Part A: National Concepts

1. General rule on the burden of proof

The issue of the burden of proof in tax proceedings is very complex and has been much debated. Not differently from what happens in civil, criminal and administrative law, evidence must be intended as a cognitive tool designed to prove a fact. In general, evidence is needed in order to establish in a rational way whether a fact can be considered true in the interest of the party. This happens in tax law as well. In order to prove the existence of a taxable event it is necessary to ascertain whether the factual statement in which such event is embedded (e.g. the accrual of income) actually occurred or not.

In the field of taxation, the issue of proof (and that of the allocation of its burden) concerns administrative proceedings even before than jurisdictional ones (indeed in tax matters the judicial stage is strongly connected to the administrative proceeding).

During the administrative proceeding, in order to prove the taxpayer’s higher income, the Tax Authorities needs to prove the facts on which the notice of assessment is based. On the other hand, in reference to the existence of facts that reduce the tax or the taxable base, or the existence of circumstances from which exemptions or subsidies emerge, the burden of proof lies on the taxpayer. This will affect the trial itself since, in this context, the allocation of the burden of proof depends on the underlying right and not on the party’s position in Court.

Article 2697 of the Italian Civil Code rules that “the party who wishes to assert a right before a court is to provide evidence of the facts on which the right is founded. The party who objects that such facts are non-effective or that the right itself has changed or expired, is to provide evidence of the facts on which the objection is founded”. This provision is a general rule: it concerns the discharge of the burden of proof in all trials, included tax trials.

In particular, the abovementioned rule plays a dual role. Firstly, it distributes between parties (in relation to their claims) the responsibility of proving facts in jurisdictional proceedings. Then, the principle of the burden of proof sets a rule in order to identify and evaluate a fact as “uncertain”: in other words, when there is uncertainty on the existence of relevant facts, the rule of the burden of proof requires the Court not to consider true all that is not sufficiently proven. In this way, the party

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that should suffer the consequences of this uncertainty can be easily identified.

As a general principle, it is nowadays accepted by Italian scholars and case law that in tax proceedings, the burden of proof stays with the party that has the interest of proving the alleged fact, regardless of its formal position in the proceeding, whether as plaintiff or defendant.

This approach has been consolidated in the landmark case of the Italian Supreme Court No. 2990, May 23rd 1979. By means of this decision the Supreme Court definitely denies the administration acts’ presumption of legitimacy. Basically, it has been held that the fact that the notice of, Torin...4.

The referred case has extended the rule according to which onus probandi incumbit ei qui dicit to the tax trial. The Court’s innovation consists in the renewal of the Tax Authorities’ position in tax proceedings: the tax authority becomes plaintiff “in a substantive way”.

In this respect, it is important to recall that the tax trial develops (with the exception of the claim regarding the denial of the refund on the part of the Tax Authorities) from an appeal against an act. Indeed, although it is the taxpayer who, in first instance, gives birth to the judicial proceeding, it is the Tax Authorities that (extra-judicially) make its claim first through the enactment of the notice of assessment. Consequently, the Tax Authorities bear the burden of proving the facts underlying the claim, in compliance with the general abovementioned principle embodied in art. 2697 of the Italian Civil Code and the taxpayer may simply disprove the facts alleged by the Office.

This being said, it should be borne in mind that that, in substance, in tax law proceedings, the burden of proof stays with the party that has the interest of proving the alleged facts, regardless of its formal position in the proceeding, whether as plaintiff or defendant.

On the other hand, if the taxpayer exercises his right to make a claim (e.g. he exercises his right to obtain the refund of undue paid tax or the concession of a tax relief/exemption, or, again, the deductability of costs relate to the activity carried on), the parties’ position is reversed: the burden of proving the right will be on the taxpayer, while the Tax Authorities will have to prove the facts against the refund or the more favorable tax treatment.

The burden of proof might stay with the Tax Authorities or with the taxpayer, depending on the

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4 In Giur. It., 1979, I, I, 1774, annotated by A. E. Granelli, Presunzione di legittimità dell’atto amministrativo e onere della prova: un altro mito giuridico finisce in soffitta, ivi; see also G. M. Cipolla, Riflessioni sull’onere della prova nel processo tributario, loc. cit., 678 ss. Nevertheless, it must be noted that Italian scholars had reached the same conclusions years before the mentioned landmark case: see, in this regard, E. Allorio, Diritto processuale tributario, Turin, 1962, 368 et seq.


On the other hand, Italian scholars are not unanimous in their view on the application of article 2697 of the civil code to the tax trial. In the affirmative, see F. Battistoni Ferrara, op. ult. cit.; G. Tinelli, op. ult. cit; P. Russo, op. ult. cit. On the contrary, amongst the scholars who are against the extension of article 2697 to the tax trial, and who, nevertheless, reach the same results in terms of allocation of the burden of proof, see, F. Tesauro, L’onere della prova nel processo tributario, in Riv. Dir. fin. Sc. Fin., 1986, I, 85 et seq.
circumstances of the case. Against this general principle, however, some procedural rules of Decree 546/92 show that in tax law proceedings, the Tax Authorities still have some advantages when compared to the taxpayer, and that therefore the equal status of the parties is not always guaranteed. In particular, the rules on the terms for appearance, combined with the respective positions of the parties, are as such to seriously jeopardizing the right of full defence of the taxpayer.

In fact, on the one hand, it is provided that the taxpayer shall appear in the proceeding within a mandatory time limit, whilst the tax administration can, as a matter of fact, appear at a very later moment, given that the term provided for its appearance is not mandatory. On the other hand, is shall be considered that, even though the express indications of the reasons is a necessary element of the notice of assessment, the construction of such condition is not strict, and the reason of the notice – which in fact shall constitute the evidence, which will become a proof in the trial phase – can also be described in a generic manner by the Tax Authorities.

The combination of these two circumstance can easily put the taxpayer in the position of not being able to know, in a timely manner, the arguments which the Tax Authorities will use in the trial phase of the proceedings. The principle of equal status of the parties with specific reference to the right of defense is, therefore, seriously jeopardized.

For what it has been said so far, one might conclude that, as far as the general rule on the burden of proof in tax law is concerned, in case of challenge of an assessment by the taxpayer, it is the Tax Authority that has to prove the income-side and the taxpayer that has to prove the cost side: this rule is based on the idea that each party must provide the evidence that is easiest for it to gather.

2. Variations on the general rule depending on time period

In Italy the period of time in which the decision on the tax dispute is being made, generally does not influence the burden of proof as such. Nevertheless, if the Tax Administration wants to issue an additional tax assessment, it has to prove that the special conditions for such an additional assessment are met. Indeed, in certain cases an additional assessment can only be issued on the basis of so called new facts, facts that were only discovered after the original assessment. The Tax Office generally has to establish that at the time of the original assessment it did not know the facts on which the additional assessment is based [art. 43(4) of the Presidential Decree No. 600/1973, art. 57(4) of the Presidential Decree No. 633/1972]. But when it comes to establishing the amount of income, there are no differences in the allocation of the burden of proof between normal assessments and additional assessments.

3. Burden of proof regarding discretionary decisions on tax issues or regarding estimated assessments

In Italian tax law, tax assessment may be made by estimation in numerous cases, often by means of presumptions.

With reference to the value of presumptions in tax litigation, a broad distinction must be made between the presumptions, either refutable or not, that are provided by tax laws (and are no remitted to the judge’s free evaluation), and those, known as presumptions *hominis*, which can be used by the judge to evaluate the facts of the case.

As far as the former presumptions apply by operation of law are concerned, according to the case law of the Italian Constitutional Court, are not incompatible with Art. 53(1) of the Italian Constitution - which provides for the ability to pay principle - if (i) the presumption of this ability is rebuttable and (ii) based on facts or acts that “reasonably” show some kind of wealth. The first condition is quite easy to determine. The taxpayer must have the right to prove that the effects

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presumed by the legal provision do not apply in the specific case in question. Nevertheless, the right to rebut the legal presumption is insufficient, in itself, to make the provision compatible with Art. 53(1) of the Italian Constitution, as this right must be effective. There is, however, much greater uncertainty regarding the second condition, i.e. the fairness of the indication and of the logical inference assumed by the legal presumption. These elements should be evaluated according to the id quod plerumque accidit rule in regard to facts of common experience. Consequently, the legal presumption can be defined by the legislator according to the criterion of the likelihood of the presumption/interference on the basis of general experience.

When the law expressly requires the reversal of the burden of proof through the use of presumptions, the general rule of the burden of proof based on the parties’ substantive position does not apply. In this case it is sufficient for the Tax Authorities to demonstrate the existence of the specific conditions prescribed by the law for the application of that presumption. Symmetrically, the taxpayer must only provide contrary evidence.

The aforementioned presumptions hominis, on the other hand, in order to be legitimately used by the judge in his ruling, must be material, precise and consistent. Particular issues are dealt with by Italian tax law jurisprudence with reference to the admissibility of chains of presumptions (so-called presumptio de presunto).

The first case of “estimated assessment” is that applicable to individuals. Indeed, the whole individual income can be determined by using the estimated method provided for by Art. 38(4) et seq. of Presidential Decree No. 600/1973, as amended by Law Decree 31 May 2010, No. 78. The estimated assessment is based on the taxpayer’s spending capacity and capital growth. The Tax Office can determine the taxpayer’s total income through a so-called “synthetic” assessment on the basis of expenses of any kind incurred during the taxable year. A “synthetic” assessment may also be based on inductive factors (so-called “redditometro”) which identify the taxpayer’s ability to pay through the analysis of representative tax payers. In particular, the statute establishes that certain expenses connect the attainment or the simple possession of certain assets (real estate, cars, boats, horses, etc.) have to be consistent with the reported income. If the estimated income does not match the reported income, the Tax Authorities can rectify the income if the difference exceeds 20%.

In this case, the taxpayer has the burden of proving the validity of the lower income and must supply the contrary evidence, for example by demonstrating that the expenses were connectable to exempt income or income subject to definitive withholding taxes or, again, that the expenses under examination have been financed by income accrued in other taxable periods or by funds received by inheritance or by donation.

A case of tax assessment that may be made by estimation is the one provided for by Art. 39(1)(d) of the Presidential Decree No. 600/1973 dealing with the “presumptive method of assessment” (accertamento analitico-induttivo) applicable to enterprises and self-employed persons. This provision permits the Tax Authorities to assess the income tax liability of taxpayers by either allocating to them income not reported in the tax return or disregarding deductions claimed for losses or liabilities not actually incurred, based only on presumptions. Article 39(1)(d), however, requires the presumptions on which the assessment is based to be material, precise and consistent with other related facts. In addition, any contrary evidence is admissible against the presumptions. In other words, the taxpayer can present evidence that the reasoning of the Tax Authorities is not reasonable, or that the assumptions or outcome of this reasoning do not fit the facts and

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8 See, ex multis, Constitutional Court, 23 July 1987, Decision No 283, Para 13.
9 See L. Tosi, Il requisite di effettività, in F. Moschetti, La capacità contributiva, Padua, 1994, 106.
10 As provided for, as general rule, by Art. 2729 of the Italian Civil Code.
11 In general, case law excludes the validity of chains of presumptions as means for the judge to evaluate the facts of a case. See, among other, Supreme Court, 23 June 1994, Decision No. 6033; Supreme Court, 9 April 2002, Decision No. 5045; Supreme Court, 25 October 1991, Decision No. 11376. Contra: Supreme Court, 11 January 1992, Decision No. 239; Supreme Court, 23 January 1991, Decision No. 604.
circumstances of the case. This method of assessment is peculiar because it is based on neither the entirety of the evidence of the income that the taxpayer failed to report in its tax return, nor on the actual non-existence of losses or liabilities for which the taxpayer claimed a tax deduction in its tax return. By contrast, the presumptive assessment is carried out based on facts and circumstances from which the failure to report income or the actual non-existence of reported losses or liabilities can be inferred.

There have been many court cases involving the application of Art. 39(1)(d). An analysis of these decisions provides guidance as to the “known facts” which Courts have deemed to be a suitable basis for a presumptive assessment under Art. 39(1)(d). The Supreme Court has upheld, for instance, the assessment of income tax liability for a business taxpayer based on the relationship between the use of electric power (ascertained by reference to the energy bills of the same taxpayer) and the amount of output (inferred from similar enterprises operating in the same industry). A specific case of “presumptive method of assessment” is the one based on the so-called studi di settore (henceforth, SdS). Since 1998 Italy has adopted a tax auditing scheme which is focused on small-scale economic activities of enterprises or of self-employed people. SdS may be considered as tools based on the inductive method and are regulated by Art. 62-bis of Law-Decree No. 331/1993. SdS’ aim is to determine the taxpayer’s presumptive revenues attributable on the basis of its potential ability to produce them by using the indicators of a normal economic activity. Each taxpayer calculates the estimated gross revenue according to the SdS concerning each industry through the use of specific software provided by the Tax Administration. The estimate is based on the data supplied by the taxpayer with reference to the physical and economic characteristics of the activity, such as the number of employees, the dimensions of the premises, etc. Moreover, the software also calculates indexes that signal any possible incoherence or irregularity in the data supplied by the taxpayer. The SdS are carried out by using standard statistical techniques that single out clusters (i.e. a subset of economically homogeneous enterprises) of taxpayers having similar characteristics, relying on data from past revenue reports and from specific surveys. The enterprises are divided into clusters, and on this basis, the mathematical relationship between the characteristics and amount of revenues is identified. The taxpayer must (i) frame his activity in a cluster; (ii) indicate whether the volume of business is reasonable (i.e. if it falls within the range of so-called “confidence value”); (iii) identify the consistency of the main economic indicators that characterize his activity compared to the value assumed as normal by the cluster of reference.

As far as the burden of proof in concerned, it is noteworthy that SdS cannot be applied automatically and that the Tax Authorities have to verify case by case the reasons which may justify the lower revenues. According to case law, SdS constitute a system of rebuttable presumptions, whose materiality, precision and consistency is not predetermined by law, but arises from the taxpayer’s cross-examination in the singular case at stake.

Last but not least, tax assessments may be made also by a “pure presumptive method of assessment” (accertamento induttivo) in certain cases in which it appears to be impossible for the Tax Administration to verify the underlying facts relating to the tax assessment. More precisely the Tax Authorities may make such an assessment only in limited cases provided for by Art. 39(2) of the Presidential Decree No. 600/1973. In those circumstances, the Tax Office may: (i) use of data in any way collected; (ii) disregards findings of accounting records; (iii) employ unqualified presumptions.

In particular, if both the substantial and formal accounting irregularities are serious, numerous and repeated enough to make the company’s accounting system totally unreliable, or, alternatively, if the taxpayer does not comply with the Tax Authorities’ request to provide documentation or does

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12 Decision No. 239 of 11 January 1992. In the same line see, ex multis, the recent Supreme Court decision No. 17408 of 23 July 2010, decision No. 9884 of 8 July 2002, decisions No. 3165 and 3166 of 5 March 2001, decision No. 15991 of 20 December 2000.

13 See, inter alia, Supreme Court, 10 December 2009, Decision No. 26635, 26636, 26637 and 26638 and the Order of the Supreme Court, 9 November 2010, No. 22793.
not submit the required tax assessment forms or accounts, the Tax Office may conduct a “pure presumptive method of assessment”.

When one of the mentioned circumstances occurs, Tax Office determines the taxable turnover for VAT purposes and the total amount of taxable income for direct taxation purposes inductively by using available data. In this context, the law releases the Tax Authorities from the duty to base its reasoning on material, precise and consistent presumptions (features instead requested in the above-mentioned “presumptive method of assessment” pursuant to Art. 39(1)(d) of the Presidential Decree No. 600/1973). This does not mean, obviously, that Tax Authorities have the right to deliver arbitrary reasoning but rather that they can use wide-estimate criteria based, for instance, on the number of the employees, the consumption of raw materials, the typical earnings in the relevant business sector, in order to achieve a reliable result that seem more likely to have occurred.

4. Variations in burden of proof where a tax case contains information that is difficult or impossible for the tax administration to investigate (e.g. tax havens)

It has been stated before that, in Italy, the circumstance that the Tax Authorities have to prove the income-side and the taxpayer has to prove the cost side is based, inter alia, on the idea that each party must provide the evidence that is easiest for it to gather. This is way if the taxpayer refuses to answer specific questions from the Tax Office, the documentation and the information (e.g. accounting records) not provided to the Tax Office during the tax inspection, cannot be used by him in his favor in the following administrative or judicial proceeding. There is then a shifting of the burden of proof in the case of banking inspections: in particular there are severe presumptions arising from financial transactions that are not reflected in the accounting records. Indeed, if there are non-registered receipts in the bank account, it is assumed that these proceeds are correlated with no registered income. Moreover, when withdrawals from the bank account are not recorded and justified, these are qualified as not reported income. It is a rebuttable presumption and the taxpayer can disprove it by indicating the beneficiary of the withdrawal.

The shifting of burden of proof is frequent in international transactions or where a tax haven is involved. In relation to tax havens, Italian domestic tax law contains specific anti-abuse clauses, in which the burden of proof is altered, mostly by presumptions. These presumptions often change the object of proof that must be produced by the taxpayer in order to overcome the lack of information that generally affects this type of tax jurisdictions. Examples of this can be found in Art. 110(10) of the Italian Tax Code (see below par. 12).

5. The rule on evidence and the level of the burden of proof.

Tax litigation is substantially based on the acquisition in trial of documents, or of written evidence already existing in the pre-trial phase, together with the application of a quite large number of presumptions contained in Italian Tax law.

Both the cognitive and decisional powers of the Tax Courts are traceable to the code of civil procedure in combination with the Legislative Decree No. 546/1992. The tax litigation proceeding is a trial promoted by the parties, aimed at verifying the tax claim’s reasonableness. Therefore, the entire judgment is limited by the party’s statements of facts: the dispositive nature of the tax trial requires the exclusion of purely exploratory investigations by the Tax Court. Indeed, the general rule applies, whereby judex judicare debet iuxta alligata et probata partium.

With regard to documents and written evidence, Art. 7 of Legislative Decree 546/1992 provides that Tax Courts can summon experts, or require the technical offices of the public administration or of

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14 Cf. Art. 32(4) and 33 of the Presidential Decree No. 600/1973 and Art. 52(5) of the Presidential Decree No. 633/1972.
the tax policy produce specific technical reports, which might be useful in order to decide upon particularly complex issues. Moreover, Tax Courts are empowered to order inspections and require data, information and clarifications, which may be useful in the evaluation of facts. This does not contradict what has been said above with reference to the dispositive nature of the Italian tax trial: indeed, the Court has the mentioned powers only “within the limits of the facts submitted by the parties”; the Court should use such powers in order to compensate for the impossibility or the extreme difficulty in acquiring a piece of evidence that may be particularly complex or, alternatively, available to the adverse party only.

It is worth noting that, notwithstanding the general reference to the rules provided for by the civil law procedure, the parties to a tax dispute cannot satisfy the burden of proof through testimonial evidence nor by oath. Nevertheless, the jurisprudence has been sustaining that witness reports obtained in other trials, together with third party statements collected by the Tax Authorities during the procedural phase, may be taken into consideration as *indiccia* (clues), that, if corroborated by additional facts, may help to support the Court’s decision but, if stand-alone, cannot form the basis of the decision itself.

The limitation to use testimonial evidence imposed by tax law procedure is seen by the most prominent Italian scholars as a *vulnus* to the principles of fair trial16. However, the Constitutional Court declared the compatibility of the rule on testimonial evidence in tax law proceedings with the Italian Constitutional principles17.

As far as the level of the burden of proof is concerned, the principle is the free evaluation of the evidence (Art. 116 of the Italian civil procedure code). This principle implies that, except that specific legal provisions provide otherwise, it is up to the Tax Courts to decide what weight and relevance the various pieces of evidence shall be assigned in each individual case.

6. Evidentiary requirements in discretionary/estimated tax assessment

See what it has been pointed out in paragraph 3.

7. Evidentiary requirements depending on exchange of information, tax havens, etc.

Leaving out the specific anti-abuse clauses in relation to tax havens where the burden of proof is altered mostly by presumptions, there are no special rules for the burden of proof with regard to tax haven. It must be noted, however, that the principle of free evaluation of evidence entails that insufficient information may work in the taxpayer’s disfavour.

8. Different evidentiary requirements for different types of taxes

In general, there are no different evidentiary requirements applicable in Italy for different types of taxes. Nevertheless, in some tax laws (e.g. VAT) specific evidentiary rules are given for certain cases.

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16 F. Gallo, *cit*. , p. 20; F. Tesauro, *cit*. , p. 26; P. Russo, *Il giusto processo tributario*, in *Rass. Trib.*, 2004, p. 11 et seq.. Indeed, the limitation jeopardizes the principle of equal status between the parties before the judge: this is mainly due to the fact that the Tax Authorities, in the assessment phase, can utilize declarations made by third parties to ground their assessment; even though it is accepted that the taxpayer can oppose to those declarations other written declarations by third parties, Italian scholars still consider that the Tax Authorities have an advantageous position before the tax Courts in this respect.

17 See Constitutional Court, 21 January 2000, Decision No. 18. However, as a consequence of the amendments to Art. 111 of the Constitution, there might be room for referring again to the Constitutional Court on the compatibility of the rule on testimonial evidence in tax law proceedings with the Italian Constitutional principles on fair trial.
9. General rule on evaluation of evidence and the limitation to such rule

As stated above in par. 5, Italian tax law is based on a principle of free evaluation of evidence. This principle is statutory in the Italian civil procedure code, Art. 116. The free evaluation of evidence means that the judge is not bound, except that specific legal provisions provide otherwise, as to what weight the various means of proof shall have.


10. (Semi)General anti-abuse provision.

The Italian legislation provides a (semi)general anti-avoidance rule together with other specific anti-abuse rules. Moreover, the Italian Supreme Court recently ruled in favor of the existence of a general unwritten anti-abuse rule, based on the ability to pay constitutional principle.

The (semi)general anti-avoidance rule, regulated by Art. 37bis of the Presidential Decree No. 600/1973, states that the Tax Authorities may disregard single or connected acts, facts and transactions - carried out without valid economic reasons - intended to circumvent obligations and limitations provided under tax law in order to obtain tax savings or refunds otherwise undue. For the purpose of this article, it should be noted that the anti-avoidance rule in Art. 37bis is not a general rule in the full meaning of the term and would be better described as a “semigeneral” rule. In particular, the rule does not, in fact, apply in general, but rather, only to certain operations specifically listed in the law. The list was variably augmented in the ten years following the adoption of Art. 37bis, thereby widening the scope of the rule.

It is noteworthy that the Italian Supreme Court recently ruled in favor of a general inherent anti-abuse rule. At first, the Supreme Court supported the existence of such rule, arguing that it derived from general principles of EU law. In particular, the Italian Court based its reasoning on ECJ’s case law (Halifax case, C-255/02 and Part Service case, C-426/06). The Italian Supreme Court stated that, even though in the abovementioned judgments the ECJ dealt with the VAT issue, the doctrine on the abuse of law codified by the ECJ was actually an expression of an immanent principle also applicable to non-harmonized taxes, such as corporate income taxes. Subsequently, in December 2008 (decisions No. 30055, 30056 e 30057) the Supreme Court, in its plenary session, subverted its position and supported the existence of an unwritten anti-abuse rule under the ability to pay principle. The Supreme Court also confirmed that the prohibition of abuse of law can be applied by the judge ex officio in every stage of the proceeding, even if the argument was not initially raised by the Italian Tax Authorities.

This being said, it is worth noting that the burden of proving an abusive transaction rests on the Tax Administration. Indeed the Tax Office must provides the necessary evidence of the avoidance (i.e. of an “undue tax benefit). In doing so, the Italian Tax Authorities must make a comparison between the taxpayer’s behavior and a different “standard” behavior. In this regard the Tax Authorities must demonstrate that the interests met through the challenged legal transaction are normally satisfied through a different legal transaction. The burden of demonstrating the taxpayer’s adoption of an abnormal legal measure is on the Tax Authorities, “in order to point out the anomalous difference incompatible with a normal economic logic, if not to achieve an abusive result” 20. Once the Tax Authorities have satisfied this burden of proof, the taxpayer has to prove that his behavior was motivated by sound (“not marginal or theoretical”) business reasons. Thus, the taxpayer must

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18 The Ministerial Report to Legislative Decree No. 358/1997, which introduced Art. 37-bis, considers that the distinctive feature of (illegitimate) tax avoidance, as opposed to (legitimate) tax saving, is the “manipulation of tax provisions or the use of stratagems which – although formally legitimate – end up being in contrast with the fundamental principles of the tax system”. In the same sense also the Circular No. 320 of 19 December 1997.

19 Although some eminent scholars have already defined the rule in this way. See G. Falsitta, Manuale di diritto tributario – Parte generale, Padua, 2008.

20 See Supreme Court, 21 January 2009, decision No 1465.
provide documentary proof on the transaction’s business purposes. In other words, the burden of proving that the transaction is abusive is on the Italian Tax Authorities. Ultimately, the taxpayer has the burden of proving that its behavior, potentially abusive, was motivated by valid economic reasons.\textsuperscript{21}

\section*{11. Alternative or supplementary approaches}

The case law mentioned in the previous paragraph put an end to the discussions about the difference between anti-avoidance in tax matters and the general concept of \textit{fraus legis}. Tax avoidance and abuse of law are perceived by Italian Courts as being perfectly synonymous and neither of them requires that a transaction or a series of transactions is fictitious or fraudulent. This being said, apart from general immanent anti-abuse rule put forward by the recent case law of the Supreme Court, Italy has no alternative or supplementary provisions to the ones already mentioned.

\section*{12. Special anti-abuse provisions}

There are many special (sub)provisions in the statute law of Italy that deal with the burden of proof in specific circumstances. Most of these provisions lay a heavier burden of proof on the taxpayer than the general rules would imply. Typically, these special provisions can be found in the context of cross border situations/international transactions and this may be due to the circumstance that ex officio discovery of the facts is particularly difficult for the Tax Authorities in these cases. Indeed Italian legislation provides for a series of anti-abuse rules which combat avoidance and/or evasion at the international level, such as the rebuttable presumption of tax residence of individuals and of foreign incorporated companies and entities, the transfer pricing regime, the \textit{cfc} legislation, the anti-tax haven legislation.

Although a detailed analysis of each specific anti-avoidance provision is beyond the scope of this report, it is important to highlight that in all of the above situations the burden of proof is shifted on the taxpayer. In particular, the anti-avoidance rules are formulated as rebuttable presumptions, in which it is presumed that the transaction has been done for abusive purposes.

The rebuttable presumptions on tax residence of individuals and of foreign incorporated companies and entities are anti-evasion instruments in the hands of Italian Tax Authorities and Tax Police for unmaking undisclosed behavior, charging the taxpayer with the burden of proof.

The provision on individuals, regulated by Art. 2, paragraph 2bis of the Presidential Decree No. 917 of 22 December 1986 (the Italian Income Tax Code, hereinafter: the ITC), states that Italian citizens who move to a tax haven included in the blacklist issued on 4 May 1999 by the Ministry of Finance are subject to tax on a worldwide basis unless they prove that they are actually resident for tax purposes abroad. Accordingly, an Italian national is deemed to be resident in Italy if he emigrates to a country considered to be a tax haven, even if his name is removed from the Italian civil registry. This is a rebuttable presumption: the burden of proof that actual residence is outside Italy is shifted to the taxpayer. Therefore, when Italian citizens take up residence in any of these countries, it is presumed that they are, unless proof exits to the contrary, resident in Italy for the purposes of taxation.

On the other hand, article 73, paragraph 5bis and 5ter ITC provides for the rebuttable presumption of residence for foreign incorporated companies and entities.\textsuperscript{22} These measures were introduced with a view to countering abusive schemes carried out by companies that are not resident in Italy.

\textsuperscript{21} See the recent decision of the Supreme Court, 22 September 2010, No. 20030.

\textsuperscript{22} According to this presumption, Italy is the place of management of companies that directly control an Italian company through a holding and either: (i) in turn, are controlled, even indirectly, by Italian resident persons; or (ii) the board of directors of the foreign incorporated companies or entities consists of a majority of Italian resident persons.

The rebuttable presumption is also applicable in the case of companies or entities which have invested more than 50 per cent of their assets in an Italian closed real estate fund and are controlled directly or indirectly by Italian residents.
but which control Italian resident companies and are in fact effectively managed in Italy. This phenomenon is generally known in Italy under the term of “esterovestizione di società”. In particular, such measures reverse the burden of proof on the non-resident company, which has to prove that in fact the place of management is not situated in Italy. The foreign entity may obtain the non-application of these rules if it demonstrates that the effective management is actually located abroad. Under this regime, it is not possible to file a request for a ruling in order to secure the foreign residence of the company. The deemed residence rules apply no matter in which country the foreign entity is established, in the absence of a tax advantage, and even where there is a genuine intent to set up a foreign subsidiary.

Italian cfc legislation applies to Italian resident persons, whether individuals, corporations or entities which (i) control directly or indirectly, the non-resident entity, and (ii) the non-resident entity is resident in a tax haven, as defined in a black list laid down by the Ministerial Decree of 21 November 2001 [or a company resident in a non-listed state that carries on business through permanent establishments in states or territories that have a privilege tax regime].

The Italian CFC legislation provides for safe harbor clauses, according to which its application can be avoided if the Italian resident proves either: (a) that the foreign entity predominantly carries on an actual industrial or commercial activity in the market of the state or territory in which it is located (for bank, financial and insurance activities the first safe harbor clause is met if most of the sources, investments or turnover are generated in the state or territory where the CFC is located); or (b) that the participation in the non-resident entity is not used to localize income in tax haven countries or territories.

In both cases, the taxpayer must apply to the Tax Authorities for an advanced ruling.

As regards condition (a) above, when more than 50% of the foreign company’s proceeds is derived from the management, holding or investment of securities, shares, receivables or other financial assets, the transfer or grant of the right to use intangible rights on industrial, literary or artistic property, or the supply of services, including financial services, for the group (passive income for cfc purposes) there is an exclusion from the scope of the first safe harbour. The Circular No. 51/E, of 6 October 2010 clarified that the provision in question operates as a praesumptio iuris tantum (rebuttable presumption). Therefore, the burden of proof is shifted on the taxpayer, who will need to demonstrate the authenticity of the foreign structure, regardless of the quantitative data emerging from the ratio active/passive income.

In 2009, the scope of the Italian CFC rules have been broaden beyond the mere tax haven jurisdictions. In particular, the scope of application of the cfc rules has been extended to controlled companies localized in states or territories different from those included in the black list above (e.g. also EU companies), if both of the following conditions are met: (i) the controlled foreign company is subject to an actual taxation that is more than 50% lower than the tax that would have been levied if it was resident in Italy; and (ii) more than 50% of the proceeds of the controlled foreign company consists of passive income for cfc purposes. These provisions do not apply if the Italian controlling person proves that the localization abroad does not constitute an artificial scheme aimed at achieving undue tax advantages. To this end, the Italian resident has to apply for a ruling from the Italian Tax Authorities. In other words, if the above conditions are met cumulatively, the cfc rules apply unless the Italian controlling person requests a tax ruling from Italian Tax Authorities, in which it proves that the activity carried out by the foreign controlled company is not “artificial” (i.e. there is a real business purpose). As such, the burden of proof that the activity is not “artificial and

\[23\] See Resolution 5 November 2007, No. 312/E.

\[24\] In the Circular No. 51/E of 6 October 2010, the reference to the market has been interpreted as a mere intensifier which leaves out the strict interpretation according to which firms would be required to demonstrate that the suppliers and/or the customers are aiming at the host State’s market. In this vein, it has been stated that the fact that the CFC fails to address the local market is a mere “hint of the failure to exercise a genuine commercial activity”. This does not ban the taxpayer from purporting other arguments during the ruling in order to support the economic and business reasons that may have led the resident company to invest in tax havens.
does not aim at obtaining any undue tax advantage” is on the taxpayer\textsuperscript{25}. The Tax Authorities\textsuperscript{26} implicitly allow taxpayers to provide evidence on the existence of safe harbor clauses even later, during administrative proceedings or litigation, without applying for a preventive ruling, with the risk, in case of insufficient demonstration, of the application of administrative penalties to the maximum extent.

Another example of reversal of the burden of proof on the tax payer concerns the so called anti-tax haven legislation contained in Art. 110, paragraph 10 ITC, that limits the deductibility of expenses and other deductible items if they relate to transactions between a resident undertaking (individual or company) and either blacklisted non-resident undertakings (individual or company) or blacklisted non-resident professionals\textsuperscript{27}. Art. 110, paragraph 11 ITC provides for a safe harbor clause, according to which the expenses at issue are deductible if the resident person proves either (a) that the non-resident subject carries on a real business/professional activity or (b) that the relevant transaction(s) had a real business purpose and actually took place. The proof of the first safe harbor clause is, according to the administrative practice, largely based on the production of documents unavailable to the resident enterprise and characterized by confidentiality\textsuperscript{28}. Thus the proof for this safe harbor clause is easier for companies that have relationships with contracting partners of the same group. Conversely, when dealing with independent non-resident companies is almost necessitated the choice to invoke the application of the second safe harbor clause, thereby providing the actual economic interest of the operation. As for the second safe harbor clause, the Circular of 6 October 6 No. 51/E has clarified that the assessment of the real economic interest must take into account all aspects and circumstances of the case, giving importance to the overall conditions of transaction, such as the price of transaction, the presence of ancillary costs, the implementation of the transaction (i.e. delivery time), the possibility to acquire the same products from other suppliers etc.\textsuperscript{29}. As far as the reversal of burden of proof in the case of cross border situation with black listed jurisdictions, it is worth noting firstly the new presumption on foreign investments held in tax haven countries introduced by Art. 12 of the Law Decree No. 78/2009. According to the presumption, investments and financial activities held by Italian resident individuals, non-commercial partnerships and similarly treated entities (i) in tax haven jurisdictions (in other words, countries included in the existing black lists) and (ii) in violation of reporting obligations set forth by the Law Decree No. 167/90, are deemed to derive from tax evasion. This is the case of current accounts, investments or properties owned by an Italian taxpayer and held in a tax haven country included in the black lists defined in the ministerial decrees May 4, 1999 and November 21, 2001 without having declared them to the Italian Tax Authorities in the proper RW standard form of the Italian income tax return. The new rule introduces a rebuttable presumption based on which these assets have been originated from activities whose income was not declared and not subject to Italian

\textsuperscript{25} This provision is a clear acknowledgement of the ECJ’s Cadbury Schweppes judgment.

\textsuperscript{26} Cf. Circulars of 14 June 2010, No. 32/E and 6 October 2010, No.51/E.

\textsuperscript{27} In particular, the legislation applies to transactions between a resident undertaking (individual or company) and persons resident or located in a country or territory outside the European Union and the European Economic Area that has a privileged tax regime according to a blacklist laid down in the Ministerial Decree of 23 January 2002.

\textsuperscript{28} With reference to the first safe harbor clause, in a recent surprisingly decision (23 February 2010, No. 4272), the Supreme Court ruled that the availability of large rooms, the existence of several offices, the availability of various utilities, the use of miscellaneous supplies, such as intercompany distribution contracts, are eligible only to prove the existence of non-resident company, but not “the exercise of a real economic activity”. Totally irrelevant two other elements - high turnover and significant losses - since they are data which can be given only formal value.

\textsuperscript{29} With particular reference to the price charged by the supplier black list, it was specified that the deductibility of the costs under examination cannot be denied on the basis of the mere fact that the price of goods and services is higher than the average paid on the market. In other words, a seemingly anomalous price can be justified by the assessment of other conditions governing the transaction and therefore does not affect the existence of actual economic interest in the operation. Therefore even if the price paid to the black list supplier is higher than the average price on the market, the transaction can still qualify as having a real business purposes in the light of other elements that should be taken into account.
income taxes\textsuperscript{30}. It is the taxpayer that has to prove that such activities have not been originated from not-reported income, e.g. by demonstrating that the assets were connectable to exempt income or reported income, or, again, that have been financed by funds received by inheritance or by donation. Finally, Italian legislation provides for specific anti-abuse rules with regard to the application of EC Directives\textsuperscript{31}.

13. Competent Authority

As far as the (semi)general anti-abuse provision is concerned, it is only up to the Courts to decide whether the required level of proof is met. However, in pre-trial proceedings the tax administration decides. In particular, the (semi)general anti-avoidance rule contains an important provision on reinforced defense rights. Under paragraphs 4 and 5 of Art. 37\textit{bis}, when in the course of an assessment procedure, the Italian Tax Authorities intend to apply this rule, before issuing the final tax assessment, the office must request clarifications on the suspected transaction from the taxpayer. The request must indicate the reason why the Tax Office believes that the transaction is abusive. The final notice assessment must be motivated in relation to the justification put forward by the taxpayer in response to the office’s request. If this procedure is not followed, the notice of assessment is null and void. These reinforced defence rights are applicable only when the Italian Tax Administration makes use of Art. 37\textit{bis} of the Presidential Decree No. 600/1973, which has a broad but not unlimited scope of application. As pointed out above, the Supreme Court held that the abuse of tax law doctrine applies to all taxes, all taxpayers and all transactions. The Supreme Court ruled that several transactions falling outside of the scope of application of Art. 37\textit{bis} were nonetheless abusive. In all such cases, the special procedure set forth by Art. 37\textit{bis} was not followed and nonetheless the Supreme Court decided that the Tax Office’s assessment were valid. It must be borne in mind that taxpayer may also file a request for ruling on the application of Art. 37\textit{bis} of the Presidential Decree No. 600/1973 to a specific situation pursuant to Art. 21 of Law No. 413/1991, which set up a “Consulting Committee for the application of anit-abuse rules”. The law also stated that if the Consulting Committee did not issue the ruling within a specific time frame then the request of the taxpayer was deemed to be accepted. The Consulting Committee was composed primarily of persons belonging to the Italian Tax Administration, but it also included tax professors. The Committee was suppressed in 2006. However, the Italian Tax Authorities indicated (Circular No. 40/E of 27 June 2007) that taxpayers continue to be entitled to obtain rulings on the

\textsuperscript{30} Furthermore, it has been provided to double the tax administrative penalties provided for by Art. 1 of the Legislative Decree No. 471/1997. In practice, in case of a tax audit, the Italian taxpayer shall be requested to pay individual income taxes on the whole value of the assets hold abroad, based on the existing progressive individual tax rates, plus the provided penalties.

\textsuperscript{31} With regard to dividend payments (Directive 1990/436/EC), Italian legislation states that in the case of an EU parent company controlled directly or indirectly by one or more non-EU residents, the EU regime (i.e. no withholding tax on dividends in Italy) applies only if the recipient demonstrates that it does not own the holding (in the Italian company which distributes the dividends) with the main or exclusive aim of benefiting from the exemption from withholding tax (see article 27\textit{bis}, paragraph 4 of the Presidential Decree No. 600/1973). As for interest and royalty payments (Directive 2003/49/EC), Art. 37\textit{bis}, paragraph 3(f) of the Presidential Decree No. 600/1973 (cf. supra par. 10) contemplates, among the specific operations that might be challenged by the (semi)general anti-abuse provision , the payments of interest or royalties to EU recipient controlled directly or indirectly by one or more non-EU residents. Both rules are in line with the respective EC Directive. In fact article 1, paragraph 2 of the Parent–Subsidiary Directive and article 5, paragraph 1 of the Interest and Royalties Directive state that the directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. Furthermore, article 5, paragraph 2 of the Interest and Royalties Directive states that “Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive”. Furthermore, article 26\textit{quarter} of the Presidential Decree No. 600/1973 (which implements the Interest and Royalties Directive in Italy) provides for the beneficial ownership clause in an interest and royalties context.
possible application of Art. 37bis to any transaction directly form the Tax Office. This being said, ruling on anti-avoidance matters continue to be possible, but the competent body for their issuance is no longer the Consulting Committee, but the Tax Office itself. As a matter of fact, positive rulings are a rarity.

Moreover, Art. 37-bis, paragraph 8, provides a special rulings procedure that may be filed by a taxpayer that is subject to a targeted anti-avoidance rule; in particular, he can request from the Italian Tax Authorities to declare that such rule is not applicable to the specific facts indicated in the request and the Tax Office may declare the rule not applicable if it finds that, in the specific case, no avoidance effects could be obtained.

14. Judicial review
See the previous paragraph.

15. Case Law
As seen above, the burden of proving an abusive transaction rests on the Tax Administration. In a recent Supreme Court case (decision No. 1465 of 21 January 2009) indicates clearly that it is for the Italian Tax Administration to give evidence of the existence of tax avoidance (i.e. of an “undue tax benefit”). In doing so, the Italian Tax Administration must make a comparison between the behavior of the taxpayer and a different and “standard” market behaviour. The taxpayer must give evidence of the fact that its behavior was motivated also by sound (“not marginal or theretical”) business reasons. In the same sense is the recent Supreme Court decision, 22 September 2010, No. 20030, stating that the burden of proof falls on the Tax Authorities, which must not only explain, in detail, the elements that motivate the decision to classify the behavior of the taxpayer lacking economic substance, but must also describe the manipulation of the classical legal schemes in order to obtain an undue tax advantage.

Part C: The Burden of proof and European tax law

16. EC law and the reversal of the burden of proof
In Italy the Leur-Bloem judgment has been mainly discussed in reference to several specific anti-abuse provisions that might be incompatible with the mentioned case law: in particular the Italian cfc regime and the deemed tax residence rules. So far, however, there are no specific judgments from the Supreme Court on the issue. Indeed, in both the aforementioned anti-abuse regimes, from a European perspective, the most critical issue is the proportionality and effectiveness of the abovementioned provisions. In fact, the compatibility of tax law presumptions with EC law has been assessed in respect of both principles. With regard to the latter, the presumption, even if rebuttable, must not make the taxpayer’s right of proof “virtually impossible or excessively difficult”.

As for the compatibility of the cfc legislation with EC law, as well known, in the Cadbury Schweppes case (C-196/04), the ECJ has drawn precisely the guidelines to be used in evaluating the

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32 As for the compliance of the anti avoidance legislation with EU law there are no obvious frictions between (i) the (semi)general anti-abuse rule contained in Art. 37bis of the Presidential Decree No. 600/1973 and (ii) the abuse of law doctrine as developed by the Italian Supreme Court, and EU law.

33 According to the principle of proportionality, a national presumption should not go beyond what is necessary to attain a legitimate objective. Following this opinion, irrebuttable (iuris et de iure) presumptions are in conflict with EC law. In addition, (rebuttable) presumptions must be based on normal criteria or, as stated in Thin Cap Group Litigation, be “at arm’s length” (ECJ, March 13 2007, Case C-524/04).

34 ECJ, 9 December 2003, Case C-129/00, Commission of the European Communities v. Italian Republic, Para 27.
issue. The recent amendment to Italian cfc rules, bringing into its scope of application all foreign controlled companies, including those located in EU, presents certain aspects that may be held contrasting with EU law. The fact that the new safe harbor contained in art. 167(8-ter) – pursuant to which it has to be demonstrated that the cfc is not wholly artificial and does not aim at obtaining undue tax advantages, which is a clear acknowledgement of the ECJ’s Cadbury Schweppes judgment – may lead one to conclude that the new cfc rules have been specifically designed to face tax competition of Member States, while sheltering the rules from any possible conflict with EC law. Despite the new wording formally recalling the ECJ case law, at a European level the application of the safeguard clause may create some issues.

From substantive standpoint, the meaning of “wholly artificial arrangements aimed at obtaining undue tax advantages” should be construed in line with the ECJ case law to consider that both an artificial arrangement and the intention to avoid national taxes are necessary features of abusive structures. The burden of proof being entirely on the taxpayer, it would be sufficient to demonstrate the absence of one of these features to obtain an exemption from the cfc regime.

From the formal standpoint, the need to monitor the cfc risk and the procedure required to avoid its application place a disproportionate burden on the Italian parent company. In the first place, an analysis, and possibly a reclassification of the foreign subsidiary accounts according to the Italian rules, is needed to investigate the actual composition of the income. The virtual Italian tax burden has to be computed according to the Italian rules in order to be compared with the tax levied abroad. If both the tax rate test and the passive income test are met, a ruling has to be filed for each subsidiary that demonstrates the economic reality of the structure. Further, unlike any other Member State, the ruling has to be filed before the tax return of the Italian parent company for the same year. Such administrative burden may create conflict with the proportionality test pursuant to which when abusive behavior is presumed, the taxpayer must be given the opportunity to demonstrate the genuine nature of the transactions carried out without being subject to undue administrative constraints.

Also the companies’ tax residence presumption may result incompatible with the proportionality standards set by the ECJ since the place of management of a foreign-incorporated company/entity - controlled, even indirectly, by Italian residents - is considered to be located in Italy if such company/entity holds the control of the shareholders’ meeting on an Italian company; indeed the control does not produce, as a mean of common experience, the effect of locating the place of management at the parent’s residence. The deemed tax residence applies even if the lack of

35 The ECJ, in fact, has clarified that “Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that the controlled company is actually established in the host Member State and carries on genuine economic activities there”.  
36 See Cadbury Schweppes, note 11, Para. 64: “In order to find that there is such an arrangement there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment”.  
37 See Cadbury Schweppes, note 11, Para. 63: “[... The fact that none of the exceptions provided for by the legislation on CFCs applies and that the intention to obtain tax relief prompted the incorporation of the CFC and the conclusion of the transactions between the latter and the resident company does not suffice to conclude that there is a wholly artificial arrangement intended solely to escape that tax” and ECJ, 14 December 2000, Case C-110/99, Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas, Para. 53.  
38 On the other hand, the Italian Tax Authorities (see Circular No. 28/E of 2006) are of the opinion that the rebuttable presumption at issue is consistent with EC law. The Tax Authorities based their assumption on the judgment issued by the ECJ on case C-81/87 (The Queen/ Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC) which states that the Treaty of Rome acknowledges the differences in national legislation concerning the connecting factor for companies’ tax residence.
substance can be easily excluded, for example when the participation held in the Italian company has a negligible importance compared to other assets and activities. Shifting the burden of proof entirely onto the taxpayer means that the (likely numerous) grey-area cases, for which a convincing demonstration of either substance or lack of substance is difficult to provide, would fall within the presumption of Italian tax residence.

17. Reversal of the burden of proof and time limits
As far as the time limit is concerned, Italy has no legislation corresponding to Art. 14, paragraph 4 of the Netherlands Corporate Income Tax Act of 1969.

18. Reversal of the burden of proof and transactions with non domestic entities
As for the transactions with non-domestic entities, the above-described anti-tax haven legislation regulated by Art.110, paragraphs 10 to 12bis ITC should not deal with its compatibility with the EC law due to the fact that the legislation does not apply to costs stemming from operations with non-resident undertakings (individual or company) and professionals resident or located in a country or territory in the European Union or the European Economic Area. In any case, it is not possible to exclude that one can question the compatibility of the rule at stake according to its conflict with the free movement of payment and capital contained in Art. 63 TFEU (former article 56 of the Treaty of Rome) pursuant to which all restrictions on the movement of capital between Member States and “between Member States and third countries” shall be prohibited.

19. Donations to foreign charitable institutions and the burden of proof
As far as Italian special legislation on donations to foreign institutions, it must be pointed out that, certain specific provisions, such as those involving personal deductions of the donations to domestic cultural and research institutions [Art. 15(1), lett. h) of the ITC] as well as to charities [Art. 15(1) lett. i-bis) of the ITC], might be considered incompatible with EU law.

20. The burden of proof and proportionality
See paragraph 16.

Part D: Burden of Proof in Cross-Border situations: Transfer Pricing Aspects

21. The burden of proof between Tax Authorities and taxpayers
Transfer pricing provisions are currently embodied in Art. 110(7) ITC. The concept of the “normal value”, as defined by Art. 9(3) of the ITC, constitutes the statutory basis for the determination of the arm’s length value of an intra-group transaction.
Italian tax law does not contain any provision as to the onus of proof in litigation involving the determination of the arm’s length price of a transaction between related parties.
In the absence of any legislative clarification, the issue should be referred to the aforementioned general principle, pursuant to which the Tax Authorities must provide reasons supporting the assessment of an increase in taxable income.
In particular, recent judgments by the Italian Supreme Court have held that the burden of proof lies with the Tax Authorities, i.e. the latter must prove the grounds on which the assessment of increased taxable income is based (for example, that the transfer prices were not at arm’s length),

39 Such provision allows for the deduction of contributions to foreign charities, but only when related to initiatives in non-OECD Member countries, so as to support charitable activities in developing countries, which is not required for donations to Italian charities.

40 See, inter alia, the Supreme Court Decisions No. 22023 of 13 October 2006.
and calculate the proper arm’s length value.

In arriving at such a conclusion, the Supreme Court adopted a peculiar line of reasoning. Specifically, the Supreme Court first construed the domestic provision of Art. 110(7) of the ITC as an anti-avoidance provision that originates from the EU law doctrine of abuse of law\(^{41}\), as well as other areas of domestic anti-avoidance legislation (Art. 10 of Law 408 of 1990). This means that the domestic rule is intended to counter cases where taxable income is transferred from Italy to a low-tax jurisdiction via intra-group transactions. The Supreme Court held that, insofar as the purpose of transactions is other than the creation of a tax advantage, the burden of proof should lie with the Tax Office\(^{42}\). To this end, the Supreme Court also referred to Para. 5.2 of the 1995 Transfer Pricing Guidelines.

Based on this, the Supreme Court held in favour of the taxpayer, concluding that: (1) the Tax Authorities should have demonstrated that the overall tax burden was greater than that in the states in which the related parties were located; and (2) the Tax Authorities should have recalculated the arm’s length value of the transfers. As the Tax Authorities had done neither, there were no grounds for the Supreme Court to accept the assessment.

Although one may agree with the outcome of these cases, it is questionable whether or not the interpretation provided is consistent with the true scope of a transfer pricing provision. It is also peculiar that the Supreme Court required the Tax Authorities to prove that the effective tax burden in the state to which the income was transferred was lower than that in Italy when the controlled transaction was entered into.

22. Set of documents

Until 2010, under Italian tax law, there were no specific documentation requirements with regard to transfer pricing till the enactment of the Law Decree No. 78/2010.

Indeed, the Italian tax system lacked specific provisions on documentation requirements. With reference to the evaluation of evidence and documents, general rules have been applied. However, the Tax Authorities expected taxpayers to support their transfer pricing methods by demonstrating their compliance with the arm’s length principle and with the comparability analysis. In this respect, Art. 52 of Presidential Decree No. 633/1972, the content of which is recalled by Art. 33 of Presidential Decree No. 600/1973, refers to circumstances in which the taxpayer refuses to produce financial books, records and relevant documentation during a tax audit. If this is the case, a Court would have to disregard their existence for purposes of the tax assessment during the administrative phase or in litigation. More generally, the Tax Authorities has appeared to follow a rather formalistic approach regarding the documentation underlying intercompany transactions, as in a number of instances the focus of the tax auditors has been on: (1) ascertaining the consistency of the contractual arrangements with the actual conduct of the parties; (2) proper accounting documentation on the computation and allocation of total costs, particularly in the context of cost sharing arrangements and rendering of intra-group services\(^{43}\); and (3) detailed documentation of the group structure (including organizational charts stating the functions performed by personnel) with regard to the activities of the group companies.

Pursuant to the recently introduced provision, however, appropriate transfer pricing documentation may be relevant to avoid the application of administrative penalties on transfer pricing violations. The provision is laid down in Art. 1, paragraph 2ter of Legislative Decree No. 471/1997. It has been

\(^{41}\) The Supreme Court expressly cited the judgment of the European Court of Justice in Case C-110/99, Emsland-Starke (14 December 2000).

\(^{42}\) Such an interpretation was recently confirmed at a lower court level. See Provincial Tax Court of Milan decisions No. 66-6-07 of 17 October 2007 and No. 87 of 13 March 2009. Contra Provincial Tax Court of Turin, decision No. 15/11/08 of 20 March 2008.

\(^{43}\) Supreme Court decision No. 5926 of 12 March 2009 stated that the balance sheet and its certification by an audit company represent sufficient evidence to prove the existence of deductible costs (in the case in question, costs incurred by the Italian PE of a non-resident company).
introduced through Art. 26 of above mentioned Law Decree No. 78/2010, as converted with amendments into Law No. 122 of 30 July 2010. According to the above provision, the penalties set forth under Art. 1, paragraph 2 of Legislative Decree No. 471/1997 (ranging from 100% to 200% of the additional tax due) are not applicable when the following two requirements are both met: (i) the taxpayer has filed a communication with the Tax Authorities, where it has declared that it has appropriate transfer pricing documentation, and (ii) during possible tax investigations by the Tax Authorities, the taxpayer provides the Tax Authorities with appropriate transfer pricing documentation. The documentation that needs to be provided by the taxpayer must comply with the requirements specified by the Revenue Agency’s detailed regulation, issued on 29 September 2010 (No. 2010/137654). On 15 December 2010, the Italian Tax Authorities issued Circular No. 58/E that clarifies the indications outlined in the regulation No. 2010/137654. The regulation provides for a 10-day term for the taxpayer to deliver the transfer pricing documentation starting from the relevant request made by the tax auditors during an inspection. If further information is needed, the taxpayer must provide the additional documentation within seven days from the request, or within a longer term assigned by the tax auditors in case of complex inspections, provided that such longer term is compatible with the timing of the inspection. If the taxpayer fails to deliver the transfer pricing documentation or the additional documentation requested within the prescribed term, the Tax Office is not bound to refrain from imposing administrative penalties in case of transfer pricing adjustments.

Similarly, the Tax Office may still impose penalties if it finds that the transfer pricing documentation delivered by the taxpayer, although formally in line with the required standards, is incomplete or provides false information, unless the missing or incorrect information does not undermine the effectiveness of the tax auditors’ inspection.

23. Imposition of penalties and burden of proof

No statutory requirements to prepare documents, except for ordinary requirements, are provided for in Italy. The new provision contained in Art. 1, paragraph 2ter of Legislative Decree No. 471/1997 (see the former paragraph), however, provides for relief from administrative penalties if the taxpayer has an appropriate transfer pricing documentation.

24. Type of documents to be provided

As already stated, the documentation that needs to be provided by the taxpayer must comply with the requirements specified by the Revenue Agency’s detailed Regulation, issued on September 29, 2010 (No. 2010/137654) and annotated by Circular No. 58/E dated December 15, 2010, issued by the Italian Tax Authorities. In particular, the Regulation makes reference to “proper” documentation; the Circular clarifies that the documentation is regarded as “proper” if: (i) it allows to verify that the transfer prices are

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44 One particular feature of the new law is that the existence of the transfer pricing documentation and its timely delivery to the tax auditors are not per se sufficient to avoid the imposition of administrative penalties on the taxpayer. In fact, a communication to the Tax Authorities of the existence of the required transfer pricing documentation is also a necessary condition for the non-imposition of administrative penalties. In this respect, the Regulation specifies that the communication of the existence of the transfer pricing documentation must be made in the annual tax return. As regards previous fiscal years, the law states that the relevant communication must be filed within 90 days of the issuance of the Regulations (i.e. by 28 December 2010).

45 The discretionary power of the tax auditors to request additional documentation (possibly assigning a short term for its delivery) seems too broad, as there are no specifications or limitations to define the cases in which such power can be exercised. This may constitute a major factor of uncertainty for taxpayers: the effectiveness of the efforts necessary to comply with the burdensome transfer pricing requirements may be at serious risk if the Tax Authorities will be exercising their power to submit additional requests extensively, and claiming the applicability of penalties in cases where the taxpayer does not fulfill those additional requests in a timely manner.
consistent with the arm’s length principle; (ii) it is consistent with the Code of Conduct, approved by Resolution 2006/c176/01 of 27 June 2006 from the EU Council and government representatives of Member States (EU Code) and with the OECD transfer pricing Guidelines; and (iii) it is complete and wholly consistent with the reality and the Regulation. The Circular explicitly states that in case of doubts or uncertainty with regard to the information that must be disclosed, the taxpayer can make reference to the EU Code and OECD Guidelines.

The required standardized documentation is made up of two separate sets of documents: (i) the Masterfile, containing common information relevant to all the group members; (ii) Country-Specific Documentation, which should include information such as amounts of transaction flows within Italy, a comparability analysis including contractual terms and functional analysis, an explanation of the particular transfer pricing methods used, and information on internal and/or external comparables if available.

Taxpayers are then divided into holdings, sub-holdings and affiliate companies in relation to their role within a multinational group and provide for different documentation structures for each category. For Italian holding companies of multinational groups the documentation required consists of both the Masterfile and Country-Specific Documentation. As far as Italian subsidiaries of foreign-based multinationals are concerned, only the Country-Specific Documentation is required. If a foreign-based multinational has an Italian subsidiary which controls one or more companies residing outside of Italy, the Italian subsidiary qualifies as a “sub-holding” and is required to set up the Masterfile (even though the information provided may be restricted to the business carried out by the “sub-group”) in addition to the Country-Specific Documentation. The same requirements also apply to permanent establishments of foreign enterprises in Italy.

25. Choice of transfer pricing method

As already stated, the tax treatment of transfer pricing is currently governed by Article 110, Paragraph 7 of the ITC. The arm’s length definition contained in this provision refers to the concept of “normal value”, which is defined by Article 9(2) of the ITC. Therefore, Article 9 of the ITC represents the statutory basis for the determination of the arm’s length value of an intra-group transaction. In order to provide guidance on the concept of “normal value” arising from Art. 9, the Italian Tax Authorities issued a Circular (32/9/2267 of 22 September 1980) [and Circular letter 42/12/1587 of 12 December 1981] in which it analytically indicated the methods to be used for each type of transaction (e.g. transfer of movable goods, transfer of technology, loans and intra-group services) based on the arm’s length principle. Although not legally binding, the Circular is generally accepted by the Tax Authorities and taxpayers, and is considered to be the main reference for the interpretation of transfer pricing issues. Such Circular refer to a body of rules which have in part been modified but are still extensively applicable and extremely important, especially with regard to the methods for determining the normal value, since they represent the only instructions of a general nature supplied by the Tax Authorities on the matter.

A reading of the above-mentioned Article 9(2) ITCA seems to indicate that the comparable price method is the only method the Italian legislator allows to be used for the actual application of the transfer pricing system. The Italian Tax Authorities, the prevailing opinion and the case law all concur in the necessity of having recourse to the transfer pricing system even when the comparable price method proves not to be applicable. In its 1980 Circular Letter, the Ministry of Finance affirmed, in harmony with the indications set forth under OECD Reports, that where a comparison between the transaction being verified and the sample one is not possible, recourse must be made to the resale price method or to cost-plus method.

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46 The Masterfile should provide information such as a general description of the business and business strategy, the group transfer pricing policy, the transactions involving associated enterprises, and the functions performed and risks assumed.
As for alternative methods (e.g. comparable profit method and profit split method), although they are not provided for by the current legislation, in the 1980 Circular the Ministry of Finance has, however, allowed that “the application of the basic methods (comparable uncontrolled price, resale price, cost-plus) may not, in some particular cases, satisfy the application of the regulations governing transfer pricing since frequently there are no comparable transactions and just as frequently a reliable comparison between independent enterprise is not possible”. Consequently, it was considered advisable that other methods suitable for a practical use be taken into consideration in the event that basic methods prove inadequate.

This being said, neither the best-method rule nor a strict hierarchy of methods is provided for by the domestic transfer pricing provision. In the mentioned 1980 Circular, however, the Tax Authorities pointed out that the comparable uncontrolled price method is to be preferred. If such a method cannot be applied, the resale price and cost-plus methods ought to be used, without a strict hierarchy; the taxpayer is free to choose the method that is most suitable to the relevant case. Alternative methods are considered as last resort.

It is however worth noting that in the recent Circular No. 58/E of December 15, 2010, that clarifies the new transfer pricing documentation regime, the Italian Tax Authorities acknowledge the 2010 version of the transfer pricing Guidelines. In the new Guidelines, the OECD has removed the exceptional character of the transactional profit method vis à vis the traditional transaction methods by putting in place a standard whereby the selected transfer pricing method should be the “most appropriate method to the circumstances of the case”. In the mentioned Circular, Italian Tax Authorities stressed the principle that if the taxpayer applies a transactional profit method when a traditional transactional method could be applied in an equally reliable manner, detailed information and explanations why the former method has been chosen must be provided. Same explanations are required when CUP method could apply but has not been chosen. The explanations have not to be provided when it has been chosen a transactional profit method since the traditional transactional methods could not be applied in an equally reliable manner.

26. Burden of proof and bilateral conventions
There are no bilateral conventions containing express provisions on the burden of proof in transfer pricing matter.

27. Burden of proof and information exchange procedures
Italian law does not require prior recourse to exchange of information procedures in order to finalize a tax assessment regarding transfer pricing. In particular, the Tax Authorities are free to issue assessments based on alleged violations of the arm’s length principle without the necessity of previously verifying abroad the information and the data. The Tax Office tends to perform all auditing activities in Italy without resorting to the bilateral or multilateral procedures available in order to verify and prove its conclusions. Therefore, the attitude of Tax Authorities is to carry out audits on the basis of information available in Italy, without resorting to the above mentioned procedures.

28. Burden of proof in the mutual agreement procedure
Mutual agreement procedures contained in double taxation agreements have not been implemented in domestic legislation and therefore difficulties are encountered by taxpayers and the Tax

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47 The Circular clarifies that, in any event, the dispute with the Tax Authorities relating to the applicability of one method rather than another does not per se imply the discharge of the applicability of the favorable penalties regime provided for by Art. 1(2ter) of Legislative Decree No. 471/1997.
Authorities. Regardless of these difficulties, a few mutual agreement procedures have been initiated (with France, Germany, Greece, Sweden, Switzerland and the United States).

As far as the corresponding adjustments are concerned, pursuant to Art. 110(7) of the ITC, they are authorized “(...) only in so far as is necessary for the observance of agreements concluded with the competent authority of foreign states pursuant to the special mutual agreement procedures provided for by international double tax treaties”.

The power of the Tax Authorities to make corresponding adjustments is established by the treaties with Armenia, Belarus, Denmark, Ethiopia, Georgia, Ghana, Iceland, Oman, Slovenia, Syria, Turkey, Uganda, Uzbekistan, the United States and Vietnam; by the protocols to the treaties with Albania, Estonia, France, Germany, Israel, Kazakhstan, Latvia, Lithuania, Macedonia, the Netherlands, Qatar, Russia, Senegal, South Africa and the United Arab Emirates; and by the exchange of notes of 21 October 1998 between Italy and the United Kingdom.

The treaties themselves provide that such adjustments are to be effected within the framework of the mutual agreement procedure.

Finally, it is worth noting that Italy ratified the Arbitration Convention (90/436/EEC of 20 August 1990) on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Law 99 of 22 March 1993). This Convention expired on 31 December 1999. However, Italy recently ratified the Protocol amending the Arbitration Convention. This Protocol was ratified by all the contracting states and the instruments of ratification were deposited, so that the Protocol entered into force from 1 November 2004. From that same date, the Arbitration Convention re-entered into force with amendments.

With regard to the procedure under the Arbitration Convention, a transfer pricing case concerning the dealings between a French company and an Italian affiliated company was decided by an advisory commission on 19 May 2003, pursuant to the arbitration procedure laid down by Art. 7 et seq. of the Arbitration Convention. The opinion of the advisory commission has not been published.