

DE BERTI ■ JACCHIA

De Berti Jacchia Franchini Forlani
studio legale

2018 Budget Law

Client TAX Alert –
January 2018

What's new on Permanent establishment

The 2018 Budget Law amends the domestic definition of permanent establishment (“PE”) - implementing certain principles set forth by the OECD in its Final Report on BEPS Action 7 - to prevent the artificial avoidance of PE status.

The new definition applies from 1 January 2018.

In a nutshell, according to the amended PE definition, multinational groups having business operation in Italy should pay attention to the following:

- **Restriction of the “*negative list*”** of activities that do not entail *per se* the existence of a permanent establishment: the new provision expressly introduces the condition that the listed activities must be “preparatory” or “auxiliary” (and therefore NOT represent an essential part of the core business of the company at hand). As a consequence thereof a preliminary assessment on the relevant activities will be necessary in order to establish whether or not the same may fall under the definition of “preparatory” or “auxiliary”.
- **Extension of the “agent PE clause”:** persons - different from independent agents - acting on behalf of non-resident enterprises and who:
 - (i) habitually execute contracts, or
 - (ii) anyhow are involved in the conclusion of contractsthat are routinely executed by such enterprises without material modifications, may give rise to an agency PE.

It must be noted that persons that act exclusively (or almost exclusively) on behalf of one or more *closely related enterprises* do not qualify as independent agents.

In the light of the above, activities performed by cross-border sales teams in Italy should be re-assessed in order to exclude that the same may fall under the definition of Agent PE. To such purpose clear guidelines should be implemented with respect to the authority to decide on pricing, discounts or changes to terms and conditions.

- **Anti-fragmentation rule:** should the activities carried out by *closely-related enterprises* represent *complementary functions that are part of a cohesive business operation* which is carried out by the non resident enterprise:
 - (i) the assessment on whether or not such activities may qualify as “preparatory” or “auxiliary” must be done on an aggregated basis and
 - (ii) the activities performed by all *the closely-related enterprises* must therefore be considered as a whole.

In other words if an International group carries out several activities in Italy even through different legal entities the above assessment must be done considering all the activities carried out in Italy even through different legal entities and on an aggregated basis.

This especially in all those cases whereby the different activities/functions are carried out in Italy by different group entities as a consequence of a splitting up of the value chain for allocating various functions and risks over different group entities even within the same jurisdiction.

- **Anti-avoidance provision:** a “*significant and continuous economic presence*” in the Italian territory may entail the existence of a permanent establishment even if the business model has been structured in such a way that does not give rise to a physical presence in Italy.

When the economic presence is considered significant and continuous enough in order for a PE to be deemed to exist is still debatable.

It is instead fully clear that this change, introduced with a view to the digital economy, is fully applicable also to other industries.

The impact of the amendments to the PE definition may be of course mitigated in all those cases whereby the foreign group/entities with activities in Italy are resident in countries having a double tax treaty in force with Italy (since in these cases the tax treaty’s PE definition prevails).

The above having been said, an evaluation on the sustainability of the existing business models is any case advisable since:

- the BEPS Multilateral Convention, which Italy signed on 7 June 2017, may modify the relevant tax treaty and the PE definition according to BEPS guidelines and therefore in line with the Italian new provision of law;
- the approach of the Italian tax authorities and of the tax Courts may become more aggressive in view of the more restrictive approach consolidated at OECD level and implemented in the new Italian provision of law;
- the new PE definition may have an impact also in all those cases whereby a PE does already exist: as a matter of facts, the anti-fragmentation clause and the anti-abuse rule may play a very

significant role also in determining the amount of profits attributable to already existing PE.

The new provision of law may therefore constitute a valid test to assess whether the existing operating models are robust enough to face the new international approach to the PE issues or improvements may be implemented.

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TIZIANA ZONA

DE BERTI JACCHIA FRANCHINI FORLANI

Via S. Paolo, 7 – 20121 Milano

T +39 02 72554 1

F +39 02 72554 500

E t.zona@dejalex.com

www.dejalex.com



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