



Italy: Recent updates on the permanent establishment issue

Tax Alert

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1) New criteria for the translation into euro of the accounts of foreign permanent establishments

Under the new article 110(2) of the Italian Income Tax Code (IITC)⁽¹⁾, with effect from fiscal year 2017 the translation into euro of the balance of accounts of foreign permanent establishments will no longer be based on the exchange rate at the end of the reporting period, but on the exchange rate determined by the accounting principles adopted by the Italian headquarters (domestic GAAP or IAS/IFRS), i.e. the exchange rate on the date of the transaction or the average rate for the period. It is confirmed that the difference between the balance of accounts of the current reporting period and that of the previous reporting period is not to be included in the calculation of taxable income⁽²⁾.

2) Definition of permanent establishment with respect to a logistics hub

The Italian Revenue Agency (IRA), in its first ruling on substantial investments⁽³⁾, clarifies the definition of permanent establishment (PE) with respect to a logistics hub.

The facts

A multinational group is planning to set up a warehouse and distribution centre in Italy. This logistics hub (the 'hub') will handle the worldwide distribution of the group's products. It is planned that:

- the hub will be managed by a professional logistics firm;
- the hub will be a VAT and customs warehouse;

(1) Article 7-*quater* of Law Decree no. 193 of 2016 - converted into Law no. 225 of 1 December 2016, published in Official Gazette no. 282 of 2 December 2016 - replaced article 110(2) IITC.

(2) The Italian association of joint-stock companies (Assonime) provides clarifications on this new provision in Notice no. 27 of 22 December 2016.

(3) Ruling no. 4 of 17 January 2017. The 'ruling on substantial investments' procedure was introduced in 2015 as a result of the decree encouraging the growth and internationalization of companies (see our [Tax Alert of 8 June 2016](#)).

- only the products owned by the foreign headquarters will be stored in the hub;
- negotiations will be conducted and product sales agreements will be concluded outside Italy by the foreign headquarters with no involvement of the Italian subsidiary or the hub.

The IRA ruling

The group asked for confirmation that the hub will not represent a PE in Italy of the foreign headquarters, as defined in article 162 of the IIRC and in article 5 of the double tax agreement between Italy and the country of the headquarters (the 'DTA').

The IRA, citing article 5 of the OECD Model and its Commentary, clarifies that the hub at the disposal of the foreign enterprise will not constitute a fixed-place PE of the foreign headquarters if the following conditions obtain.

- Only the products of the foreign headquarters are stored in the hub (and not those of other enterprises, including the Italian subsidiary).
- The headquarters only uses the hub for the preparatory and auxiliary activities listed in article 5(3) of the DTA - in particular for 'storing, displaying or delivering its own goods or merchandise' - and not for other activities such as the collection of orders or conclusion of sales.

Moreover, the hub will not represent an agency PE of the foreign headquarters provided that no one in Italy, other than an agent of an independent status acting in the ordinary course of their business, has the authority to conclude contracts in the name of the foreign enterprise or to bind and represent the foreign enterprise with respect to third parties.

Comment

In this ruling, the IRA does not cite the OECD BEPS principles contained in the Final Report on Action 7 of 5 October 2015⁽⁴⁾ - such as the condition that the taxpayer must always demonstrate that an activity is preparatory or auxiliary, which it cannot be if, for instance, the warehouse at the disposal of the enterprise is very large compared to the size of the enterprise itself⁽⁵⁾. This is surprising as, on other occasions, Italy has expressed its support of the BEPS project⁽⁶⁾ and on 24 November 2016 agreed on the text of the OECD Multilateral Convention to implement the BEPS package in double tax agreements⁽⁷⁾.

(4) See OECD 'Preventing the Artificial Avoidance of Permanent Establishment Status, ACTION 7: 2015 Final Report', p.28.

(5) See OECD 'Preventing the Artificial Avoidance of Permanent Establishment Status, ACTION 7: 2015 Final Report', p. 31, paragraph 22 of the amended Commentary on article 5.

(6) See, for instance, the explanatory report on the decree encouraging the growth and internationalization of companies (Legislative Decree no. 147/2015).

(7) See the OECD 'Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting'.

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