broad array of fact patterns where the note is issued as consideration for some group's assets which are reallocated internally. Corporate assets were either transferred directly or purchased by virtue of previous capital contributions, thus, their subsequent purchase should not be disguised as debt. The following chart will exemplify the three circumstances referred to above.

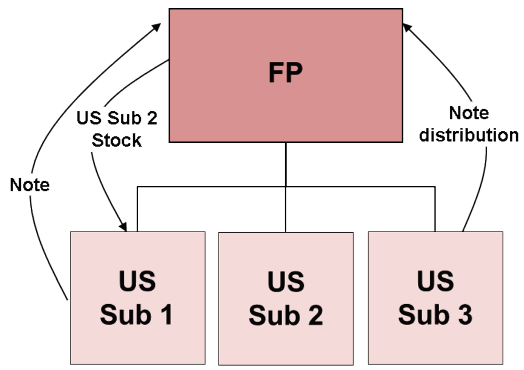


Figure 3.6: Latham&Watkins, 'Treasury Issues Final and Temporary Regulations on Related-Party Debt Instruments' (2016) Client Alert Commentary No 2023.

As shown in the picture, US sub 1 issues a note to FP both in a distribution and to purchase the stock of US sub 2. These two transactions are recharacterised by the IRS as capital contribution and the deduction is disallowed. The same transactions if performed by a foreign subsidiary would not be subject to any tax consequence since the erosion hits foreign taxable bases.

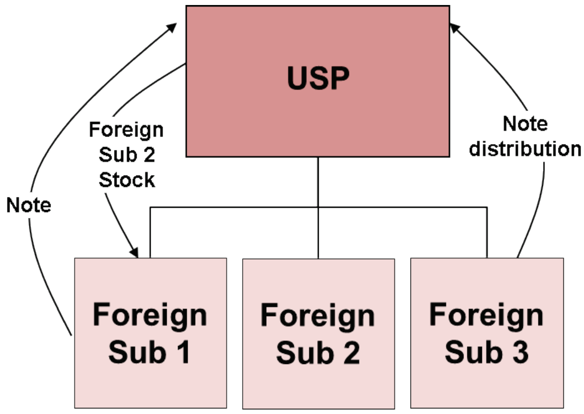


Figure 3.7: Latham&Watkins, 'Treasury Issues Final and Temporary Regulations on Related-Party Debt Instruments' (2016) Client Alert Commentary No 2023.

Aside from the general rule, the other tainted transaction is identified by the funding rule. According to the regulations, whenever a debt instrument is issued in exchange for property (a funded debt instrument), it is treated as stock so long as the main purpose for the issuance of such debt is financing one or more distributions or acquisitions. (a principal purpose debt instrument). Under the regulations, any funded debt instrument is governed by a rebuttable presumption that the main purpose of its issuance is the distribution or the acquisition of another company. The per se reclassification operates if the issuance occurred 36 months after or before the distribution or acquisition. Any similar transaction outside this window can still be recharacterised based upon facts and circumstances. The following chart will give a better understanding of the funding rule.

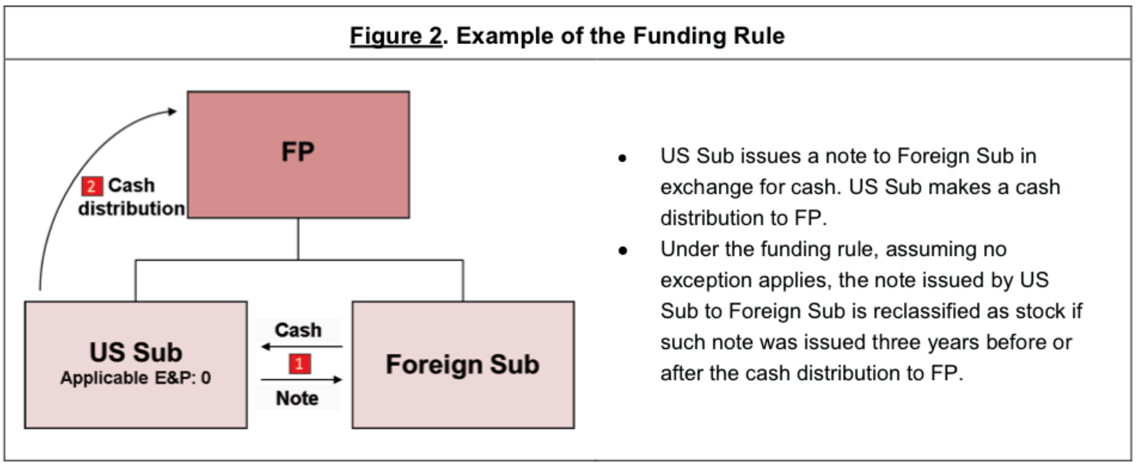


Figure 3.8: Latham&Watkins, 'Treasury Issues Final and Temporary Regulations on Related-Party Debt Instruments' (2016) Client Alert Commentary No 2023.

Unlike the general rule, the funding rule deals with actual cash movement. US sub issues a note in favour of foreign sub and then makes a distribution to FP. If the loan was not reclassified as stock, US sub could deduct interest any time it made a distribution to its foreign parent company. To avoid this abusive scheme, the IRS is given the power to treat the note as stock.

Both the general and funding rules are subject to limited exceptions which will be reported below. Firstly, the regulations make an exception for short-term debt and cash pooling arrangements. These are generally demand deposits or loans with a maturity date not exceeding 120 days and made in consideration of ordinary course property other than money. The exception is justified by the necessity to finance a business so long as there is genuine economic substance. Secondly, if the distribution made by the US subsidiary is made out of the accumulated earnings and profits, just the exceeding part of the loan is subject to the anti-tax avoidance rules. For instance, supposing that US sub has $25 million of retained earnings and profits and issues a note to Foreign sub for $100 million which then distributes to its Foreign Parent, then, only $75 million would be treated as stock.[454] Thirdly, there is a threshold exception if the expanded group's covered debt instruments issued do not exceed $50 million on an aggregate basis. If the covered debt instruments exceed the allowed threshold, just the surplus is treated as stock. As such, the earnings and profits exception and the $50 million threshold can be cumulated when calculating the accrued allowance under section 385 regulations. Suppose US sub issues a note to Foreign sub for $200 million and then makes a $150 million distribution to its Foreign Parent.[455] Assuming US sub had $40 million in earnings and profits, together with the $50 million threshold only $60 million out of the initial distribution would be treated as stock. Finally, the last safe harbour is the so called "net equity" exception which does not treat as stock the distribution financed through debt instruments to the extent it is set off by a former capital contribution. For instance, suppose Foreign Parent contributed to US sub $25 million and that US sub issues a note to Foreign Sub for $100

[454] Latham&Watkins, 'Treasury Issues Final and Temporary Regulations on Related-Party Debt Instruments' (2016) Client Alert Commentary No 2023.
[455] Ibid.

million which then distributed to Foreign Parent.[456] Out of the total distribution only $75 million would be reclassified as stock.

The members of the expanded group are subject to report requirements in respect of tainted transactions so as to allow the IRS to monitor the compliance with section 385 and assess whether some deductions claimed should be denied.

3.3 The New Provisions to Neutralise Hybrid Mismatch Arrangements

The following international tax planning issue, which has been taken into account also by the Tax Cuts and Jobs Act, concerns hybrid mismatch arrangements. The 2017 tax reform introduced section 267A in the federal income tax code, thus, tackling the hybrids' problem for the first time.[457] Again, the Trump's Tax Act is in line with the best practices and recommendations set forth by the OECD and modernises the US tax system. Like section 385, also section 267A has a very essential discipline which is then implemented by the Treasury and the IRS by means of regulations. The US law-maker is heavily reliant on the law-making powers of federal agencies and in the field of tax law this phenomenon is particularly evident with regard to abusive practices which need to be countered by identifying unlawful fact patterns. In short, whenever a great deal of legislative details is necessary, the US Congress prefers to set some general guidelines and allows the IRS and the Treasury to fill the gaps and lay down effective regulations.

As a general rule, the Tax Cuts and Jobs Act allows no deduction for any "disqualified related party amount" paid or accrued pursuant to a hybrid transaction or hybrid entity.[458] Differently from the approach followed by the ATAD II and its implementing decree in Italy, the US tax reform sets forth only one remedy. The IRS shall disallow the deduction in any case there is no inclusion in the income of the recipient located in the foreign country due to a hybrid mismatch arrangement. By contrast, if the US is the country of the recipient of the payment, the taxation of the payment, which is deductible in the payor's jurisdiction, is not triggered automatically and in every circumstance whenever

456 Ibid.
457 Internal Revenue Code 1986, 26 USC § 267A.
458 Internal Revenue Code 1986, 26 USC § 267A(a).

the foreign country does not take adequate action to disallow such deduction. The inclusion in the US recipient's taxable income occurs just in the case of "hybrid dividends". More specifically, if the recipient corporation is a specified 10% corporation (the dissertation will analyse new section 245A further on) entitled to receive exempt dividends from a controlled foreign corporation (on income not treated as subpart F or GILTI), the 100% foreign dividend deduction under section 245A(a) shall not be applied if the actual distribution benefits from a deduction in the country of the payor.[459] Basically, when a US shareholder (as defined under section 951(b)) receives an exempt non-subpart F/non-GILTI dividend, the exemption shall not apply if the controlled foreign corporation is allowed to claim a deduction upon distribution. The decision to tax reverse-deduction/no inclusion situations just in limited circumstances confirms the US-centric view of the reform and follows the reasoning of the "America first" propaganda upon which the Trump administration based its political campaign.

The term disqualified related party amount means the payment of any royalty or interest paid to a related party which is either not included in the taxable income of the recipient or is allowed a second deduction according to the general tax laws of the country of the beneficiary related party.[460] Therefore, the IRS shall disallow a deduction in cases of deduction/no inclusion (first scenario) and when a double deduction takes place (second fact pattern). The term related party is defined by means of referral to section 954(d)3 of the Internal Revenue Code.[461] It is so classified any related person which, with respect to a controlled foreign corporation, is an individual, corporation, partnership, trust or estate which controls, or is controlled by, the same controlled foreign corporation or is subject to the common control of a third party like the controlled foreign corporation.[462] For the purposes of assessing the required control, it is necessary that the interest holder has more than 50% of the vote or value of the stock.[463]

Section 267A then defines the notions of hybrid transactions and hybrid entity. The former is any arrangement with respect to interest or royalties which are considered as

---

[459] Internal Revenue Code 1986, 26 USC § 245(e)1, -4
[460] Internal Revenue Code 1986, 26 USC § 267A(b)1A-B.
[461] Internal Revenue Code 1986, 26 USC § 267A(b)2.
[462] Internal Revenue Code 1986, 26 USC § 954(d)3.
[463] Ibid.

debt instruments in the US and equity instruments in a foreign country (while the opposite situation is defined, under section 245A(e), as a hybrid dividend as explained earlier). The term hybrid entity is used in the code with some laxity since it tends to cover both proper hybrid entities and reverse hybrids. As such, section 267A covers both business associations treated as flow through entity in the US and as corporations outside the US and vice versa.[464]

Section 267A(e) calls for the US Department of the Treasury and the IRS to lay down the necessary regulations to counter hybrid mismatch arrangements.[465] The regulatory powers given to the tax agency are broad and tend to enlarge the application of hybrid provisions to branches and dual resident entities.[466] Nevertheless, the tax code already provided for a limitation upon dual consolidated losses under section 1503(d). According to this section, whenever a domestic corporation is taxed on its worldwide income even in a foreign country (the case of dual residence is also explained in the first chapter), a loss cannot offset income produced in the US unless the deduction is not claimed abroad.[467] The double dipping is generally put in place by using domestic corporations which have their place of effective management abroad (in countries where the residence is established, solely or alternatively, by looking at where the decision-making powers of an enterprise are exercised) and are thus considered resident even in the foreign country. By doing so, the US corporation, following its consolidation with two corporate groups both in the US and abroad, uses the same losses to offset income twice. The code prevents any taxpayer from claiming dual consolidated losses.[468] This provision is in line with the recommendations and best practices put forward by the OECD in its BEPS Action plan.[469]

The IRS proposed regulations expanded incredibly the application of section 267A. As a general rule, not only does the deduction/no inclusion recapture rules apply to (reverse) hybrid entities, but also to (reverse) hybrid branches which are treated as a corporation in

[464] Internal Revenue Code 1986, 26 USC § 267A(d)1-2.
[465] Internal Revenue Code 1986, 26 USC § 267A(e).
[466] Internal Revenue Code 1986, 26 USC § 267A(e)2, -6.
[467] Internal Revenue Code 1986, 26 USC § 1503(d)2A-B.
[468] Internal Revenue Code 1986, 26 USC § 1503(d)1.
[469] OECD, *Action 2 – 2015 Final Report; Neutralising the Effects of Hybrid Mismatch Arrangements* (OECD Publishing 2015).

either the US or the foreign country and as a branch in the other.[470] In other words, the IRS considers that the use of foreign branches can lead to the same consequences of hybrid entities. However, the regulations also provide for a de minimis threshold to the extent that the related party interest or royalty payments do not exceed $50,000.[471]

Firstly, the regulations take care of regulating hybrid transactions, which are arrangements or a series of arrangements which are deductible under US tax law and non-includible in the income of the recipient according to the foreign jurisdiction's general tax laws.[472] As already explained in the previous chapters, the arrangement combines the participation exemption regime in the country of the recipient with the deductibility of interest expenses in the country of the payor. The best mechanism used internationally to set up such arrangement is the repurchase agreement. In the following example, country A deems Company A's transaction as a purchase and sale of stock entitled to an exemption on eventual gains (as a matter of fact, there has already been subjection to corporate taxation at the issuer's level). By contrast, US sub is allowed to claim a deduction upon the interest rate paid (which in this case is expressed as the difference between the discount value and the repurchase value).

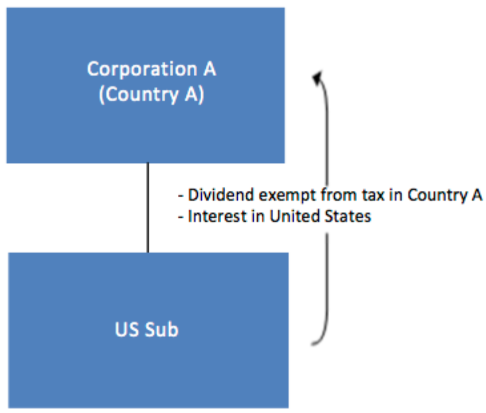


Figure 3.9: Mayer Brown, 'IRS Releases Proposed Anti-Hybrid Regulations' [2019] Legal Update.

[470] US Department of the Treasury Proposed Regulations § 1.267A-2, -4.
[471] US Department of the Treasury Proposed Regulations § 1.267A-1(b).
[472] US Department of the Treasury Proposed Regulations § 1.267A-3(a).

The second issue considered by the Treasury regulations are hybrid and reverse hybrid entities and branches. Hybrids, whether entities or branches, are simply business presences abroad which are flow through for the investor's jurisdiction and taxable for the host country. Therefore, any payment from hybrid entities or branches to their parent company or head office are deductible in the foreign country and deemed as remittances (thus, untaxed) under US tax law. Generally speaking, the benefits are increased by the presence of income tax treaties between the two countries involved with the result that any withholding taxes on intercompany payments are either considerably reduced or totally waived. Vice versa, reverse hybrids are entities or branches which are flow through for the host jurisdiction and corporations for the investor's country. Hence, any payment to a reverse hybrid is deductible for the payor and non-includible for the recipient. The illustration below shows the fact pattern regarding a payment from a US subsidiary to a reverse hybrid owned by a third-country investor. US sub can claim a deduction upon the interest or royalty paid to Corporation A. However, according to the tax laws of country A, Corporation A is a fiscally transparent entity and thus the payment is a remittance from US sub to Corporation A which goes untaxed. Meanwhile, Investor B which owns a certain percentage of corporation A considers the entity as a corporation and therefore the payment is not included in its gross income until repatriated through a dividend distribution. This double-reverse-hybrid sandwich scheme allows to park untaxed earnings in country A, while neither the US nor country B are able to tax those profits.

Figure 2

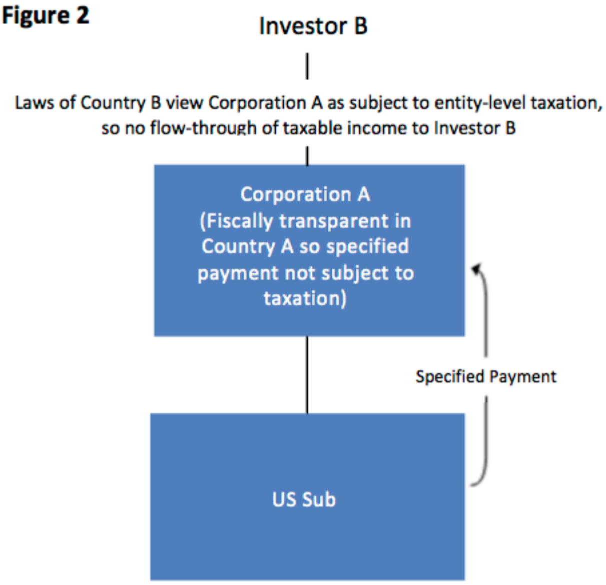


Figure 3.10: Mayer Brown, 'IRS Releases Proposed Anti-Hybrid Regulations' [2019] Legal Update.

Lastly, the Treasury regulations deal with a particularly vicious type of hybrid transaction known as imported hybrid mismatches.[473] Like the EU and Italy, the US has taken action to prevent the use of third party countries in order to disguise the hybrid nature of certain arrangements. Broadly speaking, the imported hybrid mismatch uses a country with outdated and ineffective international tax law provision in order to avoid the denial of a deduction upon a hybrid transaction. As exemplified in the chart below, the US taxpayer (US sub) makes a deductible payment in favour of the first recipient (Corporation B) which should theoretically include the payment in its gross income, thus, avoiding the anti-hybrid rules application. However, Corporation B makes a second deductible payment in favour of a second recipient (Corporation A). Unlike Corporation B, according to the tax laws of its country of incorporation, Corporation A treats the payment as a dividend subject to the participation exemption regime. Given that country B does not have any hybrid recapture rules, the arrangement allows the group to obtain the deduction/no inclusion dual benefit. However, section 267A regulations disregard the interposition of Corporation B and deem the payment as occurred between US sub and Corporation A. By doing so, US sub is denied the deduction like a plain-vanilla hybrid transaction.

[473] US Department of the Treasury Proposed Regulations § 1.267A-4.

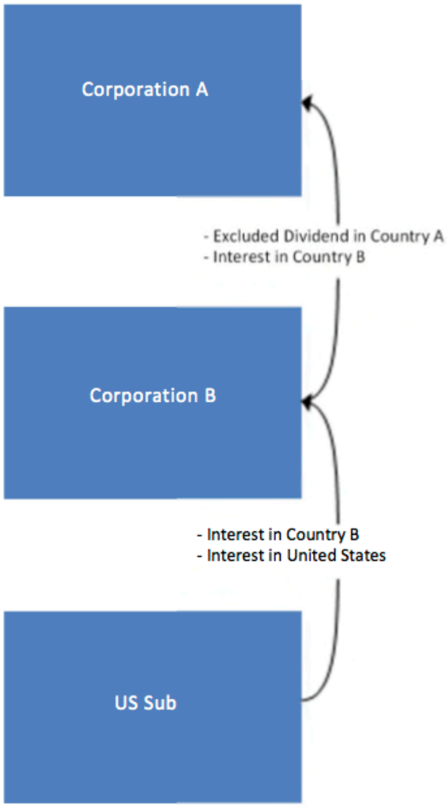


Figure 3.11: Mayer Brown, 'IRS Releases Proposed Anti-Hybrid Regulations' [2019] Legal Update.

Following the overall analysis of the newly-enacted US regime on hybrids (which does not differ from the BEPS Action 2 and the ATAD II), it is necessary to mention the significance of the so-called "check-the box regulations". The issuance of these regulations dates back to 1996 when the IRS, in an attempt to simplify the prior law, gave US taxpayers a formidable tax planning device. Unlike previous regulations, the new regime allowed US taxpayers to classify foreign business entities other than per se corporation as either: (1) corporations, (2) pass through entities, or (3) single member entities (thus, disregarded for tax purposes and treated as foreign branches).[474]

The main effect of the check-the-box regulations was, and still is, allowing US-based multinationals to structure their outbound investments in the most tax-efficient manner possible. The possibility to pick the best fit for foreign investments has led to abuses in

[474] US Department of the Treasury Proposed Regulations § 301.7701-1, -2, -3, -4.

respect of hybrid mismatch arrangements. If this dissertation heavily criticised the EU approach for having provided complex hybrid rules in spite of a mirror-treatment of foreign entities, the US must be blamed twice for giving taxpayers a massive loophole to avoid their taxes.

Despite the challenging complexity and the admirable sophistication of section 267A and its regulations, the Tax Cuts and Jobs Act did not appear to have solved the hybrid-based tax arbitrage problem. Instead of focusing on the roots of the issue, the 2017 tax reform acted on its consequences and thus it is doomed to fail. Moreover, an additional complication already explained in the second chapter can arise from the interplay between section 267A and income tax treaties. Sometimes, international obligations provide a safe harbour for multinational enterprises as in the McDonald's case looked at in the second chapter. As a brief reminder, the fast-food giant had a foreign branch within the US which licensed IP rights abroad and was not subject to US tax under a special sourcing rule which does not consider as US-source income the revenues generated by offices or fixed places of business set up within the US for export purposes only.[475] However, according the US-Luxembourg income tax treaty, the US branch of the Luxembourg company was a US permanent establishment, therefore, not subject to taxation in Luxembourg. The case took place before the enactment of section 267A, but it is still doubtful whether anti-hybrid provisions could apply to this fact pattern. As a matter of fact, there is no deductible payment in the US but a non-inclusion which does not refer to hybrid dividends. Accordingly, similar arrangements could still allow multinational enterprises to make massive untaxed profits notwithstanding the new-generation anti-hybrid rules.

3.4 The CFC Regime in the US and the new GILTI tax

The other significant core part of US international tax law consists of all the intricate and multiple regimes concerning controlled foreign corporations and, more broadly, anti-deferral provisions. The US is well-known in the area of CFC legislation for having introduced for the first time in history an anti-deferral tax regime under the Kennedy

[475] Internal Revenue Code 1986, 26 USC § 865(e)2B.

administration. In his speech before the Congress on April 20, 1961, the US President John Fitzgerald Kennedy affirmed:

> *"Changing economic conditions at home and abroad, the desire to achieve greater equity in taxation […]compel us to examine critically certain features of our tax system […]. Elimination of tax deferral privileges in developed countries and "tax haven" deferral privileges in all countries. Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to United States tax only when they are returned to the parent company in the form of dividends. In some cases, this tax deferral has made possible indefinite postponement of the United States tax; and, in those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through overseas subsidiaries that is not available to companies operating solely in the United States".*[476]

The words pronounced by JFK, apart from their political implications, make clear that the goal of the anti-deferral legislation is countering aggressive tax avoidance practices. From a tax law perspective, the speech is full of technicalities and can be fully understood in its far-reaching implications just by those who are familiar with international tax law concepts. It is noteworthy to mention that the use of such a degree of complexity is unusual for politicians and has often remained extraneous to their speeches.

The US regulatory framework of anti-deferral is composed of four different regimes: (1) subpart F, (2) passive foreign investment companies (PFIC), (3) investment of earnings in US property and, last but not least, (4) the newly-introduced global low-taxed intangible income (GILTI). The analysis will begin with some common definitions and

[476] President John Fitzgerald Kennedy, 'Special Message to the Congress on Taxation' [1961] Tax History Project Article Archive.

rules regarding previously taxed income and then focus on each single anti-deferral body of law.

Generally speaking, anti-deferral applies to foreign corporations if they are controlled foreign corporations (not for PFICs). A foreign corporation falls into the definition of controlled foreign corporation if more than 50% of the stock, either by vote or value, is owned by US shareholders.[477] Even the term US shareholder has a specific meaning which differs from the one attributed in everyday language. As a matter of fact, any interest holder in a foreign corporation which has at least 10% of its stock, either by vote or value, is considered a US shareholder under the definition of the code.[478] For the purposes of determining the stock ownership in respect of a CFC, the Internal Revenue Code provides for direct, indirect and constructive attribution rules. Under section 958(a), a US interest holder is deemed to have all the stock it holds directly and the pro rata share of stock which it holds through foreign entities. Section 958(b) deals with constructive ownership and it is more complex.[479] There are three types of constructive attribution. Firstly, in the case of family members, the stock they own are aggregated for the purposes of establishing whether more than 50% of a foreign corporation is owned by US shareholders.[480] Secondly, if both a US individual and a US entity in which the same US person is an interest holder own stock of a foreign corporation, there are two other constructive attribution rules. The “upward attribution” considers the US individual as owning its stock plus the pro rata share of stock owned indirectly through the domestic entity.[481] The “downward attribution” considers the domestic entity as owning its stock, if any, plus all the stock owned by its interest holder.[482] The downward attribution has been amended by the Tax Cuts and Jobs Act with the consequence that, even though a US entity does not own any stock in a foreign corporation, it is considered to own any ownership percentage owned by its parent company or individual shareholders. However, in this case there would be no income inclusion since there is no direct ownership (as a

[477] Internal Revenue Code 1986, 26 USC § 957(a).
[478] Internal Revenue Code 1986, 26 USC § 951(b).
[479] Internal Revenue Code 1986, 26 USC § 958(a)1A-B.
[480] Internal Revenue Code 1986, 26 USC § 958(b)1, 318(a)1A.
[481] Internal Revenue Code 1986, 26 USC § 958(b)2, 318(a)2.
[482] Internal Revenue Code 1986, 26 USC § 958(b)3, 318(a)3.

matter of fact, the deemed inclusion takes into account only section 958(a) direct ownership).

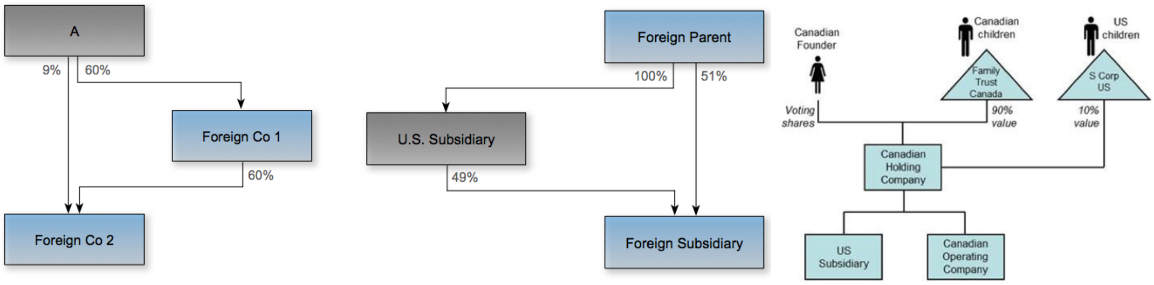


Figure 3.12: Neha Rastogi and others, 'Changes to CFC Rules – More CFCs, More US Shareholders, More Attribution, More Compliance' (2018) 5 Insights 3; KPMG, 'More Canadian Companies May Now be Considered US CFCs' [2018] Newsletter.

The three charts above show nearly all the combinations of ownership attribution under section 958(a) and –(b). Apart from the plain-vanilla direct ownership, the first diagram starting from the left is an example of indirect ownership. Assuming A is a US citizen, the stock owned through Foreign Co 1 is attributed pro rata. Thus, A owns 45% of Foreign Co 2 (9% plus 60% multiplied by 60% which is 36%). In the second chart there is an example of downward attribution. The US subsidiary owns just 49% of Foreign Subsidiary. However, by virtue of section 958(b) it is considered to own also all the stock of its Foreign Parent, thus, possessing constructively 100% of Foreign Subsidiary. Assuming that Foreign Parent were a US parent company, there would be an upward attribution of the pro rata share of the stock owned by US Subsidiary in Foreign Subsidiary. Lastly, the last diagram on the right shows the family constructive attribution (together with indirect ownership). Assuming that the Canadian children were resident-aliens, their stock ownership would be added to the US grandchildren, thus, resulting in a 100% indirect ownership of US Subsidiary, which in turn would constructively own all stock of Canadian Operating Company.

Another important consideration, before delving into subpart F and the other anti-deferral provisions, concerns the dual mechanism designed under the code to avoid a phenomenon of double taxation on deemed included income when an actual distribution or the sale of the stock takes place. It is necessary to remember that the deemed inclusion operates only in respect of the stock held directly or indirectly (not constructively).[483] Under section 959, any actual distribution of dividends which have been already subject to a deemed inclusion under either subpart F or GILTI is not included a second time in the gross income of the US shareholder.[484] The rule applies also to chains of CFCs. If a US shareholder has a CFC and one or more lower tier CFCs, the deemed inclusion operates for every CFC. For this reason, when the actual distribution occurs, either to other upper tier CFCs or to the US shareholder, no inclusion is required.[485] The previously taxed income exclusion from gross income applies also to passive foreign investments companies which did not opt for the deferral of the deemed includible dividends.[486] With regard to investments of earnings in US property, the previously taxed income exclusion applies to both actual distributions and income which has already been taxed under other anti-deferral regimes.[487] As a matter of fact, section 956 could, in the absence of any such provision, double the CFC's tax bill by applying not only to income already taxed under the same section 956, but also to income subject to subpart F or GILTI.

The other scenario where double taxation could possibly occur is the sale of stock in a CFC. Given that under section 1248 the sale of a CFC's stock is treated as a dividend, the income so generated is subject to the anti-deferral mechanism under the same conditions explained so far.[488] In this scenario, instead of receiving an actual distribution, the US shareholder is the beneficiary of the appreciation of the stock which is due to the retained earnings and profits found in the CFC. Given that these earnings and profits have been already taxed, it would be unjust to tax them a second time upon sale of the stock. In order to avoid double taxation, the code requires an increase in the adjusted tax basis of the stock equal to the amount of income already subject to anti-deferral under subpart F or GILTI.[489] By contrast, any actual distribution requires a reduction of the adjusted tax basis of the stock since the retained earnings and profits are distributed tax-free under section

---

483 Internal Revenue Code 1986, 26 USC § 951(a)2; The subpart F rules are applicable also to other anti-deferral regimes so long as they are compatible with the specific rule of each alternative anti-avoidance mechanism.
484 Internal Revenue Code 1986, 26 USC § 959(a), 951A(f)1A.
485 Internal Revenue Code 1986, 26 USC § 959(b).
486 Internal Revenue Code 1986, 26 USC § 1293(c).
487 Internal Revenue Code 1986, 26 USC § 959(c), -(f).
488 Internal Revenue Code 1986, 26 USC § 1248(a).
489 Internal Revenue Code 1986, 26 USC § 961(a), 951A(f)1A.

959.[490] The stock basis value increases and reductions apply also to passive foreign investment companies which did not opt for the deferral of the deemed includible dividends.[491]

Following the explanation of the common grounds of all anti-deferral regimes, it is necessary to analyse the most significant one, namely subpart F. Subpart F income is composed of several categories of mobile low-taxed foreign derived income: (1) foreign personal holding company income, (2) foreign base company sales income, (3) foreign base company services income and (4) insurance income. Also income derived from illegal activities and business activities carried out in foreign countries involved in international boycotts are treated as subpart F income.[492] However, the dissertation will not focus on these last two types of subpart F income since their inclusion is based upon political (instead of tax policy) considerations. With regard to foreign base company sales and services income, the code allows the IRS to adjust the related parties' transaction under section 482 and the transfer pricing regulations, but subpart F provisions offer a more effective way to tax the reallocated profits shifted abroad.

Foreign personal holding company income is basically a term used by the code to identify all foreign base passive income: dividends, interests, rents, royalties, net gains from the sale of passive-income producing assets or non-income producing assets and substitute payments.[493] Generally speaking, these types of passive income are isolated from the US parent company and shifted to a foreign subsidiary located in a low-tax jurisdiction. Despite the general definition, there are many exceptions to the foreign personal holding company income. Firstly, interest income derived from the active conduct of the banking business which generates qualified banking or financing income does not constitute subpart F income.[494] This exception can also be satisfied by a qualified business unit (in other words, a branch) of a CFC given that in the banking industry foreign business is generally dealt with through a branch rather than an incorporated subsidiary due to regulatory burden (namely, obtaining a new charter and creating adequate capital

[490] Internal Revenue Code 1986, 26 USC § 961(b), 951A(f)1A.
[491] Internal Revenue Code 1986, 26 USC § 1293(d), 1296(b).
[492] Internal Revenue Code 1986, 26 USC § 952(a).
[493] Internal Revenue Code 1986, 26 USC § 954(a)1, -(c).
[494] Internal Revenue Code 1986, 26 USC § 954(h).

requirements in the foreign country). The code also provides a similar exception for the insurance business which, instead of interests, makes profits out of premiums.[495]

Another relevant exception to the foreign personal holding company income is the active business exception in respect of rents and royalties.[496] This rule applies every time the rents and royalties are earned by virtue of an active trade or business carried out by the employees of the CFC, rather than through contracts concluded with related parties. The exception can be satisfied either through extensive production activities or marketing and servicing performances.[497] Although rents and royalties received by a CFC from a related party cannot meet the requirements of the active business exception, they are still not considered subpart F income if they are paid from a related CFC incorporated in the same country which conducts an active trade or business.[498] This rule is called "same country exception" and applies also to dividends and interests.[499] The last exception to the foreign personal holding company income is the "look through rule".[500] This exception is broader than the previous one and deems active income all dividends, interests, rents and royalties received from a related CFC incorporated in a foreign country if it carries out an active trade or business. Basically, the payment assumes the same character of the underlying income thereby becoming active and non-includible in the subpart F category.

A last remark should be made with regard to tax planning strategies and the look through exceptions. Given that dividends, interests, rents and royalties can be assimilated to the underlying income of the lower tier CFC, when a upper tier CFC sells the stock of a lower tier CFC it recognises a gain which is taxed as subpart F. In order to avoid this detrimental treatment there are two options: (1) the sale of the active assets followed by a dividend distribution (asset deal), or (2) the sale of the stock when the lower tier CFC has elected to be treated as a flow through entity, thus, replacing the recognition of a passive gain on

---

[495] Internal Revenue Code 1986, 26 USC § 954(i).
[496] Internal Revenue Code 1986, 26 USC § 954(c)2A.
[497] US Department of the Treasury Regulations § 1.954-2(d)1, -2T.
[498] Internal Revenue Code 1986, 26 USC § 954(c)3A(i).
[499] Internal Revenue Code 1986, 26 USC § 954(c)3A(ii).
[500] Internal Revenue Code 1986, 26 USC § 954(c)6.

stock with an active gain on business assets (which are the same shares, but fiscally transparent) (pass through share deal).[501]

The second category of foreign base company income is the foreign base company sales income.[502] This type of subpart F income is derived from the sale of property to related parties when such inventory is produced outside the CFC's country of incorporation and sold for the use or consumption abroad.[503] The sale can either follow a previous purchase from a related party or be made in accordance with an agency agreement to sell related parties' products upon commission fees. This rule suffers from two exceptions: (1) the destination exception and (2) the manufacturing exception.[504] More specifically, whenever the inventory property is manufactured abroad, but sold locally or vice versa, the income so generated does not fall within the foreign base company sales income. A special rule applies to foreign branches of controlled foreign corporations which are used to sell inventory manufactured abroad outside the country where they are set up.[505] These branches, if subject to an effective tax rate less than 90% of the CFC's tax rate and at least 5% points less than the CFC's tax rate, are considered separate CFCs for tax purposes so long as the head office does not tax their profits based upon a territorial tax system or a foreign branch exemption rule.[506] The foreign base company sales income characterisation does not apply when the CFC sells property manufactured from an unrelated party, although the manufacturer is a contract manufacturer.[507] This rule could potentially allow US taxpayers to use unrelated parties to mediate the sale to their CFCs. Additionally, although a large part of the manufacturing process takes place abroad, the CFC is not considered to have foreign base company sales income if it makes a "substantial contribution" to the manufacture of the inventory.[508] To conclude with

---

[501] Charles H Gustafson, Robert J Peroni, Richard Crawford Pugh, *Taxation of International Transactions* (West Publishing, 4th edn, 2011), 549-553; *Dover Corp v Commissioner* 122 TC 324 (2004).
[502] Internal Revenue Code 1986, 26 USC § 954(a)2, -(d).
[503] Internal Revenue Code 1986, 26 USC § 954(d)1
[504] Internal Revenue Code 1986, 26 USC § 954(d)1A-B; US Department of the Treasury Regulations § 1.954-3(a)4(iii).
[505] Internal Revenue Code 1986, 26 USC § 954(d)2.
[506] US Department of the Treasury Regulations § 1.954-3(b)1.
[507] *Ashland Oil Inc v Commissioner* 95 TC 348 (1990); *Vetco Inc v Commissioner* 95 TC 579 (1990).
[508] US Department of the Treasury Regulations § 1.954-3(b).

section 954(d), it need to be said that the use of interposed partnerships between a US parent and its CFC or the use of a partnership as a selling agent on behalf of the CFC does not allow to avoid subpart F income.[509] As a matter of fact, despite the look through treatment of partnerships' earnings, the Treasury regulations consider this scheme abusive and treat the partnership as a corporation.

The last type of foreign base company income is foreign base company services income.[510] This category of income is composed of income derived from the performance of services for or on behalf of a related party outside the CFC's country of incorporation.[511] The services covered by the provision are: technical, managerial, engineering, architectural, scientific, skilled industrial, commercial or similar services. The aim of this foreign base company income provision is preventing the isolation of services income form the parent company by setting up a subsidiary in a low tax jurisdiction. Again, there are two exceptions: (1) the destination rule and (2) the manufacturing rule. Under the first rule, whenever the CFC performs services within the country where it is organised, there is no subpart F inclusion.[512] According to the manufacturing exception, when the services provided are related to inventory property which is manufactured by the same CFC the income so derived does not fall in the foreign base company services umbrella.[513] Another important fact pattern which is deemed to give rise to subpart F is the so called substantial assistance test.[514] If a CFC which provides services outside its country of incorporation receives substantial assistance from the US parent company or another CFC the income so derived is foreign base services income. This is so even though the second CFC provides substantial assistance in its country of incorporation. To be more clear, suppose US parent owns CFC 1 and CFC 2 in country 1 and 2 respectively.[515] CFC 1 provides services in country 2 by hiring CFC 2 in return for the payment of a at arm's length fee. Basically, CFC 1 earns the majority of

---

509 US Department of the Treasury Regulations § 1.954-1(g)3.
510 Internal Revenue Code 1986, 26 USC § 954(a)3.
511 Internal Revenue Code 1986, 26 USC § 954(e)1.
512 Internal Revenue Code 1986, 26 USC § 954(e)1B.
513 Internal Revenue Code 1986, 26 USC § 954(e)2.
514 US Department of the Treasury Regulations § 1.954-4(b).
515 Mindy Herzfield, Richard L Doernberg, *International Taxation in a Nutshell* (West Academic Publishing, 11th edn, 2018), 253.

the income by not carrying out any effective activity, while CFC 2, generally located in a high-tax jurisdiction, earns only some fees. Under these scheme, the US parent shall include CFC 1's income in its gross income.

In order to conclude the analysis of foreign base company income, it is necessary to briefly talk about the allocation and apportionment of deductions of CFCs' expenses in favour of other related parties which give rise to further subpart F income. Under subpart F rules, each CFC is taxed upon the net foreign base company income it earned. This means that if the CFC has both subpart F and non-subpart F income, as it is usually the case, all payments giving rise to subpart F income in respect of other CFCs shall be deducted first against foreign base company income and only then against non-subpart F income. For instance, the payment of interest to a related party reduces first the portion of foreign personal holding company income and only then the rest of the foreign base company income and eventually non-subpart F income.

The last type of subpart F income which, however, does not belong to foreign base company income is the insurance income.[516] This type of income is derived from the premiums received in consideration of the insurance of risks located outside the country of incorporation. Unlike other categories of subpart F income, insurance income can arise even though the foreign company is not a more-than-50%-owned CFC and the interest holders are not US shareholders. As a matter of fact, the captive insurance company is treated as a CFC so long as it is at least 25%-owned by any US person regardless of their ownership percentage.[517] The Internal Revenue Code adopted this solution to prevent that insurance companies set up abroad were owned by more than ten equal shareholders for the sole purposes of insuring them thereby shifting profits to low-tax jurisdictions.

The last issue concerning subpart F income concerns the existence of certain special rules which simplify the tax administration work when assessing the existence of any foreign base company income or insurance income. Following the recommendations of the OECD (which, as pointed out in the first chapter, expressly called for G20 countries to

[516] Internal Revenue Code 1986, 26 USC § 952(a)1.
[517] Internal Revenue Code 1986, 26 USC § 953(c).

introduce an exemption threshold and an effective tax rate exclusion),[518] the US income tax code provides taxpayers with: (1) a de minimis exclusion, (2) a full inclusion rule and (3) a so called high-tax kickout exception. According to the de minimis exclusion, although a CFC might report some subpart F income, none of that income shall be subject to the anti-deferral mechanism if such income amounts to less than the lower of 5% of the total gross income or $1 million.[519] This rule is in force since every company, even manufacturing ones, has a portion of foreign personal holding company income derived from interests on deposits, financing sales and the like despite the fact that they are engaged in an active trade or business. By contrast, the Internal Revenue Code (this time without any suggestion from the OECD) establishes a full inclusion rule under which every company having subpart F income exceeding 70% of its total income shall consider also the rest of its gross income as subpart F.[520] The full inclusion rule operates only for subpart F purposes and does not apply when determining the foreign tax credit basket of the deemed included income. Lastly, the US tax law framework has laid down another exception to the subpart F deemed inclusion which relies solely upon the effective tax rate paid by the CFC to the foreign Treasury. Any foreign base company or insurance income subject to an effective foreign tax rate of at least 90% the US one (therefore, 18.9%) shall not include any such income in the gross taxable base of its US parent corporation.[521] In order to provide the reader with a better understanding of the de minimis rule, the high-tax kickout and the full inclusion rule, the following formulas will summarise what explained so far.

$$de\ minimis\ rule \rightarrow gross\ subpart\ F\ income < \begin{cases} 5\%\ gross\ income < \$1\ million;\ or \\ \$1\ million < 5\%\ gross\ income \end{cases}$$

$$high - tax\ kickout\ \rightarrow \frac{foreign\ taxes}{net\ foreign\ income + gross - up} \geq 18.9\%$$

[518] OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015).
[519] Internal Revenue Code 1986, 26 USC § 954(b)3A.
[520] Internal Revenue Code 1986, 26 USC § 954(b)3B.
[521] Internal Revenue Code 1986, 26 USC § 954(b)4.

$$full\ inclusion\ rule \rightarrow gross\ subpart\ F\ income > 70\%\ total\ gross\ income$$

Finally, it needs to be pointed out that the subpart F income generated in one taxable year can probably differ from the earnings and profits of the controlled foreign corporation. The subpart F income can exceed the earnings and profits (subpart F excess) or be negative if the activities generating deemed includible income gave rise to a loss. In case of subpart F excess, the exceeding part is carried forward and future non-subpart F income and is recaptured as such.[522] Vice versa, in case of subpart F deficit, it can be carried forward to offset future subpart F income arising in the same activity,[523] or offset subpart F income of other related controlled foreign corporations so long as they are organised in the same country and wholly owned.[524]

After having considered the subpart F provisions, it is now time to focus on the newly-enacted CFC regime known as GILTI (global intangible low-taxed income). Unlike subpart F, which is designed to make sure that US persons cannot shift mobile income to low-tax jurisdictions, the Tax Cuts and Jobs Act shaped the new GILTI as an alternative minimum tax on controlled foreign corporations so as to ensure a minimum tax bill upon multinational enterprises.

In technical terms, GILTI means, with respect to any US shareholder, the excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The net deemed tangible income return is statutorily set at 10% of the qualified business assets investment (QBAI) minus the net interest expense.[525]

$$GILTI = Net\ CFC\ tested\ income - (10\%QBAI - \ net\ interest\ expense)$$

As it can easily be understood, unlike subpart F, GILTI is calculated at shareholders' level and not at CFC level. This complicates the calculation, but allows to mingle GILTI inclusions of different CFCs (whether for each shareholder only or at the level of consolidated group will be seen later on). The net tested income is simply the pro rata

[522] Internal Revenue Code 1986, 26 USC § 952(c)1A, -2.
[523] Internal Revenue Code 1986, 26 USC § 952(c)1B.
[524] Internal Revenue Code 1986, 26 USC § 952(c)1C.
[525] Internal Revenue Code 1986, 26 USC § 951A(b).

share of the CFC's tested income minus the pro rata share of the CFC's tested loss (including foreign taxes).[526] The CFC's tested income is the gross income earned by the controlled foreign corporation without regard to certain items of income: (1) effectively connected income with the US, (2) subpart F income, (3) any income which is taxed at 18.9% or more (so called high-tax kickout), (4) dividends received from another CFC subject to the look through rule and (5) any foreign oil and gas income as defined under section 907(c)1.[527]

The qualified business assets investment is the annual average aggregate of the adjusted taxable bases of all tangible property used in a trade or business carried out by the CFC and with respect to which the code allows a deduction under section 167.[528] If the CFC holds an interest in a partnership, the 10% of its pro rata share of the partnership's QBAI will be included too. As a general rule, it is only the amount equal to the 10% QBAI which is not subject to US tax and is allowed to benefit from the newly enacted foreign dividend deduction under section 245A. Generally speaking, in the case of highly profitable companies the earnings and profits will exceed by far the 10% QBAI resulting in a hefty tax bill for multinational enterprises. As a matter of fact, the deemed tangible return is statutorily set at 10%, but this does not necessarily reflects the value of IP rights or other intangible assets. In brief, the combination of subpart F first and GILTI then will subject to US tax almost all income produced abroad which benefits from low taxation.

In order to show the efficacy of GILTI, suppose a US corporation owns 100% of CFC 1. CFC 1 has $200 subpart F, $300 income, $400 expenses and $100 QBAI.[529] If foreign taxes paid are $0 (otherwise they should be deducted), the subpart F inclusion would be $40 ($200 minus $160), while the tested income would be $60 ($300 minus $240). The GILTI inclusion would be $50 ($60 minus $10 which is 10% QBAI). In the end, out of $100 income $90 is subject to US tax either through subpart F or GILTI.

[526] Internal Revenue Code 1986, 26 USC § 951A(c)1.
[527] Internal Revenue Code 1986, 26 USC § 951A(c)2.
[528] Internal Revenue Code 1986, 26 USC § 951A(d)1.
[529] Mindy Herzfield, Richard L Doernberg, *International Taxation in a Nutshell* (West Academic Publishing, 11th edn, 2018), 262-63.

Once the GILTI inclusion has been calculated, the calculation of the US tax requires other necessary steps. First, the GILTI inclusion must be grossed up by the foreign taxes paid (since foreign taxes are deducted to calculate the GILTI inclusion) multiplied by the ratio obtained by dividing the GILTI inclusion over the tested income.

$$gross - up = foreign\ taxes \times \frac{GILTI\ inclusion}{tested\ income}$$

Secondly, only for corporate US shareholders (not individual US shareholders) section 250 allows a 50% deduction of the grossed-up GILTI inclusion in order to grant the same tax treatment of the FDII (which will be analysed further on).[530] Basically, instead of paying 21% of US taxes, the deduction reduces such amount to 10.5%. However, unlike subpart F, the deemed paid credit for foreign taxes is not granted entirely, but only up to 80% of the ratio of foreign taxes paid upon the GILTI inclusion.[531] As such, the effective tax rate paid on GILTI rises to 13.125%. Moreover, the 2017 tax reform has created a separate foreign tax credit basket for GILTI and does not allow any carry-back or carry-forward of excess foreign taxes paid abroad[532] This mechanism of reduced recognition of foreign taxes and the impossibility to carry forward eventual excess foreign tax credit has not so seldom rendered subpart F inclusion more convenient than GILTI for multinational enterprises.

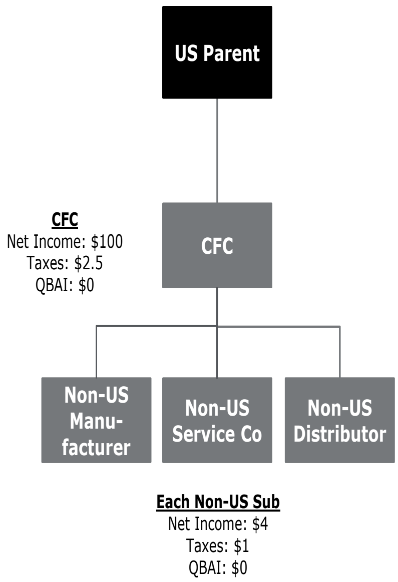
$$deemed - paid\ credit = 80\%\ foreign\ taxes \times \frac{GILTI\ inclusion}{tested\ income}$$

$$UStax = \left(\left(\frac{GILTI\ inclusion + gross - up}{2}\right) \times 21\%\right) - deemed - paid\ credit$$

To follow-up on the detailed explanation of how the new GILTI works, it can be useful to provide the reader with an example of a practical example of the GILTI due by a US corporate shareholder which controls a CFC.

[530] Internal Revenue Code 1986, 26 USC § 250.
[531] Internal Revenue Code 1986, 26 USC § 951A(e)2.
[532] Internal Revenue Code 1986, 26 USC § 904(c), -(d).

Example post-US tax reform:



Effective Tax Rate on GILTI

- Global Intangible Low Taxed Income: $100 + $4 + $4 + $4 = $112 - (10% * QBAI) = $112
- Deemed deduction: 50% * $112 = $56
- GILTI taxation: ($112 - $56+$5.5) * 21% = $12.92
- Foreign tax credit calculation:
  - Inclusion percentage: 112/112 = 100%
  - Aggregate foreign income taxes: $2.5 + $1 + $1 + $1 = $5.5
  - Deemed paid credit: 80% * 100% * $5.5 = $4.4
- GILTI taxation after credit: $12.92 - $4.4 = $8.52
- **Effective tax rate on GILTI:**
  - $5.5 foreign tax + $8.52 GILTI tax = $14.02 total tax
  - $14.02 / $112 * 100 = **12.52%**

Key considerations:

- Need to allocate expenses and taxes between tested income and other categories of income such as subpart F income or net deemed tangible income return
- Additional complexities exist if there are tested losses

Figure 3.13: Deloitte, 'US Tax Reform: Major US Tax Reform Impacts' [2018].

As shown in the chart above, the US Parent has a CFC which has in turn three non-US subsidiaries. The CFC net tested income is $100 plus $12 from al subsidiaries considered together. Given that the QBAI is $0, the GILTI inclusion is $112. The tentative US tax is $12.92 ($112 multiplied by 10.5%), but it shall be reduced by $4.4 which is 80% of the foreign taxes paid ($2.5 by the CFC and $1 for each non-US subsidiary). The result is an additional US tax bill of $8.52 on top of $5.5 of foreign taxes.

Following the explanation of the GILTI provisions, it is necessary to highlight the existence of two interpretative issues in respect of the application of the new tax. Firstly, it is unclear how new section 951A should related to section 163(j). As a matter of fact, when calculating the GILTI inclusion, the net tested income shall be reduced by the QBAI minus the net interest expense. It is still not clear whether the fixed ratio rule shall apply also when subtracting such amount from the QBAI. From a tax policy perspective the fixed ratio rule would keep the QBAI higher than it would be without the application of section 163(j) and thus more foreign income would be subject to the foreign dividend deduction under section 245A. Secondly, as already mentioned earlier in the text, there is uncertainty as to whether the GILTI inclusion should be limited to the single US shareholder's level or should take into account all the US shareholders which are part of a consolidated group (this can happen only among US corporate shareholders). To illustrate this situation, suppose US parent owns 100% of CFC 1 and 100% of a US subsidiary which owns 100% of CFC 2. CFC 1 has $100 tested income, while CFC 2 reports $100 tested loss. If the GILTI inclusion is calculated at the single shareholder's level, the tested income and tested loss which US parent and US subsidiary shall include cannot offset each other. By contrast, if the GILTI inclusion is made at the consolidated group's level, the tested income would be $0 and no US tax would apply. As it can be easily understood, the difference between one solution and another makes a great difference in terms of both tax consequences and tax planning for undertakings. The need for clarity is compelling and it is for this reasons that the US Department of the Treasury and the IRS have been given the power to issue regulations to further implement GILTI.[533] It is presumable that the IRS and the Treasury have a lot of work to do in order to provide taxpayers with the necessary tools to comply with the GILTI tax in the future years ahead.

The third type of anti-deferral regime is regulated under section 956 and is known as investment of earnings in US property.[534] The purpose of this section, at the time it was enacted, was to prevent US taxpayer to defer their profits abroad indefinitely and then use CFCs' loans, or other types of tax-free investments, to repatriate these capitals without paying US taxes and eventually claiming as additional deduction against US income. Under section 951(a), not only is a US shareholder taxable on his pro rata share of subpart F income, but also on any CFC's investment in US property which is made out of non-subpart F earnings and profits.[535]

Following the entry into force of the Tax Cuts and Jobs Act there several reasons to doubt section 956 is still a useful provision to maintain in the code. Firstly, following the introduction of GILTI, it has been shown that nearly all the pro rata share of the income

---

[533] Internal Revenue Code 1986, 26 USC § 951A(d)4.
[534] Internal Revenue Code 1986, 26 USC § 956(a).
[535] Internal Revenue Code 1986, 26 USC § 951(a)1A-B.

of a CFC is deemed included in the gross income of US shareholders. Therefore, under the rules concerning previously taxed income, section 956 can now apply to tax the deemed tangible return only (equal to 10% QBAI), which compared to the rest of the CFC's earnings and profits is just a small portion.[536] Secondly, even if the US taxpayer were engaged in operations which would give rise to an investment in US property and, thus, to anti-deferral, before section 956 could apply, the amount of section 956 investments must exceed the previously taxed income, since the code wants to avoid any phenomenon of double taxation.[537] In practical terms, the investment in US property should exceed the already taxed portion of subpart F and GILTI which generally consists of a large portion of the CFC's income. Imagining that a loan or another investment in the US, which exceeds the majority of the overall CFC's income, would take place is rather unlikely. Finally, the 2017 tax reform introduced a 100% foreign dividend received deduction in favour of US shareholders of 10/50 companies or CFCs (when they are not subject to either subpart F or GILTI). If a taxpayer can repatriate all earnings and profits not falling into sections 951 and 951A through an exempt distribution, why would it opt for a loan or another investment? And why should it make a difference whether it is a distribution or a loan in the light of section 163(j)? There are not any reasonable answers to these two questions and one is probably forced to assume that the law-maker made a mistake when it decided not to repeal section 956. Frankly, this provision has no purposes in the Internal Revenue Code and should be taken off as soon as possible by means of a corrective action.

The investment in US property is calculate by comparing the average annual adjusted tax basis of investments in the US by a CFC in the current taxable year with the adjusted tax basis at the end of the previous one.[538] This means that if a CFC makes a loan of $1 million to its US parent in January, all the loans consists of investment in US property.[539] If the same loan is made in July, only $500, 000 would be considered investment in US property for year 1 and the remainder for year 2.

---

[536] Internal Revenue Code 1986, 26 USC § 959(a).
[537] Internal Revenue Code 1986, 26 USC § 959(c).
[538] Internal Revenue Code 1986, 26 USC § 951(a)1B.
[539] Mindy Herzfield, Richard L Doernberg, *International Taxation in a Nutshell* (West Academic Publishing, 11th edn, 2018), 268.

The term investment in US property covers a broad range of items: (1) any indebtness of US persons, (2) any US security, (3) any tangible property located in the US and (4) any right to use intangible property in the US.[540] Furthermore, a CFC which is a partner in either a US or foreign partnership is considered to possess the pro rata share of US property belonging to the partnership for the purposes of section 956.[541] The codes provides for some notable exceptions: (1) investing in US Treasury bonds, (2) deposits in US banks, (3) a debt obligation of the parent company lasting less than 30 days so long as all the indebtness for the year is less than 60 days, (4) investing in the stock of an unrelated US corporation (which means owned by less than 25% by US shareholders in aggregate), (5) investing in US property which is related to foreign activities, (6) loans made in connection with the sale or processing of property under normal arm's length transactions.[542]

The code and regulations provide for some section 956 anti-avoidance rules. Firstly, if the US shareholders takes a loan from a bank, but the lending facility is guaranteed by the CFC or pledged by means of CFC's property, the loan is treated as investment in US property. Nevertheless, the arrangement could be structured by having the US shareholder borrow money and pledge directly the stock of the CFC. By doing so, section 956 would not apply. The second type of arrangement which the IRS tries to claw back into the application of section 956 is the use of foreign partnerships. Suppose a CFC lends money to a foreign partnership in which the US shareholder is a partner. If the money lent are used to make a distribution to the US shareholder, the CFC could avoid the application of section 956. However, the regulations treat the partnership's obligation as separate obligations of each partner to the extent of their pro rata share.[543] In such manner, the indebtness of the partnership is treated as indebtness of the US shareholder up to its ownership percentage.

To conclude the discussion about section 956, it is necessary to say that apart from the lack of reasons for its maintenance into force, taxpayers could potentially benefit from it.

---

540 Internal Revenue Code 1986, 26 USC § 956(c)1.
541 US Department of the Treasury Regulations § 1.956-4(b)1.
542 Internal Revenue Code 1986, 26 USC § 956(c)2.
543 US Department of the Treasury Regulations § 1.956-4(c).

As a matter of fact, while the investment in US property was initially enacted as an anti-tax-free repatriation mechanism, it could now be used as a tax planning tool. Given that GILTI grants only 80% of foreign tax credit upon foreign taxes paid abroad, section 956, if structured in a manner to take priority over GILTI, could become an effective tool to claim foreign tax credits.

The last anti-deferral regime in the US Internal Revenue Code is the so called “passive foreign investment company” (PFIC). The regime was initially enacted for granting the same tax treatment to US investors investing in domestic funds and those investing in foreign funds. As a matter of fact, taxpayers investing in mutual funds own generally low percentage ownerships which do not exceed the 10% threshold necessary to be a US shareholders as defined under section 951(b). However, the PFIC provision have more far-reaching effects than simply levelling off the playground between foreign and domestic investment companies. PFIC rules applies to any US persons which own less than 10% in either a CFC or a non-CFC which falls into the definition of passive foreign investment company. Basically, PFIC is an anti-deferral provision which is totally unrelated to the common concepts explained at the outset of this paragraph.

Firstly, it is necessary to understand what PFIC means. Section 1297(a) defines under the label of passive foreign investment corporation any foreign company which meets either the “passive income test” or the “passive assets test”.[544] According to the first test, a foreign company is treated as a PFIC when 75% or more of its gross income is passive income.[545] The terms passive income encompasses interests, dividends, rents, royalties, gains from assets not used in a trade or business and more broadly all income which falls into the definition of foreign personal holding company income under section 954(c).[546] However, if such passive income is received from a related party within the meaning of section 954(d)3 (which means subject to control or common control by vote or value by more than 50%) then a look through rule applies.[547] In short, so long as the underlying income produced by the related party is active, even the interests, dividends, rents,

[544] Internal Revenue Code 1986, 26 USC § 1297(a).
[545] Internal Revenue Code 1986, 26 USC § 1297(a)1.
[546] Internal Revenue Code 1986, 26 USC § 1297(b)1.
[547] Internal Revenue Code 1986, 26 USC § 1297(b)2C.

royalties shall be considered active. A second look through rule applies in respect of foreign corporations which own at least 25% by value of another corporation. To determine whether the controlling company is a PFIC, the pro rata share of the income of the other company shall be treated as received directly.[548] It is important to remind that the income test uses gross income as a factor. As such, if net income is mainly active, but gross income before passive deductions is predominant, then, the foreign company shall be a PFIC.

The second test is based upon ownership of passive assets.[549] If the average percentage of assets which are held for the production of passive income is at least 50% or more, then, the foreign company is treated as a PFIC for tax purposes. If the tested company is not publicly traded, it can choose between using the default fair market value or the elective adjusted tax basis value to determine whether the 50% threshold is reached.[550] Also this test has a look through rule. Again, if the tested foreign corporation owns at least 25% by value in another company, then, the pro rata share of assets held by the lower-tier company is treated as held directly by the upper-tier company.[551]

Before going on to analyse the three different taxation patterns of PFICs, it is necessary to give a brief overview of the so called "once a PFIC, always a PFIC rule".[552] In simple words, once a foreign company meets either the income test or the asset test, the qualification as PFIC is not lost even though these requirements are not met in future taxable years. If the taxpayer wants to avoid the anti-deferral regime, it can purge its stock in the foreign company from the PFIC taint. The way to do so is straightforward. The taxpayer is required to treat the stock as if it was sold and pay to the Treasury the tax due on the eventual earnings and profits of the PFIC. If the PFIC has no earnings and profits, then, the purging of the stock is costless. The deemed sale allows US taxpayers to purge

548 Internal Revenue Code 1986, 26 USC § 1297(c)2.
549 Internal Revenue Code 1986, 26 USC § 1297(a)2.
550 Internal Revenue Code 1986, 26 USC § 1297(e)2.
551 Internal Revenue Code 1986, 26 USC § 1297(c)1.
552 Internal Revenue Code 1986, 26 USC § 1298(b)1.

their tainted shares and benefit from deferral once again, unless they are corporate shareholders and thus reive the foreign dividend deduction.[553]

As we said at the beginning of the PFIC analysis, this set of rules can apply to both CFCs and non-CFCs. Whenever a US persons has less than 10% in a foreign company (also a CFC) which is a PFIC or even more than 10% in a specified ten-percent-owned foreign company (also known as 10/50 company) which is again a PFIC, the anti-deferral rules for passive foreign investment companies apply. Basically, if a CFC is also a PFIC there could be an overlap between subpart F and PFIC regimes. However, the code provides that subpart F provisions always take priority over PFIC rules.[554] Suppose that a CFC, which is also a PFIC, has one US shareholder owning 51%, a US person owning 4% and another foreign investor owning 40%. The US shareholder will be taxed according to subpart F rules, while the US person will be taxed under PFIC law. It is also useful to provide an example with a 10/50 company, a non-CFC which has US shareholders. Supposes a foreign company, which is a PFIC, has three US corporate (not individual) shareholders having 15% each and one foreign investor having the remaining 55%. The foreign company is not a CFC, but it is a PFIC. Subpart F provisions do not apply to 10/50 companies, but PFIC rules can. As a matter of fact, if the foreign 10/50 company did not have PFIC status the dividends could have been subject to section 245A exemption for corporate US shareholders. However, the three US corporate shareholder will be subject to the anti-deferral PFIC rules and thus have to include the earnings and profits in their gross income. It is reasonable to assume that the same rules apply with regard to GILTI despite there no being any such clarification. Again the IRS is supposed to clarify this issue.

Following the clarifications between the CFC-based anti-deferral rules and PFIC, it is time to analyse the three taxation patterns offered by the code, a default one and two elective. If the US taxpayer does not make any election, the so called "deferred interest charge method" applies.[555] The taxation of the earnings and profits derived from the PFIC

[553] Internal Revenue Code 1986, 26 USC § 245A.
[554] Internal Revenue Code 1986, 26 USC § 1297(d)1.
[555] Internal Revenue Code 1986, 26 USC § 1291.

are deferred up until an excess distribution or the sale of the stock takes place.[556] The benefit of deferral is countered by the application of an interest rate on the deferred tax amount.[557] An excess distribution means a distribution by the PFIC which exceeds 125% of the average annual distribution made in the previous taxable years.[558] With regard to the disposition of the stock, any such arrangement will trigger taxation of the earnings and profits derived from built-in capital gains.[559]

The second method applies whenever a taxpayers makes a "qualified electing fund" election.[560] By doing so, the US taxpayer is taxed annually on its deemed included pro rata share of the earnings and profits of the qualified electing fund. This method works exactly like subpart F and allows for foreign tax credit recognition as well as previously taxed income and stock basis adjustments.[561] The qualified electing fund election, once made, cannot be revoked without the consent of the IRS.[562]

The last PFIC taxation method is named mark-to-market. The application of such anti-deferral regime is subject to two requirements: (1) the election to be taxed under the mark-to-market method and (2) the stock of the passive foreign investment company must be regularly traded on a stock exchange (e.g. an exchange traded fund (ETF)).[563] Once the election has been made, the taxpayer includes in its gross income either the income or loss derived from the appreciation or depreciation of the stock according to its fair value at the end of the year.[564] The election cannot be revoked, unless there is the consent of the IRS or the stock ceases to be regularly traded on any stock exchange (e.g. delisting operation).[565]

As the dissertation showed, the US tax legislation concerning anti-deferral regimes is extremely developed and modern, but also very complex and intricate. Tax planners and

[556] Internal Revenue Code 1986, 26 USC § 1291(a) 1-2.
[557] Internal Revenue Code 1986, 26 USC § 1291(c).
[558] Internal Revenue Code 1986, 26 USC § 1291(b)2.
[559] Internal Revenue Code 1986, 26 USC § 1297(a)2.
[560] Internal Revenue Code 1986, 26 USC § 1293(a)
[561] Internal Revenue Code 1986, 26 USC § 1293(c)(d)(f).
[562] Internal Revenue Code 1986, 26 USC § 1295(b).
[563] Internal Revenue Code 1986, 26 USC § 1296(e)(k).
[564] Internal Revenue Code 1986, 26 USC § 1296(a).
[565] Internal Revenue Code 1986, 26 USC § 1296(k).

advisors have to master the different set of rules of how the various provisions relate to each other. Compared to other foreign countries' anti-deferral laws, the US system is way more complex and can sometimes seem fuzzy and confusing. As already proposed, section 956 should be repealed since it lost a real purpose following the GILTI tax introduction. With regard to GILTI, the Treasury and the IRS need to work a lot in order to clarify how the new anti-deferral system is supposed to be applied and complied with. Furthermore, the GILTI regime has been frowned upon by foreign countries with low-taxation regimes since the 10% return on QBAI does not reflect the economic reality of income production. Critics point out that the percentage has been arbitrarily set and that tangible assets located abroad can by far have a return margin above the 10% rate set by the Tax Cuts and Jobs Act.

3.5 The Trump's Attempt to Make the US More Competitive Internationally: Between the Foreign Divided-Received Deduction and the FDII Preferential Tax Regime

This paragraph of the dissertation will analyse two other new tax provision recently introduced by the 2017 tax reform in an attempt to make the US a more competitive environment to invest in internationally. Apart from the striking corporate income tax rate reduction (which dropped from pre-2017 35% to 21%),[566] there are other significant provisions which tried to make the US more attractive to foreign investors. The first provision to be looked at will be section 245A, followed by the transition tax under section 965. Then, the paragraph will focus on the FDII deduction and its interplay with GILTI, which has been already touched upon at the outset of this chapter.

Prior to the introduction of section 245A, US corporations were granted a dividend received deduction restricted to other domestic entities. The rule was enacted in order to limit the multiple levels of corporate taxation in case of tiered corporate structures. The percentage of the divided received deduction was related to the ownership interest which the upper tier corporation held in the lower tier one. The deduction was: (1) 50% of the dividends received if the ownership was up to 20%, (2) 65% of the dividends received if the ownership was up to 80% and (3) 100% of the dividends received if the ownership

[566] Internal Revenue Code 1986, 26 USC § 11.

was at least 80%.[567] Also, the US corporation was allowed to have a dividend received deduction from a specified 10%-owned foreign corporation with respect to the portion of the dividends sourced within the US. For instance, suppose US parent has a wholly owned foreign subsidiary with $100 income 10$ of which sourced in the US (thus, 10%). If the foreign subsidiary distributed $50 out of its earnings and profits, $5 would receive a dividend received deduction, while the remaining $45 would be subject to US tax reduced by the foreign tax credit.

The Tax Cust and Jobs Act has made the US tax system a quasi-territorial system. For the past one-hundred years the US has had a worldwide taxation system imposing US tax on outbound investments of US taxpayers. New section 245A brings a revolutionary change in the international tax provisions of the code and allows a dividend received deduction on foreign dividends received by corporate taxpayers from specified 10%-owned foreign corporations.[568] This means that the dividend received deduction is not allowed to any individual taxpayer (since there would not be a double corporate tax level) and to corporate shareholders who do not qualify as US shareholders within the meaning of section 951(b) (at least 10% ownership). The decision to exclude non-US shareholders from the participation exemption follows the same scheme adopted under prior law. As a matter of fact, before the dividend received deduction, the code, under section 902, allowed an indirect foreign tax credit (or deemed paid credit) for corporate taxpayers which has at least a 10% stake in a foreign corporation.[569] Since the tax reform introduced an exemption, there can be no credit and section 902 was repealed. However, like before, corporate taxpayers owning less than 10% in a foreign corporation cannot credit foreign taxes and neither can they benefit from the newly-enacted foreign dividend received deduction. Therefore, when planning to invest in foreign companies without exceeding the 10% threshold, the use of a partnership or S-corporation (both pass through entity) is a better choice since it allows a direct foreign tax credit under section 901 which is not subject to any ownership requirement.

[567] Internal Revenue Code 1986, 26 USC § 243.
[568] Internal Revenue Code 1986, 26 USC § 245A(a).
[569] Internal Revenue Code 1986, 26 USC § 902(a).

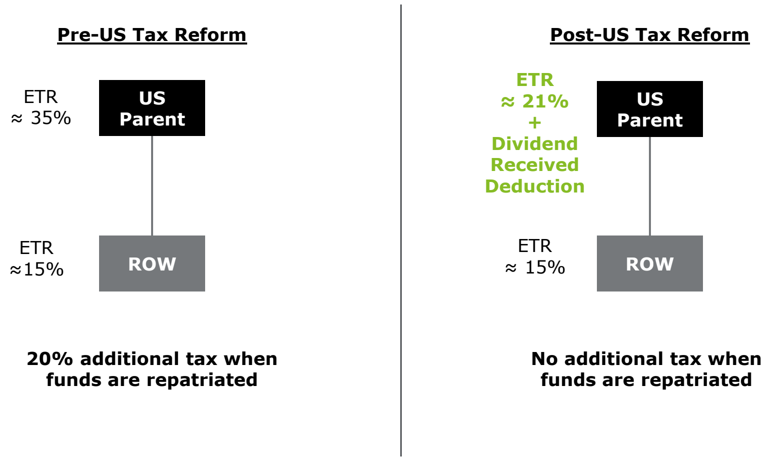


Figure 3.14: Deloitte, 'US Tax Reform: Major US Tax Reform Impacts' [2018].

After explaining the effects of section 245A, it is necessary to look at the interaction with the anti-deferral provisions. Both CFC and PFIC rules take priority over the dividend received deduction. New section 245A applies so long as neither subpart F, GILTI or PFIC rules claw back into tax the undistributed earnings and profits of the company. In order to clarify this issue, three fact patterns should be taken into account. First, if the foreign corporation has no US shareholder subpart F, GILTI and section 245A cannot apply. Only PFIC could tax the earnings and profits of the foreign corporation if it is a passive foreign investment company. Secondly, if the foreign corporation is a 10/50 company (a company with one or more US shareholders which own up to 50%, but no more), CFC rules cannot apply (neither subpart F, not GILTI), but section 245A and PFIC do. As such, the corporate US shareholders will receive exempt dividends so long as the foreign corporation is not a passive foreign investment company. Lastly, if the foreign company is a CFC, then all rules apply. Subpart F and GILTI tax all foreign income which exceeds the 10% QBAI threshold. With regard to the 10% QBAI section 245A allows US corporate shareholders to receive an exempt foreign dividend so long as the foreign corporation is not a passive foreign investment company.

The term "dividend received" shall be interpreted broadly. It is uncontested that whenever a US corporation owns the stock of a foreign corporation indirectly through a partnership, the dividend received deduction applies as if the domestic corporation were owning the shares directly.[570] The rule refers exclusively to the foreign portion of the dividend received.[571] The effectively connected income with a trade or business in the US shall be excluded from the foreign source portion. For instance, suppose foreign subsidiary, owned by US parent has a branch in the US with $100 income and its head office abroad with additional $900 income. The branch income will be taxed in the US, thus, only $900 will be granted the foreign dividend deduction.

Lastly, to conclude the analysis of section 245A, it needs to be said that the dividend received deduction is conditioned upon a minimum holding period of more than 365 days. This requirement is satisfied if the foreign corporation is a specified 10%-owned corporation and the US stockholder is a US shareholder (at least 10% ownership under section 951(b)) at all time during the holding period. Once all requirements are satisfied, the corporate shareholder will receive a tax free distribution which, however, will not be allowed any foreign tax credit in respect of any tax burden borne abroad.[572]

Before going on to talk about the FDII deduction, it is necessary to mention new section 965. The Congress had the US tax system shift from a worldwide to a quasi-territorial system. An eventual straightforward application of new section 245A would have meant the possibility to repatriate tax-free all earnings and profits parked abroad since 1986 which benefited from prior-law deferral. Basically, without any transition provision section 245A could have been applicable retroactively, meaning a great tax break for all multinational enterprises. As the dissertation pointed out at the beginning of this chapter, the majority of the international tax revenue increase reported in figure 3.1 is due to the enactment of section 965 transition tax on all deferred post-1986 earnings and profits. The purpose of this newly introduced tax is to prevent the retroactive application of the dividend received deduction and have all multinational enterprises begin with a clean slate in terms of contribution to the public expenditure. However, the enactment of this tax as a one-time levy to be paid as the price to have a more beneficial system of taxation

---

[570] Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. I* (December 18, 2017).
[571] Internal Revenue Code 1986, 26 USC § 245A(c)1.
[572] Internal Revenue Code 1986, 26 USC § 245A(d)1.

on foreign income is somewhat ironic; the immediate taxation imposed by GILTI upon CFCs' earnings and profits does seem to betray the initial purpose of the provision.[573]

Section 965 requires all US shareholders in foreign companies to include in their tax base as subpart F income their pro rata share of foreign earnings and profits which have been subject to deferral.[574] Thus, the provision applies to both CFCs and to 10/50 corporations so long as there is at least one US shareholder. The portion of foreign income to be included as subpart F does not include: (1) foreign income earned before 1986, (2) income which is effectively connected with a trade or business within the US, (3) previously taxed income under anti-deferral provisions and (4) earnings and profits accumulated by the foreign company before attaining the status of specified 10%-owned foreign corporation.

It may be the case that a US shareholder is so in respect of more than one foreign corporation and as such it may report either an earnings and profits surplus or deficit. In this circumstance, the US shareholder is allowed to offset the deficit of each specified 10%-owned corporation with the surplus of other such corporations to the extent of the percentage ratio obtaining by dividing its surplus by the overall group's surplus. Suppose a US shareholder has 4 CFCs with $100 deficit, $100 deficit, $1,500 surplus and $500 surplus each. The overall deficit of $200 is prorated upon the surplus generated by each CFC by the ratio explained above. So one CFC will be allocated $150 deficit ($200x$1500/$2000) thus reducing its surplus to $1350, while the other will be allocated $50 deficit (($200x$500/$2000) thus reducing its surplus to $450. Not only does this mechanism work at the single shareholder's level, but also within the same US affiliated group.

As shown in the chart below, US parent on the left owns two foreign subsidiaries with a surplus and a deficit respectively. The US parent is allowed to offset the deficit of foreign Sub 2 against the surplus of Foreign Sub 2. In a like manner, US parent on the right has two foreign subsidiaries. However, one is owned directly while another indirectly through US sub. Despite this, the deficit of Foreign Sub 2 can be used against the surplus of

[573] Mindy Herzfield, Richard L Doernberg, *International Taxation in a Nutshell* (West Academic Publishing, 11th edn, 2018), 278.
[574] Internal Revenue Code 1986, 26 USC § 965(a).

Foreign Sub 1 to reduce the section 965 subpart F income inclusion. In short, the deficit netting rule operates both at shareholders' and at US affiliated group's level.

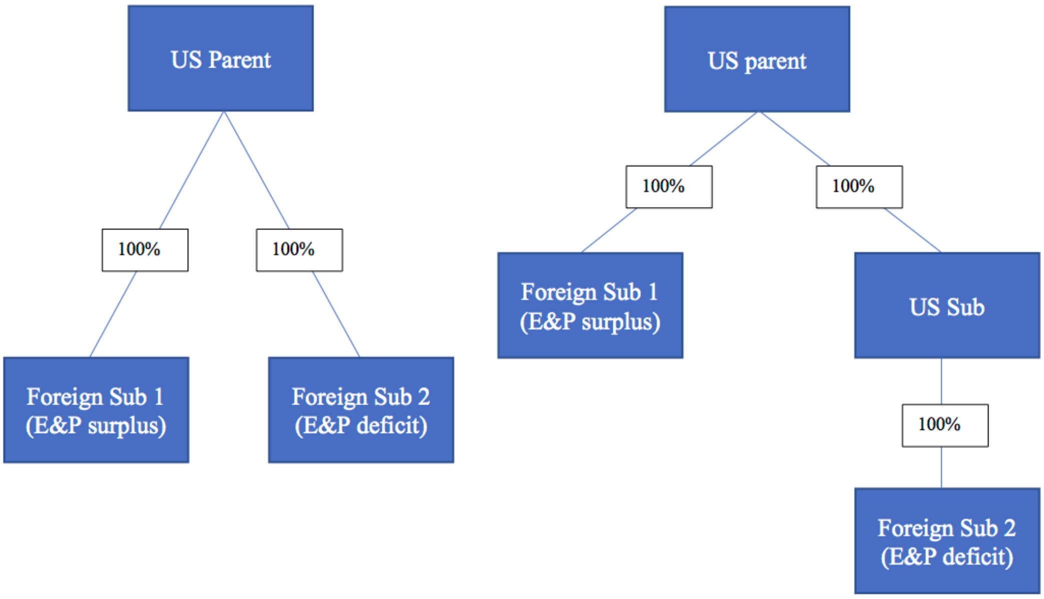


Figure 3.15: This chart was designed by the author of the dissertation.

Section 965 provides for a beneficial tax treatment upon repatriation of deferred foreign earnings and profits. The transition tax regime offers a deduction which is equal to a 15.5% tax rate upon all cash assets and 8% on non-cash assets. Section 965 defines cash assets as: (1) cash, (2) net accounts receivables and (3) securities actively traded on an established financial market. Non-cash assets are described by means of exclusion as all other assets which do not fall into the definition of cash assets. Given that a taxpayer could easily use the cash assets and convert them into non-cash ones, the Treasury and the IRS have been given the power to disregard all transactions which have to sole purpose of transforming cash assets into non-cash ones so as to benefit from a lower tax rate.[575]

[575] Internal Revenue Code 1986, 26 USC § 965(o).

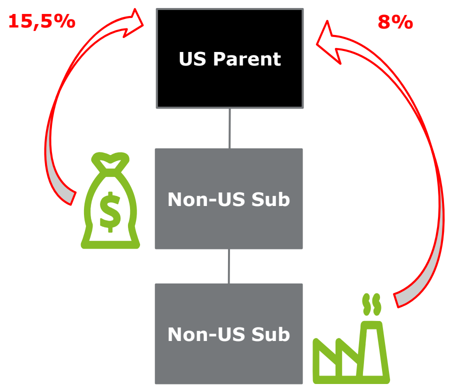


Figure 3.16: Deloitte, 'US Tax Reform: Major US Tax Reform Impacts' [2018].

For foreign tax credit proposes, a portion of the foreign taxes paid upon deferred foreign earnings and profits is disallowed.[576] More specifically, the disregarded portion of deemed paid credit is equal to 55.7% with respect to aggregate cash positions and 77.1% in respect of the remaining portion of section 965 inclusion. The transition tax gives the opportunity to all US shareholders covered by this rule to pay their tax bill in eight annual instalments.[577] However, section 965 provides an anti-abuse clause which consists of a recapture rule of the partial foreign income deduction that the US shareholder benefited from if, during a ten-year period starting from December 22, 2017, the US shareholder becomes an expatriated entity.[578] An expatriated entity is a foreign entity which has acquired all the assets of a domestic corporation without there being a substantial change in ownership.[579] By definition the foreign entity is a surrogate with respect to the former US corporation. A foreign entity is a surrogate foreign corporation if (1) it holds all the assets previously held by the domestic corporation, (2) the previous owners of the domestic corporation have at least 60% ownership of the foreign entity and (3) the expanded affiliated group does not have actual business activities in the country where the foreign surrogate is organised.[580]

[576] Internal Revenue Code 1986, 26 USC § 965(g).
[577] Internal Revenue Code 1986, 26 USC § 965(j)4.
[578] Internal Revenue Code 1986, 26 USC § 965(l).
[579] Internal Revenue Code 1986, 26 USC § 7874(a)2.
[580] Internal Revenue Code 1986, 26 USC § 7874(a)2B.

Following the explanation of section 245A and 965, the last issue to deal with in this paragraph is the newly introduced foreign derived intangible income deduction which the Tax Cust and Jobs Act adopted as an export incentive. It is noteworthy to mention that this new regime is not the first introduced in terms of export subsidies. As a matter of fact, the first export subsidy dates back to 1971 when the US Congress enacted the domestic international sales company (DISC) legislation which had the practical effect of exempting a portion of the US export profits from US taxation by funnelling all earnings derived from foreign sales into a DISC.

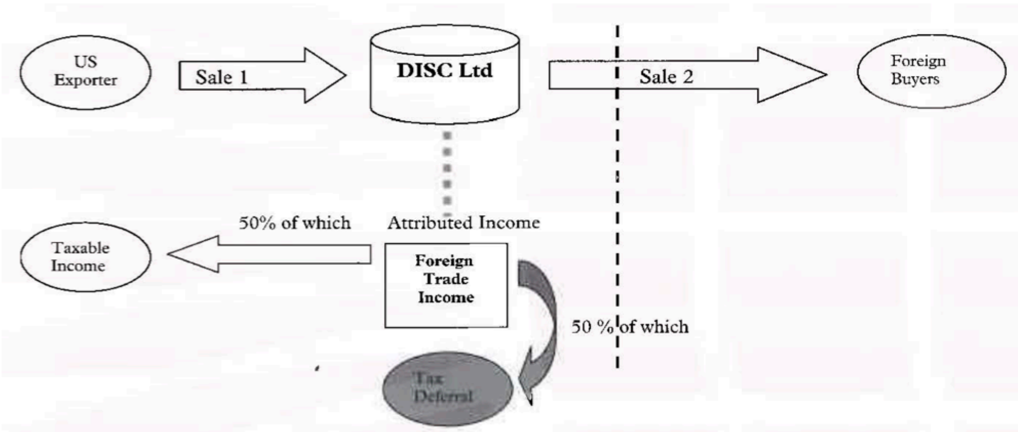


Figure 3.17: Asif H Qureshi, Amine M Sassi, 'United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO' 13 (2002) Commonwealth Trade Hot Topics.

The European Economic Community brought a lawsuit against the DISC legislation and the GATT, predecessor of the World Trade Organization (WTO), ruled that the DISC was an illegal tax subsidy.[581] The DISC legislation is still in force, but in its current wording it simply allows a one-level taxation upon shareholders and a limited deferral on earnings and profits up to $10 million.[582]

The US Congress tried to comply with the GATT's decision and introduced the foreign sales corporation (FSC) provisions. The FSC was a foreign corporation located in a white-list jurisdiction which was in charge of all exports activity. All

[581] GATT Panel Report, *United States Tax Legislation (DISC)*, L/4422 (7 December 1981) BISD 23S/98.
[582] Internal Revenue Code 1986, 26 USC § 995(a), 995(b)1E.

income of the FSC was deemed not connected with a US trade or business and was allowed a 100% dividend received deduction upon distribution to the foreign parent.

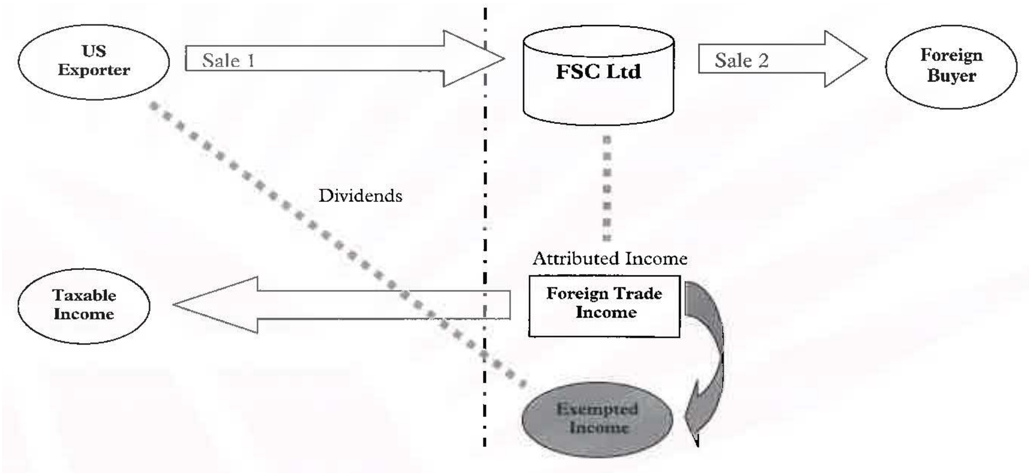


Figure 3.18: Asif H Qureshi, Amine M Sassi, 'United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO' 13 (2002) Commonwealth Trade Hot Topics.

Again the EU sued the US before the WTO and it was held that between 1984 and 2000 the US government bestowed an unlawful tax subsidy upon domestic exporters.[583] The Congress attempt to use a foreign corporation to comply with the previous GATT's ruling turned out to be a failure.

The Congress repealed the FSC legislation in 2000 and enacted the extra-territorial income (ETI). The assumption behind this new regime was to adopt some features of territorial tax systems which are compliant with international trade law. However, in another dispute before the WTO between the EU and the US, the defendant lost again. As a matter of fact, the ETI legislation proposed the same subsidy of the FSC except for not being entity-related. All income derived from exports was considered not sourced in the US and thus exempt from US tax.

[583] WTO Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, (20 March 2000) WT/DS108/R as modified by Appellate Body Report, WT/DS108/AB/R; WTO Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, (20 March 2000) WT/DS108/AB/R.

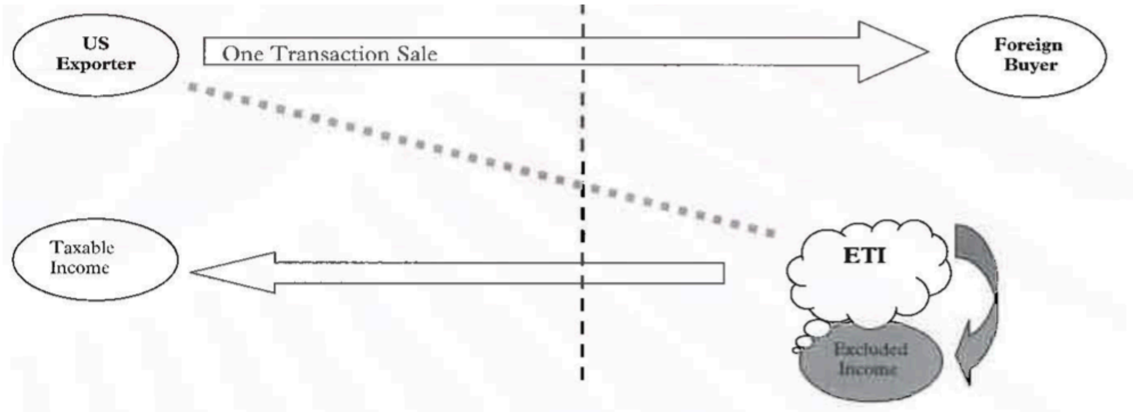


Figure 3.19: Asif H Qureshi, Amine M Sassi, 'United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO' 13 (2002) Commonwealth Trade Hot Topics.

While confirming the lawfulness of territorial tax systems, the WTO stated that when such system is adopted just in respect of export related income it constitutes a selective and thus illegal tax subsidy.[584] In short, either a tax system is entirely territorial or it is wholly based upon the worldwide taxation system. Following this decision the US repealed the ETI and enacted a production incentive which allowed for an income deduction for all manufacturing activities located in the US, regardless of whether the final product was sold domestically or abroad.[585] The fact that the incentive was given to all manufacturing activities, and not just to those related to export, made the qualified domestic manufacturing deduction appear immune to WTO challenge.

Nevertheless, the Tax Cuts and Jobs Act repealed former section 199 and replaced it with new section 199A which allows a qualified business activities deduction for pass through entities.[586] This new provision proposes the same concepts of former section 199, but in this case the qualified business deduction is limited to domestic activities only (literally, "income, gain, deduction and loss with respect to any qualified trade or business of the taxpayer").[587] With regard to export activities, the US Congress enacted a new export incentive which is likely to face another WTO challenge. In brief, new section 250

[584] WTO Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" - Recourse to Article 21.5 of the DSU by the European Communities*, (29 January 2002) WT/DS108/AB/ RW.
[585] Internal Revenue Code 1986, 26 USC § 199(a)1.
[586] Internal Revenue Code 1986, 26 USC § 199A(a)1-2.
[587] Internal Revenue Code 1986, 26 USC § 199A(c)1.

provides for a foreign derived intangible income (FDII) deduction which aims at stimulating export and encourages US corporations to keep in the US the intangible assets developed domestically. The FDII regime allows US taxpayers to claim a 37.5% deduction against deemed intangible income which is derived from either foreign sales or foreign services.[588]

The FDII is a domestic corporation's deemed intangible income which is obtained by multiplying the deduction eligible income (DEI) minus 10% of the qualified business asset investment (QBAI) by the ratio obtained by dividing the foreign derived deduction eligible income (FDDEI) by the DEI. The following formula will help a better understanding.

$$FDII = (DEI - 10\%QBAI) \times \frac{FDDEI}{DEI}$$

The FDII is then allowed a 37.5% deduction which lowers the effective tax rate from 21% to 13.125% which is the same tax rate applicable to the GILTI inclusion to which all multinational enterprises are subject (after December 31, 2025 the rate will rise to 16.406% like for GILTI). As mentioned in the first paragraph of this chapter, the aim of the US Congress was to ensure neutrality between storing intangible assets abroad or domestically. The FDII is probably the most protectionist tax measure in the 2017 tax reform.

After having provided an overview of the FDII calculation, it is necessary to explain what the other factors really mean. The term deduction eligible income is a corporation's gross income without regard to the following amounts: (1) subpart F income, (2) GILTI inclusion, (3) financial services income as defined under section 904(d)2, (4) any dividend received from a CFC with respect to which the domestic corporation is a US shareholder, (5) any domestic oil and gas income, (6) any foreign branch income, (7) any income which would fall into the category of foreign personal holding company income

[588] Internal Revenue Code 1986, 26 USC § 250(a)1A.

under section 954(c) and (8) any PFIC income deemed received from a qualified electing fund under section 1293.[589]

The second factor in the formula is the deemed intangible income (DII) defined as the excess of the deduction eligible income (DEI) over the deemed tangible income (DTI) which is statutorily set at 10% of the qualified business asset investment.[590] The definition of QBAI is the same used for GILTI. The term refers to specified tangible property used by a domestic corporation in its trade or business with respect to which a deduction under section 167 or a depreciation under section 168(g) is allowed.[591] The concept of specified tangible property means any tangible property used in the production of deduction eligible income (basically, gross income).[592] In the case of dual-use property, which is property used both for the purposes of producing gross income and for other, the amount taken into account for the QBAI calculation is equal to the percentage of use allocable to the production of deduction eligible income.

The foreign derived deduction eligible income is simply any portion of deduction eligible income derived in connection with: (1) property which is sold to non-resident persons for foreign use and (2) services provided to non-resident persons for foreign use.[593] Section 250 provides also for special rules with regard to property and services which can be considered as generating FDDEI although they are not directly sold or supplied to non-resident for foreign use. More specifically, property or services provided or supplied to domestic intermediaries fall within the definition if they have the same final destination of the products and services.[594] The same rule applies for sales or services directed to related parties (subject to control or common control by more than 50% by vote or value)[595] if they act as intermediaries of the US taxpayer.[596]

[589] Internal Revenue Code 1986, 26 USC § 250(b)3.
[590] Internal Revenue Code 1986, 26 USC § 250(b)2.
[591] Internal Revenue Code 1986, 26 USC § 951A(d)1, -3.
[592] Internal Revenue Code 1986, 26 USC § 951A(d)2.
[593] Internal Revenue Code 1986, 26 USC § 250(b)4.
[594] Internal Revenue Code 1986, 26 USC § 250(b)5B.
[595] Internal Revenue Code 1986, 26 USC § 250(b)5D.
[596] Internal Revenue Code 1986, 26 USC § 250(b)5C.

Following the explanation of the FDII deduction, the dissertation will provide an example to show how this newly introduced deduction works and to what extent the effective tax rate on the deemed intangible income derived from foreign sales and services is lowered.

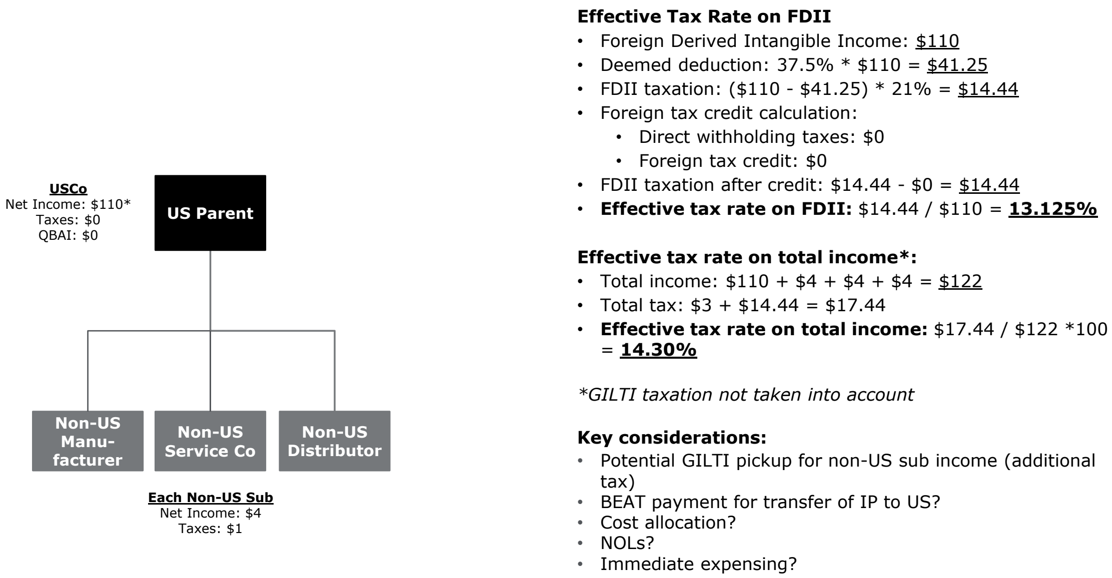


Figure 3.20: Deloitte, ‘US Tax Reform: Major US Tax Reform Impacts’ [2018].

As shown in the chart above, assuming US Parent has a FDII of $110, the allowed 37.5% deduction amounts to $41.25. Thus, the 21% ordinary tax rate applied to the FDII post-deduction ($110-$41.25=$68.75 multiplied by 21% is $14.44 US tax) gives rise to the same tax burden of the lower 13.125% rate applied to the FDII pre-deduction amount ($110x13.125%=$14.44 US tax). This example shows the neutrality of the FDII deduction mechanism in respect of the GILTI inclusion. The tax rate applied on the deemed intangible income of a CFC and the one derived from export activities of a domestic corporation is the same. Thus, whether setting up a corporation abroad or not depends mainly upon two factors. Firstly, the 10%QBAI is taxed at the ordinary rate of 21% in the US. Therefore, if the gross income is totally or almost entirely absorbed by the 10%QBAI, then establishing a corporation abroad is more convenient if the foreign tax rate is lower than the US one. Secondly, the main disadvantage of GILTI is the twofold limitation of the foreign tax credit which is, on the one hand, allowed up to 80% of foreign taxes (this is why the effective GILTI tax rate goes up from 10.5% to 13.125%) and, on the other hand, disallowed any carry-back or carry-forward for the excess foreign tax credit.[597] Therefore, if the foreign subsidiary is likely to have an excess foreign tax credit it could plan to throw off some subpart F income and receive the carry-back and carry-forward benefit, but the applicable tax rate would be 21% once again. Basically, the FDII grants a better tax treatment for export-based income and, unless the foreign subsidiary can avoid the CFC status, tax planner would probably recommend setting up a domestic corporation used as a patent box for intangibles.

3.6 Why Did the US Avoid a Withholding Tax on the Digital Economy?

This last paragraph concerning the 2017 tax reform will briefly expose the reasons why the US did not enact a withholding tax on the digital economy. As explained in the first chapter, the BEPS Action 1 recommended three measures to deal with the profits of web giants: (1) a revision of the current CFC regime which would tax the profits shifted abroad by digital multinational enterprises, (2) a generalized profit split method which would aim at reapportioning the tax base according to the portion of profits allocable to the market jurisdiction regardless of whether there is a physical nexus with that country and (3) a withholding tax applied by the contractors located in the market jurisdictions upon the web giants for each sale performed without any permanent establishment in the country (the solution adopted by the Italian government in the Finance Act 2019 and explained in the last paragraph of chapter 2).

The three recommendations should not be considered as excluding each other, but rather as complementary. As a matter of fact, they all refer to different fact patterns. The CFC regime is beneficial for countries which have the parent company located within their territory, but other foreign corporations controlled by the parent company making the most of the profits. The new-generation profit split method is useful for market countries in which the web giants operate with a limited taxable presence. As already mentioned, the company organised in the market jurisdiction performs a simple resale task and pays hefty royalties to other affiliates located in low tax jurisdictions. Finally, the withholding tax ideal for those countries in which the web multinationals do not have any physical

[597] Internal Revenue Code 1986, 26 USC § 904(c).

presence and simply use independent contractors or local websites, servers or other digital facilities to sell their products and services.

As it can be clearly understood, the US falls into the first category. All the biggest internet players have their parent companies in the US (Google, Amazon, Facebook, Microsoft, Apple and the like), but shift enormous amounts of profits by lawfully transferring valuable intangibles to low tax offshore jurisdictions. Therefore, instead of enacting a withholding tax or commanding a revision of the transfer pricing regulations, the Tax Cuts and Jobs Act provided for the GILTI tax. This new CFC based inclusion aims at clawing back into US tax all the deemed intangible profits of CFC which have been shifted abroad. As a matter of fact, the US and specifically California are the geographical areas where all the research and development is located. However, after benefiting from the research tax credit, the US-based internet giants shift their profit abroad and pay very little US tax. The GILTI inclusion, which, as mentioned before, is basically inevitable, becomes for the US a formidable device against tax avoidance.

For the time being, the US economy does not find itself in a situation which urges the enactment of a withholding tax. The issues which affected the Treasury are fully dealt with by means of the GILTI tax. By contrast, European countries have started taking opposite steps since they are the market jurisdictions in which the base erosion takes place either by virtue of limited taxable presences or by remote income-producing activities.

CONCLUSIONS

The final remarks of this dissertation will focus on a possible outlook with respect of the future developments of international business taxation. Firstly, the reader will be provided with an assessment regarding the efficacy of the reforms introduced in the US and EU respectively and the different approaches followed by the US Congress and the EU law-maker. More specifically, the thesis tries to answer the questions whether multinational enterprises will face more difficulties in putting into practice base eroding and profit shifting arrangements and whether there are still some loopholes left to be dealt with by means of amendments to current legislation. Also, due consideration will be given to prospective diplomatic relations between the US and the EU with regard to the new reach of US jurisdiction to tax under the Tax Cuts and Jobs Act. Secondly, the end of the dissertation will put the stress on the topical issue of administrative cooperation in international tax matters and information sharing among different jurisdictions. As a matter of fact, all the anti-avoidance regimes analysed so far are dependent upon the exchange of information to be fully implemented and to make sure an adequate level of compliance is actually ensured.

An overall consideration of the reforms enacted both in the US and in the EU following the BEPS Action plan must necessarily lead to a positive judgement of the initiatives undertaken across the Atlantic Ocean. As a matter of fact, the two reforms closed many loopholes of domestic legislations which were consistently exploited by multinational enterprises. The first measure taken into account is the rock-solid interest limitation deduction. Regardless of the option to apply the fixed ratio rule at nationally-consolidated or standalone basis, the 30% EBITDA net interest rule seems impenetrable and reduces enormously the possibilities of profit shifting and base erosion. In the US the Tax Cuts and Jobs Act did not exempt banks, insurances and financial institutions from the application of section 163(j) since the US Congress considered that a genuine financial business should always have a positive net interest rate (borrowing interests are always lower than active lending ones).[598] As such, any US-based trade or business has a fixed annual percentage of deductible interest which cannot be avoided or circumvented under

[598] Internal Revenue Code 1986, 26 USC § 163(j).

any corporate structure. By contrast, the EU allowed the banking and insurance industry to be exempted from the fixed ratio rule.[599] By doing so, a taxpayer could simply establish another financial institution either in the same country or another member state and shift all the non-deductible interest rate to the financial undertaking which is exempted from the EBITDA rule. Italy too allowed such exemption, but, unlike the ATAD I, the ATAD decree can recapture such shifted income under the CFC regime.[600] As such, intercompany financing among affiliates is considered by the Revenue and Collection Agency passive income subject to the CFC clawback, thus limiting the hypothetical profit shifting and base erosion. Nevertheless, if the financial intermediary is the controlling company and the Italian subsidiary is controlled, then, even the Italian CFC recapture rule would be neutralised. Therefore, a sensible solution would be amending the irrational bias that the EU and its member states have towards the financial industry and subject these institutions to the net interest limitation rule like in the US. As a matter of fact, although the OECD itself recommended such exemption, the rule does not make so much sense taking into account that the 30% EBITDA is calculate on the net interest instead of the gross interest.

The second international taxation anti-avoidance measure analysed concerned hybrid mismatch arrangements. The dissertation pointed out that, despite the great work of both reform, there still might be some issues with regard to the so-called “shielded hybrid scheme” carved after the McDonald’s case. To facilitate the reader with the understanding of this “McDonald’s model” the dissertation will outline the essential traits of this peculiar tax planning arrangement. A company in country A (A co) has a branch in country B (B branch) which obtains income from export related activities targeted to unrelated parties located in other jurisdictions. Country A and country B have entered into a tax treaty which grants country B the exclusive right to tax B branch’s business profits, thus, preventing double taxation issues. However, according to the general tax laws of country B, B branch’s export-derived income is not considered sourced in country B. By doing so, the income reported by B branch is neither taxed in country A, nor in country B. The main problem here is that it is unclear whether the anti-hybrid legislation

[599] ATAD I, art 4(7).
[600] ATAD I, art 7(3).

can apply. Indeed, the deductible payment is made by an unrelated party located in a third-party jurisdiction and the payee is exempted under domestic laws of country B. The lack of a related-party deductible payment prevents the hybrid rules from being triggered and the income remains untaxed.

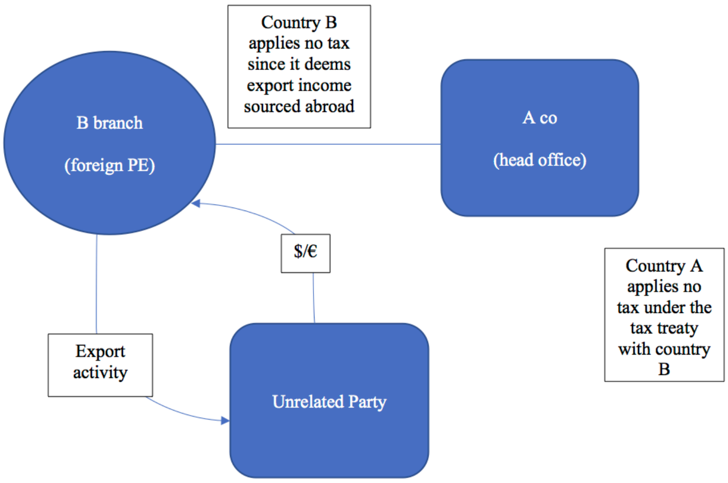


Figure 4.1: This chart was designed by the author of the dissertation.

However, the income so produced can still be subject to country's A taxation under the revised rules for CFCs. As a matter of fact, all branches which are exempted under the laws of the country of organisation are considered as controlled foreign corporation for CFC purposes and thus taxed under the deemed income inclusion.[601] Therefore, it can be said that the shielded hybrid scheme or McDonald's model is no longer a threat to the Revenues of G20 countries which neutralised this tax planning arrangement by means of CFC legislation rather than anti-hybrid mismatches.

The third outstanding anti-tax avoidance measure and probably the most important one is the controlled foreign corporation regime. As explained throughout all the three chapters of the dissertation, this provision allows the tax administration of the controlling company's country of organisation to include in the gross income of the controlling corporation the undistributed pro-rata share of earnings and profits of the foreign controlled entity. The application of CFC regimes banks on two main requirements: (1)

[601] Internal Revenue Code 1986, 26 USC § 954(d)2; ATAD I, art 7(1); T.U.I.R., art 167(3)(a)(b).

the control and (2) the production of passive or foreign base income. In these final considerations, it must be pointed out that multinational enterprises will try to do everything to avoid the application of the CFC regime by divesting control of the foreign base subsidiaries. In the US a strict more-than-50% ownership by vote or value is required. As such, a mother company could own a stock which does not exceed 50% of the foreign company and still be able to control the foreign entity by establishing in the articles of association that no other shareholder can acquire a stock ownership which exceeds a certain percentage. By doing so, US-based parent companies could easily avoid the application of subpart F and GILTI, but not PFIC. Therefore, it will also be necessary to avoid meeting the passive income and passive asset tests explained in the third chapter. If the PFIC taxation is avoided and the stock owned is at least 10%, the foreign dividend will be exempt under new section 245A. the ATAD I provides for a very similar definition of CFC and as such all the considerations said about the US are valid also at EU level (except for PFIC which has no equivalent in EU law). However, the Italian law-maker has a stricter approach and considers a foreign subsidiary as a CFC even if the ownership percentage is less than 50%, but can still exercise a dominating influence, as broadly defined under article 2359 of the civil code. Therefore, the Italian CFC regime is extremely difficult to avoid and can just be circumvented by producing less than one-third of passive income. Nevertheless, a similar scenario would still not accrue considerable tax benefits for the controlling company. Indeed, the definition of passive income includes also foreign base company income and banking or insurance income derived from transactions with related affiliates. It is for this reason that the dissertation considers the Italian CFC regime the best model analysed so far which both the US and EU should follow by amending their current CFC-ownership rules.

Despite what has been written so far, the CFC rules importance is probably deemed to diminish in the future. All CFC laws included an exemption provision which is called high-tax kickout. Basically, whenever the jurisdiction in which the foreign controlled company operates is not deemed to be a low-tax country due to the effective tax rate to which the subsidiary is subject, the deemed inclusion is not triggered. Recently, taxpayers have witnessed an increased tax competition among states and the corporate tax rates have considerably diminished. The reduction of tax rates had the perverse effect of rendering the tax bill due in high-tax and low-tax jurisdictions somewhat similar. This in turn resulted in a larger application of the high-tax kickout at global level. Just to provide an example, the Tax Cuts and Jobs Act reduced the US corporate tax rate from 35% to 21%. The steep drop caused a considerable reduction in the application of the CFC regime. It could probably be predicted that in the foreseeable future G20 countries will all standardise their corporate tax rates around a certain percentage which is very likely to neutralise the extra-territorial deemed inclusion of undistributed earnings and profits.

The last issue of tax avoidance which the thesis has taken into account is the taxation of digital services and web giants. As already pointed out, while the US refused to enact any digital services withholding tax and subjected taxpayers to the new GILTI inclusion, the EU largest economies did the opposite notwithstanding the failure of a common European web tax. It can be surely affirmed that this topic has already caused the biggest diplomatic scandal of international taxation, second only to the tariff war.[602] As a matter of fact, on the one hand, the GILTI inclusion works as a minimum tax on multinational enterprises based in the US and includes all the foreign income which exceeds the deemed intangible income return (10% QBAI) regardless of whether the income is active or passive (which means irrespective of whether it raises genuine BEPS concerns or not). This measure can be considered a hostile expansion of the US jurisdiction to tax which neutralises the benefits of moving overseas and turns the CFC legislation into a protectionist measure. On the other hand, however, the most prominent economies of the Eurozone enacted a digital services tax on revenues (thus, costs cannot be deducted) which is disapplied only if the internet-based foreign company has an incorporated permanent establishment in the country which does not exceed the revenue threshold and thus no withholding toll is necessary. In practice, setting up a permanent establishment will probably not exempt from the payment of the withholding tax as already explained at the end of the second chapter since the threshold could be easily exceeded by a local incorporated entity. From a legal perspective, the European law-makers gave internet multinationals no choice but be subject to a withholding tax regardless of whether they have a physical taxable presence. However, from an economic perspective this choice increases the price of goods and services sold to consumers (due to the withholding tax) and could turn out to be a

[602] Chaim Gartenberg, 'Trump responds to France's digital tech tax, promises 'substantial reciprocal action': The White House has yet to reveal details' (2019) The Verge.

double-edge sword since it penalises also resident digital businesses (which are already at a competitive disadvantage as pointed out at the end of the second chapter). It can be then said that the legislative interventions in the field of taxation of digital multinational businesses have an aggressive character. Both the US and the EU countries relying on digital services taxes are trying to claw back into tax all the profits which these companies were able to subtract from their taxable bases. However, while pursuing a noble purpose, they are putting into practice unfair tax competition measures which have the only effect of worsening diplomatic relations and complicating the already confused international trade law scenario.

The other important topic of nowadays international business taxation is centred upon information sharing in tax matters. While it is true that the reforms and new rules analysed so far have a tremendous impact upon tax equity and fairness, their application is always subordinated to an efficient tax assessment which, at international level, cannot do without transparency among countries and information sharing mechanisms. With regard to this second issue, the OECD highlighted the necessity of an enhanced administrative cooperation among G20 countries in its BEPS Action 12.[603] The first step taken towards this direction is represented by article 26 of the OECD Model Convention which imposes upon both states parties to an income tax treaty against double taxation to cooperate and exchange information in all matters related to levying taxes in accordance with the treaty.[604] However, this obligation is more limited than it might seem since it does not require contracting parties to amend their domestic laws, nor to exchange information if such act would be contrary to the laws, the normal course of the tax administration, or the public policy of one of the covered jurisdictions.[605] In 2014 the OECD issued the paper on the Automatic Exchange of Financial Information in Tax Matters which provided for the first system alternative to bilateral instruments and to the exchange upon request

[603] OECD, *Action 12 – 2015 Final Report: Mandatory Disclosure Rules* (OECD Publishing, 2015).
[604] OECD, *Model Tax Convention on Income and Capital* (OECD, Publishing, 2017), art 26(1).
[605] OECD, *Model Tax Convention on Income and Capital* (OECD, Publishing, 2017), art 26(3)(a)-(c).

regime.[606] The proposed multilateral instrument, commonly known as "common reporting standard" (CRS) is actually based upon a combination of two agreements: (1) a Model Competent Authority Agreement (Model CAA) and (2) the CRS. The Model CAA constitutes the legal basis for the exchange of information which provides for the possibility and modalities of exchange of the appropriate flows of information.[607] More specifically, it lays down the type of information subject to exchange, the time and manner of exchange, the confidentiality standards and data safeguards to be observed by the competent authorities and the procedure for consultation and collaboration between tax authorities.[608] By contrast, the actual CRS includes the due diligence requirements which lies behind the exchange of financial account information. The CRS regards financial institutions (instead of tax administrations) and imposes on them an obligation to report: (1) pre-existing individual accounts, (2) new individual accounts, (3) pre-existing entity accounts which exceeds the total value of $250,000 and (4) new entity accounts regardless of their amount.[609] The information related to each account covers interests, dividends, account balance or value, income from certain insurance products, gains from the sale of financial assets, any income generated from assets held on the account and any payment with respect to such account.[610]

In 2015, the OECD specified its proposal of mandatory disclosure rules in its BEPS Action 12.[611] According to this action a proper and effective system of exchange of information should be designed taking into account several building blocks: (1) the person(s) subject to the disclosure requirements, (2) the information which has to be reported and (3) the consequences of any failure to do so.

With regard to the applicable taxpayers, the disclosure regimes can be either transaction-based, or promoter based. The first approach is centred upon mandatory disclosure of certain schemes identified as reportable which the taxpayer must pinpoint to the tax

[606] OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (OECD Publishing, 2014).
[607] Ibid, para 17.
[608] Ibid, para 18.
[609] Ibid, paras 19, 21.
[610] Ibid, para 20.
[611] OECD, *Action 12 – 2015 Final Report: Mandatory Disclosure Rules* (OECD Publishing, 2015).

administration. By contrast, the promoter-based approach focuses on the suppliers of tax planning which have to report the arrangements proposed to taxpayers any time they fall into the category described by specific hallmarks. The distinction explained so far does not bear significant importance since in the real world no system is purely transaction or promoter based and because in practice the outcome of each model ends up to be the same one.

Basically, the reporting requirements are placed upon: (1) the taxpayer, (2) the promoter, or (3) both the taxpayer and the promoter. While placing the burden upon the promoter firstly represents a solution which hives more certainty in terms of accuracy of the information reported (as a matter of fact, the eventual tax liability which might follow from the disclosure will be borne by the taxpayer), there are certain situations in which it is still more appropriate to oblige the taxpayers to do so. For instance, the taxpayer could choose to be safe from being reported when the promoter is offshore and thus not subject to any disclosure requirement enacted by the taxpayer's jurisdiction. Also, the promoter could be non-existent. Many multinational enterprises have their own in-house tax legal counsels which offer tax planning services. However, since there is no separate legal entity supplying the tax arrangement, there would be no obligation to report the transaction. Lastly, the promoter could be a legal professional covered by the legal professional privilege if the jurisdiction at stake protects the confidences between clients and attorneys.

Accordingly, the OECD recommended a mandatory disclosure based primarily on the promoter's report which switches alternatively to the taxpayer when the promoter is either offshore, in-house, or can assert the legal professional privilege. Nevertheless, it has to be pointed out that a similar dual-report could give rise to greater costs and to multiple disclosures of the same transaction. Furthermore, when the taxpayer is obliged to report the transaction, there might be the issue of legislative incoherence with the privilege against self-incrimination in jurisdictions where tax avoidance is subject to criminal penalties too. In this case the OECD designed a twofold solution: (1) either requiring that the report takes places before the implementation of the scheme (a sort of ruling) so that the information taken becomes part of the tax assessment procedure, or (2) simply excluding all the transactions which might cause friction with the privilege against self-incrimination from the scope of the mandatory disclosure regime.

The second building block regards the type of information which must be disclosed. Theoretically, every information bears importance, but a 100% disclosure would flood tax administrations with so many reports which prevent an accurate check of all transactions. Therefore, a reportable scheme must have certain general or specific hallmarks in order to fall into the category of covered transactions and filter out all the irrelevant ones. Countries can follow either a single-step approach (like the US), where the transaction does not require a tax benefit constituting tax avoidance or the main purpose of the arrangement to be reported, or a multiple-step approach which require all schemes to meet a minimum threshold to be reportable. Moreover, it is suggested to provide a de-minimis filter to exclude all transactions below a certain amount form the mandatory disclosure (since the risks of avoidance are meaningless or negligible). Whether the covered jurisdiction chooses a single or multiple step approach, the transaction shall still bear a hallmark to be considered a reportable one. The first category of hallmarks is the generic one. The targeted schemes are those in which the promoter or adviser requires the client to keep the scheme confidential under a contract, or those in which the client has to pay a premium or contingent fee to the promoter or adviser for the tax benefit accrued by means of the tax planning scheme. These generic hallmarks are generally designed for including all mass-marketed tax planning arrangements and are extremely useful in enlarging the category of reportable information. By contrast, specific hallmarks are put into place to require mandatory disclosure of certain potentially aggressive of abusive tax arrangements. These broadly include the following: loss schemes, leasing arrangements, employment schemes (to circumvent salary taxation), converting income schemes, schemes involving low-taxed entities or hybrid mismatch arrangements, or transactions which significant book-tax differences (where the tax accounting value and the financial accounting evaluation differ greatly).

The OECD recommended a system including a mixture of generic and specific hallmarks. As a matter of fact, while the former enlarges the number of reportable transactions, the latter allows tax administrations to target certain known or common areas of risks. Also, with regard to the disclosure timeframe, the OECD recommended that the promoter or adviser report the tax planning scheme when it becomes available to the taxpayer (this scenario requires that the reporting obligation be placed upon the promoter). Vice versa, when the taxpayer bears the burden of disclosure, it is recommended that the arrangement be reported only when the actual implementation takes place and, thus, the tax benefit is accrued.

If a transaction is reportable, the consequence of non-compliance must be the imposition of a penalty. The OECD did not propose a particular sanction against transgressors, but suggests G20 countries provide a variety of monetary and non-monetary (like the revocation of necessary business licenses) penalties. Also, the penalty shall be graduated in accordance with the seriousness of the violation. Practically speaking, the reporting person has to include several information regarding the taxpayer. A breach consisting of the lack of a bit of information (for instance, the lack of the taxpayer's ID number) is considerably less material than the failure to file the report with the competent authorities.

Following the explanation of the G20 framework of mandatory disclosure of information in tax matters, it is important to provide an example of how necessary such action is in connection with one of the issues analysed throughout the dissertation, namely hybrid mismatch arrangements. As a matter of fact, while the legal treatment of certain arrangement is pivotal, the ascertaining mechanism of tax avoidance has no less importance. In brief, without the exchange of information the anti-tax avoidance legal framework explained so far would lead to no successful result. The example below will exemplify a case of imported hybrid mismatch, commonly known as the most deceptive scheme in the absence of information exchange.

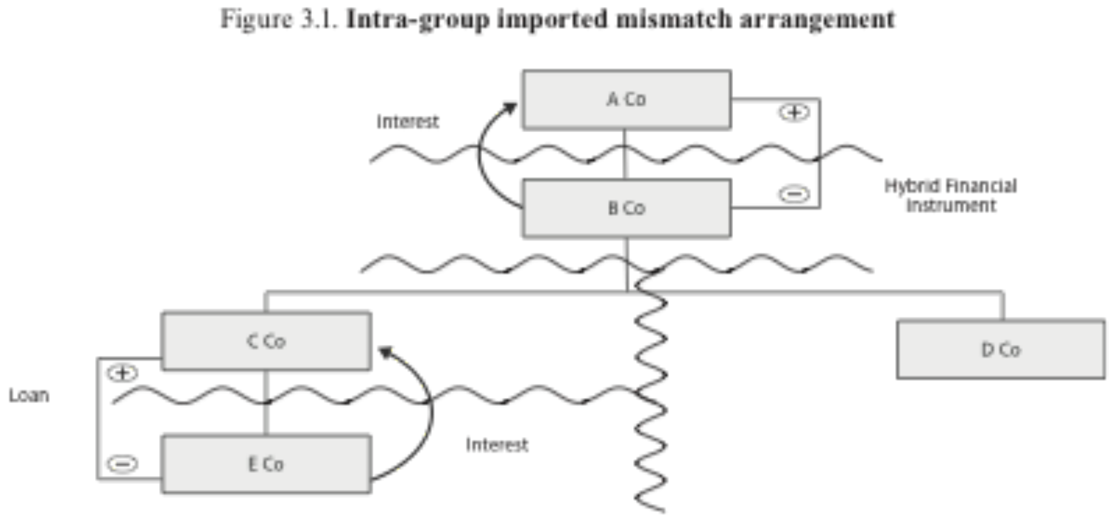


Figure 4.2: OECD, *Action 12 – 2015 Final Report: Mandatory Disclosure Rules* (OECD Publishing, 2015), para 257.

Suppose A co in country A, owns all the shares of B co in country B which is the holding company of all the other corporate entities: C co in country C, D co in country D and, indirectly through C co, E co in country E. A co lends money to B co by means of a hybrid financial instrument which gives rise a deduction/no inclusion tax benefit. If the money borrowed by B co is then lent to other subsidiaries, the hybrid financial instrument is imported into another country by shifting the deduction from B co to another corporate entity belonging to the same group. Without the necessary disclosure mechanism, the countries where the borrowing entity is located cannot understand that the deduction is linked with a deduction/no inclusion scheme and, thus, would not be able to trigger the anti-hybrid laws to disregard the deduction for tax purposes.

So far these international (and thus, extra-EU) reporting recommendations are applied by 129 different countries across the globe which all signed and ratified the Convention on Mutual Administrative Assistance in Tax Matters under the OECD umbrella.[612] While the framework explained so far applies to EU member states in respect of extra-EU countries which are parties to the Convention, the US did not enter into the multilateral instrument and keeps relying upon Intergovernmental Agreements it concluded under the

[612] OECD, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as Amended by the 2010 Protocol* (OECD Publishing, 2011).

Foreign Account Tax Compliance legislation. The Convention provides for a wide range of administrative cooperation rules: (1) automatic exchange of information, (2) exchange of information upon request, (3) spontaneous exchange of information, (4) simultaneous tax examinations and (5) tax examinations abroad.[613] Given that the OECD-based CRS and the EU Directives implementing the CRS within the single market contain similar obligations, the analysis of the administrative cooperation means is carried out by referring to the EU Directives examined below.

Following the explanation of the OECD's recommendations and the Multilateral Convention effort to harmonise the exchange of information in respect of tax matters, it is necessary to briefly analyse both the European CRS and the US Foreign Account Tax Compliance Act (FATCA) in order to compare the two systems and imagine what the future outlook of international tax law will be like.

The EU has taken upon a project to ensure administrative cooperation and exchange of information in tax matters within the single market ever since the enactment of the first Directive on Administrative Cooperation (DAC) in 2011.[614] This first directive has been amended five times from 2014 to 2018 and broadened the scope of application of DAC 1.[615] As a matter of fact, the initial field of application was limited to five categories of income: income from employment, director fees, life insurance products, ownership of and income from immovable property. The DAC 2 extended the application of the

---

[613] OECD, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as Amended by the 2010 Protocol* (OECD Publishing, 2011), artt 6-9.
[614] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L 64.
[615] Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2014] OJ L 359; Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L 332; Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2016] OJ L 146; Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities [2016] OJ L 342; Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L 139.

automatic exchange of information in order to include financial account information held by foreign financial institutions (similarly to the FATCA)[616]. The third and fourth directives on exchange of information enlarged the list of shared data in order to cover cross-border tax rulings, advance pricing agreements and the country-by-country reports to be filed by the mother company of international corporate groups. The DAC 5 allowed tax authorities of each EU member state the possibility to have automatic access to anti-money laundering information gathered by other EU countries. Lastly, the 2018 Directive expanded the reach of automatic exchange of information to cross-border arrangements.

This consistent regulatory framework allows different types of administrative cooperation. Apart from the automatic exchange to be filed in electronic form on a periodic basis, EU laws provides for a spontaneous exchange of information which occurs when a member state discovers relevant information regarding tax evasion or avoidance relevant to another EU country which is either the income source jurisdiction or the country of residence. Also, each member state is allowed to petition the tax authorities of another EU jurisdiction to receive additional and complementary information necessary for an accurate assessment of a taxpayer's position. Lastly, the DACs equip member states with other types of administrative cooperation means, such as the presence of officials of a member state's tax authorities in the offices of the tax administration of another EU country, also during the pre-litigation enquiries carried out therein. Another useful tool of cooperation is the possibility for two or more member states to conduct simultaneous controls of one or more taxpayers of common or complementary interest and eventually request the other country's authority to notify tax instruments and or decisions issued by the competent authorities of another member state.

The EU legislation regarding exchange of information in tax matters closely resembles the one designed under the OECD's BEPS Action 12. As a matter of fact, the persons subject to the reporting requirements are both the taxpayer and the promoter or adviser. Specifically, the primary obligation is placed upon the promoter and just in the instances mentioned above (offshore adviser, in-house counsel and assertion of legal professional

[616] Rosario Dolce, 'Normativa FATCA e CRS/DAC2: sanzioni per le violazioni degli obblighi di due diligence e reporting' (2016) 36 Il Fisco 3447.

privilege) the duty is shifted upon the taxpayer.[617] Therefore, any service provider which, by reason of its assistance, can be deemed informed about the taxpayer's arrangement must file the necessary report with the competent member state authority. Subsequently, the piece of information will be shared by the receiving tax administration with any affected member states in accordance with the array of administrative cooperation methods mentioned above. The following chart will sum up the different service providers which can be subject to the report.

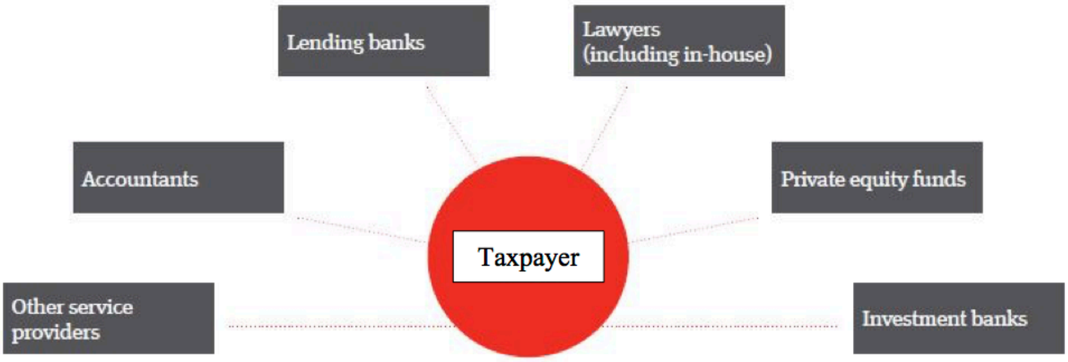


Figure 4.3: Norton Rose Fullbright, 'DAC 6: new EU tax disclosure rules. Mandatory reporting of cross-border transactions for taxpayers and intermediaries' [2018] Publication.

Moreover, the Directive 822/2018, which shall be implemented by each member state within December 31, 2019, also provided for generic and specific hallmarks which limit the amount of reportable information to the competent tax authority.[618] So far the Italian government has implemented all the Directives on Administrative Cooperation except for DAC 6 whose implementing decree is still in the preparatory works phase.[619]

---

[617] Gianluca Selicato, 'Le comunicazioni preventive secondo la Direttiva 822/2018/EU: dalla "collaborazione incentivata" agli "obblighi di disclosure"' (2019) 1 Rassegna Tributaria 112, para 3; Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L 139.
[618] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L 139, Annex IV.
[619] Legislative Decree No 29/2014; Ministerial Decree 28 December 2015; Legislative Decree 52/2017; Ministerial Decree 23 February 2017; Legislative Decree No 60/2018.

While the DACs are based upon a mechanism of automatic, spontaneous and request sharing among member states, the Foreign Account Tax Compliance Act 2009 enacted by the US Congress has a completely different philosophy.[620] The FATCA is designed to counter tax avoidance and evasion by requiring non-US financial institutions and other non-financial offshore vehicles to report certain information regarding US taxpayers who hold financial assets abroad. Foreign financial institution (FFI) are required to enter into an FFI agreement or comply with the Intergovernmental Agreement (IGA) which their local government concluded with the US. Failure to comply with this twofold option results in the imposition of a 30% withholding tax applied by US withholding agents on certain payments made to non-reported US customers and to their counterparties (the banks and other financial institutions or offshore shell companies).

Under US law, a withholdable payment is any payment in respect of US source FDAP (fixed, determinable, annual, periodic) income (basically, passive income represented by dividends, interests, rents, royalties) and gains from the sale of any property which can generate US source dividends or interests.[621] The other two important definitions under the Internal Revenue Code are: foreign financial institutions (FFI) and specified non-financial foreign entities (NFFE). A FFI is any non-US entity which performs the activities of a financial institution, custodial institution (a trustee that holds financial assets for third parties), investment companies or vehicles and insurance companies. Also, the list can include certain holding companies or so called treasury centres, which are entities primarily engaged in financing other affiliated belonging to the same corporate group. By contrast, a specified NFFE is any entity which is a passive vehicles at least more-than-10%-owned by vote or value by a US person (the ownership percentage can be set at a higher rate under an Intergovernmental Agreement with another country) which does not provide the US withholding agents with a certification regarding its substantial US owners. There are some notable exclusions from the NFFE definition for publicly traded corporations and their affiliates, and for active NFFEs. A NFFE is considered to be active if less than 50% of its gross income and weighted average percentage of assets is passive.

---

[620] Internal Revenue Code 1986, 26 USC §§ 1471-1474.
[621] US Department of the Treasury Proposed Regulations § 1.1473-1(a)1(i).

The FATCA applies a 30% withholding tax by means of a US withholding agent on any payment made to a FFI or NFFE which does not exchange the required information to the IRS and thus does not qualify for the FATCA withholding exemption.[622] The information to file with the IRS are basically the classic anti-money laundering information prescribed under the so called "know your customer rule".[623] Nevertheless, the Internal Revenue Code provides for a de minis threshold which exempts from reporting the information related to depository accounts held at FFIs when they do not exceed $50,000.[624]

One of the main issue with FATCA is the lack of reciprocity in terms of information which is shared with the US and the amount which the IRS shares with other countries' tax administrations. The US is the only G20 country which did not enter into the Common Reporting Standard prompted by the OECD and keeps relying exclusively on its FATCA.[625] As such, given that nearly every country in the globe has consistent business relationships with the US, national governments worldwide have started committing to Intergovernmental Agreements with the US in order to simplify and standardise the information which their domestically chartered banks and financial institutions have to exchange with the IRS. By giving a look at the website which contains all the signed IGAs, it is possible to notice that there is an imbalance in the amount of information which are shared with the US and the counter-flow of data which goes from the US to the other partner jurisdiction.[626] Most of the times, the US receives more information of the one it shares with its partners and sometimes the flow of tax data has a one-way direction only. Moreover, even in those cases where the IGAs allow the exchange of information, the array of data is limited and concerns only accounts which also earn US-source income. The IRS is practically prevented from sharing foreign-source income information since this is not reported to the IRS by US financial institutions.

---

[622] Internal Revenue Code 1986, 26 USC §§ 1471(a), -(b)1.
[623] Internal Revenue Code 1986, 26 USC § 1471(c)1.
[624] Internal Revenue Code 1986, 26 USC § 1471(d)1B.
[625] Rachel E Brinson, 'Is the United States Becoming the New Switzerland: Why the United States' Failure to Adopt the OECD's Common Reporting Standard Is helping It Become a Tax Haven' (2019) 23 North Carolina Banking Institute 231, 237.
[626] US Department of the Treasury, 'Foreign Account Tax Compliance Act (FATCA)' (Resource Centre, 29 July 2019) < https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx > (accessed 4 August 2019).

With respect to the EU, the European Parliament took after the perplexities expressed by the French National Assembly and prompted the European Commission to take action in order to rectify the above mentioned imbalance.[627] The European Parliament Resolution addresses the issue of reciprocity and the safeguard of EU citizens privacy in case of so called “accidental US citizens”. As a matter of fact, the cross-border application of FATCA by foreign banks with regard to accidental Americans (US citizenship holders who live abroad have another nationality and are not aware of their second US citizenship status) can eventually target up to three-hundred-thousand people living within the EU and cause problems of double taxation as well as privacy breaches.[628]

In short, the US is becoming a rogue banking state which does not share an adequate level of information with its partners and strong-arms other jurisdictions in order to obtain financial account data with regard to US nationals. The result of this situation is strengthening the US banking industry and creating an unfair competition where foreign countries are not attractive for US investors, but the US becomes appealing to foreign taxpayers. It is somewhat ironic that the country which has been the leader against tax avoidance (just to mention, the Kennedy administration enacted the first CFC regime ever introduced globally) is now becoming the most opaque jurisdiction in the G20 group.

The final remarks of the dissertation will be focused on the interplay between international tax provisions which might cause unfair tax competition and the different approaches followed by the US and EU in terms of jurisdiction to tax and information sharing. As already mentioned throughout the thesis, the EU followed an approach based upon cooperation and mutual assistance between member states when drafting the ATAD I and II. Each provision contained therein strikes a balance between national sovereignty and the necessity to protect the single market functioning by any distortion of competition which can arise from tax avoidance. By contrast, the main principle which inspired the Tax Cuts and Jobs Act was the slogan “make America great again”. The BEAT, GILTI and FDII provisions raise serious concerns of non-compliance with the OECD principles

[627] European Parliament, Resolution of 5 July 2018 on the Adequacy of the Protection Afforded by the EU-US Privacy Shield 2018/2645(RSP).
[628] The Local fr, ‘Who are France’s ‘accidental Americans’ and why are they suing big banks’ [2019] The Local.

of international tax law and might constitute a violation of international trade law. the US approach to the reform was simply guaranteeing the best interest of domestic revenues and enhance the attractiveness of the US towards foreign investors. Whether the reform is detrimental to other jurisdictions or not was simply immaterial for the drafters of the 2017 Tax Act. So long as the US best interest is safeguarded the mission can be considered as accomplished regardless of the consequences which might arise outside the country's borders.

Additionally, the overall US position is worsened by the analysis of its information sharing mechanism. The FATCA has the same approach of the Tax Cuts and Jobs Act. The IRS must receive all the necessary information needed to ensure an adequate tax assessment, but the same cannot be said in respect of other jurisdictions. The reciprocity is not assured since the IRS is not reported by US banks the same information which foreign banks have to file with regard to US foreign account holders. As such, the lack of data regarding financial accounts held by foreigners in US banks prevents the IRS from sharing the information. Sometimes, the Intergovernmental Agreements make sure that a certain level of reciprocity is respected, but this is not always the case. In order to rectify the current situation, the EU should impose a retaliating penalty upon US financial intermediaries which do not render the necessary information available to EU tax administrations. While this aggressive approach should be avoided when possible, it is also true that the current US administration would turn a deaf ear to any proposal which is not conveyed in the form of a threat.

Interestingly, the combination of protectionist measures which: (1) benefit US deductible purchases (see how the BEAT penalises deductible expenses derived from foreign related parties), (2) level off the effective tax rate applied within and without the US (GILTI and FDII effective tax rate upon the deemed intangible income) and (3) shield foreign investors from the common reporting standard have the sole purpose of boosting the US economy by rendering it more attractive for corporate groups with an international presence. Additionally, investing within the US offers another vast array of advantages which are not related to tax policy and cannot always be found elsewhere. The US economy boasts the largest capital market worldwide, has a strong internal demand of goods and services and compared to EU countries has fewer workers' rights safeguards.

It is no surprise that while the global economy is slowing down and the Eurozone does not grow as it should,[629] the Trump's administration has achieved extraordinary results in terms of GDP growth and employment rate.[630]

The comparison between the economic results across the two sides of the Atlantic Ocean prompts a question which can leave the reader somewhat bewildered. It could be argued that the enactment of new generation protectionist measures might have positive effects on economic growth contrary to what all liberal economic theories have always affirmed. However, this assumption is far from being true or at least it is difficult to find compelling evidence to back up such assertion. As a matter of fact, the US economic growth is the result of a strong and stable internal market which sees no equals globally apart from its Chinese counterpart. The digital services tax, which is the only partially protectionist measure enacted by Italy and other EU countries, did not have the effect of turning the fate of these countries' economies. Conversely, the web tax could be seen as a desperate attempt to keep up with an industry which is virtually non-existent within the EU or at least greatly underdeveloped.

Overall, it can be said that the reforms enacted both in the US and in the EU represent a landmark achievement in international tax law. Nevertheless, there is still room for improvements. Specifically, another OECD intervention is needed in order to harmonise the G20 countries approach with the US tendency to tax isolation. In today's complex global economy the need for international cooperation is always more compelling. The absence of mutual assistance and coordination among jurisdictions is the source of loopholes within the international tax system and allows multinational enterprises to exploit tax arbitrage and other planning schemes to their advantages. In short, despite the recent character of the BEPS Action plan, it is predictable that a new coherent intervention of the OECD might take place in the next few years in order to prompt major economies to have their domestic legislation come closer.

---

[629] Jeanna Smialek, Jim Tankersley and Jack Ewing, 'Global Economy Is Already Slowing. The U.S. Trade War Is Making It Worse' (2019) The New York Times; Oleksandra Vakulina, 'Europe's economy is slowing down' (2019) Euronews.
[630] Genevieve Wood, 'State of the Union 2019: The Trump Economy is a Success Story Not Even His Harshest Critics Can Deny' (2019) The Heritage Foundation.

BIBLIOGRAPHY

Books, Textbooks, Journals and Academic Sources

Aloys R, 'Anti-Tax Avoidance directive (2016/1164): New EU Policy Horizons' (2016) 56 European Taxation 497

Avolio D, Ruggiero P, 'Il recepimento della Direttiva ATAD e le nuove disposizioni in materia di CFC' (2019) 3 Il Fisco 253

Avolio, 'Chiarimenti per Paesi a fiscalità privilgiata e transfer pricing' (2019) 9 Il Fisco 852

Barone B and Bendini R, 'Protectionism in the G20' (Directorate General for External Policy Department Publishing, 2015)

Brinson R E, 'Is the United States Becoming the New Switzerland: Why the United States' Failure to Adopt the OECD's Common Reporting Standard Is helping It Become a Tax Haven' (2019) 23 North Carolina Banking Institute 231

Brown M, 'IRS Releases Proposed Anti-Hybrid Regulations' [2019] Legal Update

Ceriani V, 'Riflessioni sul coordinamento internazionale della fiscalità d'impresa' (2019) 1 Rassegna Tributaria 30

Chalk N, Keen M and Perry V, *IMF Working Paper: The Tax Cust and Jobs Act: An Appraisal* (IMF Publishing, 2018)

Cipollina S, 'La legge civile la legge fiscale. Il problema dell'elusione fiscale' [1992] CEDAM, 149

Cockfield, Arthur J and Hellerstein, Walter and Millar, Rebecca and Waerzeggers, Christophe, ‘Taxing Global Digital Commerce’ (2013) Wolters Kluwer Law & Business 3

Colombaioni G, ‘Italy Unilaterally Implements the European Commission’s Digital Services Tax Proposal’ [2019] Rivista di Diritto Tributario Pacini Giuridica

Davis A, ‘Does the BEAT Violate International Law?’ [2018] Columbia Journal od Transnational Law

Della Rovere, Francesca Pecorari and Piergiorgio Valente, ‘Nuova disciplina dell’exit tax: estensione dell’ambito applicativo e richiamo al valore di mercato’ (2019) 4 Il Fisco 357

Deloitte, ‘US Tax Reform: Major US Tax Reform Impacts’ [2018]

‘Digital services tax Europe’ (2019) Grant Thorton

Dolce R, ‘Normativa FATCA e CRS/DAC2: sanzioni per le violazioni degli obblighi di due diligence e reporting’ (2016) 36 Il Fisco 3447

Dott. Turri G, ‘FISCALITÀ FINANZIARIA: TASSAZIONE DEI DIVIDENDI E DELLE PLUVALENZE’ (2019) 3 Diritto e Pratica Tributaria 989

Fibbe G K, ‘Hybride mismatches onder de ATAD; symptoombestrijdiing is geen oplossing’ [2016] Weekblad Fiscaal Recht

Frattola E, ‘La web tax scomparsa’ [2019] Osservatorio Conti Pubblici Italiani

Furlan A, Sormani L, ‘Interrelazioni tra disciplina CFC e dividendi da società estere alla luce delle modifiche introdotte dal decreto ATAD: casi pratici’ (2019) 4 Fiscalità e Commercio Internazionale

Garbarino C, 'Nuove dimensione della transnazionalità dell'imposizione' (2002) 3 Rassegna Tributaria 864

Garbarino C, 'La tassazione del reddito transazionale: nozione e principi generali' (2002) 14 Correire Tributario 1275

Gasparri T, 'Un caso di struttura ibrida "scudata" dalla Convenzione tra Lussemburgo e USA' (2019) 1 Il Fisco 49

Ginevra G, 'The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU Level' (2017) 45 Intertax

Gustafson C H, Peroni R J, Pugh R C, *Taxation of International Transactions* (West Publishing, 4th edn, 2011)

Haskins C P, 'A Factory in a Fortress,' *The New York Times* (Sept 2, 1979)

Herzfield M, Doernberg R L, *International Taxation in a Nutshell* (West Academic Publishing, 11th edn, 2018)

Latham&Watkins, 'Following the BEAT: IRS Issues Proposed Regulations on Application of Base Erosion and Anti-Abuse Tax' (2019) Client Alert Cometary No 2433

Latham&Watkins, 'Treasury Issues Final and Temporary Regulations on Related-Party Debt Instruments' (2016) Client Alert Commentary No 2023

Lestok J, 'How the Congressional Reconciliation Process Works' [2017] The NCLS Blog

Luburdi D, Nobile L, 'Norme sul disallineamento da ibridi: gli aspetti procedimentali' (2019) 1 Il Fisco 58

Mazzarella G, Tempestini A, ‘Esimenti disallineate con le CFC’ [2018] Il Sole 24ore, in Norme e Tributi

Norton Rose Fullbright, ‘DAC 6: new EU tax disclosure rules. Mandatory reporting of cross-border transactions for taxpayers and intermediaries’ [2018] Publication

Onyshchuk N, ‘EU Directives on Direct Taxation Part II’ [2018] Malta Institute of Taxation

Piazza M, della Carità A, Biaggio E, ‘CFC e tassazione dei dividendi esteri: breve guida al self-assessment’ (2019) 5 Fiscalità e Commercio Internazionale 40

Picciotto S, *International Business Taxation: A Study in the Internationalisation of Business Regulation* (electronic edn, CUP 2013)

Pinkernell R, ‘Internationale Steuergestaltung im Electronic Commerce’, (2014) 494

Prof. Meusen G, ‘EJTN Judicial Training on EU Direct Taxation’ (Radboud University Nijmegen, The Netherlands, 21 April 2016) < http://www.ejtn.eu/Documents/About%20EJTN/Administrative%20Law%202016/AD201602%20Tax%20Law%20Thessaloniki%2021-22%20April/Gerard_Meussen_WS1_AD201602_Thessaloniki.pdf >

Qureshi A H, Sassi A M, ‘United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO’ 13 (2002) Commonwealth Trade Hot Topics

Rastogi N and others, ‘Changes to CFC Rules – More CFCs, More US Shareholders, More Attribution, More Compliance’ (2018) 5 Insights 3; KPMG, ‘More Canadian Companies May Now be Considered US CFCs’ [2018] Newsletter

Redactionele Aantekening, ‘Hybride mimastches en hybride leningen’ [2017]

Rizzardi R, 'La disciplina CFC: un punto fermo dopo la Direttiva ATAD?' (2019) 3 Corriere Tributario

Rossi Maccanico P, 'Giustificazione del sistema internazionale di tassazione dei redditi' (2002) 40 Il Fisco 6389

Sebastianelli M, Cardinali N, 'NUOVE REGOLE DI DEDUCIBILITÀ DEGLI INTERESSI PASSIVI PER I SOGGETTI IRES' (2019) 2 Amministrazione & Finanza 35

Selicato G, 'Le comunicazioni preventive secondo la Direttiva 822/2018/EU: dalla "collaborazione incentivata" agli "obblighi di disclosure"' (2019) 1 Rassegna Tributaria 112

Sencar D, 'Le nuove disposizioni in tema di disallineamenti ibridi' [2018] PwC – TLS Avvocati e Commercialisti

Serena A, Pavetto S, 'Il recepimento della Direttiva ATAD in materia di interessi passivi' (2019) 2 Bilancio e reddito d'impresa 5

Serena A, Pavetto S, 'Modifiche alla disciplina CFC e alla tassazione dei dividendi e delle plusvalenze black list' (2019) 3 Bilancio e reddito d'impresa 17

Sherlock M F, Marples D J, 'The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law' [2018] Congressional Research Service

Silbering-Meyer J, 'Tax Cuts and Jobs Act: A Response to BEPS' (2018) 29 Journal of International Taxation 40

Smith A, *An Inquiry into the Nature and Causes of the Wealth of Nations* (W Strahan and T Cadell, 1776)

Tabellini P, 'L'elusione della norma tributaria' [2007] Giuffrè

Tomassini A, Di Dio A, 'Web tax sui servizi digitali: soluzione transitoria in attesa delle decisioni dell'OCSE' (2019) 4 Il Fisco 344

Vassalo M, 'Esterovestizione e reato di omessa dichiarazione: l'assoluzione Dolce & Gabbana' [2015] Altalex

Wallace S, Muprhy S, 'Exit Taxes: Where to Now? After National Grid Indus BV' (2012) 2 Deloitte 80

Newspapers

Allen K, 'Trump's economic policies: protectionism, low taxes and coal mines', The Guardian (Noveber 9, 2016), < https://www.theguardian.com/us-news/2016/nov/09/trumps-economic-policies-protectionism-low-taxes-and-coal-mines >

Bricco P, 'Il sorpasso della Francia (che non c'è). Perché l'Italian rimane la seconda manifattura europea' [2019] Il Sole 24ore

Conlon S, 'Dolce & Gabbana Case Officially Closed' [2016] British Vogue

Gartenberg C, 'Trump responds to France's digital tech tax, promises 'substantial reciprocal action': The White House has yet to reveal details' (2019) The Verge

Longo M, 'Il paradosso dell'Italia: terza economia in UE, penultima sui mercati' [2019] Il Sole 24ore

Neville S and Treanor J, "Starbucks to pay £20m in tax over the next two years after customer revolt: Starbucks UK says it will pay corporation tax over next two years after consumer anger comes across 'loud and clear'," The Guardian, December 6, 2012, >https://www.theguardian.com/business/2012/dec/06/starbucks-to-pay-10m-corporation-tax>

Sondergaard P, SVP Gartner, 2011

Piazza M, ‘Partecipazione agli utili oltre il 50% per il controllo della società estera’ in Il Sole 24ore (2019) 5 Norme e Tributi Focus

Rigatto A, ‘Fiat Chrysler Automobiles, perché non serve l’exit tax’ [2014] Wired.it

Smialek J, Tankersley J and Ewing J, ‘Global Economy Is Already Slowing. The U.S. Trade War Is Making It Worse’ (2019) The New York Times

The Local fr, ‘Who are France’s ‘accidental Americans’ and why are they suing big banks’ [2019] The Local

Vakulina O, ‘Europe’s economy is slowing down’ (2019) Euronews

‘Web tax non parte: rischio mini-buco per le casse dello stato da 150 milioni nel 2019’ [2019] Teleborsa

Wood G, ‘State of the Union 2019: The Trump Economy is a Success Story Not Even His Harshest Critics Can Deny’ (2019) The Heritage Foundation

OECD Publications

OECD, ‘Explanatory Statement 2015 Final Reports’, (OECD, Publishing 2011)

OECD, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as Amended by the 2010 Protocol* (OECD Publishing, 2011)

OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD Publishing 2012)

OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (OECD Publishing, 2014)

OECD, *Policy Brief: Taxing Multinational Enterprises; Base Erosion and Profit Shifting (BEPS)* (OECD Publishing, 2015)

OECD, *Action 1 - 2015 Final Report; Addressing the Challenges of the Digital Economy* (OECD Publishing, 2015)

OECD, *Action 2 – 2015 Final Report; Neutralising the Effects of Hybrid Mismatch Arrangements* (OECD Publishing 2015)

OECD, *Action 3 - 2015 Final Report; Designing Effective Controlled Foreign Company Rules* (OECD Publishing, 2015)

OECD, *BEPS Action 4 – 2015 Final Report: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD Publishing 2015)

OECD, *BEPS Actions 8-10 – Aligning Transfer Pricing Outcomes with Value Creation* (OECD Publishing, 2015)

OECD, *Action 12 – 2015 Final Report: Mandatory Disclosure Rules* (OECD Publishing, 2015)

OECD, *BEPS Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* (OECD Publishing, 2015)

OECD, Background Brief: Inclusive Framework on BEPS (OECD Publishing, 2017)

OECD, *Model Tax Convention on Income and Capital* (OECD, Publishing, 2017)

OECD, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax' (OECD Publishing, 2017)

OECD, *Public Consultation Document – Addressing the Tax Challenges of the Digitalisation of the Economy* (OCED Publishing, 2019)

Italian Sources of Law and Case Law

D.P.R. No 597/1973

D.P.R. No 600/1973

D.P.R. No 917/1986 [TUIR]

Italian civil code

Italian Constitution

Law No 408/1990

Law No 212/2000

Law No 342/2000

Law No 23/2014

Law No 205/2017

Law No 145/2018

Law Decree No 41/1995

Law Decree No 83/2012

Law Decree No 50/2017

Legislative Decree No 241/1997

Legislative Decree No 29/2014

Legislative Decree 52/2017

Legislative Decree No 60/2018

Legislative Decree No 142/2018

Ministerial Decree 21 November 2001

Ministerial Decree No 429/2001

Ministerial Decree No 48/2009

Ministerial Decree No 49/2009

Ministerial Decree 8 June 2011

Ministerial Decree 2 July 2014

Ministerial Decree 28 December 2015

Ministerial Decree 23 February 2017

Ministerial Decree 3 August 2017

Ministerial Decree 14 May 2018

Cass Civ Sez V, 3 settembre 2001, No 11351

Cass Civ Sez V, 21 ottobre 2005, No 20398

Cass Civ Sez V, 14 novembre 2005, No 22932

Cass Civ SU, 23 dicembre 2008, No 30055-57

Cass Sez V, 28 December 2016, Nos 27112-13 and 27115-16

Cass Sez V, 21 December 2018, No 33234

EU and International Law Sources

Agreement on Subsidies and Countervailing Measures [1994] 1869 UNTS 14

Charter of the Fundamental Rights of the European Union [2000] OJ C 364/01

Consolidated version of the Treaty on the Functioning of the European Union OJ C 326/47

Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L 157/49

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1

Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfer of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L 310/34

Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures [2010] OJ L 84/1

Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC [2011] OJ L 64/1 [DAC 1]

Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L 345/8

Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2014] OJ L 359 [DAC 2]

Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L 332 [DAC 3]

Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2016] OJ L 146 [DAC 4]

Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities [2016] OJ L 342 [DAC 5]

Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements [2018] OJ L 139 [DAC 6]

Council Directive (EU) 2016/1164 of 12 July laying down rule against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193/1 [ATAD I]

Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L 144/1 [ATAD II]

OECD Articles of the Model Convention with respect to Taxes on Income and Capital

International Financial Reporting Standard 15

US Model Income Tax Convention

EU and International Case Law

Case 30/59 *Gezamenlijke Steenkolenmijnen in Limburg* [1961] ECR 1

Case C-323/82 Intermills v Commission [1984] ECR 3810

Case C-234/84 Kingdom of Belgium v Commission [1986] ECR 2281

Case T-129/95 Neue Maxhutte v Commission [1999] ECR-II 21

Case C-108/99 *Commissioners of Customs and Excise v Cantor Fitzgerald International* (CFI, 9 October 2001)

Case C-143/99 Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke [2001] ECR-I 8384

Case C-501/00 Spain v Commission [2004] ECR-I 6721

Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2431

Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031

Case C-222/04 Cassa di Risparmio di Firenze and Others [2006] ECR-I 325

Case C-255/02 *Halifax plc and Others v Commissioners of Customs and Excise* [2006] ECR I-1655

Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-7445

Case C-321/05 *Hans Markus Kofoed v Skatterministeriet* [2007] ECR I-5818

Joined Cases C-78/08 to C 80/08 *Paint Graphos and Others* [2011] ECR-I 7641

Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam* [2011] ECR I-12273

Case C-269/09 *European Commission v Kingdom of Spain* [2012] (CFI, 12 July 2012)

Case C-301/11 *European Commission v Kingdom of the Netherlands* [2013] (CFI, 19 March 2013)

Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] (CFI, 23 January 2014)

Case C-72/14 and C-194/14 *X v Inspecteur van Rijksbelastingdienst and T.A. van Dijk v Staatssecretaris van Financiën* [2015] (ECJ, 9 September 2015)

Case C-6/16 *Eqiom SAS, ex Holcim France SAS and Enka SA v Ministre des Finances at des Comptes publics* (CFI, 7 September 2017)

C-28/17 *NN A/S v Skatteministeriet* (CFI, 4 July 2018)

GATT Panel Report, *United States Tax Legislation (DISC)*, L/4422 (7 December 1981) BISD 23S/98

WTO Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, (20 March 2000) WT/DS108/R as modified by Appellate Body Report, WT/DS108/AB/R

WTO Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, (20 March 2000) WT/DS108/AB/R

WTO Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" - Recourse to Article 21.5 of the DSU by the European Communities*, (29 January 2002) WT/DS108/AB/ RW

Foreign Sources of Law and Case Law

Code des Impôts sur les Revenus/Wetboek Inkomstenbelastingen

Congressional Budget Act 1974, 2 USC

Internal Revenue Code 1986, 26 USC

Income Tax Assessment Act 1936

Revenue Act 1962, 26 USC 1

US Department of the Treasury Proposed Regulations

Bullock v Unit Construction Company [1960] AC 455

Ashland Oil Inc v Commissioner 95 TC 348 (1990)

Vetco Inc v Commissioner 95 TC 579 (1990)

Dover Corp v Commissioner 122 TC 324 (2004)

Miscellaneous

Assonime, *Explanatory Note No 21/2016* (August 4, 2016)

Audizione dell'Agenzia delle entrate, VI Commissione Finanze e Tesoro del Senato, 10 ottobre 2018

Commissioner's Ruling No 143239 of 16 September 2016

Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, No 5936/16)

Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, 6788/16)

European Commission, *Fair Taxation: Commission presents new measures against corporate tax avoidance*, (Press Release, 2016)

Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, 9342/16)

Economic and Financial Affairs Council, *Outcome of the Council Meeting* (Press Release, No 15205/16)

European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) [2011] EN 121/4

European Commission, *Commission proposes major corporate tax reform for the EU* (Press Release, 2016)

European Commission, Proposal for a Council Directive laying down rules against tx avoidance practices that directly affect the functioning of the internal market [2016] EN 026/16

European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues from the provision of certain services [2018] EN 0073/18

European Parliament, Resolution of 5 July 2018 on the Adequacy of the Protection Afforded by the EU-US Privacy Shield 2018/2645(RSP)

Everson M W, Letter from the Commissioner of Internal Revenue to the Honourable Charles E Grassley, Chairman of the Senate Committee on Finance (May 19, 2019)

Financial Committee, *Report on Double Taxation* (Economic and Financial Commission of the League of States Publishing, 1923)

General Secretariat of the Council FISC 104 ECOFIN 628 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] EN 10426/16

General Secretariat of the Council FISC 173 Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2016] EN 13733/16

Government Explanatory Report to the Legislative Decree No 142/2018

House Concurrent Resolution No 71 (115th Congress)

Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement of H.R. I* (December 18, 2017)

Presidency of the Ministers' Council, *Explanatory Report* (2018)

President John Fitzgerald Kennedy, 'Special Message to the Congress on Taxation' [1961] Tax History Project Article Archive

Revenue and Collection Agency, *Resolution No 471/E* (December 3, 2008)

Revenue and Collection Agency, *Explanatory Statement No 23/E* (May 26, 2011)

Revenue and Collection Agency, *Explanatory Statement No 21/E* (June 5, 2012)

Revenue and Collection Agency, *Explanatory Statement No 9/E* (March 5, 2015)

Revenue and Collection Agency, *Explanatory Statement No 35/E* (August 4, 2016)

US Department of the Treasury, 'Foreign Account Tax Compliance Act (FATCA)' (Resource Centre, 29 July 2019) < https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx > (accessed 4 August 2019)