Italian Supreme Court dealt with the existence of, and attribution of profits to, a permanent establishment in Italy

In its order No. 21693 of October 8, 2020, the Italian Supreme Court (also "**Court**") examined certain issues concerning the existence of an Italian permanent establishment ("**PE**") of a Panamanian company and the attribution of profits thereto for corporate income tax purposes.

The company purchased building stones from Italian suppliers and resold them to both Italian and foreign clients. This activity was carried out through an individual, who, according to the Revenue Agency, acted as a de facto director of the company at a fixed place of business in Tuscany. Based on these findings, the Revenue Agency issued a tax assessment claiming the existence in Italy of a PE, to which it attributed the profits stemming from the purchase and resale of building stones to Italian and foreign clients. Both the Tax Court (first instance) and the Tax Court of Appeals (second instance) partially annulled the tax assessment, holding that the company was liable to tax in Italy only with regard to the profits stemming from the activity carried out towards Italian clients, as the purchase of building stones resold to foreign clients did not amount to a complete business operation and therefore should have been regarded as a preparatory activity.

The Supreme Court set aside the decision of the Tax Court of Appeals and remanded the case to a different chamber thereof, affirming the following principles of law to be followed by the latter judge.

First, where a fixed place of business is used to carry out both preparatory/auxiliary activities and other (non- preparatory/auxiliary) activities, that place of business constitutes a PE for all activities performed.

Second, an essential characteristic of preparatory/auxiliary activities is that they are carried out exclusively for the benefit of the head office (or other parts of the same enterprise). By contrast if the same activities are carried out for the benefit of third parties, including other group companies, the activities so performed can never be regarded as preparatory or auxiliary in character. This statement appears to be substantially in line with the principle upheld by the OECD Commentary on Article 5 (para. 61), which states that a "*permanent establishment would […] exist if such activities were performed on behalf of other enterprises at the same fixed place of business*". The Court, therefore, rejected the view expressed by the lower judges that the activity consisting of purchasing building stones and reselling them to non-Italian clients should be regarded as a preparatory/auxiliary activity.

Third, the Court seems to take the view (although the argument is not fully clear) that, if a PE carries out both (i) preparatory/auxiliary and (ii) non-preparatory/auxiliary activities, only the profits stemming from the latter activities (ii)

should be attributed to the PE. This principle, if confirmed, appears at odds with the Italian domestic law provisions dealing with the attribution of profits to PEs, as well as with Article 7 of the OECD MC, as such provisions do not include any carve-out from the right of the source State (Italy in this case) to tax any profit stemming from preparatory or auxiliary activities carried out at the fixed place of business, once it is concluded that such place constitutes a PE (the only exception being the limited rule, provided for by Article 7(5) of the pre-2010 OECD MC, concerning the mere purchase of goods or merchandise for the enterprise). Finally, the Court focused on the role played by the individual acting as a *de facto* director of the non-resident company, holding that all functions carried out by that person in Italy should be taken into account for determining the profits attributable to the PE that came into existence as result of his activities.

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