



# Italy: Update on the definition of permanent establishment

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### 1. Draft Budget Law 2018 - new measures for enterprises of the digital economy

As one of the measures aimed at addressing the income taxation of services provided in Italy by digital economy MNEs, an amendment to the draft Budget Law 2018 broadens the domestic permanent establishment (PE) definition<sup>(1)</sup>, in order to make it fully consistent with that proposed by the OECD in the BEPS Action 7 Final Report. More specifically, the amendment:

- extends the agency PE definition;
- makes the 'negative' list conditional on the taxpayer proving the preparatory or auxiliary nature of the activities;
- includes the 'anti-fragmentation rule'.

Moreover, the amendment introduces an additional definition of a fixed-place PE: a 'significant and continuous economic presence in the territory of Italy, built in such a way that it will not result in a physical presence in Italy'.

The amendment, even if included in the new tax measures for the digital economy, may also affect non-resident enterprises operating in industries other than the digital economy.

These changes to the domestic PE definition, if ultimately approved, will need to be coordinated with the position on the Multilateral Convention, signed on 7 June 2017, where Italy, for instance, reserved the right not to broaden the agency PE definition<sup>(2)</sup>.

The text of the Budget Law might be amended before its final approval by 31 December 2017.

(1) Given in article 162 of the Italian Income Tax Code.

(2) As per article 169 of the Italian Income Tax Code, domestic provisions prevail over those of double tax conventions only if they are more favourable to taxpayers. Consequently, the provisions of the double tax conventions in force with Italy should prevail over the stricter rules now introduced in the domestic provision.

## 2. Definition of permanent establishment with respect to a building site

The Supreme Court<sup>(3)</sup> has clarified that the activity carried out in Italy by a non-resident enterprise does not automatically trigger a building site PE for the purposes of article 5 of the Italy-Yugoslavia Double Tax Convention.

The fact that an enterprise carries out its activity at building sites organized by its customers is not sufficient to give rise to a PE. Firstly, a place of business in Italy constitutes a PE if the following conditions are fulfilled:

- (i) permanence for a certain time;
- (ii) capacity (even potentially) to generate income;
- (iii) independence of the activity from that of the foreign headquarters.

Assessments must be based on factual evidence and substance.

Above all, however, the foreign enterprise must carry out its activity *through* such a place of business - a circumstance which the tax authorities did not demonstrate in the case in question.

## 3. Definition of permanent establishment with respect to an office with only one employee who purchases advertising services

Citing the decisions of the EU Court of Justice, the Supreme Court<sup>(4)</sup> has clarified that the presence in Italy of an office at the disposal of a non-resident enterprise, with only one employee who merely purchases advertising services on behalf and in the name of the non-resident enterprise, does not trigger a PE in Italy for income tax or VAT purposes. A fixed place of business that carries out only preparatory or auxiliary activities on behalf of a non-resident enterprise does not constitute a PE.

(3) Judgment no. 28059 of 24 November 2017.

(4) Judgment no. 27070 of 15 November 2017.

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