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Italian Finance Law 2018: Focus on the New Tax on Digital Transactions ("Web Tax") and on the New Features of the Italian Permanent Establishment

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Introduction

The Italian Finance Law 2018 is Law 27 December 2017 n.205 ("Finance Law 2018").

It was definitively approved by Parliament (Senate) on 23 December and published on the Italian Official Gazette of 29 December.

Among several topics we chose to pick up a couple of them which constitute a real change in the Italian tax landscape, namely the introduction (starting from 1 January 2019) of a tax on digital transactions, better known as "web tax," and the reform of art. 162 of the Italian consolidated text on direct taxation (*Testo Unico delle Imposte sui Redditi*) which partially requalifies the concept of permanent establishment.

The reform of art. 162, which entered into force on 1 January, is aimed at aligning Italian tax rules with Action 7 of BEPS (Preventing the artificial avoidance of Permanent Establishment Status) and it not only consists of a legal reshape of the previous version, but, further than better clarifying some aspects, introduces some changes which in our view need to be underlined.

Furthermore, the two topics seem to us connected, as we will better report in the conclusion paragraph.

Within the practitioners, the debate started around 20 years ago on how to tax internet transactions and e-commerce and where, among many others, the two potential alternative solutions had been spotted on the introduction of a "bit tax" and on the extension and modernization of the concept of permanent establishment. The latter was historically linked to tangible structures/assets and not to intangibles (and subsequent intangible transactions), so the need to find new tools of taxation has remained unchanged since then.

Finance Law 2018 somehow brings together both solutions, both a tax on digital transaction and a modernized and extended concept of permanent establishment.

Italian legislation had somehow addressed this topic both in Law 27 December 2013 n.147, art. 177, and in art. 1-bis of Decree Law 24 April 2017 n.50, both accompanied by the announcement that a web tax had been introduced.



The announcements were misleading because no true web tax had been effectively introduced.

In the law of 2013 the Italian legislator had merely introduced some rules about advertisement services taxation under VAT legislation, plus some specifications on direct taxation and transfer pricing related issues.

In the law of April 2017 a new administrative procedure towards any (and not limited to internet companies) Italian subsidiary of international groups with more than a billion euros global turnover and fifty million Italian subsidiary turnover, was introduced.

Through such procedure companies can address the Italian Tax Agency, ask for a ruling in order to verify whether or not group companies act in Italy through a permanent establishment and finally decide whether or not to adhere to the Italian cooperative tax compliance regime.

In this latter case the web tax was simply the potential set up of an enhanced cooperation between the Italian Tax Agency and large taxpayers.

Both provisions described above remain in place.

Finance Law 2018 thus represents a sort of “third attempt” to introduce a truly existing taxation of digital transaction, a web tax, and in this case, for the first time, a brand new tax has been effectively introduced into the Italian tax system.

Web Tax – The Letter of the Law

The introduction of the web tax is reported in Parr. 1011-108 of the Finance Law 2018.

The web tax will be a tax of 3% over some internet transactions provided both by Italian resident and non-resident entities, performed in a highly automated manner, which means with extremely limited human support.

The Italian taxpayers who receive the digital services, mainly companies, will apply and pay the tax upon payment of the service and at the same time will be required to mandatorily recharge the amount to the supplier.

The digital transactions hit by the tax will be identified by a decree of the Italian Tax Agency to be issued before 30 April. By the same or different decrees, rules on the effective application of the tax will be indicated.

At present, the Italian web tax looks like a type of withholding tax.

A further condition in order for the transaction to be subject to the tax is that the provider has to put in place at least 3,000 transactions per year; this figure is to be considered a minimum threshold as a condition of application of the tax.

In order to prevent the application of the tax, the digital service provider will have to report on the invoice that the threshold has not been exceeded.

Finally, the rules of the application of the tax in respect of assessments, penalties, payment and litigation will be VAT rules, as compatible.

Our Comments

It seems clear that the most relevant pending feature remains as to what type of digital services will be subject to the tax. This specification will remain unknown until the issue of the Decree by the Italian Tax Agency.



One certainty at present is that e-commerce transactions will be out of the web tax scope.

Though no hint is reported in the law yet, some assumptions about the kind of services which should be subject to the tax lead to internet advertisement services and similar services.

One piece of information which should not escape the attention of those potentially interested in this topic is that the date of 30 April set in the law is not mandatory, and it should not be taken for granted that the issue of the Decree will take place within the due date. In fact, due to the extremely complex administrative process behind the issue of decrees by Government bodies, it could be delayed even further to a much later date.

Italian Authorities will look at international experience, especially towards eventual positions, studies, and/or guidelines from OECD, but experience tells that there is always an "Italian way" to address very new tax issues without a well settled international experience, as is the case of the Italian web tax.

Another point which should be underlined is the minimum threshold of "global" 3,000 transactions.

At this point the law seems very unclear since it is not clarified where and when such global transactions are put in place in order to assess that eventual statements contained in the invoice in order to prevent the application of the tax are true and accurate.

If the service provider is a non-resident entity, it seems unlikely for Italian Tax Authorities to calculate how many transactions are put in place globally (except, in theory, through an international exchange of information, but tracking such a number may become extremely onerous and burdensome), so a rational interpretation should lead to the conclusion that the 3,000 transactions should be the transactions performed on behalf of Italian resident taxpayers, which can be checked much more easily.

Another comment is made about eventual future aspects linked to tax audits, assessments and litigation related to web tax.

Though web tax is not an EU harmonized tax like VAT, the connection with application of VAT rules also in respect of litigation (as expressly stated by the law, which uses the term "*contenzioso*") might lead one to think that also with reference to web tax the same defense guarantees applicable to VAT might become applicable also in respect of web tax, namely the obligation of Tax Authorities to put in place a preliminary dialogue with the taxpayer before issuing any tax assessment or tax payment request (in Italian: "*contraddittorio endoprocedimentale*").

According to the current jurisprudence of the Italian High Court such obligation has an EU source and remains applicable only to EU harmonized taxes, as VAT is.

Finally, there is still one year to go before the effective application of the web tax and more clarity on the application of the tax should be expected within such timeframe.

The Main Changes of the "New Italian Permanent Establishment"

The reform of the tax rules pertaining to the permanent establishment are contained in Par. 1010 of the Finance Law 2018.

The description of the tax features of permanent establishments ("pe") contained in art. 162 of the Italian Consolidated Text on Direct Taxation had been introduced with effect from 1 January 2004, together with the enactment of the so-called "Tremonti Tax Reform," from the name of the Minister of Economy in charge at the time.



Art. 162 aligned Italian legislation with art. 5 of the OECD Model Tax Convention, which had always been used as legal reference by Italian Tax Authorities in the lack of a domestic norm.

The Italian legislator had made two add-ons to the OECD Model version, one at Sec. 5 and the other at Sec. 8 of art. 162.

The one at Sec. 8 regards maritime brokers, whose activity does not integrate a pe, and this rule has remained unchanged.

On the other hand, the one at Sec. 5 has been abolished, and this is of particular relevance in our reading of the new art. 162, especially with reference to taxation of digital transactions.

Sec. 5 reported that the presence of a server on the Italian territory does not entail that such server integrates a pe of the foreign owner. The rule was appreciated at the time, though commentators had underlined that the same clarity had not been used, for example, on the potential qualification of internet sites (would they constitute a pe?). The question remained formally unanswered.

However, the rationale behind such choice was that the existing concept of pe derived from old experience, where only tangible structures could be considered potential permanent establishments, and this went against some OECD trends which, around the year 2000, tried to compare heavy oil drilling machines to pieces of memory into hard disks, supporting the view that the two “things” could be considered the same for tax purposes. This stand had not been considered acceptable by the Italian tax legislator.

Sec. 5 of art. 162 thus represented a legislative obstacle to taxation of digital transactions in Italy.

As a consequence, we think that the need to modernize and reshape the concept of permanent establishment and to open the way to taxation of digital transactions entailed the abolition of Sec. 5 of art. 162, which the Italian legislator has effectively and materially done now.

The introduction of a web tax together with the abolition of Sec. 5 of art. 162 appear to be somehow coordinated, two sides of the same coin, and interpreters should consider this very seriously as an anticipation of future trends.

The abolition of Sec. 5 is also to be considered strictly connected to another material change to art. 162: the introduction of subpart f-bis to Section 2.

Sec. 2 of art. 162 is like Sec. 2 of art. 5 of the OECD Model Tax Convention and qualifies the term “permanent establishment.”

It reads as follows:

“The term “permanent establishment” includes especially:

- a. a place of management;
- b. a branch;
- c. an office... etc.”

The newly introduced subpart f-bis tells the following (free translation):

f-bis a significant and continuous economic presence on the territory of the State construed in such a way as to not result in a physical consistency on the territory itself.



It seems that the description above may refer to or include companies that put in place digital transactions on the territory, so that they may have an **economic** presence on the territory without having a **physical** presence, and this may be a typical feature of internet companies.

Future stands and interpretations will cast more light over the above, but the concept seems already extremely wide and it is not clear how one could limit or ringfence the application of such a rule.

A final hint about the changes brought to art. 162 must refer also to the notion of “independent agent.”

The revised art. 162, Sec. 7, specifies in fact that if Italian resident controlled entities perform an activity as agent on behalf of their controlling entity and/or of its related parties, such controlled Italian entity performing the activity of “agent” would be never considered an activity of an “independent agent,” thus making it likely, if not automatic, that such agent will be qualified a pe of its controlling entity and/or also of its foreign related parties on behalf of which the activity is performed.

Conclusion

Italian Finance Law always represents a big pot of changes to tax legislation, and in fact there are many other issues which might be addressed, both on company taxation and personal taxation (where tax incentives related to renewable energy investments and expenses and energy savings have been prolonged also to 2018 in an effort to reduce economic dependency from oil).

However we think that the features we have commented on seem to be the most innovative in the Italian tax scenario and it is worthwhile to follow their developments with great attention and care.

The above is relevant also because Par. 1019 of Finance Law 2018 reports that the Ministry of Economy and Finance will have to submit a report on the application, execution of Parr. 1010-1018 (web tax and pe) to Parliament every year. The report will include also details over economic consequences of such norms.

In our view, this implies that the new web tax and the new rules on permanent establishment, or at least some of them, have a strict connection.

It also seems likely that a target on which the attention of Parliament will focus in future years is taxation of internet companies, especially internet giants, which, in the past few years have undergone both tax audits and criminal proceedings in Italy, as widely reported by the local press.

Monitoring, with attention to the developments, will be key for these companies.



If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings Milan lawyer:

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