

The exemption for genuine economic activity

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Even where both conditions of paragraph 4 are met, the controlling person may escape the CFC rules. It must demonstrate that the controlled entity "carries on an effective economic activity, by means of the use of personnel, equipment, assets and premises" (Article 167 paragraph 5 TUIR).¹ The formulation follows the wording of the Anti-Tax Avoidance Directive and the case law of the Court of Justice of the European Union on wholly artificial arrangements, which began with the *Cadbury Schweppes* judgment of 12 September 2006.² The taxpayer may seek an advance ruling (*interpello*) from the Revenue Agency on the exemption, and if the conditions are met without a ruling, the participation must be reported in the tax return.

For a trading company in Lugano the exemption requires precisely what the transfer pricing analysis requires. Traders, risk managers and back-office staff must be employed in Lugano and use real offices. Systems and contracts must show that the company itself concludes the transactions, finances them and bears their risks. A company with one employee, a fiduciary director and a letter box, whose trades are decided in Brescia or Milan, will not satisfy paragraph 5. If the Revenue Agency applies the CFC rules, the controlled company's income is attributed to the Italian controlling person in proportion to its participation. It is taxed separately at the average rate applicable to that person, but not less than the IRES rate.³

1 Esterovestizione: the Swiss company as an Italian resident

The CFC rules presuppose that the Swiss company is a non-resident. A more drastic consequence follows if the Italian authorities treat the Swiss company itself as resident in Italy, a practice known as *esterovestizione* (literally "foreign dressing"). Article 73 paragraph 3 TUIR, as amended by Legislative Decree No. 209 of 2023, sets out three alternative criteria. A company is resident in Italy if for the greater part of the tax period it has

its registered office, its place of effective management or its principal ordinary management in Italy. The place of effective management is defined as the "continuous and coordinated assumption of strategic decisions concerning the company or entity as a whole". Ordinary management means the "continuous and coordinated performance of day-to-day management acts concerning the company or entity as a whole".⁴ The reform replaced the former criteria of administrative seat and principal object, which had been interpreted broadly by the tax authorities and the courts.

Article 73 paragraph 5-bis adds a rebuttable presumption. A foreign company that holds controlling participations in Italian companies is presumed resident in Italy in two cases. The first is control, direct or indirect, by Italian residents. The second is administration by a board of directors or equivalent body composed predominantly of Italian residents.⁵ Imagine a Lugano trading company owned by an Italian family that also holds an Italian subsidiary, perhaps a warehouse or processing company. It starts with a presumption of Italian residence, which it must rebut by proving that its strategic decisions and its day-to-day management take place in Switzerland. The Italian courts have dealt with many such cases. The best known concerned a Luxembourg holding company of the Dolce & Gabbana group and ended in 2014 with the acquittal of the two designers by the Court of Cassation on the criminal tax charges. The case showed that a foreign company with genuine activity and its own management cannot be treated as Italian merely because its owners are Italian.⁶

2 Notes

1. TUIR, Art. 167 para. 5 (Brocardi.it, above). ↩
2. Court of Justice of the European Union, judgment of 12 September 2006, C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, EUR-Lex, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62004CJ0196>; Council Directive (EU) 2016/1164 of 12 July 2016, Art. 7 para. 2 lit. a ("substantive economic activity supported by staff, equipment, assets and premises"), <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016L1164>. ↩
3. TUIR, Art. 167 para. 6 (attribution in proportion to the participation in profits) and para. 8 (separate taxation at the average rate of the controlling person and "comunque, non inferiore all'aliquota ordinaria dell'imposta sul reddito delle società"), Brocardi.it (above). ↩

4. TUIR, Art. 73 para. 3, text at Brocardi.it, <https://brocardi.it/testo-unico-imposte-redditi/titolo-ii/capo-i/art73.html> (as amended by Legislative Decree No. 209 of 27 December 2023). Italian text: "la continua e coordinata assunzione delle decisioni strategiche riguardanti la società o l'ente nel suo complesso" (sede di direzione effettiva) and "il continuo e coordinato compimento degli atti della gestione corrente riguardanti la società o l'ente nel suo complesso" (gestione ordinaria in via principale). ↩
5. TUIR, Art. 73 para. 5-bis (Brocardi.it, above). ↩
6. Corte di Cassazione, decision of 24 October 2014 acquitting Domenico Dolce and Stefano Gabbana "per non aver commesso il fatto" after their earlier conviction for tax evasion in 2013 (the charge concerned some EUR 249 million of taxable income diverted to Luxembourg in 2004–2006), as reported in Wikipedia (it), "Dolce & Gabbana", https://it.wikipedia.org/wiki/Dolce_%26_Gabbana (used as a last resort). ↩

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