

The presumption of residence in Italy of foreign holdings

(Law Decree July 4th, 2006 n. 223 and subsequent Tax Authority instructions)

Introduction

Italian rules referred to the determination of residence for tax purposes (of companies and other entities subject to the corporate income tax) have been recently modified (Art. 35, Par. 13 of the Law Decree July 4th, 2006 n. 223 (hereinafter "*L.D. 223/2006*").

General rules stated by Art. 73, Par. 3 of the Italian Income Tax Code (hereinafter "*IITC*") have been modified, since January 1st, 2007 through a presumption of residence in Italy applies to foreign companies that do present specific connections with the Italian territory by reason of the composition of their share capital, their shareholders and/or their directors.

As illustrated by the Explanatory notes to the L.D. 223/2006, such rule shifts the burden of proof as to the place of effective management of said companies.

General rules for determining the State of residence

In general, according to Art. 73, Par. 3, of the IITC, for income tax purposes, a company is considered to be resident in Italy if, for the most part of the tax period, it has in Italy:

- its legal seat;
- its management seat; or
- its main business object.

The criterion of the management seat attributes relevance to the place where key management decisions – that are necessary for the conduct of the company's business – are in substance made, by the highest management level (i.e. Board of Directors or General Management).

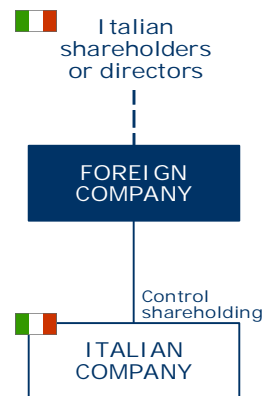
The Italian Tax Conventions are in most part consistent with the OECD Model Convention, stating that (Art. 4, Par. 3): "*where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated*"¹.

¹ Such general rule does not apply to Conventions signed with United States, Canada, Estonia, Lithuania, Latvia and Ireland that, in the case of possible double residence, entitle the competent authorities of the Contracting States to settle the question by mutual agreement.

The (new) presumption of residence in Italy

According to the new Art. 73, Par. 5-*bis* of the IITC, unless proof to the contrary, the place of management of companies, that hold a control share in a company resident for tax purposes in Italy, is considered to be in Italy if one of the following requirements is met:

- the foreign company is controlled, directly or indirectly, by persons (individuals or companies) resident for tax purposes in Italy; or, alternatively,
- the foreign company is managed by a Board of Directors composed in most part by Directors resident for tax purposes in Italy.



In order to verify if the holding company retains a control shareholding, such requirements shall be verified at the end of the financial year of the foreign participated company.

According to Italian Tax Authorities (Circular Letter August 4th, 2006, n. 28/E, Par. 8.3), to avoid the presumption of residence, the foreign company shall demonstrate that the place of effective management is abroad and not in Italy and there is an actual connection of the effective management in the foreign Country.

At present, neither the law nor the instructions provided by the Tax Authorities do provide for a specific list of elements suitable for avoiding the presumption of residence in Italy. However it shall be underlined that according to a recent interpretation (Circular Letter February 16th, 2007 n. 11, Par. 12.3), a foreign company shall be considered tax resident in Italy if, for the most part of the tax period, it has been managed by Directors resident for tax purposes in Italy.

Preliminary considerations

The location of the effective place of management shall be verified on a case by case basis. Thus several elements shall assume relevance or not depending on each specific case.

According to main case law, the place where the governance body, entitled by law or by the Articles of Association to the company management, takes its decisions shall achieve a great relevance. Thus in the case of companies managed by a Board of Directors the place where the Board meetings usually take place does assume relevance, while in the hypothesis of a sole Managing Director the place where such person exercises its management powers does assume relevance.

Consequently, in order to avoid the presumption of residence in Italy, it is essential that the Board of Directors meetings are periodically held in the company legal seat, abroad.

Indirectly, the State of residence of each Director is relevant as well as the State of residence of Managing Directors entitled to specific powers by the Board. In the hypothesis of a foreign company controlled by an Italian company particular attention shall be paid, for example, when Directors (or Employees) of the Italian parent company (individuals resident for tax purposes in Italy) are appointed as Directors of the foreign controlled company and/or are assigned to particular decision-making (or representative) powers.

In summary, the detection of the place of management depends on several issues. The most relevant ones are the following:

- the State of residence of the most part of Directors. If Directors are resident for tax purposes in Italy, their intervention to Board of Directors' meetings – necessarily held abroad – shall be accurately documented (for example, through travel tickets and similar);
- the availability, in the State of the legal seat of an office (owned or loaned, also on the basis of an inter-company agreement) suitable for the performance of the management functions (supplied with employee and opportune technical devices).

Contact Person:

Mr. Giovanni Rolle

Editor:

R&A Studio Tributario Associato
Corso Francia, 32
I – 10143 Torino
Italy

Phone +39 011 433 83 51

Fax +39 011 430 47 41

www.taxworks.it
segreteria@taxworks.it

www.wts-alliance.com

This information is intended to provide general guidance with respect to the subject matter. This general guidance should not be relied on as a basis for undertaking any transaction or business decision, but rather the advice of a qualified tax professional should be obtained based on a taxpayer's individual circumstances. Although our Info Letters are carefully reviewed, we accept no responsibility in the event of any inaccuracy or omission. For further information please refer to R&A Studio Tributario Associato.