



Newsletter n. 7/2008

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## ITALY

### *In 2008 the Italian Supreme Court decided on the “abuse of rights” in tax matters*

#### *The abuse of rights principle is inherent to the Italian tax system*

The year 2008 has been characterized by several decisions of the Italian Supreme Court regarding the application of the “*abuse of rights*” principle to tax matters.

The importance of these decisions is due to the fact that (until now) a general principle of “*abuse of rights*” is *not explicitly* provided for by Italian law<sup>1</sup>.

Differently from tax fraud, the “*abuse of rights*” lies in the formal observance of the legal rules, through which, however, the taxpayer substantially pursues unlawful tax savings. In such cases, when the tax authorities prove the lack of economic substance, they may disregard the tax effects of the transactions carried out by the taxpayer and, accordingly, deny the tax advantage.

\* \* \*

In three decisions (n. 8772/08, n. 10257/08 and n. 25374/08), the Supreme Court held that the notion of “*abuse of rights*” can be derived from EC law, as defined by the European Court of Justice in the *Halifax* case (C-255/02).

Therefore, according to the Supreme Court, the “*abuse of rights*” principle must be considered as part of the Italian legal system as well, and, as such, encompasses the whole Italian tax system.

As a result, not only does the scope of the “*abuse of rights*” doctrine cover taxes that are harmonised within the EU (like V.A.T.), but also those that are not, *i.e.* direct taxes<sup>2</sup>.

The Supreme Court made clear that the taxpayer has the *onus probandi* that the legal forms chosen for a series of transactions correspond to a “*sound business purpose*” (other than tax savings); on the other hand, the tax authorities are required to provide evidence that the

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<sup>1</sup> The abuse of rights principle is laid down by other European Countries; the German legislator, for instance, provide it in Par. 42 of the *Abgabenordnung* (Revenue Code).

<sup>2</sup> It's worth to be noticed that the abuse of rights principle has been applied by the ECJ also to direct tax cases (for instance in *Cadbury Schweppes* case, C- 196/04, 12 September 2004).



aforesaid transactions lack “*economic substance*”. The tax authorities shall thus act cautiously, taking into account that the taxpayer’s choice to use contractual forms that may result in a lower tax burden is part of his business freedom, enshrined in the Italian Constitution as well as in the EC legal system<sup>3</sup>.

Finally, the Supreme Court stated that, having its source in the EC law, the “abuse of rights” principle can be applied *ex officio* by the judge at any time in the course of the proceedings<sup>4</sup>.

\* \* \*

On 23 December 2008 the Joined Chambers of the Supreme Court handed down two decisions (n. 30055 and 30057), which, to some extent, redefined the previous judgments. Mainly, the Supreme Court’s Joined Chambers upheld the conclusions reached in the 2008 previous decisions, that is the existence of a general anti-avoidance rule (*i.e.* the “abuse of rights” principle).

However, the 23 December 2009 decisions stated that, with regard to direct taxation, the source of the aforesaid principle is to be found in the Italian Constitutional rules, rather than in the EC (case) law. Specifically, the “ability to pay” principle (under art. 53, paragraph 1, of the Italian Constitution) and the “progressive income taxation” principle (art. 53, paragraph 2) are the bases for both laws applying taxes and those providing for tax benefits.

Therefore, according to the Italian Supreme Court, the “abuse of rights” principle is embodied in these fundamental tax rules, whereby a taxpayer is not allowed to obtain tax saving through an “artificial use of legal forms”, if these have no other substantial motive than the tax saving itself.

The joined chambers of the Supreme Court observed that the introduction of specific anti-avoidance rules in the Italian tax system does not interfere with the existence of an inherent and general anti-avoidance principle; on the contrary, specific anti-avoidance rules should be interpreted as an actual indication of the existence of a general anti-avoidance rule.

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<sup>3</sup> Also the ECJ in many occasions stated that the use of a fundamental freedom in order to obtain a lower tax burden does not entail in itself abuse of rights.

<sup>4</sup> According to the authors of this Newsletter, this statement does not respect the rights of the parties to cross-examine the relevant facts of the case since the first instance.



The conclusions of the 2008 Supreme Court decisions are likely to strengthen the position of the Italian tax authorities in pending cases involving the use of sham transactions. Stating that a general anti-abuse rule is inherent to the Italian tax system will give the tax authorities an extra tool to counter tax abuse schemes.

On the other hand the taxpayer – according to the Supreme Court’s Joined Chambers decisions – may prove that there is a “*sound business behaviour*” in order to avoid the application of the abuse of rights principle.

a cura di:

***Giovanni Moschetti***

***[g.moschetti@studiosmoschetti.com](mailto:g.moschetti@studiosmoschetti.com)***

***Alessandro Vigna***

***[a.vigna@studiosmoschetti.com](mailto:a.vigna@studiosmoschetti.com)***

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