

Hong Kong and the Italian Black List - The Project of Sviluppo Cina (the Italian Institute for the Development of China-Italy Economic Relations)

1. Italian Legislation

The 2008 Finance Law (Law No. 244 of 24th December 2007 laying down “Provisions for the formation of the State annual and multi-annual balance – Finance Law 2008” (text approved by the Council of Ministers on 28th September 2007)¹ has

¹ 83. The following modifications have been made to the Italian Income Tax Code as per Presidential Decree No. 917 of 22nd December 1986:

a) Article 2 Para 2-bis is replaced with the following:

“2-bis. Italian citizens removed from the resident population registers and transferred to States or territories other than those identified by the Decree of the Ministry of Economy and Finance, to be published in the Gazzetta Ufficiale, are also deemed to be residents, unless proven otherwise”

b) In Article 10, Paragraph 1, e-bis, second sentence, the words “and in signatory States of the Agreement on the European Economic Area which are included in the list as per the Decree of the Minister of Finance of 4th September 1996, published in Gazzetta Ufficiale No. 220 of 19th September 1996 and subsequent modifications, issued pursuant to Article 11, Para 4 c) of Legislative Decree No. 239 of 1st April 1996” are replaced with the following: “and in signatory States of the Agreement on the European Economic Area which are included in the list as per the Decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”

c) in Article 47, Para 4, the first sentence is replaced by the following: “Notwithstanding the requirements of the previous Paragraphs, profits from companies resident in States or territories other than those as per the decree of the Minister of the Economy and Finance issued pursuant to Article 168-bis shall count in full as part of the taxable income, except in cases where they have already been allocated to the partner as per Para 1 of Article 167 and Article 168 or if resident there proof has been provided of compliance with the conditions laid down in Article 87, Para 1 c, by exercising the appeal in the manner laid down in Para 5 b) of the said Article 167.”;

d) in Article 68, Para 4, in the first sentence, the words: “Countries or territories with low tax systems as per the decree of the Minister of Economy and Finance adopted pursuant to Article 167 Para 4”, are replaced by the following “States and territories other than those as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis;

e) Article 73;

f) in Para 3, second sentence, the words “instituted in countries other than those indicated in the decree of the Minister of Finance of 4th September 1996, published in Gazzetta Ufficiale No. 220 of 19th September 1996, and subsequent modifications” are replaced with the following:

“instituted in States or territories other than those as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”;

2) in Para 3, third sentence, the words: “instituted in a State other than those indicated in the said decree of the Minister of Finance of 4th September 1996” are replaced with the following: “instituted in a State other than those indicated in the said decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”

f) in Article 87, Para 1, c), is replaced by the following:

“c) tax residence of the company held in a State or territory as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis, or, alternatively, proof, produced by exercising the appeal by the methods described in Para 5, b) of Article 167, that the holdings have not been given rise, from the beginning of the period of possession, to the income being located in States or territories other than those identified in the same decree as per Article 168-bis”;

g) in Article 89, Para 3, the first sentence is replaced by the following: “If the conditions as per Article 44, Para 2 a) last sentence arise, the exclusion as per Para 2. shall be applicable to the profits originating from parties as per Article 73, Para 1 d), and to remunerations arising from contracts as per Article 109, Para 9, b), entered into with such parties resident in the States or territories as per the decree of the Minister of Economy and Finance issued pursuant to Art. 168-bis, or, if not resident there, relative to which, following the exercise of the appeal by the methods laid down in Para 5 b) of Article 167, the conditions laid down in Article 87 Para 1 c) are met”;

b) Article 110;

f) Para 10 is replaced by the following:

“10. Costs and other negative components arising from transactions with companies resident or located in States or territories other than those identified in the list as per the Ministerial Decree pursuant to Article 168-bis shall not be deducted. Such deductions shall be permitted for transactions with businesses which are resident or located in States of the European Union or the European Economic Area included in the list in the said decree”;

2) In Para 12-bis, the words “low tax States or territories which are not members of the European Union” are replaced with the following: “States or territories other than those identified in the list as per the Ministerial Decree issued pursuant to Article 168-bis. This provision is not applicable to professionals domiciled in member States of the European Union or the European Economic Area included in the list as per the said Decree”;

i) in Article 132, Para 4, second sentence, the words “resident in a State or territory other than those with low tax systems as per the Ministerial decree issued pursuant to Article 167 Para 4” are replaced with the following: “resident in States or territories as per the decree of the Minister of the Economy and Finance issued pursuant to Article 168-bis”;

l) in Article 167:

1) in Para 1, first sentence, the words “States or territories with low tax systems” are replaced by the following “States or territories other than those as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”;

2) in Para 1, second sentence, the words “subject to the aforesaid low tax systems” are replaced by the following: “located in States or territories other than those as per the aforesaid decree”;

3) Para 4 is repealed;

4) in Para 5 b) the words “by the holdings does not achieve the effect of locating the income in low tax States or territories as per Para 4” are replaced by the following: “by the holdings does not achieve the effect of locating the income in States or territories other than those as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”;

m) Article 168:

1) in Para 1, first sentence, the words “States and territories with low tax systems” are replaced by “States and territories other than those as per the decree of the Minister of Economy and Finance issued pursuant to Article 168-bis”;

2) in Para 1, the second sentence is replaced by the following: “the regulations as per this Paragraph are not applicable for holdings in subjects resident in the States and territories as per the said decree with regard to income arising from their permanent organisations located in States or territories other than those covered by this decree”;

n) the following is inserted after Article 168:

“Art. 168-bis. – (Countries and territories permitting an adequate exchange of information) – 1. The Decree of the Minister of Economy and Finance identifies the States and territories which permit an adequate exchange of information, for the purpose of application of the provisions contained in Articles 10, Para 1, e-bis), 73, Para 3, and 110, Paras 10 and 12-bis of this Tax Code, I Article 26, Paras 1 and 5, and Article 27, Para 3-ter, of Presidential Decree N. 600 of 29th September 1973 and subsequent modifications, in Article 10-ter, Paras 1 and 9, of Law No. 77 of 23rd March 1983 and subsequent modifications, Articles 1, Para 1, and 6, Para 1, of

Legislative Decree No. 239 of 1st April 1996 and subsequent modifications, Article 2, Para 5 of Decree Law No. 351 of 25th September 2001 converted with modifications into Law No. 410 of 23rd November 2001.

2. The same decree as per Para 1 identifies the States and territories permitting an adequate exchange of information and in which the level of taxation is not considerably lower than that applied in Italy, for the purposes of application of the provisions contained in Article 47, Para 4, 68, Para 4, 87, Para 1, 89, Para 3, 132, Para 4, 167, Paras 1 and 5, and 168 Para 1, of this Tax Code, as well as Articles 27, Para 4, and 3-bis, Para 3, of Presidential Decree No. 600 of 29th September 1973, with subsequent modifications.

84. The following modifications have been made to Presidential Decree No. 600 of 29th September 1973:

a) Article 26:

1) In Para 1, the third sentence is replaced by the following: “However, if the securities indicated in the previous sentence are issued by businesses and organisations other than banks, whose capital is represented by shares not negotiated in the regulated markets of member States of the European Union or the European Economic Area which are included in the list as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code as per Presidential Decree No. 917 of 22nd December 1986 or by quotas, the 12.50 per cent rate is applicable on condition that, at the time of issue, the actual yield rate is not greater than a) twice the official reference rate for bonds and similar securities negotiated in markets regulated by member States of the European Union or the European Economic Area which are included in the list as per the aforesaid decree, or placed by public offer within the meaning of the legislation current at the time of issue; b) at the official reference rate plus two thirds for bonds and similar securities other than the above”;

2) in Para 5, the third sentence is replaced by: “the rate withheld is set at 27% if the recipients are resident in States or territories other than those as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree 917 of 22nd December 1986”;

b) in Article 27, Para 4, b), the words “on the full amount of the remunerations paid, in relation to holdings, securities, financial instruments and contracts not relating to the company within the meaning of Article 65, from companies and bodies resident in low tax Countries or territories as per the Ministerial Decree issued pursuant to Article 167 Para 4 of the aforesaid Tax Code” are replaced by the following: “on the full amount of the remunerations paid, in relation to holdings, securities, financial instruments and contracts not relating to the company within the meaning of Article 65, from companies and bodies resident in States or territories other than those in the Ministerial Decree issued pursuant to Article 168-bis of the aforesaid Tax Code”;

c) in Article 37-bis, Para 3, f-quater), the words: “in one of the low tax States or territories identified by Article 167, Para 4, of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986” are replaced by the following: “in a State or territory other than those as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”.

85. The following modifications are made to Article 10-ter of Law No. 77 of 23rd March 1983:

a) in Para 1, first sentence, the words: “and in member States of the European Economic Area which are included in the list as per the Decree of the Minister of Finance of 4th September 1996, published in Gazzetta Ufficiale No. 220 of 19th September 1996 with subsequent modifications, issued in implementation of Article 11, Para 4, c) of Legislative Decree No. 239 of 1st April 1996,” are replaced by the following: “and in member States of the European Economic Area which are included in the list as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”;

b) in Para 9, the words “and in member States of the European Economic Area which are included in the list as per the Decree of the Minister of Finance of 4th September 1996, published in Gazzetta Ufficiale No. 220 of 19th September 1996 with subsequent modifications, issued in implementation of Article 11, Para 4, c) of Legislative Decree No. 239 of 1st April 1996,” are replaced by the following: “and in member States of the European Economic Area which are included in the list as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”;

86. In Article 2, Para 5, second sentence, of Decree-Law No. 351 of 25th September 2001, converted with modifications by Law No. 410 of 23rd November 2001, the words “carried out by non-resident parties, excluding parties resident in low tax States or territories, identified by the Decree of the Minister of Finance of 4th May 1999, published in Gazzetta Ufficiale No. 107 of 10th May 1999” are replaced by the following: “carried out by parties

reformed the matter of the so-called “black list”, moving in the direction of application of the OECD recommendations.

The procedure covers an in-depth review of the matter, with the adoption of the criterion of “*effective exchange of information*” to identify States or territories which will be included in a new “white list”, replacing the present “black list” criterion for Countries with “*levels of taxation considerably lower than those applied in Italy*”. The new text of Article 168-bis of the Italian Income Tax Code in fact states that a Decree by the Ministry of Economy and Finance will identify the States or territories which permit a real exchange of communications with Italy and cannot therefore be described as low tax areas.

However, a five-year transitional period is provided for, in particular “to stimulate new Conventions, modify existing arrangements or urge new States to sign

resident in States or territories identified by the Decree of the Minister of Economy and Finance provided for by Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”.

87. *The following changes are made to Legislative Decree No. 239 of 1st April 1996 with subsequent modifications:*

a) in Article 1, Para 1, the words “which are included in the list as per the Decree of the Minister of Finance of 4th September 1996, published in Gazzetta Ufficiale No. 220 of 19th September 1996 with subsequent modifications” are replaced by the following “included in the list as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”;

b) in Article 6, Para 1, the words “Countries which permit an adequate exchange of information” are replaced with the following: “States or territories included in the list as per the Ministerial Decree issued pursuant to Article 168-bis of the Italian Income Tax Code, as per Presidential Decree No. 917 of 22nd December 1986”;

c) in Article 11, Para 4 c) is repealed.

88. *The provisions in Paras 83 to 87 are applicable, except where provided otherwise in Para 89, as from the tax period commencing after the date of publication in the Gazzetta Ufficiale of the Decree of the Minister of Economy and Finance issued pursuant to Article 168-bis of the aforesaid Tax Code as per Presidential Decree No. 917 of 22nd December 1986; up to the previous tax period, the provisions valid at 31st December 2007 continue to be applicable,*

89. *The provisions of Para 83, a) apply from the tax period following that of publication in the Gazzetta Ufficiale of the Decree provided for therein; up to the previous tax period, the provisions valid at 31st December 2007 continue to be applicable.*

90. *The decree as per Article 168-bis of the Italian Income Tax Code as per Presidential Decree No. 917 of 22nd December 1986, introduced by Para 83 n) of this Article also includes, for a period of five years from the date of publication of the said Gazzetta Ufficiale, the States and territories which, prior to the date when this Law comes into force, are not listed in the decrees of the Minister of Finance of 4th September 1996 or 4th May 1999 published respectively in Gazzetta Ufficiale No. 220 of 19th September 1996 and No. 107 of 10th May 1999, and subsequent modifications, as well as in the decrees of the Ministry of the Economy and Finance of 21st November 2001 and 23rd January 2002, published respectively in Gazzetta Ufficiale No.273 of 23d November 2001 and No. 29 of 4th February 2002. Also included for the same period, in the decree as per the aforementioned Article 168-bis, are the States or territories mentioned in Article 2 of the said Decree of the Minister of Economy and Finance of 21st November 2001, restricted to the parties mentioned there, as well as the States or territories as per Article 3 of the said Decree, with the exception of the parties indicated therein.*

Conventions on mutual assistance in tax matters”;² however, the present regulations will continue throughout the transitional period.

In the case of China, a Treaty against double taxation is already in force, signed in Beijing on 31st October 1986 and ratified by Law No. 376 of 31.10.89 (*Gazzetta Ufficiale O.S.* No. 274, 23.11.89) covering the exchange of information (Art. 26³); however, this agreement is not applicable to the Hong Kong Special Administrative Region, which was returned to the sovereignty of the People’s Republic of China in July 1997, nor to the territory of Macao.⁴

For the moment, then, Hong Kong remains on the black list as per the Ministerial Decree of 24th April 1992 for transactions with parties resident in low tax Countries between 1st January 2002 and 4th February 2002; it is also included on the latest black list, under the Ministerial Decree of 23rd January 2002 for transactions with parties resident in low tax countries as from 5th February 2002, more specifically on the list of “*pure low tax countries*”.

The regulatory framework starts with Art. 76 (then 110 Para 10) of Presidential Decree No. 917, as modified by Laws 342/2000 and 448/2001: “*Expenses and other negative components arising from transactions between resident companies and companies resident for tax purposes in low tax States or territories which are not European Union members cannot be deducted*”.

The law requires the compilation of a black list, indicating the following criteria for inclusion:

- a level of taxation “considerably lower” than that applied in Italy;
- lack of an adequate exchange of information;
- other, equivalent, criteria.

² See “*Il Sole 24 Ore*” of 11th October 2007: “*Tax havens, the rules are changing*” by Giovanni Rolle

³ 1. *The competent authorities of the signatory States will exchange the information required to apply the provisions of this Treaty or those of the internal laws of the signatory States regarding the tax provided for in the Treaty, in so far as the taxation covered by such laws is not contrary to this Agreement, and in particular to prevent avoidance of such taxes. The exchange of information is not restricted by Article 1. The information received by one contracting State shall be kept secret, as will the information obtained on the basis of the internal legislation of the said State, and shall be disclosed only to the persons or authorities (including the legal authorities and administrative bodies) in charge of assessing and collecting the taxes provided for under this Treaty, the procedures and proceedings relating to such taxes, and the decisions regarding appeals against such taxes. The above persons or authorities shall use such information for these purposes only. This information may be used during open court or in legal proceedings.*

⁴ See Min. of Finance Circular No. 33 of 18.04.02: *Administrative Cooperation Activities in the Direct Taxation Sector. Exchanges of Information.*

The conditions for disapplication were initially laid down by Law 342/2000, then reformulated by Law 448/2001, as the grounds provided for in the old Para 7-ter were excessively difficult to prove.

Pursuant to Art. 110 Para 11 of Presidential Decree 917/1986, resident taxpayers can therefore proceed with normal deduction of expenses if they provide proof:

- that the foreign parties are predominantly carrying on a *genuine business*;
- that the transactions set up correspond to a *genuine economic interest* and have actually been *carried out*.

The deductible nature of the negative components of income earned in Countries on the black list was, however, subject to their being *indicated separately in the income tax return* for the period in question. Many operators were unaware of this, and in any case it was very difficult to justify in logical terms the irreversible loss of the right to deduction.

Law No. 296 of 27th December 2006 (Gazzetta Ufficiale No. 299 of 27th December 2006 – Ord.Supp. No. 244) - Provisions for the formation of the annual and multiannual State budget (Finance Law 2007) Art. 110 Para 11 of the Italian Income Tax Code, has been modified on this specific point, considering the separate entry in tax returns no longer as a condition for deductibility, but as a mere matter of behaviour, failure to comply with which thus becomes subject to penalisation only as a formal non-fulfilment.

Art. 21 of Law No. 413/91 also introduced, in this context, the tax-payer's right to appeal, with the sole consequence of the reversal of the burden of proof, laid on the party which does not agree with the opinion of the aforesaid committee.

However, the matter of the ruling has recently been revolutionised, following the suppression of the Advisory Committee on the Application of Anti-Avoidance Legislation.⁵ The removal of this Committee has also meant the implicit repeal of the

⁵ See Italian Revenue Service Circular No. 40/E of 27th June 2007: "Decree-Law No. 223 of 4th July 2006, converted with modifications by Law No. 248 of 4th August 2006, provided among other things, in Article 29, that, to achieve the purpose of containing the costs borne by the authorities for collegiate bodies and other bodies operating in the aforesaid administrations, the "... organisations should be reorganised, and even removed..."

In particular, pursuant to Para 3 of the aforesaid Article 29, non-State authorities provide with regulatory acts provided for in the respective orders.

Para 4, the next Paragraph of Article 29, as modified by Decree-Law No. 300 of 28th December 2006, with modifications, of Law No. 17 of 26th February 2007, establishes that bodies not identified by the procedures provided for by Paras 2 and 3 of the said Article, by 15th May 2007, are "removed".

As the procedures mentioned in the said Decree-Law No. 223 of 2006, Art. 29 Para 4 are not identified, the Advisory Committee on the application of anti-avoidance legislation is one of the bodies removed.

MASSIMO BURGHIGNOLI, Solicitor

Via San Damiano, 9 - 20122 MILAN (Italy)

provisions of Article 21 of Law No. 413 of 1991 regarding its activities, the enforceability of the relevant opinions, and above all the tacit consent generated by any failure by the Committee to act within 120 days.

According to the Administration, however, Law No. 413 Art. 21 Para 9, which enables the taxpayer to obtain the opinion of the Italian Revenue Service with regard to the application of the anti-avoidance provisions to specific cases, must be deemed to be in force, but with the opposite effect to the previous system with the Advisory Committee; failure by the Service to act within 60 days in fact means rejection of the procedure, whereas previously failure by the Committee to act within 120 days meant its acceptance.

Thus an Italian business which has borne negative income components with Hong Kong has two options:

- to appeal in advance to the Revenue Service,⁶ providing in advance proof of the authenticity of the contractor, the transaction, and the economic interest of the latter;

⁶ See http://www.finanze.it/documentazione/com_antielusione/index.htm

From the procedural point of view, the legislation on this point provides for several levels of jurisdiction. The request, sent by registered post, is initially addressed to:

Agenzia delle Entrate (Italian Revenue Service)

Direzione Centrale Normativa e Contenziosa

Viale Europa, 242

00144 ROME

via the Regional Revenue Service Department for the applicant's tax residence. This department will, within 15 days of receipt or, in highly complicated cases or where there are additional investigations, within 30 days from the hearing, forward this by priority mail, along with its own opinion, to:

Agenzia delle Entrate (Italian Revenue Service)

Direzione Centrale Normativa e Contenziosa

Ufficio del Direttore Centrale – Torre “B”, 8° piano

Viale Europa, n. 242

00144 Rome

stating that this is an appeal made pursuant to Art. 21 Para 9 of Law No. 413/91.

Subject to being inadmissible, the application must contain:

- 1. Details identifying the taxpayer or legal representative and other interested parties;*
- 2. Details of the specific case and the hoped-for interpretative solution;*
- 3. Information on any office to which notices should be sent;*

- to show at cost the negative components of the income tax declaration without showing them separately in the said return, banking on the fact that the Revenue Service will not pick them up (and thus risking penalties for failure to highlight the information, of between 258 and 2,065 euros if proof can be provided that it is genuine, or 500 and 50,000 euros if not);

-
4. *Copy of the documentation, with the relevant list, required for the purpose of identification and qualification of the case in question;*
 5. *The signature of the tax-payer or legal representative.*

The Revenue Service Central Legislation and Disputes Department will issue its opinion by registered post with 60 days of receipt of the request, and, if this agrees with the interpretation supplied by the tax-payer, this excludes further procedure by the Committee.

If the taxpayer does not wish to comply with the opinion of the Central Legislation and Disputes Department or the said opinion has not been notified within 60 days, the case may be resubmitted to the Committee.

With regard to the method of presenting the appeal, it should be noted that it must be sent by registered post to the revenue department with territorial jurisdiction on the basis of the tax-payer's fiscal residence.

Subsequently it will be the responsibility of the department which received the case to forward it to the technical secretary of the Advisory Committee for the Application of Anti-Avoidance Legislation by priority mail.

Agenzia del Entrate

Direzione Centrale Normativa e Contenzioso

Ufficio del Direttore Centrale

Segretaria Tecnica del Comitato Consultivo per l'applicazione delle norme antielusive

Torre B, piano 6°

V.le Europa, n. 242

00144 Rome

F.a.o. Dr. A. Giordano

(Tel. 06/50545431 – 06/50545421 – Fax 06/50545671)

E-mail: dc.nc.segretaria.comitatoantielusione@agenziaentrate.it

The cover letter from the Regional Department – also to be sent by priority mail – must state

- *any grounds for inadmissibility of the application provided for in Art. 5 Para 2 of Decree No. 194 of 1997;*
- *any assessment already carried out or under way regarding the object of the appeal;*
- *the details of the report on the transmission of the prior request for an opinion sent by the taxpayer to the Revenue Service Central Legislation and Disputes Department.*

The Department will send a copy of the dossier to the Central Legislation and Disputes Department at the same time.

- to show the negative components separately in the tax return and wait for the Revenue Service to request the evidence already mentioned and trust in providing it successfully; otherwise, to wait for the assessment and appeal against it before the tax tribunals.

It is in fact said that neither the response to the appeal, nor an amicable notice deeming the evidence produced at the invitation of the administration insufficient are automatically deemed to be open to appeal, as the assessment must then be waited for;⁷ this makes the defence of the taxpayer particularly burdensome.

2. The ruling of the Advisory Committee for the Application of the Anti-Avoidance Laws

Although now merely of “historic” interest, it is still worth considering the principles that can be deduced from the rulings laid down in the past by the Committee.

- For the purpose of the Committee forming an opinion, the fact that payments made abroad are considerably lower than those made nationally is not sufficient to demonstrate genuine economic interest, as the taxpayer has to verify the difference between the sale prices applied by the foreign supplier and those which can be found on other markets, taking into account all the intermediate costs to be added to the original prices requested abroad (e.g. transport, deposit and insurance) (Opinion No. 55 of 15th December 2005; Opinion No. 4 of 7th March 2006)
- For the purpose of the Committee forming an opinion, it is not sufficient to provide documentation showing that the contractual counterpart, resident in a low tax country, is represented by an operating company originating in the territory where it is formed, but it is necessary to submit detailed

⁷ See Milan Provincial Tax Committee, Section. XIX 26.11.2004 No. 242: *the opinion obtained from the financial administration in response to the appeal provided for in Art. 11 of Law No. 212 of 27th July 2000 is binding in relation to the administration, while the taxpayer, on the other hand, is free to comply with this opinion and oppose any procedure adopted by the same financial administration in accordance with this opinion. Given the interpretative nature of the said opinion, it cannot be brought before the tax tribunal pursuant to Art. 19 of Leg. Dec. 546/92.*

T.A.R. Emilia Romagna Section 1 17.1.2005 No. 47: *“Direct recourse against an appeal judgement to the Tax Commission is not admissible, as this falls within an administrative activity prior to the establishment of a tax relationship, the binding nature of which only relates to the tax administration and not to the taxpayer making the appeal.*

examination the economic and legal content of the transaction to be set up (Opinions Nos. 54 and 56 of 15th December 2005).

- Every document produced before the Committee, if drawn up in a foreign language, must be accompanied by a translation into the Italian language (Opinion No. 56 of 15th December 2005).
- The following are suitable documents for proving not only the physical connection of the foreign supplier's structure with the territory of the low tax State, but also the genuine exercise of a business activity within the territory (Swiss): - balance sheets; - copies of registry certificates showing ownership of business premises; - turnover for the year 2003; - invoices for the purchase and resale of goods to Swiss clients; - draft distribution contract; - list of employees; - bills for telephone services; bills for power supply services (Opinion No. 3 of 7th March 2006);
- The predominant genuine business of the foreign company can be proven by means of a commercial report provided by a website; - the transactions may be proven to fulfil a genuine economic interest of the Italian company via the suitability of the prices charged by the foreign company, in relation to other commercial channels or the cost which the appellant would have borne to construct the machinery in question on his own; - the fact that the transaction has actually taken place can be demonstrated by customs declarations and invoices (Opinion No.14 of 22nd March 2007).

3. Consequences.

Although, during the validity of the Committee, there was a gradual increase in the evidence deemed to be admissible and conclusive (significantly the commercial information report provided by a website and relating to companies assigned in Hong Kong), it seems, however, clear that the burden of proof and of the relevant procedure is highly cumbersome given the required speed of the matter. In addition, the transfer of the assessment procedure to the Italian Revenue Service, an interested party, in comparison with the Committee (a party of "third" origin, even if part of the Financial Administration), and the replacement of the "tacit consent" with "tacit rejection" leads to legitimate concerns as to the worsening of the already uncomfortable position of the taxpayer, and the effectiveness of his right of defence.

Italian businesses therefore have to support a competitive gap with the extreme difficulty of deducting costs borne in a country on the black list; these difficulties

have been efficiently summarised in the hearings of the tax advisors of major companies which took place in Rome before the Business Tax Advisory Committee on 19th October 2006 (furthermore still prior to the removal of the Committee)⁸:

“Commercial transactions with companies resident in black-listed countries which are not part of a group.

Under the current legislation (Art. 110, Paras 10 and 11 of Presidential Decree No. 917/1986), a resident company, in order to be able to deduct the costs relating to a transaction with companies resident in black-listed countries, must comply with the obligations of declaration and evidence, and must therefore:

- *show such costs separately in income returns;*
- *provide, at the request of the financial authorities, evidence that the foreign company carries on a genuine business or, alternatively, that the transactions have actually taken place and have a genuine economic interest.*

The efficacy of this Law in order to counter locating companies in tax havens is at least dubious, given that it affects a party other than the one abroad over which it has no control.

Here it should be pointed out that:

- *with regard to the genuine nature of the business, the resident company has problems, as it has no participative link with the foreign supplier in order to obtain the necessary documentation; these difficulties become insurmountable if the resident company is not in a position to force the foreign supplier to comply;*
- *with regard to the evidence that the transactions have actually been carried out and are of genuine economic interest, it should be noted that there is still no unequivocal guidance by the advisory committee for application of the anti-avoidance regulations.*

The negative consequences of the application of the legislation in question may be particularly penalising, especially if compared with the international legislative picture and if it is considered that they may also arise from lack of respect of merely formal obligations (such as, for example, failure to state such costs separately in a tax return), with the automatic loss of the deductibility of the costs borne to produce income taxed in Italy.

It would be appropriate to revise the legislation in question, excluding at least commercial transactions set up between parties in the same group”.

⁸ See Commissione Consultiva Sulla Imposizione Fiscale Delle Società, Rome, 19th October 2006; Hearing of tax experts of major companies – Dr. Bruno Ciappina: Autostrade – Dr. Aldo Correale: Finmeccanica – Dr. Roberto Fanelli: Ferrovie Dello Stato – Dr. Stefano Giuliano: General Electric – Dr. Carlo Monfregola: Fintecna – Dr. Roberto Moro: Telecom Italia – Dr. Agostino Nuzzolo: Italcementi – Dr. Walter Paglieri: Fiat – Dr. Carlo Palsaciano: Enel – Dr. Giancarlo Patti: Eni – Dr. Carlo Sauve: Poste Italiane – Dr. Alberto Taccani: Pirelli.

4. European Legislation

Here the EC Court of Justice has issued two rulings which are significant in terms of tax avoidance: first of all the sentence of 17th July 1997, C-28/95 (Leur Bloem), confirming, but incidentally, that the concept of “valid economic reason” – within the meaning of EEC Directive 90/434 – must be interpreted in the sense that it transcends the mere quest for tax relief on its own.

Subsequently, the ruling of 12th September 2006, case C-196/04 (Cadbury Schweppes) states more specifically that:

“Arts. 43 EC and 48 EC must be interpreted in the sense that they obstruct the inclusion in the taxable basis of a business resident in a member State of proceeds made by a controlled foreign country established in another State when such proceeds are subject there to a lower level of taxation than is applicable in the first State, unless such inclusion does not cover purely artificial structures designed to avoid the national tax which would normally be payable. The application of a tax measure of this nature should therefore be excluded where it can be seen from objective information that can be verified by third parties that, although there are motivations of a fiscal nature, the controlled company is really established in the State of the establishment and genuine business is carried on there”.

The following principles arise from this ruling:

- the freedom of circulation of goods and services established by the Treaties bans a member State from adopting “sterilisation” measures in the tax competition between States, unless the structure of the business adopted by the taxpayer in the individual case is “purely artificial” and does not involve any appreciable economic interest;
- the requirement of business purpose cannot be identified from the taxpayer’s point of view by mere fiscal convenience;
- the “authenticity” of the business structure, in the opinion of the Court, is open to proof by the taxpayer;⁹

⁹ “The resident company, which is the one in the best position for this purpose, must be made able to produce information regarding the establishment of the SEC and its business”. it is significant that, according to the Court, the evidence offered by resident companies can be certified by competent national authorities, with recourse “to the mechanisms of cooperation and exchange of information between tax national tax authorities instituted by juridical instruments...”; this cooperation on information which, by definition fails or is excessively difficult in countries on the black list.

- the evidence must, however, be possible and not unreasonably difficult: “...it must be made able to produce information regarding the authenticity of the establishment ... and of its activities...”; otherwise, the restrictive measure does not pass the test of proportionality and could be deemed illegitimate as an obstacle to the free circulation of goods.

It is therefore possible that the principle of freedom of circulation of goods and services can be put forward, if not to exclude Hong Kong from the black list, at least to consider the burden of proof at present incumbent on the taxpayer excessively cumbersome.

5. The OECD regulations

In 1998, the OECD, the Organisation for Economic Cooperation and Development, identified the following criteria for defining a “tax haven”:

- absence or omission of taxation or nominal taxation;
- limitation on the exchange of information with other States;
- lack of transparency;
- absence of genuine business activity in the territory.

Following these definitions, black lists were issued of off-shore countries or tax havens, these lists being open and liable to variation depending on changes in the incriminating aspects of the listed territories.

On 26th June 2000, the OECD published the report “Progress in Identifying and Eliminating Harmful Tax Practices”, identifying 35 tax havens, accused by the OECD of practicing harmful tax competition. The 35 countries identified were: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, British Virgin Islands, Guernsey, Cook Islands, Dominica, Gibraltar, Grenada, Isle of Man, Jersey, Liberia, Liechtenstein, Maldives, Marshall Islands, Monaco, Montserrat, Nauru, Dutch Antilles, Niue, Panama, St. Kitts & Nevis, Saint Lucia, Saint Vincent and Grenadine, Western Samoa, Seychelles, Tonga, Turk & Caicos islands, American Virgin Islands, and Vanuatu.

Finally, on 18th April 2002, an OECD report reduced the tax havens from 35 to 7, leaving the following on the black list: Andorra, Liberia, Liechtenstein, Marshall Islands, Monaco, Nauru, and Vanuatu. However, some of these countries are also gradually coming into line with the OECD guidelines.

It can be seen, with regard to our context, that Hong Kong is not on any OECD black list – neither the “long” list of 2000, nor the shorter list of 2002. In particular,

the first version considered countries where taxation was zero or irrelevant in practical terms or where there was no real exchange of information or transparency in the application of the tax laws (e.g. secret rulings) were deemed to be tax havens. In the 2002 version, the OECD totally eliminated the requirement of the level of taxation, basing the qualification of “tax haven” exclusively on the degree of *cooperation* of the State with the Authorities of the other States and the degree of *transparency* regarding the characteristics of the taxation system.

As the principles of inclusion on the black lists are to be deemed to be binding for the member States, as stated in two Recommendations (the “Recommendation of the Council on Counteracting Harmful Tax Competition” of 9th April 1998 and the “Recommendation of the Council on Implementing the Proposals contained in the 1998 Report on Harmful Tax Competition” of 16th June 2000), the Italian inclusion of Hong Kong gives a wider and therefore stricter interpretation of the OECD rules.

The changes made with the 2008 Finance Bill specifically tend to overturn the previous system, applying the OECD recommendations but, for a 5-year transitional period, encouraging “uncooperative” States to enter into bilateral agreements and thus “leave” the black lists.

This change of direction is certainly considerable, but the fact still remains that Hong Kong will continue to be on the black list for five years, with the problems we have seen, and that this inclusion specifically takes as a Parameter the level of taxation, unlike the principles adopted by the OECD.

The excessive burden of proof, with a muddled administrative procedure and no autonomous jurisdictional guarantee, will continue for five years, in fact impeding the taxpayer from benefiting from a right enshrined by the positive system.

Reasonable doubt also remains with regard to the inclusion of Hong Kong on the black list in the absence of an analogous OECD recommendation and also, beyond the limits of this, cancelling out an instrument for regulating fiscal competition (set up by the OECD to protect businesses in fiscally “virtuous” countries from competition) and thus harming these same businesses, reducing their economic efficiency in all transactions with operators in Hong Kong. Furthermore, even the national tax charges could be improved by a more liberal measure, widening the field for taxpaying businesses in trade with Hong Kong;

Finally, the assumption of the principle of level of taxation to identify “tax havens” is, at the moment, in contradiction with the “Recommendation of the Council on Counteracting Harmful Tax Competition” of 9th April 1998 and the “Recommendation of the Council on Implementing the Proposals contained in the 1998 Report on Harmful Tax Competition” of 16th June 2000.

6. An operative project to change the present situation

These arguments could usefully be brought to the attention of the political authorities and governments of both our own country and Hong Kong; the former so that they can simplify the burden of proof, starting negotiations for a bilateral treaty, and the latter for political pressure to be brought to bear on the former, and also to prepare measures such as to enable Italian companies to prove the genuine nature of their transactions with companies located there (e.g. certification).

Furthermore, appropriately developed, the same arguments can be used in defence of Italian companies subject to assessment to recover as deductible costs borne in Hong Kong which, in the opinion of the Revenue Department, are insufficiently proven, causing an exception of constitutional illegitimacy of Art. 110, Paras 10 and 11 of the Italian tax laws.

However, the protection of the European Convention on Human Rights does not appear to be applicable, as the European Court of Human Rights has repeatedly been able to prevent the return to the sphere of application of the Convention the disputes regarding obligations, although of a patrimonial nature, arising from tax legislation.¹⁰ Only some accessory procedures, such as, for example, verification or tax inspection, have been deemed liable to the ECHR as being comparable to a “criminal” procedure.¹¹

As an alternative to defence in court, the evolution of the rulings of the Advisory Committee on the Application of Anti-avoidance Laws seems to leave room for work to alleviate the burden of proof by cooperation between businesses, their partnership, and the Government of Hong Kong itself.

7. Scope of negotiation between the Government of Hong Kong and the European Union.

The divergence between the OECD recommendations and the principle of free circulation of goods on one hand, and Italian law on the other, is an argument of great legal and political strength for exercising constant pressure on the European Union to obtain a common position on “tax havens”, a position which could not be different from that of the OECD, and would cause immediate exclusion of national black lists. In addition, the Government of Hong Kong could complain of the

¹⁰ *Sentence in König v. Federal Republic of Germany*, 28th June 1978, *Pierre Bloch v. France* 21st October 1997; *Shouren and Meldrum v Netherlands* 9 December 1994; - *Ferrazzini C / Italy* – (Appeal No. 44759/98) 12th July 2001 (but with dissenting opinions of judges Lorenzen, Rozakis, Bonello, Stra Nicka, Birsan E. Fischbach).

¹¹ *Sentence of the European Court of Human Rights in Strasbourg of 2nd January 2006 Grand Chamber Case of Jussila V. Finland* (Application No. 73053/01).

excessive burden of proof weighing on Italian businesses wanting to justify expenses and investments borne in the territory of Hong Kong.

8. Initiatives for facilitation of businesses by the Government of Hong Kong

On the basis of the latest opinion of the Advisory Committee for the application of the anti-avoidance laws, information on the genuine exercise of economic activity by Hong Kong businesses can also be obtained by recourse to databanks which are unofficial, but come from normal operators specialising in commercial reports. This ruling opens the way to easing the burden of proof incumbent on Italian businesses. The Government of Hong Kong could do a great deal in this direction, either via its own data banks, or by making available accredited and recognised private data banks. Data banks of comparative international price lists could be studied and suitable certification methods worked out.

9. Business lobbying initiative

Naturally, Italian companies must also – and above all – carry out constant lobbying of political parties and national institutions.

The sparse initiatives adopted to date could be brought together for greater effect.

China Development (Sviluppo Cina) proposes that this should be done first of all by a meeting bringing together the Government Authority of Hong Kong, the largest business associations, the Italian authorities, the European Union authorities, and the OECD authorities to discuss the matters outlined here.

If the meeting is successful, it should set up a working party made up of experts appointed by the business associations, in constant contact with the national and international authorities, so that the problem of black lists would be constantly on the agenda and find a solution with a timeframe compatible with the competitiveness requirements of Italian firms. The natural opening would be a bilateral treaty with the Government of Hong Kong permitting an exchange of information.

Last revision: 10 JUNE 2008

Author: Massimo Burghignoli, Solicitor, member of the Board of Sviluppo Cina

The publication of this document is authorized by quoting the source:

Sviluppo Cina (the Italian Institute for the Development of China-Italy Economic Relations)
Milano (Italy) – T. +39 02 8953 4108 - www.sviluppocina.com – info@sviluppocina.com

Massimo Burghignoli, Solicitor - Milano (Italy) – T. +39 02 78 16 61 – lexburg@tin.it



中國國際關係拓展委員會