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Selected Issues Regarding the New Italian Exit Tax Rules

In this note, the authors analyse the extent to which the new Italian exit tax regime applies in the event of a qualified transfer of a branch of business characterized as the Italian permanent establishment of the foreign tax resident transferor, in relation to assets (and liabilities) that were not transferred but, at the same time, do not qualify (no longer qualify) as an Italian permanent establishment of the transferor.

1. Introduction

On 12 January 2019, the new exit tax regime provided for in article 166 of the Consolidated Income Tax Act (ITA),[1] as completely reworded by article 2(1) of Italian Legislative Decree No. 142 of 29 November 2018,[2] entered into force. The new article 166 of the ITA applies, for calendar year companies, as of the 2019 fiscal year.

The recasting of the Italian exit tax regime, however, seems to have produced more than one issue, especially in the event of a transfer of assets[3] where the Italian branch of activity qualifies as the Italian permanent establishment (PE) of the foreign tax resident transferor (Transfer).[4] A key point is that, at least in the first instance, the new exit tax regime does not seem to specify the tax consequences applicable to assets (and liabilities) that were not transferred but, at the same time, do not qualify (no longer qualify) as an Italian PE of the foreign tax resident transferor (Outstanding Assets).

This note mainly aims to investigate the extent to which, in the event the Italian PE is wound up following the Transfer, the exit tax regime applies in connection with the Outstanding Assets. In addition, such an analysis offers an opportunity to evaluate other new issues stemming from the recent amendments to the Italian exit tax regime.

For the purposes of the research topic mentioned, the authors: briefly explain the possible tax consequences, in the hands of foreign tax resident companies having a PE in Italy under the exit tax regime, provided for by article 166 of the ITA (section 2.); analyse the possible relevance of the unrealized capital gains arising from the Outstanding Assets for Italian tax purposes (section 3.); critically comment on the application, with regards to the Outstanding Assets, of the exit tax regime provided for in respect of the transfer of the entire Italian PE (section 4.) and, finally, summarize the conclusions reached in this note (section 5.).

2. Tax Consequences in the Hands of Foreign Tax Resident Companies under Article 166 of the ITA

As a general remark, it should be noted that the exit tax regime provided for by article 166 of the ITA does not expressly address the "winding up" of the Italian PE as a result of a business reorganization.

In fact, on the basis of article 166(1)(e) of the ITA, the exit tax regime expressly applies where companies carrying on a commercial business are resident in Italy for tax purposes and: (i) are subject to a merger by way of incorporation into a foreign tax resident company; (ii) are subject to a division in favour of one or more foreign tax resident companies; or (iii) have transferred (a branch of) a PE located abroad to a foreign tax resident company in exchange for the issuance of new shares of the latter. In such instances, for corporate income tax (CIT) purposes, the capital gain, calculated as a whole, amounts to the difference between the market value and the tax cost of the

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1. IT: Income Tax Consolidation Act, Presidential Decree no. 917/1986 (*Testo Unico delle Imposte sui Redditi*) [hereinafter ITA].
2. IT: Legislative Decree no. 142 of 29 Nov. 2018, which implemented Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193/1 (2016), Primary Sources IBFD.
3. More specifically, the authors analyse an operation whereby a foreign tax resident company transfers, without being dissolved, all or one or more branches of its activity to another company in exchange for the issuance of new shares of the transferee. Under this research, the term "branch of activity" means all the assets and liabilities of a division of a company which, from an organizational point of view, constitute an independent business, i.e. an entity capable of functioning by its own means.
4. For ease of reading, the authors will only focus on the case of a Transfer (i.e. a transfer of an Italian branch of activity – qualifying as the Italian permanent establishment (PE) of the foreign tax resident transferor – in exchange for the issuance of new shares of the transferee). The reasoning developed in this note, however, may be extended to comparable cases as follows: (i) a transfer of an Italian branch of activity – qualifying as the Italian PE of the foreign tax resident transferor – to another company in exchange for cash; (ii) a transfer of single assets attributed to the Italian PE of the foreign tax resident transferor to another company; (iii) a partial division involving the Italian PE of the divided company; (iv) a transfer of single assets attributed to the Italian PE to the foreign head office or to another foreign PE of the same enterprise; or (v) a transfer of the Italian branch of activity – qualifying as the Italian PE of the foreign tax resident transferor – to the foreign head office or to another foreign PE of the same enterprise where – with respect to all the scenarios depicted above – there are assets not included within the scope of the relevant transaction that do not amount to an (additional) Italian PE of the foreign tax resident company.

assets and liabilities that, before the relevant transaction, were part of the assets of the Italian tax resident company and, after the same transaction, do not flow into the Italian PE of a foreign tax resident company. Conversely, the provisions of article 166 of the ITA do not expressly address the "closure" of the PE in Italy of a foreign tax resident company as a result of an extraordinary transaction. It should also be noted that the introduction of the new exit tax regime was accompanied by the repeal of article 179(6) of the ITA, pursuant to which the assets or (the branch of) activity of the company involved in the transactions listed under article 178(1)(a) to (d) of the ITA were to be considered as realized at their "normal value" (*valore normale*, a criterion substantially similar to fair market value), where they did not flow into an Italian PE as a result of the relevant transaction or were subsequently diverted from it (according to scholars, to protect the Italian taxing power, such a provision was to be considered as also applying to other extraordinary transactions, in principle tax neutral, with an international profile, for example, the transfer of an Italian PE between "non-EU" companies pursuant to article 176(2) of the ITA).[5]

That being said, as far as foreign tax resident companies are concerned, the exit tax regime regulates situations of a transfer to the head office (HO) or another foreign PE[6] of:
– the "entire Italian PE" under article 166(1)(c) of the ITA; and
– individual assets of the Italian PE under article 166(1)(d) of the ITA.

Note that the meaning of the "entire Italian PE" is unclear. At first glance, this seems to refer to all the assets suitable to constituting a PE in Italy;[7] however, this is further analysed in section 3. of this note. Further, in the event that an entire Italian PE is transferred, a capital gain, amounting to the difference between the market value and the tax cost of the PE's assets and liabilities, is deemed to arise for Italian CIT purposes in the hands of the Italian PE. Such a capital gain must be calculated as a whole, which implies, inter alia, that any liability transferred should be factored into the calculation. Furthermore, tax losses can be used to reduce the income from the latest tax period. This capital gain is not subject to the 80% limit ordinarily applicable with regards to the use of tax losses.[8]

In contrast, in the event of a transfer of individual assets of the Italian PE, the capital gain arising for CIT purposes in the hands of the Italian PE amounts to the difference between the market value and the tax cost of the transferred assets; note that any liability transferred appears to be irrelevant under a strict interpretation of the provision at issue. Furthermore, the absence of a derogating provision to the limits provided for the use of tax losses seems to lead to the conclusion that the latter can be used to reduce up to 80% of the income.

In the authors' view, there are sound arguments to support the idea that the exit tax regime regarding the transfer of individual assets of an Italian PE to its foreign HO has been designed for instances in which the Italian PE qualifies as such not only at the time of the transfer but also afterwards. For example, the absence of an express derogation from the application of the limits on the use of tax losses (by reducing the capital gain under the exit tax regime) is easily justified considering that the Italian PE does not cease to exist and, therefore, will still be able to use the remaining tax losses to offset the CIT base in subsequent fiscal years.[9]

5. *See* P. Ceppellini, in *Operazioni straordinarie* [Extraordinary Transactions] ch. X, sec. 4.3.2.a. (R. Lugano & Associati ed., 1st ed., Ipsoa 2018); M. Confalonieri, *Trasformazione, fusione, conferimento, scissione e liquidazione delle società* [Transformation, Merger, Business Contribution, Division and Liquidation of Companies] p. 353 (37th ed., Gruppo 24 Ore 2022). In the authors' opinion, the repeal of the entire art. 179(6) ITA reflects a legislative plan that was not implemented in an optimal manner. This is particularly the case given that the exit taxation instances previously provided therein have not been completely embedded into the new art. 166 ITA. Although not the object of the present note, a possible extension of the exit tax regime to the Italian PE should be further investigated with regards to Italian tax resident companies involved in extraordinary transactions (hypothesizing that, within this regime, the position of the Italian PE of foreign tax resident companies should be substantially equated to that of Italian tax resident companies). Under such an interpretation, a capital gain would be deemed to arise in connection with the PE assets included in the scope of an extraordinary transaction (i.e. those assets of the PE that are transferred from the foreign tax resident company to another company) diverted from the business regime for Italian tax purposes (for example, where they did not flow from the beginning into the Italian PE of the foreign tax resident transferee) – derogating from the possible tax neutrality regime, in principle, granted to the said extraordinary transaction. It does not seem correct, however, to extend this regime to unrealized capital gains related to assets that, as in the case under study, are excluded from the scope of the extraordinary transaction (i.e. the assets remaining in the hands of the foreign tax resident transferor), the possible taxation of which seems indeed connected, as will be seen, to the "closure" of the Italian PE following cessation of the business activity in Italy by the foreign tax resident transferor. Nevertheless, the exit tax regime reserved for scenarios listed under art. 166(1)(e) ITA does not differ from that applicable to a transfer of the entire Italian PE pursuant to art. 166(1)(c) ITA (i.e. the regime that, in the subsequent sections of this note, the authors will argue should apply to the case under examination).

6. In the following sections reference will be made only to a transfer of the entire Italian PE and single assets of the Italian PE to the foreign head office (HO).

7. It is not clear if, in order to apply art. 166 ITA, it is necessary for the PE to also be recognized, for tax purposes, by the jurisdiction in which the HO is located or, in contrast, Italian recognition of the PE is to be considered sufficient for the application of the exit tax regime. In this regard, as observed by Assonime, in a Circular of 4 Aug. 2021, No. 24 pp. 14-15, a literal interpretation of the provision implies that Italian recognition of the PE should suffice. In those instances, however, where the HO jurisdiction does not recognize the PE, double taxation might arise since the HO jurisdiction may not recognize any foreign tax credit. Nonetheless, it should be noted that, in those bilateral situations that are covered by tax treaties, the PE definition should, as a general rule, be aligned and, by consequence, the risk highlighted above should be significantly reduced.

8. In particular, the general corporate income tax (CIT) provision regarding the use of tax losses carried forward, which limits their annual use to 80% of annual taxable income (*see* art. 84(1) ITA), does not apply.

9. This view seems to be shared, among others, by G. Ascoli & M. Pellecchia, *Prospettive di ampliamento delle ipotesi di applicazione della exit taxation* [Prospects for Extending the Cases of Application of the Exit Taxation], Il fisco 38, p. 3621 (2018); R. Michelutti, *Exit tax, doppio binario sul regime delle perdite* [Exit Tax, Double Track on the Losses Regime], IlSole24Ore (19 Sept. 2018); and indirectly also by E. Zanetti, *La stabile in Italia del soggetto estero post fusione incide sulle perdite del residente* [The Italian Permanent Establishment of the Foreign Entity After the Merger Impacts on the Losses of the Resident Entity], Eutekne.info - Il punto – operazioni straordinarie (23 Apr. 2019), to which reference should be made for an overview of the tax loss regime in the instances addressed by art. 166 ITA.

3. The Relevance of Unrealized Capital Gains Arising from the Outstanding Assets for Italian Tax Purposes

In light of the brief analysis carried out in section 2., it appears that the exit tax regime does not specify what the tax consequences are when, following the Transfer, some of the assets (and liabilities) of the Italian PE (i.e. the Outstanding Assets) are not transferred but, at the same time, do not qualify (no longer qualify) as an Italian PE of the foreign tax resident transferor.[10] In fact, adopting a literal interpretation of article 166 of the ITA, the transfer of the Outstanding Assets to the foreign HO does not seem to be comparable to the situations regulated under article 166(1)(c) and (d) of the ITA, since the Outstanding Assets cannot qualify as an Italian PE.[11]

Nevertheless, it is arguable that, for a variety of reasons, whenever an Italian PE "winds up" (even in instances other than a transfer of the entire Italian PE to the foreign HO), the unrealized capital gains relating to the Outstanding Assets are relevant in determining the CIT basis of its last fiscal year.

First and foremost, the fact that the foreign tax resident company ceases to carry out business activities in Italy should interrupt the functional connection between the Outstanding Assets and the Italian PE under the functionally separate entity approach.[12] Therefore, the Outstanding Assets should be considered for Italian tax purposes as either transferred to the foreign HO or used for purposes other than business activities; in both scenarios, they would be subject to CIT based on their fair market value.[13]

Moreover, even when the previous legislation was in effect, the Italian tax authorities already considered a transfer abroad of (business) assets following the " winding up" of the Italian PE as being subject to CIT;[14] even though the applicable provision had not been clearly identified in that scenario, scholars nevertheless agreed with the approach adopted by the Italian tax authorities.[15]

Furthermore, an interpretation of Italian tax law at odds with Recital No. 10 of the EU Anti-Tax Avoidance Directive (2016/1164)[16] should be avoided. The latter requires each EU Member State to tax the economic value of any capital gain created in its territory (even if such capital gains are yet to be realized), where a taxpayer moves assets or its tax residence out of the tax jurisdiction of the said state.

Indeed, in analysing the explanatory report to Italian Legislative Decree No. 142 of 29 November 2018, it becomes apparent that the purpose of the reworded article 166 of the ITA is to provide a more systematic and comprehensive set of rules on the topic.[17] Stated differently, the inten-

10. For the sake of clarity, it should be noted again that this article does not address the (equally interesting) analysis, in light of the new exit tax regime (and the repeal of art. 179(6) ITA), of the tax treatment of unrealized capital gains of assets that, in the context of tax neutral transactions (for example, a transfer of a branch of activity or partial division), even though transferred from the Italian PE of a foreign tax resident company to another foreign tax resident company, do not flow into the Italian PE of the latter (in this respect, the authors tried to outline a cursory answer in *supra* n. 6).
11. It is worth remarking again that, according to a strict interpretation of the provision at stake, the case targeted by art. 166(1)(c) ITA is a transfer of an entire Italian PE, whilst the event depicted under art. 166(1)(d) is a transfer of single assets of an Italian PE (which, however, in the case posed cease to exist after the Transfer).
12. *See* art. 152(2) ITA. More specifically, it is possible to argue that, since the foreign tax resident company ceases to carry on a business activity in Italy, all the functions, risks and, hence, the assets (and liabilities) previously allocated to the Italian PE with regards to such a ceasing business activity should, in turn, be re-attributed to the foreign HO in accordance with the *functionally separate entity approach* in art. 152(2) ITA (as modified by art. 7 of Legislative Decree No. 147 of 14 Sept. 2015, No. 147). In other words, since the Italian PE could not be deemed as exercising *economic ownership* (as defined under OECD*, 2010 Report on the Attribution of Profits to Permanent Establishments* (22 July 2010)) over these assets, the latter should be considered as automatically attributed to the foreign HO. In this respect, note that the OECD principles for the attribution of profits to the PE are also taken into consideration by art. 13 *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD, pursuant to which gains from the alienation of movable property forming part of the business property of a PE that an enterprise of a contracting state has in the other contracting state, including such gains from the alienation of such a PE (alone or with the whole enterprise), may be taxed in that state. Indeed, *OECD Model Tax Convention on Income and on Capital: Commentary on Article 13* para. 10 (21 Nov. 2017), Treaties & Models IBFD clarifies that, where a contracting state treats the transfer of an asset from a PE situated in the territory of such a state to a PE or the foreign HO of the same enterprise situated in the other contracting state as an alienation of property, art. 13 does not prevent the taxing of the profits or gains deemed to arise in connection with such a transfer, provided that such taxation is in accordance with art. 7, i.e. in accordance, inter alia, with the OECD principle regarding the attribution of profits to a PE.
13. *See*, respectively, art. 152(3) ITA (pursuant to which the income attributable to an Italian PE arising from, inter alia, the transactions entered into with its foreign HO should be determined at fair market value in accordance with the transfer pricing regulations provided for by art. 110(7) ITA) and arts. 85(2) and 86(1)(c) ITA (pursuant to which, in the event of the use of qualified assets for purposes other than business activities, the relevant capital gains are considered to be realized at their "normal value" – *valore normale* – a criterion substantially similar to fair market value).
14. *See* Resolution of the Italian Revenue Agency of 7 Nov. 2006, No. 124/E; it is worth remarking that when this Resolution was issued, the provisions of art. 166 ITA then in force did not expressly address the transfer of (all the) assets of the Italian PE to its foreign HO as a result of the "closure" of such a PE.
15. For an exhaustive analysis of the position of the Italian tax authorities and of scholars on the taxation of unrealized capital gains in the event the Italian PE is wound up, *see* S. Mayr-B. Santacroce (ed.), *La stabile organizzazione delle imprese industriali e commerciali* [The Permanent Establishment of Industrial and Business Enterprises] p. 117 et seq. (1st ed., IPSOA 2013). More recently, the Italian tax authorities stated, inter alia, that in the event of a transfer of one of the Italian branches of activities belonging to the Italian PE of a foreign tax resident company in exchange for the issuance of new shareholdings of the transferee, the shareholdings received by the foreign tax resident company as consideration should be subject to tax in Italy in the event of a lack – at the time of the transfer or subsequently – of the aforementioned functional connection between such shareholdings and the same PE (*see* the Resolution of the Italian Revenue Agency of 9 Aug. 2018, No. 63/E, issued before the new Italian tax regime entered into force and Ruling Answer of the Italian Revenue Agency of 6 Apr. 2022, No. 164, which confirmed the principles provided in the said Resolution with reference to the legislation currently in force); for a critical analysis of the position held by the Italian tax authorities, *see* A. Fuccio & R. Villa, *Critical Insights into the Tax Regime Applicable to a Transfer of a Business by an "Italian Permanent Establishment" in Exchange for Shares of the Transferee*, 59 Eur. Taxn. 2/3 (2019), Journal Articles & Opinion Pieces IBFD.
16. Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193/1 (2016), Primary Sources IBFD [hereinafter ATAD 1].
17. In commenting on Chapter II – Exit Tax Provisions – of Italian Legislative Decree No. 142/2018, the relevant explanatory report states:

    Articles 2 and 3 [of Italian Legislative Decree 142/2018] transpose Article 5 of the ATAD on 'Exit Taxation.' They thus replace Article tion underlying such an amendment was, on the one hand, to include within the scope of article 166 of the ITA the single exit tax hypotheses covered elsewhere[18] and, on the other hand, to expressly regulate the tax treatment of, inter alia, a transfer of assets from an Italian PE to its foreign HO. Indeed, although they are not perfectly suited to this scenario, the exit tax cases regulated under article 166 of the ITA, i.e. regarding a transfer of an entire Italian PE (article 166(1)(c) of the ITA) or of individuals assets (article 166(1)(d) of the ITA), could, in principle, be resorted to in investigating the tax consequences of a transfer of the Outstanding Assets.

In the authors' view, the fact that the transfer of the Outstanding Assets is not expressly contemplated under article 166(1)(c) and (d) of the ITA does not necessary mean that it is beyond the scope of the current exit tax regime. Indeed, the transfer of an entire Italian PE and that of individual assets were already included and treated equally under the former version of the Italian exit tax regime.[19] Thus, the new distinction between them (provided by the current exit tax regime) seems to be merely aimed at better distinguishing the calculation of the taxable capital gain and the use of tax losses in situations where the PE is being wound up versus the PE continuing, not at providing an exhaustive list of exit tax events.[20] Not surprisingly, such a distinction is not provided for under article 5(b) of the ATAD 1,[21] since the latter does not address the calculation of the capital gain for tax purposes nor restrictions on the use of tax losses.

In light of the foregoing, the failure to include a transfer of the Outstanding Assets among the events listed under article 166 of the ITA cannot be interpreted as demonstrating an intention not to effectively subject the relevant capital gain to tax. The criterion for calculating the capital gain and the restrictions on the use of tax losses, however, remain unclear; thus, in the absence of a specific provision, the issue here is to identify the applicable regime (i.e. either the regime applicable to a transfer of an entire PE or the regime designed for the transfer of assets).

4. Application of the Exit Tax Regime Applicable to a Transfer of the Entire Italian PE on Unrealized Capital Gains Following the Transfer

With regard to unrealized capital gains on the Outstanding Assets, these could be considered subject to CIT by alternatively (i) resorting to the fiction of a transfer of assets between the PE and the foreign HO (and, thus, investigating which of the cases provided for by article 166 of the ITA is relevant) or (ii) assuming use of the Outstanding Assets for purposes other than business activities.

In the authors' view, the tax treatment applicable to a transfer of the entire Italian PE could extend to the case under analysis by applying an expansive interpretation of article 166(1)(c) of the ITA. While, at first glance, a transfer of the "entire Italian PE" might mean a transfer of the entire business (enough to amount to an Italian PE), upon closer inspection, the same could also be interpreted as a transfer of "all the assets of the Italian PE". Such an interpretation should disregard the nature of these assets and whether some of them would not be eligible, taken individually, to qualify as an Italian PE. Therefore, the tax treatment reserved for a transfer of the "entire Italian PE" could apply, in principle, whenever the Italian PE ceases to exist, including where the Outstanding Assets are no longer sufficient to amount to an Italian PE. Thus, the time sequence should be: first the Transfer, then the transfer of the Outstanding Assets (representing "all the assets of the Italian PE"), after which the Italian PE should be considered as wound up.

In contrast, neither the exit tax regime applicable to a transfer of individual assets of the Italian PE (which, again, appears to have been specifically designed for a situation in which the PE continues to qualify as such following the transfer of individual assets),[22] nor the tax treatment reserved for the use of assets for purposes other than business activities, seem to properly target such a transfer.

It should be also remarked that by literally applying to the transfer in question the exit tax regime provided for a transfer of individual assets, the limits on the use of losses should apply and the question on the possible relevance of any liabilities transferred would arise.

Similar conclusions can also be reached by arguing in favour of the use of the assets for purposes other than business activities (in place of the transfer of assets to the foreign HO). In such a scenario, the calculation of the relevant income would not factor in any liability trans-

166 of the ITA for that purpose, with provisions setting forth comprehensive regulation on the topic.

18. *See* the exit tax provided for in art. 179(6) ITA, now repealed.
19. In any event, both the transfer of single assets and that of the entire PE to its foreign HO were already subject to CIT at fair market value under art. 152(2) and (3) ITA before the new art. 166 ITA entered into force.
20. In this respect, *see also* the specific wording used under art. 166 ITA. For instance, in the event of a transfer of the entire PE to its foreign HO, art. 166(6) ITA provides for a derogation to the 80% limit provided under art. 84 ITA with regards to "tax losses accrued until the end of *the last fiscal year of existence of the permanent establishment* in Italy" [emphasis added]. According to F. Capitta & F. Rossi, *Imposizione in usITA e valori fiscali in ingresso – regime fiscale delle operazioni straordinarie transnazionali* [Outbound taxation and inbound tax costs – tax regime of cross-border extraordinary transactions], *in Fiscalità internazionale e dei gruppi* (Giuffrè Francis Lefevbre 2021), this derogation is consistent with the fact that the limitation on the use of tax losses is subject to exceptions under specific circumstances – as is the case with a "closure" of the PE, since no further income would be derived in Italy and, by consequence, leftover losses would never be used.
21. It is worth noting that both a transfer of single assets and that of an entire PE seem to fall within the case provided under art. 5(1)(b) ATAD 1 (i.e. a transfer of assets from a PE to the related HO or to another PE located in another EU Member State or in a third country). Note that the distinct case provided under art. 5(1)(d) ATAD 1 (transfer of assets by a PE) is not the same as that in art. 166(1)(c) ITA, since a transfer of assets by a PE under the ATAD 1 can only occur in favour of another EU Member State or a third country, and not in favour of the HO. In addition, under art. 2(8) ATAD 1, a "transfer of a business carried on by a PE" means "an operation whereby a taxpayer ceases to have taxable presence in a Member State whilst *acquiring such presence* in another Member State or third country *without becoming resident* for tax purposes in that Member State or third country" [emphasis added]; clearly, tax presence (without acquiring tax residence) cannot be acquired anew in the EU Member State where the company is already established.
22. *See supra* n. 10.

ferred.[23] Furthermore, a taxpayer resident in an EU or EEA Member State would be precluded from opting for both: (i) the option to make five annual instalment payments of the tax due, following the application of the exit tax regime;[24] and (ii) the option to defer the impact of the capital gain on its CIT basis for up to five years[25] (since the PE ceases to exist for Italian tax purposes).

Based on this clarification, the authors believe that the application of one of the latter two regimes (i.e. (i) the rules applicable to a transfer of individual assets of an Italian PE; or (ii) the regime for the use of assets for purposes other than business activities) to the case at stake cannot be supported.

First, this could lead to an unjustified restriction of the freedom of establishment of a resident of an EU Member State ceasing to carry on business activities in Italy. Resident companies can use the tax losses without restriction when they cease to carry on business activities in Italy following (i) a liquidation procedure,[26] (ii) a transfer of their tax residence, or (iii) business transactions addressed under article 166(1)(e) of the ITA;[27] furthermore, under points (ii) and (iii) above, the liabilities are factored into the calculation of the relevant capital gain.[28] In this respect, the Court of Justice of the European Union has already clarified that national legislation restricting the use of tax losses suffered by the PE of a taxpayer of a different EU Member State that does not apply symmetrically to a company based therein restricts the exercise of the freedom of establishment and is, thus, not compatible with the provisions of the Treaty on the Functioning of the European Union (2007).[29]

Moreover, the use of losses without restriction, in the event the Italian PE is wound up, should also be granted based on the non-discrimination principle in article 24(3) of a relevant tax treaty drafted based on the OECD Model (2017).[30]

Further, under a systematic interpretation of the new instances where losses are wholly used under article 166(6) of the ITA, the limits on the use of losses should be disregarded when the (Italian or foreign tax resident) company ceases to carry on a business activity in Italy. This is because the restrictions in question are aimed at ensuring that the Italian tax authorities receive a benefit that is purely of a financial nature, namely that of mitigating the adverse impact the immediate use of all losses would have on tax revenue.[31]

Finally, it is worth remarking that capital gains could, in principle, also arise from liabilities where their fair market value is lower than their tax value. Any capital gains that have accrued on the liabilities would not, however, in principle, be of significance at the time of the "winding up" of the Italian PE, by applying (only) the exit tax regime applicable to the transfer of individual assets of the Italian PE or the tax treatment reserved for the use of assets for purposes other than business activities. The authors note that the exit tax regime applicable to unrealized capital gains arising from liabilities transferred from the Italian PE to the foreign HO is an issue that needs to be further investigated; nevertheless, it can be noted, at this point, that any possible non-taxation would diminish the effort, underlying the ATAD, to ensure that the tax is paid where the profits and value are generated.[32]

23. Under this interpretation, the transfer of liabilities would also fall outside the exit tax regime. Indeed, if the Outstanding Assets (i.e. assets (and liabilities) that were not transferred but, at the same time, do not qualify (no longer qualify) as an Italian PE of the foreign tax resident transferor) are not considered as transferred to the HO but used for purposes other than business activities, it would not be possible to argue that, in contrast, the liabilities (only) should be considered as transferred to the HO.
24. *See* art. 166(9) ITA, implementing art. 5(2) ATAD 1.
25. *See* art. 86(4) ITA.
26. As far as the liquidation procedure is concerned, it is worth noting that Italian tax law does not provide for an express derogation from the application of the 80% limits on the use of tax losses for the last fiscal year of the company being liquidated. However, such a derogation is unanimously recognized by scholars; to the best of the authors' knowledge, there are no contrary positions held by the Italian tax authorities in this respect. It should also be noted that a national provision construed and applied by national administrative authorities and courts in such a way as to infringe the EU obligations incumbent on an EU Member State is in breach of EU law (*see* IT: ECJ, 9 Dec. 2003, Case C-129/00, *Commission of the European Communities v. Italy*). Therefore, should the Italian tax authorities deny the unrestricted use of tax losses in the last fiscal year of a PE (but not of Italian companies), Italy would be in breach of the obligation to guarantee the freedom of establishment of any company resident in an EU or EEA Member State.
27. *See* art. 166(6) ITA. Note also that the Italian exit tax regime expressly provides for a derogation from the 80% limits with regards to the use of tax losses only in connection with transactions listed under art. 178(1)(a) to (b-bis) ITA (i.e. EU cross-border mergers, divisions and partial divisions). Nevertheless, there are sound arguments to argue that such a derogation should also be granted in connection with any extraordinary transaction with an international profile (for example, extra-EU mergers) (*see* sec. 4.).
28. *See* art. 166(3)(c) and (d) ITA. For the sake of clarity, it should be noted that, under the exit tax regime, in the event of a transfer of tax residence abroad or other extraordinary transaction (*see* art. 166(1)(e) ITA), if the relevant assets do not flow into an Italian PE, the capital gain is calculated as a whole (for example, also factoring in any liability transferred), regardless of whether the relevant company (for example, the company that transferred its tax residence abroad) continues to carry on business activities in Italy (for example, through a newly established Italian PE). Stated differently, factoring in the relevant liabilities in the calculation of the capital gain does not seem to require that any business activity cease to be carried on in Italy.
29. *See* UK: ECJ, 6 Sept. 2012, Case C-18/11, *Philips Electronics UK Ltd*, paras. 15 and 16.
30. *OECD Model* (2017). In this respect, para. 34 *OECD Model: Commentary on Article 24* (2017) clarifies, inter alia, that administrative practices that seek to determine the profits that are attributable to a PE on a basis different from that required by art. 7(2) *OECD Model* (2017) should be considered as violating art. 24(3) *OECD Model* (2017), which requires that the taxation of the PE not be less favourable than that levied on a domestic enterprise carrying on similar activities. Thus, it appears clear that a challenge raised by the Italian tax authorities to the full use of the losses at the time of the "closure" of the Italian PE would violate art. 24(3) of the relevant tax treaty (drafted in accordance with the OECD Model) applicable from time to time, where the full use of the losses were, instead, recognized in the last fiscal year of Italian tax resident companies under a liquidation procedure (*see supra* n. 27).
31. *See* explanatory report (*nota di lettura*) of July 2011, No. 108, to IT: Law No. 111 of 15 July 2011; Assonime, Circular of 22 Dec. 2011, No. 33, p. 17.
32. Note that, although art. 5 and Recital 10 of the ATAD 1 expressly take into account the taxation of unrealized capital gains on assets relating to the business of a company, but not that on any liabilities, the ATAD 1 nonetheless is aimed at ensuring that the tax is paid where profits and value are generated (Recital 1 ATAD 1), through provisions targeting, inter alia, a transfer of profits and value outside the internal market, including the exit tax regime (Recital 5 ATAD 1).

5. Conclusions

In light of the analysis carried out in this study, the authors submit that unrealized capital gains on any Outstanding Assets remaining following the Transfer should be subject to CIT in the hands of the Italian PE.

In this respect, there are several arguments in favour of applying the exit tax regime applicable to a transfer of an entire Italian PE in calculating the capital gain at issue so that, on the one hand, it is calculated as the difference between the fair market value and the tax cost of the assets and liabilities of the Italian PE and, on the other hand, the limits on the use of losses will not apply. Moreover, taxpayers should not be precluded from being able to make instalment payments under the conditions of article 166(9) of the ITA.

Even if, however, it is deemed more appropriate to adopt the exit tax regime applicable to the transfer of individual assets of the Italian PE or the tax treatment reserved for the use of assets for purposes other than business activities, then either the freedom of establishment or the non-discrimination principle (depending on the case) should be applicable. For such purposes, liabilities should be factored in when calculating the relevant capital gain, tax losses should be capable of being used without restriction and the option for five annual instalments of the tax due should be available[33] (assuming all of the other requirements are met).[34] Indeed, full use of the tax losses should be granted regardless of whether or not the freedom of establishment or the principle of non-discrimination can be invoked (and, thus, regardless of where the company is resident for tax purposes).[35]

33. *See supra* n. 25.
34. Note that such tax benefits are already granted under the exit tax regime where a business ceases to be carried out in Italy (for example, (i) a transfer of tax residence; and (ii) other extraordinary transactions listed under art. 166(1)(e) ITA).
35. In contrast, a company not resident in an EU Member State may be unable to obtain an acknowledgement of liabilities in calculating the capital gain, since the Treaty on the Functioning of the European Union (2007) (TFEU) does not require the EU Member States to ensure freedom of establishment in favour of legal persons residing in third countries. Additional research would be needed as to the ability of a "non-EU" company to have its liabilities included in calculating the capital gain by alleging breach of the freedom of movement of capital (which, under art. 63(1) TFEU, must also be afforded to "non-EU" companies). As per the specific case under examination, moreover, the analysis should also consider the ECJ case law regarding scenarios involving a "non-EU" PE of a company residing in an EU Member State (a circumstance mirroring the one in question). More specifically, a national law discriminating against "non-EU" companies investing in an EU Member State through PEs cannot be challenged as a breach of the freedom of movement of capital since that law "predominantly affects freedom of establishment" (*see* DE: ECJ, 6 Nov. 2007, Case C-415/06, *Stahlwerk Ergste Westig GmbH v. Finanzamt Düsseldorf-Mettmann*, Case Law IBFD and SE: ECJ, 10 May 2007, Case C-102/05, *A and B*, Case Law IBFD) and, as mentioned, the latter cannot be pleaded in this instance. For a more detailed analysis of the relationship between the freedom of movement of capital and the freedom of establishment, *see* P. Arginelli, *In tema di applicabilità della libera circolazione dei capitali a dividendi provenienti da Stati terzi e relativi a partecipazioni di controllo o di collegamento* [On the Applicability of the Free Movement of Capital to Dividends from Third Countries Relating to Stakes in Controlled or Affiliated Companies], Rivista di diritto tributario 5, part IV, p. 114 (2013) and P. Arginelli, *La tassazione dei dividendi di fonte estera: i problemi di compatibilità con le libertà fondamentali e la normativa secondaria* [Taxation of Non-resident-Source Dividends: Compatibility Issues Relating to Fundamental Freedoms and Implementing Regulation], Rivista di diritto tributario 9, part IV, p. 237 (2007).