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The new Italian CFC Legislation and EU Tax Law

Stefano Marchese

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I. Introduction

It is a pleasure for me to make this contribution in a book in honour of Friedrich Rödler. I first met Friedrich in early 2001, when I became a member of the Direct Tax Working Party of FEE – The Federation of European Accountants – when representing the Italian Accounting Institutes. During that year I became Chairman of this Working Party, and I had chance to meet Friedrich, who was member of it. I was impressed by his deep knowledge of EU Tax Law and by the fact that he could speak Italian very well, not least I suspect thanks to his Italian wife.¹ We have since worked together during all the years which have passed since: for a period of time he was also Chairman of the Direct Tax Committee of the CFE and we had chance not only to share our opinions on EU Tax Law matters but also to enhance the relationship between the FEE and the CFE. At the end of 2009, after nine years of serving as Chair of the Direct Tax W.P. of the FEE, my mandate expired in accordance with the wise rotation rule included in the FEE Statutes. Friedrich has been appointed as the new Chairman of the Working Party and I am sure that under the chairmanship of Friedrich it will produce more and more documents of a very high standard. However, this succession will not mean the end of any stimulating debates with Friedrich at FEE level, since I shall indeed remain Vice-President of the FEE and be in charge of taxation. Therefore, we will have chance, also in the future, to share opinions on hot issues of EU Tax Law.

A number of very interesting papers have been written by the Working Party, many of them with the invaluable contributions of Friedrich. One such paper that I would define as very successful was related to CFC legislation in Europe²: here, we were substantially able to anticipate the outcome of the decision of the European Court of Justice in *Cadbury-Schweppes*, the first CFC case³.

On the basis of the fact that new and interesting developments in Italian CFC legislation took place in July 2009, my contribution in honour of Friedrich is related to this topic.

II. The policy rationale for CFC legislation and its different regimes

CFC legislation⁴ can be broadly defined as a technical provision that allows the shareholder's country of residence to tax the income produced by a foreign company that they control ("*sheltered income*"), according to the accrual method. There are many reasons

¹ It seems that one of the best way to learn foreign languages is by love, i.e. because of a foreign partner. I had the same experience when I learned Spanish due to the fact that my girlfriend (and now my wife) is Cuban.

² See *FEE Position Paper on Controlled Foreign Company Legislations in the EU*, Brussels, April 2002, available at <http://www.fee.be/fileupload/upload/PP%20Controlled%20Foreign%20Companies1632005381014.pdf>.

³ See also *FEE Observations on European Court of Justice Pending Case C – 196/04 Cadbury Schweppes Plc and Cadbury Schweppes Overseas Ltd v. The Commissioners of UK Inland Revenue*, Brussels, December 2005, available at <http://www.fee.be/fileupload/upload/FEE%20Observations%20on%20Cadbury.051212122005281537.pdf>.

⁴ The decision by the ECJ in this case is dated 12 September 2006.

⁵ See *FEE Position Paper*, already quoted, *passim*.

to justify a tax policy for CFC legislation; consequently, when viewed from different perspectives, CFC legislation could be seen as:

- an *anti-avoidance provision*⁵;
- a tool for ensuring the *international tax neutrality*⁶;
- a defensive measure against those countries that undertake *harmful tax competition*, be it as tax havens or adopting harmful preferential tax regimes;
- a tax policy measure against *tax erosion*⁷;
- a tool that solves some practical difficulties in the administration of *transfer pricing rules*⁸;
- a tool that solves some inefficiencies of company *fiscal residence* criteria⁹;
- a tool that allows the *enforcement of domestic taxation*¹⁰.

Different approaches are followed to provide the legal basis for the taxation of shareholder's sheltered income:

- the "*deemed dividend approach*", according to which the income is deemed to be distributed as a dividend (taxation of foreign dividend according to the accrual method instead of the remittance basis);
- the "*piercing the veil approach*", according to which the income is deemed to have arisen in the hands of the shareholders, *i.e.* company activities are to be attributed to them;
- the "*increased ability to pay approach*", according to which the income is deemed to have improved the ability of shareholders to pay taxes because it is economically at their disposal.

⁵ The aim is to counteract the techniques used by taxpayers to obtain tax deferrals by simply interposing a foreign corporate structure (often resident in a low-tax jurisdiction or benefiting from a low-tax regime in a high-tax country) between themselves and the source of income; since foreign corporations are treated as separate taxpayers, their income is generally taxed in the residence country of its shareholders until such income is remitted.

⁶ Namely following the Capital Export Neutrality model, according to which domestic and foreign incomes should be taxed in the hands of the resident taxpayers in the same way and without deferrals.

⁷ Aimed at reducing the outflows of capital from high-tax countries to low-tax countries that erode domestic taxable bases.

⁸ Clearly, if some income is improperly transferred from the high-tax country of residence of the parent company to the low-tax country of residence of the subsidiary, when CFC legislation is in place, it becomes much less important to adjust the inter-company prices according to the transfer price rules since the surplus of income unduly transferred will be taxed in any case in the first country as income of the CFC.

⁹ In some cases it is difficult to assess a domestic fiscal residence of a foreign company; that assessment becomes less important when its income is taxed according to the CFC rules in the country of residence of its shareholders.

¹⁰ Even if a foreign corporation is subject to domestic taxation, there are obviously problems regarding the enforcement of such taxation, both in terms of gathering the necessary information to determine tax liability and in terms of collecting the taxes owed, if it has no assets in the domestic jurisdiction; with a CFC system, the information and taxes are collected from resident shareholders.

Four general methods have been used in designing the legislation:

- the “*transactional approach*”, that concentrates on the nature of the income (typically on passive income, *i.e.* income arising from financial investments and other similar activities);
- the “*jurisdiction approach*”, that concentrates on the location of the foreign entity (typically a low-tax jurisdiction);
- the “*shopping approach*”, a variant of the transactional approach, that exempts some “passive incomes” produced in high-tax regimes;
- the “*exemption approach*”, a variant of the jurisdiction approach, that exempts some “active incomes” produced in low-tax regimes.

III. The Italian CFC legislation before the 2009 amendments

The Italian CFC rules were introduced in 2000¹¹. These rules apply to any Italian resident controlling, directly or indirectly, a company or any other entity resident or located in States or territories with a “privileged tax regime”. In such a case, the income of the controlled foreign entity is attributed to the resident taxpayers proportionally to the shares held in such a CFC. In other words, the CFC is treated as a transparent entity: therefore, the piercing the veil approach is followed.

The States or territories with privileged tax regimes are listed in a “black list” approved by a Decree of the Ministry of Finance¹² on the grounds of: (i) a level of taxation significantly lower than the Italian one, (ii) the absence of an adequate exchange of information or (iii) “other equivalent criteria”. It has to be pointed out that the 2008 Finance Act abolished the “black list” and replaced it with a “white list”, based on similar criteria; however, such a white list has yet to be approved and the 2008 amendment is not in force. The black list does not include any EU Member States, except Cyprus and Malta. However, considering that these two countries were not EU Member States when the list was approved, there is some debate as to the actual relevance of these two States after their entry to the EU. On the basis of these remarks it is evident that the Italian CFC system follows a jurisdiction approach.

Italian CFC legislation does not apply if the Italian taxpayer provides evidence, alternatively, that: (i) the CFC carries on a real industrial or trade activity, as its main activity, in the State or territory in which it has its legal seat; or (ii) the participation in the CFC does result in the allocation of any taxable income in States or territories in which they

¹¹ See Law 21 November 2000, no. 342; the legislation is contained in Art. 167 and 168 of the *Testo Unico delle Imposte sui Redditi* (Income Taxes Consolidated Act). On Italian CFC legislation see *inter alia*, in international literature, P. Tognolo, New Italian CFC Rule: Main Issues and Comments, in *Tax Planning International Review*, 1 (2002), p. 19 et seq.; P. Valente and M. Magenta, Italy: New CFC Legislation, in *Intertax*, 2 (2001), p. 52 et seq.; M. Gazzo, Italy's CFC Legislation Implemented and Participation Exemption Extended, in *Bulletin for International Fiscal Documentation*, 2 (2002), p. 77 et seq.; B. Dassert, The Italian CFC Provisions: Traced from a French Model, or another Italian Renaissance?, in *European Taxation*, 12 (2002), p. 522 et seq.; P. Troiano, Italian Controlled Foreign Company Legislation: Publication of the “Black List”, in *Intertax*, 3 (2002), p. 109 et seq.

¹² See Decree of the Ministry of Finance dated 21 November 2001.

are taxed at a preferential tax regime. In such a second case, if the taxpayer intends to escape from CFC legislation, he has the duty to file a request for advance ruling with the Tax Administration. Such a provision is in line with the so-called "exemption approach".

IV. The 2009 amendments to Italian CFC legislation

The 2009 Amendments¹³ first of all reduce the scope of the first exemption (a real activity of the CFC in the State of establishment), requiring that the activity will have to take place in the market of such a State or territory and specifying that for banking, financial and insurance activities such a condition is satisfied if the majority of the financial inflows, outflows or revenues have their source in the State or territory of establishment. For example, a financial company established in a black listed State can no longer escape from CFC legislation providing evidence that it is not a pure corporate structure without any real activity because it owns premises and employs personnel in the State. It will have to be financed from such a State (if it issues bonds to finance its activity, the majority of such bonds have to be subscribed by "locals" and if it lends money, the majority of its receivables have to be towards "locals"). Similarly, a manufacturing company located in a blacklisted country, having a substantial economic activity but operating on the basis of an import-export business model, will no longer satisfy the exemption clause because the majority of its purchases and sales are not addressed to the local market of the State of which it is resident for tax purposes.

However, such an exemption is not applicable for CFC companies, located in black-listed countries or territories, when more than 50% of its revenues arise from management, holding or investment in securities, shareholdings or other financial activities, from the disposal or licensing of intellectual property rights or from the provision of intra-group services, including financial services.

Therefore, according to the new legislation, for any CFC located in blacklisted States which earns passive income or provides intra-group services, a purely transactional approach is followed. The resident controlling shareholder will no longer be able to be exempted from the taxation of the profit of the foreign company, even if the latter has an active and real business, unless evidence is given that the income is not taxable in a privileged tax regime and such evidence is "approved" by an advance ruling of the Tax Administration.

Secondly, the Amendment enlarges the scope of CFC legislation: in addition to black-listed States and territories, CFC will apply also to any State or territory if the following requirements are both met: (i) the CFC is subject, in its own State, to an effective rate of taxation that is at least 50% lower than it would have been subject to if it had been resident in Italy and (ii) the CFC derives more than 50% of its profits from the management, holding or investment in securities, shareholding capital, credits or other financial assets, from the disposal or licensing of intellectual property rights or from the provision of intra-group services, including financial services.

¹³ Law Decree 1st July 2009, no. 78 converted by the Law dated 3 August 2009, no. 102. For details on these changes see S. Garufi, Amendments to the Italian Controlled Foreign Company Rules: a Witch-Hunt?, in *European Taxation*, 10 (2009), p. 504 et seq.

In order to obtain exemption from the "transactional approach" applied to non-black-listed States, the taxpayer has to provide evidence to the tax authority that the CFC does not represent an artificial arrangement aimed at obtaining an undue tax advantage. Such evidence has to be provided within the framework of the request for advance ruling.

It goes without saying that the broadened scope of the new Italian CFC legislation undermines corporate structures established in the EU, as CFC will apply to some tax regimes in force in countries like Belgium, Bulgaria, Denmark, Ireland, Luxembourg, the Netherlands, and so on. Considering the number of provisions related to the limitation of deduction of expenses in Italian tax law¹⁴ and the extensive use by Italian groups of companies of foreign subsidiaries for holding and financing activities, as well as for the provision of services within the group, the number of EU companies targeted by the new CFC measure will be very significant.

V. The new Italian CFC legislation and the EU tax law principles

Italian lawmakers used the principles stated by ECJ in *Cadbury-Schweppes* as a basis for drafting the new legislation: however, it seems that the new legislation has gone well beyond what the Court stated.

Indeed, the ECJ affirmed that "the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment. The right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty"¹⁵.

According to Community law, "it is immaterial, having regard to the application of the rules on freedom of establishment, that the company was formed in one Member State only for the purpose of establishing itself in a second Member State, where its main, or indeed entire, business is to be conducted"¹⁶. This is because "the reasons for which a company chooses to be formed in a particular Member State are, save in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment"¹⁷.

It is clear from settled case law that "the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only or principally in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Mem-

¹⁴ For instance, interest expenses on bonds for non-listed companies are fully deductible provided that the effective rate of interest is no more than the European Central Bank official rate increased by two thirds, irrespective of the rating of the issuing company; if the effective rate is higher, the additional interest is not deductible; there are also broader limitations in the deduction of interest expenses, since the difference between interest expenses and interest revenues is deductible within the limit of 30% of the EBITDA, and so on.

¹⁵ ECJ, 9 March 1999, Case C-212/97, *Centros Ltd and Erhvervs- og Selskabsstyrelsen*, § 27.

¹⁶ ECJ, 30 September 2003, Case C-167/01, *Inspire Art*, § 95; see also *Centros*, § 17.

¹⁷ *Inspire Art*, § 95; see also *Centros*, § 18.

ber State to deny that company the benefit of the provisions of Community law relating to the right of establishment"¹⁸.

From a purely EU tax law perspective, "the fact that a Community national, whether a natural or a legal person, sought to profit from tax advantages in force in a Member State other than his State of residence cannot in itself deprive him of the right to rely on the provisions of the Treaty"¹⁹. As to freedom of establishment, the Court held that "the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom"²⁰. Thus, the decision to establish a subsidiary in another Member State for the avowed purpose of benefiting from the favourable tax regime which that establishment enjoys does not in itself constitute abuse and that fact does not therefore preclude reliance on Articles 43 EC and 48 EC²¹.

Indeed, it is settled case law that "any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company"²².

¹⁸ *Inspire Art*, § 139, see also ECJ, 10 July 1986, Case 79/85, *Segers*, § 16; *Centros*, § 29.

¹⁹ *Cadbury*, § 36; see also ECJ, 11 December 2003, C-364/01, *Barbier*, § 71: "A Community national cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence".

²⁰ *Cadbury*, § 37; see also *Inspire Art*, § 96: "The fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State"; *Segers*, § 16: "It should be noted that for the application of the provisions on the right of establishment, Article 58 requires only that the companies be formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the community, provided that those requirements are satisfied, the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial".

²¹ *Cadbury*, § 38; see also *Centros*, § 18; *Inspire Art*, § 98: "The fact that Inspire Art was formed in the United Kingdom for the purpose of circumventing Netherlands company law which lays down stricter rules with regard in particular to minimum capital and the paying-up of shares does not mean that that company's establishment of a branch in the Netherlands is not covered by freedom of establishment as provided for by Articles 43 EC and 48 EC. As the Court held in *Centros* (paragraph 18), the question of the application of those Articles is different from the question whether or not a Member State may adopt measures in order to prevent attempts by certain of its nationals improperly to evade domestic legislation by having recourse to the possibilities offered by the Treaty".

²² *Cadbury*, § 49; see also ECJ 28 January 1986, Case 270/83, *Commission v. France*, § 21; ECJ, 26 June 2003, C-422/01, *Skandia*, § 52: "Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State. Such compensatory tax arrangements prejudice the very foundations of the single market"; ECJ, 26 October 1999, C-294/97, *Eurowings*, § 44: "Un éventuel avantage fiscal résultant, dans le chef des prestataires de services, de la fiscalité peu élevée à laquelle ils seraient soumis dans l'État membre dans lequel ils sont établis ne saurait permettre à un autre État membre de justifier un traitement fiscal moins favorable des destinataires des services établis dans ce dernier État » (official translation not available in English).

The need to prevent the reduction of tax revenue "is not one of the grounds listed in Article 46(1) EC or a matter of overriding general interest which would justify a restriction on a freedom introduced by the Treaty"²³. The mere fact that "a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty"²⁴. However, Italian law seems to establish a general presumption of avoidance or evasion whenever an Italian resident controls a company located in another Member State, the revenues of which arise from passive income or intra-group services, when the effective tax burden of the subsidiary is less than 50% of the Italian one. Indeed, the burden of proof is transferred to the taxpayer that has to demonstrate: (i) that the EU subsidiary is not a purely artificial arrangement and (ii) that it is not aimed at obtaining an undue tax advantage.

As we have seen before, ECJ case law clearly states that the aim to obtain a tax advantage is neither *per se* a justification for any limitation of the freedom of establishment, nor should it constitute a presumption of tax evasion.

With regard to "artificial establishment", the ECJ has stated that "a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned"²⁵. In this respect, "freedom of establishment is intended to allow a Community national to participate, on a stable and continuing basis, in the economic life of a Member State other than his State of origin and to profit therefrom"²⁶ and it involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period²⁷. Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there.

In this respect, we could try to contribute to the interpretation of the concept of "real establishment", as opposite to that of "artificial establishment". If, as quoted before, the former is "the actual pursuit of an economic activity through a fixed establishment in that

²³ *Cadbury*, § 49; see also ECJ, 3 October 2002, C-136/00, *Danner*, § 56; *Skandia*, § 53.

²⁴ *Cadbury*, § 50; see also ECJ, 16 July 1998, C-264/96, *ICI*, § 26: "The establishment of a company outside the United Kingdom does not, of itself, necessarily entail tax avoidance, since that company will in any event be subject to the tax legislation of the State of establishment"; ECJ, 26 September 2000, C-478/98, *Commission v. Belgium*, § 45: "A general presumption of tax evasion or tax fraud cannot justify a fiscal measure which compromises the objectives of a directive"; ECJ, 21 November 2002, C-436/00, *X and Y*, § 62: "Tax evasion or tax fraud cannot be inferred generally from the fact that the transferee company or its parent company is established in another Member State and cannot justify a fiscal measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty"; ECJ, 4 March 2004, C-334/02, *Commission v. France*, § 27: "A general presumption of tax avoidance or fraud is not sufficient to justify a fiscal measure which compromises the objectives of the Treaty".

²⁵ *Cadbury*, § 51; see also *ICI*, § 26; ECJ, 12 December 2002, C-324/00, *Lankhorst-Hohorst*, § 37; ECJ, 11 March 2004, *De Lasteyrie du Saillant*, § 50; ECJ, 13 December 2005, *Marks & Spencer*, § 57.

²⁶ *Cadbury*, § 53; see also ECJ, 30 November 1995, C-55/94, *Gebhard*, § 25.

²⁷ *Cadbury*, § 54; see also ECJ, 25 July 1991, C-221/89, *Factortame and Others*, § 20; ECJ, 4 October 1991, C-246/89, *Commission v United Kingdom*, § 21.

State for an indefinite period", it seems that such an establishment reminds us the concept of "permanent establishment" as developed under international tax law. Reference may be made, for this purpose, at the general definition of permanent establishment, as provided for by Art. 5, paragraphs 1, 2, 3, 5 and 6 of the OECD Model of Tax Convention with respect to Taxes on Income and Capital²⁸.

Therefore, we could assume that, if the CFC carries on an activity in a Member State and such an activity, if it were carried on directly by the shareholder resident in another Member State, would be considered as a permanent establishment of such shareholder in the first Member State, the CFC legislation cannot be applied, because the activity consists of a "real establishment" similar, as we said, to a "permanent establishment". In other words, the incorporation of the CFC must correspond with an actual establishment intended to carry on genuine economic activities in the host Member State. In those circumstances, "in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality."²⁹

The "permanent establishment doctrine" – if we may use such terminology – is consistent with the position of the ECJ, according to which "findings must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment"³⁰, i.e. in terms of those factors that typically characterise a place of business as a "permanent establishment".

²⁸ The quoted paragraphs of Art. 5 of the OECD Model Convention state:

- "1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:
 - a) a place of management;
 - b) a branch;
 - c) an office;
 - d) a factory;
 - e) a workshop; and
 - f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.
5. Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.
6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business".

²⁹ *Cadbury*, § 65.

³⁰ *Cadbury*, § 67.

On the other hand, if such an activity carried on by a CFC cannot be considered similar to a permanent establishment of the shareholder, we should conclude that it is an "artificial establishment". According to the ECJ, "in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory"³¹. Indeed, "if checking those factors leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a 'letterbox' or 'front' subsidiary"³².

Indeed, following the "permanent establishment doctrine", the "activity" performed by a letterbox company or "front subsidiary" is more or less "non-existent"; if the same activities were carried on directly by the controlling shareholder in the territory of another Member State, the tax authorities of such a State could not assess whether a permanent establishment were in place. From this it may therefore be concluded, from an EU tax law perspective, that no real establishment is taking place and that the CFC legislation may be applied.

It is clear that premises, staff and equipment may or may not be necessary, depending on the nature of the activity carried out. For instance, a holding company does not usually need any staff or equipment. In such a case, if the holding is purely a P.O. box company, no real activity takes place in the State of establishment and its directors are mere nominees or fiduciaries of the shareholders, it is difficult to say that a genuine establishment has taken place in accordance with the EU Treaty. However, if a holding company is domiciled on the premises of a professional firm, its local directors have competence and skills in managing the participations, the Board of Directors meet from time to time on the premises for the purpose of monitoring the financial results of the investments, there are financial relations with local banks or other financial institutions, and so on, it becomes more difficult to say that no establishment has taken place. In this respect, using the "permanent establishment doctrine" suggested in this paper, it would be worth investigating whether there is or not, in the State of establishment, a fixed place of business; if not, the holding company activity in such a State could be seen as similar to the activity of a "permanent establishment agent". If a real activity that may be considered as a permanent establishment is assessed, then a real establishment has to be affirmed, with the consequence that no CFC legislation can be applied.

VI. Conclusion

The above mentioned new Italian CFC legislation, which in some cases extends its scope to EU subsidiaries, seems to go beyond what is allowed by the freedom of establishment as interpreted by the European Court of Justice in tax cases.

³¹ *Cadbury*, § 55.

³² *Cadbury*, § 68; see also ECJ, 2 May 2006, C-341/04 *Eurofood*, § 34 and 35.

In particular, the fact that an EU subsidiary is incorporated in order to obtain a tax saving or other tax advantages cannot, *per se*, be considered as legitimating a CFC legislation. Even the fact that the EU subsidiary mainly earns passive income cannot be considered as an element to assume that a purely artificial arrangement has been put in place. Such a qualification, and the consequent taxation of the profit of the subsidiary in the hands of the controlling shareholder in the framework of a CFC mechanism, can be allowed only provided that the subsidiary has no real establishment in the Member State in which it has been incorporated or in which it has its fiscal residence.

In order to assess whether the subsidiary really is established in a Member State, a useful test may be to consider if the activity performed by it is similar to that of one characterising a permanent establishment. In case of positive result, no artificial arrangement can be assumed, and no CFC legislation can be applied.

This discussion may also serve towards the more general contribution of ideas in the framework of the current debate on tax law abuse which is currently being dealt with at Community level³³.

³³ See FEE letter to the EU Commission dated 8 February 2008, available at: <http://www.fee.be/fileupload/upload/van%20Aken%20080208%20Anti-abuse%20measures2522008141627.pdf>.