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BUSINESS INCOME TAXATION: A COMPARATIVE ANALYSIS BETWEEN AUSTRALIA AND ITALIAN LEGISLATIONS

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Phuoc Hoang Long Tong

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ABSTRACT

Along with the establishment and development of countries, business income tax has for a long time been a domestic affair in the sense that there is no single set of laws governed the business taxation ubiquitously in a geographic region, a continent or even a union of countries.

Yet for business income tax rules to sustain, it is commonly agreed that policies in this regard should be built around the concepts of neutrality, efficiency, certainty and simplicity, effectiveness, fairness, and flexibility. As a result, when it comes to business income tax, different countries may still at a certain extent share a common approach, even if the actual implementation and specific policies offered may vary depending on the goals each country try to achieve.

This study attempts to analyse the similarities and differences in terms of structure and spirit of business income tax of Australia and Italy, two countries being half the world apart from each other. To achieve that, the study is organised in the following manners:

The first chapter discusses the concept of business income for tax purposes, core principles of business income taxation including tax jurisdictions in the context of companies with activities in different countries.

The second chapter examines how business income tax legislations in Australia and Italy respective are made and updated. The principal elements of business income taxation including who are the taxpayers, what incomes are subject to tax, how to calculate the business income tax, tax incentives, tax rates and administrative aspects are analytically compared between the two countries under respective current business income tax regulations.

The third chapter further attempts to dissect how rising tides of world-wide tax reform, including those initiated by the Organisation for Economic Co-operation and Development (OECD). This chapter focuses the discussion on the impact of OECD's Base Erosion and Profit Shifting (BEPS) action plans to local business income tax legislations in Australia and Italy, and how Covid-19 as well as digitalisation have been affecting business income tax policies.

The conclusion of the research summarises the observations made while analysing the business income taxation in each country and discusses the idea whether country's income tax policies tend to converging or diverging against potential changes in business environment.

CHAPTER I: INTRODUCTION

1.1. Business income and taxes on business income

"Nothing is certain except for death and taxes" is a famous quote whose author is still a mystery and subject to debate. According to the OECD[1], taxes are compulsory, unrequited payments to general government and are divided into five broad categories:

- income and profits taxes;
- property taxes;
- consumption taxes;
- payroll taxes; and
- compulsory social security contributions.

In most countries, taxes are imposed on all of the above categories. While consumption taxes, designed as indirect taxes, would levy on expenditure connecting to the consumption of goods and services, income taxes are those directly levied on income of the earners cum taxpayers (e.g. individuals or corporates) over an annual tax period.

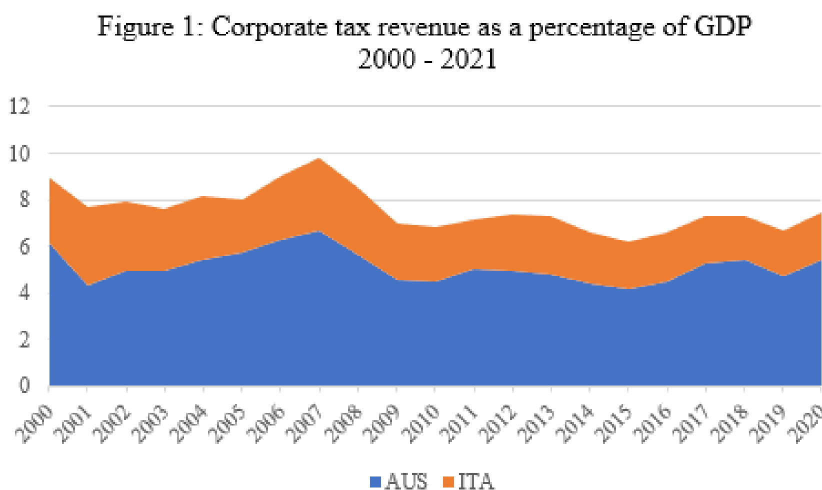


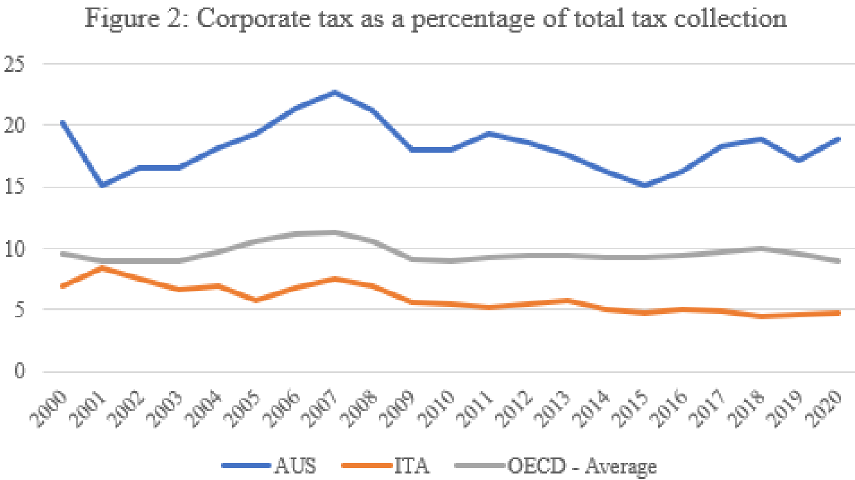
Figure 1: Corporate tax revenue as a percentage of GDP 2000 - 2021

Source: OECD's website – Revenue statistics

Per the above figure, the revenue from corporate tax collection plays a fairly important role in funding the government, especially in the case of Italy. From the perspective of total tax collection, GST or VAT should account for the most significant portion in the case of developing countries.

[1] OECD 2021, Revenue Statistics – Interpretative guide

Meanwhile, for developed countries, such a role should belong to personal income tax while corporate income tax accounts for less than 20% of the total tax collection. This is even lower in the case of Italy, which has the collection below the average OECD's data.



Source: OECD's website – Revenue statistics

In a corporate environment, identifying the amount of business income subject to tax in order to arrive at the tax to be paid is of paramount important to companies. The starting point in any analysis of business income tax is to determine what constitutes business income. From accounting perspective, business income is generally understood as the residual from offsetting revenue gained and costs incurred, measured and monitored periodically as an indication of a company's performance through the use of income statement. From economics perspective, business income is often viewed as the maximum amount which a company can distribute as dividends and still be as well off at the end of the period as at the beginning. It is therefore mostly considered in real terms as a result of balance sheet valuation rather than the those reflected in a single income statement[2].

For tax purposes, income is not measured for the lifetime of a corporate. Instead, a periodical measure is often required in order to levy tax regularly, and it is normal for businesses to measure their profits for a year (or more regularly than that in certain cases). There appears to be no unanimously agreed or readily documented definition of business income. Instead, depending on the broader economic and fiscal policies of a specific country in a timespan, tax policy considerations will be given which in turns guide and shape the development of such country's

[2] Emily, Chen Chang 1962, "Business Income in Accounting and Economics", The Accounting Review, American Accounting Association, pp. 636-644

taxation systems. Tax policy considered as a best-practice would commonly evolve around the theme of neutrality, efficiency, certainty and simplicity, effectiveness, fairness, and flexibility[3], a broad explanation of which are summarised as below. Based on the policy chosen and adopted, tax laws will be built to determine which income is to be considered as tax base comprehensively.

- *Neutrality*: Taxation is expected to be equitable and neutral among different business forms. A neutral tax helps to ensure that (i) tax system raises revenue while minimising discrimination in favour of, or against, any particular economic choice; and (ii) allocation of production resources is optimally achieved and thus contributes to the efficiency. To achieve neutrality, same taxation principles should apply to all forms of business, while at the same time addressing specific features to ensure an equal and neutral application of those principles.

- *Efficiency:* The costs of compliance borne by business and costs of administration for governments should be minimised to the extent possible.

- *Certainty and simplicity:* Taxation regulations should be clear and simple enough for taxpayers and regulators to understand respective rights and obligations, from which optimal decisions and policy choices are enabled to be made. Complexity and volatility of taxation regulations often results in aggressive tax planning, which may result in deadweight losses for the economy.

- *Effectiveness and fairness:* Taxation is considered as effective and fair if it helps collect the right amount of tax at the right time, while avoiding any unfair non-taxation (taxpayers that are technically subject to tax but are not legally required to under current tax enforcement), double taxation and minimising the acts of tax evasion and avoidance. As a result, the practical enforceability of tax rules is an important consideration for policy makers as it influences the collectability and the administerability of taxes.

- *Flexibility:* Tax system and legislations should be flexible enough to ensure they can keep up with new economic development arising such as technology, in order to ensure the stability of tax revenue collection and adaptability to potential impacts to such revenue streams. This means that the system should be durable in terms of structure yet dynamic enough to allow regulators to volatile future changes which are often be difficult to predict.

[3] OECD 2014, Addressing the tax challenges of the digital economy, Chapter 2 Fundamental principles of taxation

In designing a tax on business income, a number of key considerations are often given towards (i) tax base; (ii) timing to tax; and (iii) where the profit of a business operating across jurisdictions should be taxed.

- *Approaches towards tax base:* When corporate or business income tax systems were first introduced, one of their primary objectives was to collect personal income taxes due by the shareholders early (i.e. the "gap-filling" function[4]), thus preventing potentially deferral of personal income tax indefinitely. As a result, the corporate tax base was seen as a proxy for the return on equity capital. With times, two broad approaches towards defining tax base are worth noting. An approach known as Allowance for Corporate Equity (ACE) offers a deduction of interest payments as well as the opportunity cost of the equity capital that is invested in the business by the owner. The alternative approach, known as a Comprehensive Business Income Tax (CBIT)[5], taxes all income without giving any relief to the relevant financing costs. As an example, in some countries, there are cases where interest payments are not tax deductible or subject to constraint, as that in the case of interest incurred on shareholder loans.

- *Timing to tax:* The timing to tax in turn depends on the relationship between tax and financial accounting principles, which are both in a process of continuous development. In some countries where substantial uniformity between tax and accounting guidelines has achieved, the taxability of income and deductibility of expenses tends to follow an accrual basis with certain adjustment from accounting results where accounting treatments may be potentially vulnerable to manipulations of taxable income and final tax payables (e.g. denial of deduction of certain expenses, restricting method for deduct depreciation expenses to straight-line one). In other countries, tax and financial accounting are substantially independent, with tax law provisions and case laws addressing the treatment of the transactions for tax purposes.

- *Tax jurisdictions:* When a business activity crosses national borders, the question arises as to where the profits resulting from that activity should be taxed. The basis on which tax is

[4] Bird, R.M. 2002, "Why Tax Corporations?" Bulletin for International Tax, Vol. 56, No. 5, IBFD, Amsterdam
[5] Michael P. Devereux, Alan J. Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön, and John Vella, 2021, "Taxing Profit in a Global Economy", Oxford University Press

levied in a country reflects its approach to protect its tax base as well as political, legal, economic, and historic influences.

In the early 1920s, with the increase in global trade, the League of Nations started to study the rising issue of global double taxation in order to generate general principles for an international tax framework and prevent double taxation. One of the outcomes of such study was the concept of "economic allegiance". Economic allegiance reflects the existence and extent of the economic relationships between a particular state and the income or person to be taxed. The study reveals four factors constituting economic allegiance, namely (i) origin of wealth or income, (ii) situs of wealth or income, (iii) enforcement of the rights to wealth or income, and (iv) place of residence or domicile of the person entitled to dispose of the wealth or income. Among such factors, the study concluded that the greatest weight should generally be given to "the origin of the wealth i.e. source and the residence or domicile of the owner who consumes the wealth i.e. residence". In other words, the League of Nations advocated that tax jurisdiction should generally be allocated between the state of source and the state of residence depending on the nature of the income in question, being one of the core principles of modern international taxation.

1.2 Residence jurisdiction versus source jurisdiction

There are two main principles under which jurisdictions tax income – residence and source, with some few other jurisdictions such the United States applying a different test for liability to taxation by citizenship. Most countries or jurisdictions adopt both the residence and source concepts in the tax system, including Italy and Australia while some of the jurisdictions only adopt the source concept in the tax system such as Hong Kong. Some special jurisdictions like the Cayman Islands and British Virgin Islands do not impose income tax and their tax laws do not define residence for tax purposes. Companies that are incorporated in those jurisdictions have no residence for tax purposes.

A residence-based jurisdiction opines that income should be taxed in that country irrespective of the source from which it is earned because of a nexus between the country and the person earning the income i.e. taxpayer is deemed to enjoy certain protection and residence in the country it permanently resides. The residency of companies is often determined by two main tests, being where the company is incorporated or where the company is managed and controlled.

A source-based jurisdiction, on the other hand, follows the principle that income should be taxed in the country where resources in that particular country give rise to income earned irrespective of the country of residence of the taxpayer. Source-based taxation allows countries to tax the income of both resident and non-resident taxpayers, with the profits of non-resident taxpayers only taxed if there is sufficient "nexus" with the jurisdiction. Broadly, three types of income have historically met this requirement:

- Profits (including capital gains on the sale of business assets) of permanent establishments (PE): Since taxing one-off business transactions is administratively burdensome, countries have generally self-imposed a threshold only above which business activities will trigger the source country's tax jurisdiction. Finding a permanent establishment typically requires that the activity is conducted through a fixed place of business.

- Passive income payments (dividend, interest, and royalties) representing domestically sourced profits paid from resident to non-resident entities: These types of cross-border payments represent income generated in the source country, and the rights to tax them, in whole or in part, are typically exercised through withholding taxation.5

- Capital gains from the sale of domestic immovable property located in the source country, and related rights. While capital gains on immovable property are typically taxed in the country where the property is located (the source country), capital gains on movable property, such as on shares, are typically taxed in the country where the owner is located (residence country). However, the distinction between movable and immovable property is not always clear-cut.

In the modern days, along with the development of technology and cross-border intangible exchange, it is increasingly difficult for source-based taxation to determine and allocate profits to where they originate. Among the efforts to tackle this, OECD in its final report on Action Plan 1 - Addressing the tax challenges of the digital economy has tried to address issues surrounding how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes. This point will be discussed in more details in Chapter 3.

Conflicts between source and residence

When a company expands its business activities to another jurisdiction by establishing a physical presence to manage the local market, the company may become liable to pay tax on the business

profits which arise in or are derived from that source jurisdiction. Thus, the same income may be taxed twice, once by the source jurisdiction where the income arose, and again by the jurisdiction where the entity resides. To avoid such double taxation, countries enter into double tax treaties (DTT) that limit the rights of one of the contracting states to levy tax in a particular situation. The nowadays international taxation system is overlain with a network of more than 3,000 bilateral DTT. Most of these treaties follow fairly closely one of two models - OECD Model Tax Convention or the United Nations one, which are direct descendants of the first model of bilateral tax treaty drafted in 1928 by the League of Nations. Tax treaties (i) define the necessary nexus for a source country to impose tax on active business income, and (ii) give up (some or all) taxing rights in regard to passive income payments from within the source country to the residence country of the recipient. In principle, business profits shall be taxable only in the residence jurisdiction. However, profits attributable to a PE in the source jurisdiction may be taxed in the source jurisdiction. To avoid double taxation, relief is normally allowed by the residence jurisdiction for the tax paid in the source jurisdiction. In this way, only one level of national income tax will be borne by the enterprise with respect to the business profits.

The key role of the international tax framework is to govern the allocation of taxing rights between the potential tax-claiming jurisdictions to avoid both excessive taxation of a single activity and a nontaxation of a business activity and thus, facilitate cross-border trade and investment. In the course of a century-long evolution from the study of the League of Nations, the current international tax framework has turned into a hybrid construct, defined by a complex web of interactions between domestic laws and tax treaty obligations.

CHAPTER II: ITALIAN AND AUSTRALIAN BUSINESS INCOME TAX – A COMPARATIVE ANALYSIS

2.1. Comparative tax analysis approach

According to comparative tax scholars, at its best, comparative tax analysis attempts to explain how countries' tax laws differ and how and why they may be similar despite superficial differences[6]. Such analysis also involves consideration of how countries' tax systems have influenced one another and how international organisations, such as the OECD, the EU, the International Monetary Fund, or the United Nations, influence tax systems.

Hugh J. Ault and his colleagues asserted that the differences between countries' tax systems may be explained by a wide variety of factors, including different governmental institutions, different processes for the formulation of tax policy, different distributions of power, different ideas about taxation, and environmental factors such as history and geography. This is in line with the view of O. Kahn-Freund[7] that the use of comparative law requires a knowledge not only of the foreign law, but also of its social, and above all its political, context.

As noted by Avi-Yonah, Sartori and Marian on their research of "Global Perspectives on Tax Law", one of the main problems with the comparative study of law is that there is no single approach to it. In the context of this thesis, it is attempted to study the main feature of the business income tax system of Australia, a Commonwealth country, and Italy, a country following Continent system, taking into account to the extent possible the history, political and other emerging factors.

2.2. Development and structure of business income tax regulations

Business income tax regulations are among myriads of legal documents issued by legislative body of a country. In order to understand how business income tax regulations are formed (in the modern history) and developed in Australia and Italian, it is of importance to have an overview of the legal system in each country.

[6] Hugh J. Ault, Brian J. Arnold & Graeme S. Cooper 2011. "Comparative Income Taxation: A Structural Analysis". 2nd Edition
[7] O. Kahn-Freund 1974. "On Uses and Misuses of Comparative Law", The Modern Law Review, Vol. 37, No. 1

Overall, both countries share the same doctrine of the separation of powers, which partly reflects in how tax laws are created. Business income tax legislations in Australia appear to be subject to less frequent changes in comparison with Italy, which apart from legislative decree are also subject to regular tax policy and treatment changes as set out per annual Tax Budget Law.

The adoption of common law plays an important role in how tax laws in Australian are formed and interpreted while those in Italy are more rule-based.

Despite having a federal government, there are no state or municipal taxes on income in Australia, unlike Italy where regions could collect business income tax based on productive activities called IRAP.

The Commonwealth has to date exerted little power to business income tax legislation of Australian. On the other side, being a member of the European Union, the tax laws in Italy in principle follow the general guidelines set out by the Union's directives. Both countries' regulations are subject to significant changes brought about by global movements, particularly OECD's plans and initiatives, to whom both Australia and Italy are members.

More details on how tax laws are developed in each country are outlined below.

Australia

Australia operates in accordance with a federal system of government. Power is shared between the federal government and the various state governments under the division of powers. Of primary importance is the Australian Constitution, which outlines the division of powers between the federal and the state governments. The Australian Constitution (Section 51(ii)) gives the federal government the power to make laws regarding the collection of income tax. This is a concurrent power (i.e. shared between the federal and state governments) because the states or territories may also make laws with respect to taxation, except for those powers reserved exclusively for the Commonwealth (e.g. imposition of duties and customs and excise under Section 90). Where a state or territory law conflicts with a law enacted by the Commonwealth, the Commonwealth law will prevail. Despite the fact that in theory, both the Australian state and federal governments can impose income taxes, the federal government has for many decades been the only one to do so. Under Section 96 of the Constitution (revenue power), coupled with taxation, the federal government also has the power to enact grants to the states or territories. This means the federal government collects the tax, and then makes grants to the state and territory governments of funds

from income tax and goods and services tax (GST), to deliver services such as health and education.

The doctrine of the separation of powers applies in Australia where power is shared between the three arms of government separately being the legislature (i.e. parliament), the judiciary and the executive. The legislature creates laws by passing legislation while the judiciary (i.e. the courts) applies the law to individual cases. The executive, composing of governmental departments and other executive authorities (e.g. the Australian Tax Office), is responsible for implementing the laws passed.

The Australian Parliament consists of three components being the monarch (represented by the governor-general), the Senate and the House of Representatives. The two elected chambers could be considered as modelled on the United States Congress, in which the members of the Senate represent the states and territories while the members of the House represent electoral divisions according to population.

2.2.1 How a tax bill is passed through Australian parliament

In Australia, a Bill is defined as a proposed piece of legislation in draft form. In order for it to become enacted as law, it is required to go through a formal procedure containing a number of steps as describe below.

- *Step 1: Preparation of Bill.* The Office of Parliamentary Counsel is responsible for drafting the Bill for introduction into the Parliament in accordance with instructions from Treasury, the ministry responsible for revenue related matters. Proposals for tax legislation are considered by the prime minister and cabinet, who will initiate most proposed laws for debate in the parliament.
- *Step 2: Three readings in the House of Representatives.* The Bill is introduced to the House of Representatives with a first reading. Copies of the Bill and any explanatory memoranda are given to members of parliament and made publicly available. The Treasurer will then move that the Bill be read a second time. The second reading speech explains the purpose and principles of the Bill. The second reading debate gives an opportunity for the opposition and other non-government members to speak before voting on whether to agree to the Bill in principle. The Bill is then examined in detail, with the opportunity for

members to suggest amendments. The third reading is the final stage and is often of formality if the Bill is to be passed by the House.

- *Step 3: Three readings in the Senate.* After being passed by the House of Representatives, the Bill is presented to the Senate, where the procedure of three readings is carried out. Although the Senate may request for amendment to the Bill to be made by the House of Representatives, it however has no power to amend the Bill itself. If the two houses cannot reach an agreement, the Bill is to be laid aside.
- *Step 4: Royal Assent.* If the Bill is passed by both houses, it will be submitted to the Governor-General for Royal Assent, at which time it becomes an Act of parliament.
- *Step 5: Commencement.* An Act may specify the date of commencement. In case no such date is specified, the default commencement is the 28th day after assent is received.

2.2.2 The role of common law in Australian tax legislations

Australia is a common-law jurisdiction, with its court system originated in the common law system of English law. As a result, although legislation is now the primary source of new law in Australia, it does not automatically override common law and case law is still an important source of tax regulations. Generally, taxation case law falls under one of two categories.

- The first category of cases involves determining common law tax concepts, such as what constitutes ordinary income.
- The second category involves interpreting the relevant statutes so that affected groups, including tax advisers and tax officials, can apply the law efficiently and correctly. This relates to judges who are faced with the task of applying legislation to the particular case heard before them. There are a number of situations that might lead to a need for statutory interpretation, including ambiguity in legal wordings and unforeseeable developments.

2.2.3 Business income tax - Australian Taxation Acts

Early Australian income taxes adopted an income tax system applying to all forms of income. Up until the 1970s, the focus of significant changes to the tax system was on expanding the revenue base to fund expenditure programs. Since the 1980s, increased attention has been paid to reforming the tax system to improve equity and efficiency and, more recently, to reducing tax system complexity.

Under Section 55 of the Constitution, laws imposing tax can only deal with the actual imposition of taxation. Because of this, a separate form of Assessment Act deals with assessment and collection of tax while a Ratings Act imposes that tax and determines the rate. There are no state or municipal taxes on income in Australia.

There are two chief assessment Acts that govern the assessment and collection of income tax in Australia: Assessment Act 1936 (ITAA 1936) and the Income Tax Assessment Act 1997 (ITAA 1997). The purpose of the ITAA 1997 is gradually to rewrite the ITAA 1936 in simplified English and replace it. Currently both Acts are in effect as the ITAA 1997 only covers a part of the law covered by the ITAA 1936.

The Income Tax Rates Act 1986 and the Income Tax Act 1986 declare the rates of income tax and impose income tax on all types of taxpayers - individuals, companies, trusts, partnerships etc. The Taxation Administration Act 1953 states how these taxation laws are to be administered by the Commissioner of Taxation.

In Australia, the Australian Tax Office (ATO) is the Australian Government's principal revenue collection agency and administering the legislation governing tax. The ATO is under supervision of the Commissioner of Taxation, who is appointed by the Governor-General and responsible for administering Australia's tax system and significant aspects of Australia's superannuation system. The Commissioner is granted general powers of administration under Section 8 of ITAA 1936 and may delegate authority to tax officers (e.g. for the purpose of conducting audits and investigations).

Italy

The sources of law in Italy, in accordance with the Civil Code, include the followings set in the in order of importance:

- The Constitution
- The laws (codes, other parliamentary laws, regional laws)
- Regulations
- Customary law

A referendum can be a source of law, if it repeals an earlier law.

The Constitution is the principal source of law. It is framed by a constituent power and can be amended only by a special proceeding. Parliamentary laws are the result of consideration by both

the Camera dei Deputati (lower chamber) and the Senato (higher chamber) and must be enforced and respected all over Italy. Regional laws have force only in the territory of the region concerned, and can rule only on specific issues.

2.2.4 How a tax bill is passed through Italian parliament

In Italy, similar to Australia and other modern democratic countries, the political system is based on the separation of powers between the legislature, the executive and the judiciary. The normal process of adopting a law consists of three phases[8]:

- Proposal and drafting: Legislation can be initiated by the government, every member of the parliament, groups of voters (e.g. through a proposal made by at least 50,000 voters), regional councils and some special institutions (e.g. the National Council for Economics and Labour (CNEL));
- Discussion and voting: The Constitution states that the legislative function must be exercised jointly by the two chambers of Parliament (Article 70). Accordingly, for a draft law to become law, both the Chamber of Deputies and the Senate must approve an identical text. Approval to a draft must be granted by the former chamber before which it is first presented before it is passed on to the other chamber for approval in the same form or with amendments, where further amendment may be proposed until the content is approved by both the chambers in exactly the same form.
- Promulgation and publication: According to Article 73 of the Constitution, laws shall be promulgated by the President of the Republic within one month of their approval. A proclamation is made by the President of Italian Republic (who also has the power to refer bills back to Parliament for reconsideration) and publication in the official gazette.

There are two main exceptions to the normal legislative procedure[9]:

- Legislative decrees. Parliament has the power to delegate the exercise of the legislative function to the government for a limited period. Subject to strict compliance with the principles and guidance that Parliament outlines, the government can issue decrees that have the force of ordinary laws (legislative decrees)[10].

[8] https://www.senato.it/sites/default/files/media-documents/COST_INGLESE.pdf
[9] https://e-justice.europa.eu
[10] Article 77, the Italian Constitution

- Law decrees. In extraordinary cases of necessity and urgency, the government can adopt, on its own initiative, provisional measures having the force of law (law decrees). Law decrees lose their force unless Parliament converts them into law within 60 days[11].

For business income tax, the skeleton regulation is stipulated in Presidential Decree 917 of 22 December 1986 for approval of the consolidated income tax law (*Decreto del Presidente Della Repubblica 22 dicembre 1986, n. 917 (Approvazione del testo unico delle imposte sui redditi))* and the Legislative Decree 446 of 15 December. Apart from such decrees, on an annual basis, the Budget Law will be approved by the Italian Parliament which may contain changes in the business income tax policies applicable for the related period, with the latest being the Law No. 197/2022 - Budget Law 2023.

2.2.5 Business income tax in Italy - IRES and IRAP

Corporate income tax (IRES, in its Italian acronym) is currently governed under Presidential Decree 917 of 22 December 1986. In 1998, the Italian Government introduced a wide-ranging reform affecting all the main aspects of its tax system, including tax administration and tax compliance, and significantly altering the balance between central and local taxation, by substituting some national taxes with a new Regional Tax on Productive Activities (IRAP)[12]. IRAP was introduced by Legislative Decree 446 of 15 December 1997 as an implementation of the delegation provided for by the 1997 Financial Act.

2.2.6 Role of the European Union (EU)

On indirect taxation, the EU coordinates and harmonises law on value added tax (VAT) and excise duties. However, the EU Treaty makes no explicit provision for legislative competences in the area of direct taxation. As a result, the EU does not have a direct role in collecting taxes or setting tax rates. Legislation on the taxation of companies has usually been based on Article 115 of the Treaty on the Functioning of the European Union (TFEU), which authorises the Union to adopt directives, which in turn will be approximated by member state’s laws and regulations.

Noteworthily, regarding future development of income taxation in EU, on 18 May 2021, the Commission adopted a communication on business taxation for the 21st century. With it, a forthcoming proposal, scheduled to be tabled in 2023 and entitled Business in Europe: Framework

[11] Ibid
[12] Massimo Bordignon & Silvia Giannini & Paolo Panteghini, 1999. “Corporate Tax in Italy: An Analysis of the 1998 Reform” FinanzArchiv: Public Finance Analysis, Mohr Siebeck, Tübingen, vol. 56(3/4), pages 335-335

for Income Taxation (BEFIT), will provide a single corporate tax rulebook for the EU, based on apportionment and a common tax base[13].

2.2.7 Case law in Italy

Law is open to interpretation and legal precedents (jurisprudence) can influence subsequent decisions. However, they are not strictly binding as Italy has a civil law system and written law is the main guide for interpreters.

2.3. Taxable entities

For a company, determining the tax residency status is of paramount important as it decides the type of assessable income as well as the income rate. Both Australia and Italy currently tax companies being its residents on their worldwide income i.e. residence jurisdiction while apply source jurisdiction for income of non-residents sourced from the country.

The definition of resident for business income tax purpose in each country is not consistent but subject to specific wordings of domestic tax law. In the case of Australia, Australian resident is defined as a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia. Meanwhile, in Italy, a company having (i) their legal or (ii) administrative headquarters or (iii) their principal business activity within the Italian territory is considered to be Italian resident for tax purpose.

Both countries provide special rule for corporate collective investment vehicles, with was adopted in Italy in since 2011 for domestic funds, ahead of Australia in 2021.

Australia

According to the ITAA 1997 - Section 960.115 which defines corporate tax entity, an entity is a corporate tax entity at a particular time if:

- the entity is a company at that time; or
- the entity is a corporate limited partnership in relation to the income year in which that time occurs (definition of which is governed under ITAA 1936 – Section 94D); or

[13] https://www.europarl.europa.eu/factsheets/en/sheet/80/direct-taxation-personal-and-company-taxation

- the entity is a public trading trust in relation to the income year in which that time occurs (definition of which is governed under ITAA 1936).

Companies that are residents of Australia are subject to Australian income tax on their worldwide income (ITAA 1997, Section 6-5(2)) during an income year, where Australian resident means a person who is a resident of Australia for the purposes of ITAA 1936. In corporate context, according to Section 6(1)(b) of ITAA 1936, Australian resident is defined as a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia. It is observed that the amendment to the corporate residency test has been proposed for a number of years, where the proposed changes are to clarify that a company incorporated offshore would be treated as an Australian tax resident if it had a "significant economic connection to Australia". Nevertheless, as of June 2023, the above change has not been approved and the central management and control test remains valid and subject to interpretation (with the latest Commissioner's view expressed in Taxation Ruling (TR) 2018/5 and Practical Compliance Guideline (PCG) 2018/9).

With the development of finance industry and in line with the country's view to promote the area similar to that applied in Singapore or Hong Kong, a new tax and regulatory framework (Corporate Collective Investment Framework and Other Measures Bill 2021) started being applied from 1 July 2022 specifically to corporate collective investment vehicles (CCIVs). A CCIV, albeit being set up as a company limited by shares, is dedicated for funds management and for which income and gains of the entity are taxed on a flow-through basis to the investors.

Non-resident companies, on the other hand, are generally subject to Australian income tax on Australian-sourced income only in accordance with Section 6-5(3) of ITAA 1997.

The concept of source deals with the issue of where the income has been derived, which has been open to the courts to determine. The guiding principle applied by the courts in determining where income has been sourced was stated by Justice Isaacs in the High Court decision in Nathan v FCT (1918): "The legislature in using the word 'source' meant, not a legal concept, but something which a practical man would regard as a real source of income". The message conveyed is that the source of income is dependent upon the type of income derived, not the taxpayer.

The concept of derivation is about timing. In other words, derivation deals with the question of 'when has the income been derived?'. The point of derivation is important because it determines

when the income is to be taxed. There is no formal definition of derivation contained in either ITAA 1936 or ITAA 1997. As a result, case law has to be referred to. According to Justice Isaacs in FCT v Clarke (1927), the word derived is interpreted as ‘obtained’, ‘got’ or ‘acquired’.

Where a company is resident in a country with which Australia has concluded a DTT, Australia's right to tax business profits is generally limited to profits attributable to a PE in Australia.

Italy

According to Article 73 of the Presidential Decree 917 of 22 December 1986, as partly amended by Decreto Legislativo 44 dated 04 March 2014, entities subject to IRES include:

- joint-stock companies and partnerships limited by shares, limited liability companies, cooperative companies and mutual insurance companies, European companies (EC regulation No. 2157/2001) and European cooperatives (EC regulation No. 1435/2003) which qualify as tax residents in Italy;
- public and private entities resident in Italy, included consortia, trusts, undertakings for collective investment and non-profit organisations (NPOs);
- all sort of companies and other legal entities, including trusts, which are not tax resident in Italy, only with respect to the Italian sourced items income.

In accordance with Article 73, companies having (i) their legal or (ii) administrative headquarters or (iii) their principal business activity within the Italian territory are considered to be Italian resident companies. They are taxable in Italy on their worldwide income, which states that, regardless of the location/jurisdiction where the income is produced, to the extent that the income is legally attributable to an Italian resident entity, the income is taxed in Italy. Non-resident companies are subject to IRES and IRAP only on their Italian-sourced income i.e. with respect to the taxable income generated from the PE in Italy.

Incomes of Undertakings for Collective Investment set up in Italy and those established in Luxembourg are exempt from corporation tax in certain cases as provided for by law[14].

[14] Testo Unico Delle Imposte sui Redditi (TUIR), Article 73

2.4. Taxable income

Definition of income is not specifically regulated in either Italian or Australia tax legislations. However, both countries follow the concept of calculating taxable income based on assessable income minus allowable deduction.

Australia business income tax regulations make a distinction between assessable income, exempt income and non-assessable non-exempt income (NANE), for which case law significantly contributes to how the definition of each income is interpreted. In general, the application of these two methods is mainly addressed in common law cases. The application of cash or accruals basis for tax purpose is mainly addressed in common law cases. The cash method is generally applicable to small business/practice with few employees. On the other hand, the accruals method is generally applicable to large businesses/practices with many employees, or income predominantly from trading activities, or provision of services in large scale.

Italian business income tax regulations, on the contrary, are more rule-based and appears to be relatively simpler in determining assessable income for tax purposes. IRES is charged on the total net income reported in the Statutory Financial Statements, duly adjusted according to the specific tax rules. Positive and negative items of income are respectively taxed and deducted on an accrual basis. To be relevant for tax assessment purposes, incomes are required to meet certainty and objective determination principles (i.e. be certain under a legal perspective and objectively determinable in their amount).

Further details of determining taxable income in each country's set of regulations are outlined below.

Australia

There is no definition of the word income in either ITAA 1936 or ITAA 1997. However, the concept of assessable income is specifically addressed in Division 6 of ITAA 1997. According to Section 4-15(1) of ITAA 1997, taxable income is equal to the net of assessable income less deductions. In other words, a taxpayer's taxable income is determined by aggregating all assessable income and then deducting from this all of the allowable deductions. In order to calculate taxable income, assessable income has to be calculated first. An amount of ordinary income or statutory income can have only one status (assessable income, exempt income or NANE income) in the hands of a particular entity.

Assessable income is determined by Division 6 of Part 1.3, particularly Sub-session 6-5 to 6-15 of ITAA 1997. Taxpayers must pay tax on their assessable income, which includes ordinary income and statutory income (Sub-session 6-5 and 6-10). However, assessable income does not include any ordinary or statutory income that is exempt income or NANE (Sub-session 6-15 (2) and (3)). If an amount is neither ordinary nor statutory income, it is not assessable income (Session 6-15 (1)).

Ordinary income under Australian business income tax regulations

Sections 6-5(2) and 6-5(3) of ITAA 1997 are the main assessing provisions dealing with ordinary income. Section 6-5(2) states that if a company is an Australian resident, its assessable income includes the ordinary income it derived directly or indirectly from all sources whether in or out of Australia during the income year. The definition of ordinary income in Section 6-5 of ITAA 1997 is based on common law concepts. In other words, this definition of income is not found in the Act, but rather from judgments and decisions by the courts over the years. Ordinary income is also called 'income according to ordinary concepts'. In examining whether an amount is income according to ordinary concepts, the courts have tended to weigh up of a number of factors which are considered to characterise income, which could include the followings based on case law observed:

- It comes to the recipient beneficially
- It is money or money's worth
- It will often exhibit periodicity, recurrence and regularity
- It must be characterised as income in the hands of the person who has derived it i.e. of the recipient not the payer

Section 6-10(1) of ITAA 1997 states that assessable income includes some amounts which are not ordinary income. Sub-section (2) defines statutory income as income by reason of a specific statutory provision. In other words, an amount may not be ordinary income but is caught under the extended definition of statutory income. Where income may be included by more than one provision of the Act, Section 6-25(1) states that the amount is included only once in the assessable income. Furthermore, Section 6-25(2) provides that the specific provision overrides the general provision, meaning that if an amount is caught under both ordinary and statutory income, the specific (i.e. statutory) provisions will apply. Section 10-5 of ITAA 1997 contains a list of particular kinds of statutory income. The list contains a reference to the particular sections (in both

ITAA 1936 and ITAA 1997) that bring specific amounts to account. Typical types of statutory income include:

- royalties not included as ordinary income (Session 15-20) disposal of leased car for profit (Session 20-110)
- non-cash business benefits (ITAA 1936, Section 21A)
- trading stock (Session 70-35)

Exempt income under Australian business income tax regulations

According to Section 6-1(3) of ITAA 1997, exempt income is not assessable i.e. tax-free. Exempt income consists of amounts, which, although received as income and otherwise taxable, are expressly or implicitly made exempt from income tax by a provision of the Act (Session 6-20). A summary of all of the exempt provisions of the Act is stipulated in ss. 11-5 and 11-15 and is listed in alphabetical order with appropriate references to the specific sections of the Act. Generally speaking, income is made exempt under the Act in one of two ways:

- the entity is exempt from paying income tax (e.g. Division 50). These entities include charities, educational institutions, scientific and religious institutions, community service organisations, public hospitals, Government Departments and certain sports and cultural organisations; or
- the type of income is specifically made exempt under the Act.

Losses or outgoings incurred in deriving exempt income are not allowable as general deductions. However, exempt income may reduce the deduction allowable for a tax loss.

Non-assessable, non-exempt (NANE) income under Australian business income tax regulations

Exempt income is excluded from assessable income, but is still taken into account when calculating the amount of loss available to be carried forward. NANE income is disregarded for the purposes of the taxation law. Section 11-55 of ITAA 1997 provides a list of non-assessable non-exempt income provisions. Some examples of non-assessable, non-exempt income are GST payable to the ATO (Session 17-5) or non-portfolio dividends from a foreign country (ITAA 1936, Section 23AJ). Furthermore, the amount of the cash flow boost received by an entity pursuant to the Coronavirus Economic Response Package Omnibus Act 2020 (No. 22, 2020) is expressly treated as tax-free (non-assessable non-exempt income) for income tax purposes under Section 59-90 of ITAA 1997.

Losses or outgoings incurred in deriving NANE income are not allowable as general deductions. Unlike exempt income, NANE income is ignored for the purposes of deriving at taxable income and the taxpayer's available tax losses.

Italy

Income determination for IRES purpose

Under Italian tax law, all incomes derived by companies and other business entities always qualify as business income[15]. To determine the tax base for IRES purposes, the starting point is the profit or loss calculated for accounting purposes, as shown in the entity's financial statements. Such an amount must be further added or substracted in accordance with the tax provisions governing the determination of the tax base for IRES purposes.

Specific rules have been released for entities who adopt Italian Generally Accepted Accounting Principles (GAAP) instead of International Financial Reporting Standards (IFRS) for Italian statutory financial reporting purposes. Such provisions aim at aligning the taxable basis determination rules with the statutory financial reporting (i.e. deriving the corporate income taxable basis from the statutory financial statements).

The taxable basis is thus influenced by a number of factors including qualification criteria, time-based recognition, and classification in the financial statements as regulated by accounting standards.

Income determination for IRAP purpose

For IRAP purposes, relevant income and expenses are those reported in the statutory financial statements. There are different methods of computation for the IRAP taxable base, depending on the nature of the business carried out by the taxpayer. For sales and manufacturing companies, the IRAP taxable base is generally represented by the gross margin in the company's financial statements.

Gross income for IRAP purposes includes only the income obtained within Italy. In other words, income realised by a foreign PE of an Italian company is subject to IRES, but not to IRAP and vice versa i.e. an Italian PE of a non-resident company is subject to both IRES and IRAP for Italian source income.

[15] https://ec.europa.eu/ Taxes in Europe Database v3

2.4.1 Tax on capital gains

Although the term is often referred to as 'capital gains tax' (CGT), it is not governed under a separate tax law but is a part of income tax regime in both Australia and Italy. Prior to 1985, Australia did not impose income tax on capital gains. From that time on, the procedures to determine CGT in Australia's case become quite elaborate and relatively clear, following a number of steps as analysed below. In some cases, companies are eligible to apply roll over i.e. delaying a capital gain or a capital loss until a further (or later) CGT event. Specific CGT concessions may be available to qualifying small and medium enterprises.

For IRES purpose, Italian CGT allows in certain cases an option on the timing to tax of CGT (entirety in the year it is realised or on an instalment basis). Both Australian and Italian CGT provide participation exemption principle, with more stringent requirements set out in Italian case.

Australia

Tax on capital gains was introduced to Australia tax legislations in 1985, and normally applies to CGT assets acquired from on 20 September of that year onwards. Similar to normal income, for Australian residents, CGT applies to any assets held anywhere in the world. For non-Australian residents, a capital gain or loss is incurred if a CGT event happens to an asset that is a taxable Australian property. In considering whether CGT applies, other (non-CGT) tax provisions take precedence. For example, if the disposal of an asset occurs from ordinary course of a business, the gross proceeds from that transaction will be assessed as ordinary income under Section 6-5, and no capital gain will arise.

A capital gain or loss is generally calculated as the difference between the cost to acquire the asset and the proceeds received as a result of the CGT event. Under current Australia IAA, capital gains are included as part of the assessable income and thus are subject to the income tax provisions at the corporate tax rate. Capital gains arising in a tax year can be reduced by:

- capital losses arising in the current tax year, and
- any unused net capital losses and collectable losses brought forward from previous tax years.

On the other hand, a net capital loss arises in a tax year:

- if a taxpayer incurred a capital loss in the year and did not make a capital gain that could be offset against that loss, or
- where a capital gain arose during the year, and the sum of the capital losses realised during the year exceeded the capital gain made during the year (Section 102-10).

Capital loss cannot be deducted from the taxpayer's income but be used to offset against capital gains for the same income year, and/or carried forward to offset against capital gains of upcoming years. There is no limit on how long the loss can be carried forward (subject to certain rules applying to companies), and the losses are applied in the order they were incurred.

Historically, before September 1999, in order to determine the quantum of any gain for any assets acquired, the cost base is indexed according to price movements since acquisition, as measured by the official CPI. Such indexation of the cost base for price movements no longer exists from October 1999 onwards and disposals of plant and equipment are subject to general rules rather than the CGT rules.

In accordance with Australia ITAA, in order to calculate the total capital gain or loss to the taxpayer, it is essential to:

(i) Determine CGT event (types of transactions or events that might result in a capital gain or capital loss)
(ii) Identify CGT asset
(iii) Calculate capital gain/loss
(iv) Determine whether there is any exception/exemption
(v) Consider the applicability of relevant rollover provisions, which will defer a capital gain until a subsequent CGT event occurs
(vi) Consider whether any relevant discounts and small business concessions would be applied

Each CGT event sets out its own rules for when each event is considered as occur and a capital gain or loss is considered as arise. Many CGT events involve a CGT asset and some relate to capital receipts. CGT asset is defined to include any kind of property, including items such as shares in a publicly listed company, or an investment property used to generate rental income, or legal/equitable rights other than property (Section 108-5).

CGT events in Australian CGT

A capital gain or loss can only potentially arise if a defined CGT event occurs, which are listed in Division 104 of ITAA 1997. Classification of CGT event may affect how to calculate the capital gain or capital loss for that CGT event. CGT event include, among others:

- A1 - Disposal of a CGT asset (e.g. sale of shares by an investor).
- C1 - Loss or destruction of a CGT asset (e.g. factory destroyed by fire)
- D1 - Creating contractual or other rights (e.g. non-compete clause in a business sale contract).

Disposal of a CGT asset is the most common CGT event. It occurs where there is a disposal or part disposal of a CGT asset (Section 104-10). This disposal occurs only where there is a change in the beneficial ownership of the asset. There would not be a change of ownership where an asset is destroyed (CGT event C1 would apply). CGT event A1 occurs at the date the disposal contract is entered into or, if there is no contract, when the change of ownership occurs.

A CGT asset is defined in Section 108-5(1) and includes any kind of property as well as legal or equitable rights that are not property, for example land and buildings, shares in a company, rights and options, leases, goodwill, licences, convertible notes, contractual rights, etc.

As a general rule, taxpayer must determine the capital proceeds arising from the CGT event and the cost base of the CGT asset before subtracting the cost base from the capital proceeds. Where the capital proceeds exceed the cost base, a capital gain arises. In the other case, if the capital proceeds are less than the cost base, then the reduced cost base must be ascertained. If the reduced cost base exceeds the capital proceeds, there is a capital loss. If the capital proceeds are less than the cost base but more than the reduced cost base, there is neither a capital gain nor a capital loss.

The capital proceeds arising from a defined CGT event is the sum of any money the taxpayer has received or is entitled to receive plus the market value of any property the taxpayer received or is entitled to receive in respect of the CGT event occurring. Certain modification rules are also taken into account in calculating capital proceeds if applicable (e.g. any expenditure relating to illegal activities, entertainment, penalties and bribes to a public official are excluded from the cost base of a CGT asset). Capital proceeds will be assessed at the time of the CGT event, irrespective of whether they were actually received at that time.

The cost base generally includes all non-deductible expenditure incurred in acquiring, maintaining, improving and disposing of a CGT asset. Where a CGT event occurs in relation to a CGT asset,

the asset's cost base must generally be calculated in order to determine the capital gain. As with capital proceeds, the cost base is modified in certain circumstances. For assets acquired before 21 September 1999, the cost base may also be increased by indexation. Where a capital loss has arisen from a CGT event, the amount of that loss is calculated by reference to the reduced cost base, which can be different to the cost base.

When determining the reduced cost base, the taxpayer excludes the following elements (Section 110-55):

- any amount allowed or allowable as a deduction
- any decline in value of a CGT asset (i.e. depreciation deduction)
- any recouped costs not included in assessable income
- certain costs that give rise to a tax offset rather than a deduction
- if the CGT asset is shares in a company, certain distributions from amounts derived by the company before you acquired the shares
- any expenditure on illegal activities, entertainment, contributions to political parties, water infrastructure improvement payments, penalties and bribes of public officials
- any GST input tax credits after 19 February 2004 (Section 103-30).

According to Section 110-25 of the ITAA 1997, an asset's cost base consists of five elements, including:

- The money paid, or required to be paid, in acquiring the asset plus the market value of any property given, or required to be given.
- Incidental costs incurred where no tax deduction has been or will be allowed for these costs.
- The costs of owning the CGT asset, but only where the asset was acquired after 20 August 1991 and where no tax deduction has been or will be allowed for these costs.
- Capital expenditure incurred for the purpose or expected effect of increasing or preserving the asset's value (does not apply to capital expenditure incurred in relation to goodwill), or that relates to installing or moving the asset.
- Capital expenditure incurred to establish, preserve or defend title to the asset or a right over the asset.

Participation exemption (PEX), rollover and other CGT concessions under Australian regulations

A participation exemption on capital gains and losses is available to Australian resident companies to reduce capital gains and losses arising from the sale of shares in foreign companies. The Australian company must hold a direct voting percentage of 10% or more in the foreign company throughout a 12-month period in the two years before the disposal of the shares. The gains or losses are reduced to the extent that the foreign company carries on an active business.

Applying a rollover allows the taxpayer to defer or disregard i.e. roll over a capital gain or a capital loss until a further (or later) CGT event occurs. There are many types of rollovers under the taxation legislation, with the chief ones being:

- rollover for the disposal of assets to, or creation of assets in, a company (Division 122)
- replacement assets rollovers (Division 124)
- small business restructure rollovers (Division 328-G)
- demerger relief (Division 125)
- same asset rollovers (Division 126).

Certain CGT discount can apply to individuals, trusts, complying superannuation funds and life insurance companies. Companies (apart from certain life insurance companies) are not able to claim the CGT discount. Specific CGT concessions (e.g. 15-year exemption, 50 per cent active asset reduction, rollover, etc.) may be available to qualifying small and medium enterprises with conditions applied, which may allow them to disregard or defer part or all of a capital gain from an active asset used in a small business.

Italy

Capital gains are taxable in the tax period in which they are realised, as follows:

- Fixed assets: The gain realised on the sale of fixed assets is taxable for both IRES and IRAP purposes. Specifically for IRES purposes, capital gains may be included, at the company's discretion, in the taxable base entirety in the year in which they are realised, or in equal installments in the current and following tax years. However, it is not allowed to be carried beyond the fourth year. Such treatment is applicable to those who own the fixed assets for not less than three years.
- Financial investments: A specific participation exemption regime (PEX) is applicable. Under this regime, capital gains realised by Italian companies on sales of shareholdings are 95% exempt from IRES.

PEX applies only if all of the following conditions are met:

- The shareholding was held uninterruptedly for at least 12 months prior to the sale.
- The investment was classified under financial fixed assets in the financial statements relating to the first tax period of uninterrupted ownership.
- The subsidiary is actually carrying on a commercial activity (e.g. investments in companies mainly performing management of their own real estate are not entitled to PEX benefits). Such condition must be met both at the time of the sale of the investment and in the three preceding years.
- The majority of the subsidiary's income is not generated in a tax haven country or one with a privileged tax regime. Such condition must be met since the beginning of the shareholder period, or, if the buyer is a third party, over the five-year period before the disposal.

If the above conditions are not met, the capital gain realised by the company is taxed in the ordinary way.

Capital losses arising from write-down or the sale of shareholdings which meet PEX conditions are not tax deductible (capital losses realised on sales of non-PEX investments are tax deductible). Specific exemptions are provided for those entities adopting IFRS for statutory reporting purposes.

Specific anti-dividend washing rules are stipulated, which provide that where capital losses arise from the disposal of shareholdings that are not eligible for PEX, such losses are deductible only for the part exceeding the tax exempt amount of dividends received from the shares in question in the 36 months prior to the disposal.

Capital gains on financial investments generally are excluded from the IRAP taxable base.

Non-resident companies having a PE in Italy are taxed on the gains realised on assets pertaining to their business activity in Italy. For non-resident companies without a PE in Italy, the taxation of capital gains depends on the type of property being disposed of. Specifically,

- Real estate properties located in Italy are taxable as miscellaneous income in Italy if the assets are located in Italy. These gains are not subject to tax if the transferor has held the property for more than five years
- Movable assets are taxed in Italy if the assets are in Italy, unless a tax treaty prevents the taxation of the gain

- Shares of a corporation that give rise to capital gains from the sale of participating interests are subject to taxation in Italy only if the participation is an Italian company.

2.5. Deductions

Deduction provisions of business income regulations reflect the policy offered by the regulators to encourage or discourage certain activities and to ensure the fairness of tax and timing to tax.

Overall, Australia has a fairly more elaborate rule when it comes to assess the deductibility of expenses in comparison with Italy while Italy has more varied treatment to take note (e.g. super-depreciation or hyper-depreciation). Both sides share some similarities in terms of treatments for car, administrative penalties or entertainment expenses.

Unlike Italy, goodwill is not deductible under Australian regulations. Depreciation of fixed assets in Italy can only be claimed as deductible expenses for business income tax purpose following straight-line principle with it is more flexible in Australia in this regard (a choice between straight-line and reducing balance). Italy, however, offers a chance to claim deduction for depreciation more than its own cost (super-depreciation and hyper-depreciation).

Allowance for corporate equity (ACE) deduction is permissible under Italian regulations while is still unavailable in the case of Australia.

Australia

General deductions under Australian business income tax regulations

The most common deductions available to taxpayers are general deductions. These are available under the general deduction provision of Section 8-1 of ITAA 1997. The provision contains two tests for an expense to be deductible and four respective tests to deny a deduction for certain expenses as noted below. Some of those denied may still be allowed as a specific deduction. Each of the elements of Section 8-1 of ITAA 1997 have been considered in detail by the courts, from which general principles have been established in interpreting and applying the provision in this section.

According to Section 8-1(1), one can deduct from your assessable income any loss or outgoing to the extent that:

- it is incurred in gaining or producing your assessable income; or

- it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.

Specifically, the first general principle underlying Section 8-1 is that deductions from assessable income require there to be a loss or outgoing. Outgoings are normally deliberate expenses of the taxpayer and will be deductible if they meet the requirements of Section 8-1 of ITAA 1997. Losses, in contrast, (e.g. losses through theft) do not directly produce assessable income as they are outside the control of the taxpayer. However, they may still be deductible if they are associated with earning assessable income or carrying on a business that produces income.

The second general principle arising from Section 8-1 of ITAA 1997 is the use of the phrase 'to the extent that', and this applies to both positive limbs. This phrase requires that, where an expense is not used wholly for a deductible purpose, it must be apportioned into deductible and non-deductible amounts. The High Court decided in Ronpibon Tin v FCT (1949) case that apportionment is to be determined based on the amount the taxpayer actually spent, not on 'how much a taxpayer ought to spend in obtaining his income'. Where the expense results in a tax loss (the expense was greater than the assessable income), the expense may be partly non-deductible if there is a purpose other than producing assessable income.

To be deductible, expenses must be:

(i) *incurred*, either where there has been an actual payment or there is an existing liability to pay i.e. the taxpayer is legally required to pay the expenditure when it is due. The use of the term incurred also means that accounting provisions such as provisions for long service leave and doubtful debts will not be deductible as they are not incurred. At the time of making the provision there is no loss or outgoing. This only arises when the employee actually takes the long service leave or the debt becomes bad.

(ii) *related to the gaining or producing (earning) of assessable income.* This is generally described as having a nexus with the earning of assessable income or that it was incurred 'in the course of' earning assessable income.

However, one cannot deduct a loss or outgoing under this section to the extent that:

- it is a loss or outgoing of capital, or of a capital nature; or
- it is a loss or outgoing of a private or domestic nature; or

- it is incurred in relation to gaining or producing one's exempt income or non-assessable, non-exempt income; or
- a provision of this Act prevents one from deducting it.

There is no definition in the ITAA of the meaning of term capital and so it is necessary to rely on case law decisions to make the distinction between expenses that are capital in nature and those expenses that relate to the production of assessable income. A simple comparison is that the purchase of a new item of machinery is capital as it lasts for a number of years, and the cost of electricity to operate this machinery is not capital but is a cost of operating the machine to produce assessable income. However, there are many grey areas in this distinction which have been the subject of numerous court decisions.

Some of the common specific exclusions from deductible loss or outgoing are:

- Penalties imposed for breach of the law, except a penalty under Subdivision 162-D of the GST Act
- The provision for accrued long service leave, annual leave, sick and other leave.
- Contributions and gifts made to political parties and individuals who are candidates for, or members of, parliament and local government bodies.
- Wages paid to seasonal workers for which tax has not been withheld under the PAYG system.
- Travelling expenses in respect of a relative accompanying an employee or self-employed person on a business trip, unless there is a genuine and substantial business purpose for the relative's presence or the expenditure incurred is subject to fringe benefits tax.
- Bribes made to foreign and Australian public officials.
- Entertainment expenses, unless incurred in providing a fringe benefit or excepted by Subdivision 32-B.

Specific deductions under Australian business income tax regulations

The income tax legislation also provides specific deductions under Section 8-5 of ITAA 1997 which are separate to the general deductions found in Section 8-1 of ITAA 1997. The specific deduction provisions may allow a deduction for expenditure that is not deductible as a general deduction (e.g. capital expenses), or included in the legislation to provide more specific detail regarding the circumstances necessary for an expense to be deductible. To resolve the situation

where a loss or outgoing may be deductible under more than one provision, Section 8-10 of ITAA 1997 requires that an expense can only be deducted under one provision and, where more than one is applicable, the most relevant section must be applied.

Depreciation

Division 40 of ITAA 1997 allows taxpayers to claim a deduction (immediately or over the lifetime of the asset) for the decline in value of a depreciating asset that was used in part or fully for a taxable purpose. Division 40 also allows for deductions for certain other capital expenditure. It applies to all taxpayers, however a small business enterprise can choose to access simplified capital allowance arrangements. Division 43 of ITAA 1997 allows a deduction over time for capital works which includes buildings and structural improvements.

A depreciating asset is one that 'has a limited effective life and can reasonably be expected to decline in value over the time it is used' (ITAA 1997, Section 40-30(1)). It does not include land, trading stock, or intangible assets (unless they are listed in Section 40-30(2) of ITAA 1997).

Intangible assets that are considered as depreciating assets are:

- Certain mining, quarrying, or prospecting rights and information.
- Items of intellectual property (IP).
- In-house software.
- Indefeasible rights to use a telecommunications cable system.
- Spectrum licences under radio communications legislation.
- Datacasting transmitter licences.
- Telecommunications site access rights.

According to Section 40-25(2) of the ITAA 1997, capital allowance is only deductible if the depreciating asset is used for a taxable purpose in part or in full. Section 40-25(7) defines a taxable purpose as the purpose of (i) producing assessable income; (ii) exploration or prospecting; (iii) mining site rehabilitation; or (iv) environmental protection activities. The holder of the asset is entitled to the deduction and may be the economic (e.g. the lessee under a lease agreement), rather than the legal owner. In accordance with Section 40-60 (2) of the ITAA 1997, start time of asset depreciation for tax purposes is the earlier of when the taxpayer first uses the asset or when the taxpayer has the asset installed ready for use for any purpose.

There are two methods used to calculate the depreciating amount: (i) the prime cost (straight-line) method or (ii) the diminishing value method (straight-line rate multiplied by 200% applicable for depreciating asset held on or after 10 May 2006). A taxpayer can generally choose to use either method for each depreciating asset held. Once the taxpayer has chosen a method for a particular asset, they cannot change to another method for that particular asset. Diminishing value gives higher deductions in the early years while the prime cost method spreads the deduction evenly over the life of the asset. Depending on the business and revenue stream, taxpayers may select the diminishing value method as it gives the deductions earlier. However, in some particular cases e.g. making tax loss, some may prefer the prime cost method to reserve more capital allowance deduction into later years to match with taxable income.

Certain taxpayers can also be qualified for capital allowance accelerated depreciation concessions for businesses. Specifically, taxpayers who are carrying on business and who, together with certain connected or affiliated entities, have an aggregated turnover of less than AUD 5 billion for the year may be eligible to apply accelerated depreciation concessions for certain depreciating assets and may choose to claim a tax deduction for the full cost of an eligible depreciating asset located in Australia or principally used in Australia that is acquired from 7:30pm AEDT on 6 October 2020 and first used or installed by 30 June 2023.

Taxpayers may self-determine the effective life of certain items of depreciating assets or may choose the effective life for the asset as contained in a published determination of the Commissioner of Taxation.

Business taxpayers are able to:

- immediately deduct items that cost less than AUD 100; and
- choose to write off all items costing less than AUD 1,000 through a low-value pool at a diminishing-value rate of 37.5% per annum to the extent the asset is used for income-producing purposes.

Project pool and Blackhole expenditure provisions under Australian regulations

"Project pool" rules allow expenditures that (i) does not form part of the cost of a depreciating asset; (ii) is not deductible under another provision of the income tax law; and (iii) is directly connected with the business or project, to be deductible over the finite life of a project. Items that fall within the rules include the following:

- Amounts paid to create or upgrade community infrastructure for a community associated with the project.
- Site preparation costs for depreciating assets (except horticultural plants in certain circumstances).
- Amounts incurred for feasibility studies for a project.
- Environmental assessment costs applicable to the project.
- Amounts incurred to obtain information associated with the project.
- Amounts incurred in seeking to obtain a right to IP.
- Costs of ornamental trees or shrubs.

"Blackhole" expenditure provisions allow taxpayers not yet carrying on a business to claim specific deductions for certain start-up capital expenditure (e.g. such as costs of company incorporation or costs to raise equity) immediately when starting up a small business (ITAA 1997, Section 40-880(2A)). An immediate deduction is available to a small-medium business entity (i.e. a business with aggregated turnover of less than AUD 50 million) for a range of professional expenses (e.g. legal and accounting advice) and taxes or charges to an Australian government agency associated with starting a new business.

Special rules apply for primary producer assets, such as horticultural plants, water and land care assets, and the treatment of expenditure on research and development (R&D) and expenditure on certain Australian films.

Certain expenditure attracts an immediate 100% deduction if it relates to environmental protection activities, dealing with pollution and waste; landcare operations; exploring or prospecting for minerals, including the cost of mining rights and information acquired from an Australian government agency or government entity; mine site rehabilitation; and capital expenditure incurred by primary producers on fencing, water facilities, and fodder storage assets used to store grain and other animal feed.

A luxury car cost limit applies for depreciating the cost of certain passenger motor vehicles (AUD 64,741 cost limit for the 2022/23 income year).

Expenditure on the development of in-house software may be allocated to a 'software development pool' and written off over five years (30% in years two, three, and four, and 10% in year five). Amounts spent on acquiring computer software or the right to use it (except where the acquisition

is for developing in-house software) generally are treated as incurred on acquiring a depreciating asset, deductible over five years commencing in the year it is first used or installed ready for use.

A loss arising on the sale of a depreciating asset (depreciated value of the asset less sale consideration) is generally an allowable deduction. A gain on the sale of a depreciating asset, to the extent of depreciation recaptured, generally is taxed as ordinary income.

The cost of consumables may be either written off immediately or as used. Tax depreciation is not required to conform to book depreciation.

Land, along with most intangible assets (e.g. trademarks) are not considered as depreciating assets.

Goodwill and trademarks are not depreciating assets, and tax amortisation is not available.

Bad debts and interest expenses treatment under Australian regulations

Bad debts: A deduction for a bad debt would only be available for a taxpayer using the accruals system to report assessable income. Under Section 25-35(1) of ITAA 1997, if a debt cannot be collected, the taxpayer is entitled to a deduction for the resulting bad debt that has already been taxed as assessable income. A deduction for the bad debt is only allowable in the tax year that the debt is written off as bad. Therefore, an accounting provision for doubtful debts will not be deductible under Section 25-35 or any other provision. Four conditions must all be met for a debt to qualify as a bad debt.

- There must be an existing debt.
- The debt must be bad.
- The debt must have been written off as bad during the tax year in which the deduction is claimed.
- The debt must have been included in the taxpayer's assessable income for the tax year or earlier tax year, except in the case of money lenders.

If a bad debt that was claimed as a deduction is recouped in a subsequent tax year, the recouped amount is assessable income (ITAA 1997, Section 20-20).

For a debt to be a bad debt at the time it is written-off, it is necessary to be able to show evidence to support this conclusion. Evidence to support that a debt is bad could consist of showing that:

- the debtor has died without leaving assets
- the debtors and/or their assets cannot be traced

- attempts have been made to recover the debt which have now been abandoned
- a reasonable business would consider it unlikely to be paid and not merely doubtful.

Interest expenses have a nexus with earning assessable income and are deductible if the funds borrowed are used to purchase an income-earning asset or to fund business or income-earning expenses. In the case of negative gearing i.e. the allowable deductions associated with an investment exceed the assessable income from that investment, the excess of deductions over assessable income can be used as a deduction against other assessable income such as wages. Section 25-25 of ITAA 1997 also allows for a deduction for expenditure 'incurred in borrowing money' where the money is used by the taxpayer for the purpose of producing assessable income. Expenses eligible for a deduction under Section 25-25 are deducted over five years or the length of the loan if it is less than five years.

The law allows companies to claim a deduction for interest expenses incurred in relation to offshore investments that generate non-assessable, non-exempt dividend income.

Thin capitalisation and hybrid mismatch rules also affect the deductibility of interest expenses, which will be discussed separately in this research.

Treatment of other significant items under Australian regulations

Charitable contributions: Charitable contributions are generally deductible where they are made to entities that are specifically named in the tax law or endorsed by the Commissioner of Taxation as 'deductible gift recipients'. However, deductions for such gifts cannot generate tax losses. That is, generally the deduction is limited to the amount of assessable income remaining after deducting from the assessable income for the year all other deductions.

Entertainment: Subject to limited exceptions, deductions are denied for expenditure on 'entertainment', which broadly is defined as entertainment by way of food, drink, or recreation, and accommodation or travel to do with providing such entertainment. As a general rule, an income tax deduction is available for the cost of providing entertainment that is a fringe benefit (i.e. provided to employees).

Fines and penalties: Fines and penalties imposed under any Australian and foreign law are generally not deductible. This includes fines and penalties imposed in relation to both civil and criminal matters.

A deduction may be claimed for General Interest Charge (GIC) and Shortfall Interest Charge (SIC), which are imposed for failure to pay an outstanding tax debt within the required timeframe or where a tax shortfall arises under an amended assessment, in the year in which the notice of assessment is issued (ITAA 1997, Section 25-5(1)).

Taxes: In general, GST input tax credits, GST, and adjustments under the GST law are disregarded for income tax purposes. Other taxes, including property, payroll, as well as other business taxes (excluding income tax and the Diverted Profits Tax) are deductible to the extent they are incurred in producing assessable income or necessarily incurred in carrying on a business for this purpose, and are not of a capital or private nature.

Other significant items: Where expenditure for services is incurred in advance, deductibility of that expenditure generally will be prorated over the period during which the services will be provided, up to a maximum of ten years.

Other expenses that are specifically deductible include:

- the expense of managing the taxpayer's income tax affairs (ITAA 1997, Section 25-5)
- preparation of leases used in earning assessable income (ITAA 1997, Section 25-20)
- expenses in connection with the discharge of a mortgage given as security for a loan repayment, which is solely for the purpose of producing assessable income. Where the mortgage was used partly to earn assessable income, a part deduction is available (ITAA 1997, Section 25-30)
- transport expenses incurred for travel between workplaces where assessable income is earned in both workplaces and one of the places is not the taxpayer's main residence (ITAA 1997, Section 25-100)
- capital expenditure to terminate a lease or a licence, if incurred in the course of carrying on/cessation of a business (ITAA 1997, Section 25-110)
- employer contributions to a complying superannuation fund on behalf of employees (ITAA 1997, Section 290-60)
- employee contributions to a complying superannuation fund where the employee notifies the superannuation fund that it is deductible (ITAA 1997, ss. 290-150, 290-170)
- payments for membership of a trade, business or professional association (up to $42 for each association) (ITAA 1997, Section 25-55). The balance may be deductible under Section 8-1 of ITAA 1997

- charitable donations to nominated funds or institutions (minimum of $2) (ITAA 1997, Subdivision 30-A).

Italy

Italian Tax Law generally provides that costs are allowed for tax deduction only when their actual occurrence is certain. The concept of certainty should primarily be regarded under a legal perspective and could be understood as the occurrence of a legal obligation to pay a determined amount of money. Based on the above, provisions for risks are, in line of such principle, non tax deductible and give rise to timing differences between the Statutory Financial Statements results and the taxable income. Provisions accounted for in previous financial statements become deductible in the fiscal year in which they are considered certain and objectively determinable.

The below contains some of the main allowable deduction to business income for tax purposes

Depreciation and amortisation under Italian regulations

Depreciation of fixed assets used for the business purpose of the company are deductible for Italian business income tax purposes for both IRES and IRAP strictly on a straight-line basis without the option of reducing balance as offered under Australian regulations. Such principle is also observed in few European countries such as Austria or Greece. In this case, depreciation is allowed from the tax period in which the fixed asset is first used.

The maximum depreciation rates for fixed tangible assets for IRES purpose are stipulated in relevant Ministerial Decree. The depreciation rates vary depending on the type of asset and on the economic sector of taxpayer, which also will not exceed half of the normal rates for the first tax depreciation period. In case depreciation for accounting purpose of a company exceeds the amounts that are deductible for tax purpose, adjustment for temporary differences will be made in calculation of taxable income.

Over the years, a number of new measures are introduced in the form of deductions and tax credits to support certain economic areas, for example, to facilitate business investments by allowing an extra-amortisation on the purchase of certain tangible assets.

Among such measures are the so-called super-depreciation (superammortamento) and hyper-depreciation (iperammortamento) as first introduced in the 2016 Stability Law and the 2017 Budget Law respectively, and subsequently extended until 2019-2020. The super-depreciation and

the hyper-depreciation measures aim at facilitating business investments by allowing an extra depreciation on the purchase of certain tangible assets, in order to stimulate the renewal of capital goods.[16]

Super-depreciation: the increased depreciation charge is fixed at 30% and is applicable in relation to purchases (except for real estate assets, pipelines, airplanes, company cars) realised from 1 January 2018 to 31 December 2018. The purchase period is extended up to 30 June 2019, on condition that purchase orders have been accepted by the seller by 31 December 2018 and that at least 20% of their price has been paid by the same date. In relation to purchases realised up to 30 June 2018, the increased amortisation charge is fixed at 40% if purchase orders have been accepted by the seller by 31 December 2017 and at least 20% of their price has been paid by the same date. The extra 40% depreciation deduction also will be extended to apply to new intangible assets (i.e. software, systems, platforms, etc.) related to the technological transformation mentioned below (the “Industry 4.0” plan).

Hyper-depreciation: The depreciation charges are increased up to 150% of their value (i.e. total tax depreciation of up to 250% of the cost) for some listed equipment which is allowed to benefit from specific digital and technological transformation processes under the model promoted by the Italian Government’s “Industry 4.0” plan (relating to plant, equipment and machinery whose operations are digitally controlled and/or operated by smart sensors and drives interconnected with a factory’s computer systems). This benefit is applicable to purchases realised from 1 January 2017 to 31 December 2018. The purchase period is extended up to 31 December 2019, on condition that purchase orders have been accepted by the seller by 31 December 2018 and that at least 20% of their price has been paid by the same date.

Instead of extending these measures, the 2020 Budget Law replaced them with a new tax credit for expenditure in new capital goods, covering all businesses and addressing certain investments. The credit is granted at a rate that is different according to the type of goods being invested. It covers investment in new capital goods, including intangible assets for technological transformation according to the Industry 4.0 model. The Rilancio Decree (Decree-Law No 34 of 2020), issued as part of the measures to deal with the economic and health emergency, extended from 30 June to 31 December 2020 the final date for the effectiveness of the so-called super-

[16] https://www.agenziaentrate.gov.it/portale/web/english/nse/invest-in-italy/super-amortization-and-hyper-amortization

depreciation (that lets enterprises increase by 30% the cost of acquisition of new equipment). The 2020 Budget Law extended to 2020 the benefit of the tax credit for training expenditure in the field of technology 4.0, with a revised annual limit.

Similar to Australia, under Italian business income tax regulations, land is not considered as a depreciable asset, partly since is not considered to be subject to wear over time.

Amortisation of goodwill derived from an asset deal and amortisation of trademarks are deductible for an amount not exceeding 1/18 of the cost in any year. Patents, know-how, and other intellectual property may be amortised over a two-year period.

For IRAP purposes only, depreciation and amortisation (other than as related to goodwill and trademarks) are deductible in accordance with the amounts reported in the financial statements, regardless of the limits outlined above.

Bad debts and interest expenses treatment under Australian regulations

Bad debts: Yearly provision for bad debts not guaranteed by third parties and relating to sales of goods and services is tax deductible at up to 0.5% of the receivables gross value. Deduction shall no longer be permitted when the total amount of the bad debts reserve exceeds 5% of the above-mentioned gross value of the receivables as of the end of the fiscal year.

Regardless of the above, losses on bad debts shall be deductible if supported by precise and objective elements or, in any case, if the debtor is subject to bankruptcy proceedings, including foreign ones.

Specific rules apply to small credits. In particular, a loss on a bad debt can be deducted for IRES purposes when the following conditions jointly apply:

- The term for payment has elapsed by six months.
- The receivable has a determined threshold. In particular, the item is up to €2,500 for small companies and up to €5,000 for big corporations (with turnover over €100 million).

The loss is tax deductible, regardless of the amount, when the collection right is prescribed.

Moreover, losses are tax deductible in case of derecognition of bad debts applied in compliance with accounting standards (both Italian GAAP and IFRS), always provided the inherence test is met.

Interest expense is generally fully tax deductible up to the amount of interest income. Thereafter, excess interest expense is deductible at up to 30% of the gross operating margin (interest deduction capacity) relevant for tax purposes. Gross operating margin is defined as the difference between operating revenues and expenses excluding depreciation of tangible and intangible assets and charges for leased assets based on their tax value.

Net interest expense in excess of the yearly limitation is carried forward in the following fiscal years. Hence, net interest expense not deducted in previous years can be deducted in the future fiscal years as long as total interest in that year does not exceed 30% of gross operating margin. If net interest expense is lower than the annual limit (i.e. 30% of gross operating margin), this difference can be carried over to increase the company's interest deduction capacity in the future five years.

Starting from 2019, interest income exceeding interest expenses can be carried forward to offset future interest expenses in any following financial years.

The above rule is a transposition of European Directive 2016/1164/EU. However, when transposing the ATAD, Italy chose to fully allow and not to apply the de minimis threshold of net interest expenses set out in the ATAD. However, with the latest Enabling Law introduced in August 2023, it appears that Italy aims at introducing such a de minimis threshold and possibly further amend the general interest deduction limitation rule in compliance with the ATAD.

The above-mentioned rules are not applicable for financial institutions, such as banks and insurance companies, where the deductibility of interest expense (for both IRES and IRAP purposes) is fully admitted.

Where an election is made for the domestic tax consolidation regime, the net interest expense limitation applies to the consolidated tax group. As a consequence, if a company participating in a tax group has an excess interest deduction capacity, this excess may be used against the interest deduction deficit in another company belonging to the same tax consolidation group.

Treatment of other significant items under Italian regulations

Entertainment expenses: For IRES purposes, expenses for gifts and entertainment that meet the requirements (both qualitative and quantitative) contained in the specific Ministerial Decree are fully deductible on an accrual basis i.e. in the tax period in which they are incurred. A yearly cap is introduced deducing from the rate of entertainment expenses over turnover, specifically:

- 1.3% of the turnover up to €10 million;
- 0.5% of the turnover exceeding €10 million, up to €50 million;
- 0.1% of the turnover exceeding €50 million.

Entertainment expenses related to gifts with a value that does not exceed €50 are in any case entirely deductible.

Charitable contributions: Deduction of charitable contributions is allowed. The amounts allowed for deductions depend on the specific features of the recipient entity, and specific limitations are set by the law.

Travel expenses: For IRES purposes, meals and accommodation expenses incurred by employees, which are correctly and thoroughly documented, are deductible up to a maximum daily amount. The deduction for meals and lodging expenses incurred within the municipality is limited to 75% of the amount incurred.

Car expenses: Since 2013, the deduction of costs incurred in relation to company cars is limited to the following percentages:

- 20% for cars that are not assigned to employees or are granted to employees solely for business use.
- 70% for cars granted to employees for both business and private purposes.

Car costs may be entirely deducted if (i) automobiles are absolutely necessary for the company's business or (ii) automobiles are an essential element in the company's activity (i.e. vehicles owned by a car rental company).

Telephone expenses: For IRES purposes, up to 80% of the total expenses related to both mobile and landline telephones are deductible.

Fines and penalties: Fines and penalties are generally not considered inherent costs to the business activity and are thus not deductible for tax purposes.

Allowance for corporate equity (ACE) deduction

The ACE originated in the 1970s with the Meade Committee's proposed alternatives to the UK tax system. The ACE builds on the existing corporate tax system with one small but important change. It introduces a notional deduction for the cost of equity finance. In doing so, a revenue neutral ACE can address two of the main economic distortions created by the current corporate tax system:

on investment decisions (whether to invest and how much to invest); and financing decisions (whether to finance corporate activity with debt or with equity).

In Italy, the ACE is a deduction from IRES taxable basis that corresponds to the net increase in the equity employed in the entity, multiplied by a rate yearly determined by the Italian Ministry of Finance. This rate varies through the tax years, being 4% for FY 2014, 4.5% for FY 2015, 4.75% for FY 2016 and 1.3% from FY 2019.

The relevant increases are determined by the equity contributions, the coverage of losses, and the retained earnings (with the exception of profits allocated to a non-disposable reserve). The relevant decreases are reductions of the net equity with assignment to shareholders, including, in particular, dividend distribution. To calculate the equity increase, the equity disclosed in the Statutory Financial Statements for the fiscal year 2010 is used, net of the profits for the same year. For ACE purposes the capital contributions are relevant from the date of payment and retained earnings are relevant from the beginning of the year when the related reserves are appropriated.

If the allowance for a year is higher than the net IRES taxable base, the difference will be carried forward to the next fiscal period.

The Law Decree no. 73/2021 (the so-called '*Sostegni Bis Decree*') introduced a measure aimed to strengthen the ACE benefit for the tax period 2021 only. The actual rate of 1.3% has been increased to 15% for up to €5 million of the 2021 net equity increases.

Taxes: The following IRAP items are deductible in determining the IRES taxable base:

- 10% of IRAP paid during the year.
- An amount determined on the IRAP paid on the cost of employees, net of relevant deductions.

Property tax (Imposta Municipale Unica – IMU) is deductible for IRES purposes up to 100% of the amount paid in FY 2022 and in the following fiscal years. Previously it was deductible up to:

- 50% of the amount paid in FY 2019.
- 60% of the amount paid in FY 2020 and FY 2021.

Deduction for IRAP calculation purpose under Italian regulations

Provisions for liabilities and risks, as well as extraordinary items, cannot be taken into account when determining the IRAP taxable base. In addition to the non-deductible items mentioned above,

interest income and expense and provisions for bad debts are excluded for the purposes of the IRAP taxable base.

For banks, the IRAP taxable base is broadly defined as follows:

- Intermediation margin reduced by 50% of dividends.
- 90% of amortisation costs relating to fixed tangible and intangible assets.
- 90% of other administrative expenses.
- Net value of adjustments and reassessments for bad debts.
- Special rules apply to financial institutions, other than banks, and holding companies.

Companies with facilities in different regions must allocate their overall taxable base to the different regions on the basis of the employment costs of personnel located at the various sites. Facilities become relevant to the calculation of IRAP if they have been established for more than three months. Italian companies with PEs abroad, as well as shipping companies qualifying for the tonnage tax regime, are not subject to IRAP on the income earned through these PEs.

The deduction of labour costs for IRAP purposes depends on the type of hiring contract. In particular:

- Full deduction for costs related to employees hired with an open-ended contract.
- Deduction limited to contributions for compulsory insurance against accidents (i.e. Istituto Nazionale Infortuni sul Lavoro) for temporary employees.

2.6. Net operating losses

In general, both Australia and Italy allow for tax losses to be carried forward indefinitely. In Italy's case, tax losses can only be offset with taxable income for an amount not exceeding 80% of the taxable income, while there is no such provision under Australian regulations. Loss carryback measure may be applicable to some cases of Australian companies, while such a measure is currently not provided in Italian business income tax regulations.

Australia

Losses may be carried forward indefinitely, subject to compliance with tests of continuity of more than 50% of ultimate voting, dividends, and capital rights or compliance with a same business test or similar business test (the latter only applicable to losses incurred in income years from 1 July 2015).

Section 36-15 of ITAA 1997 provides that a tax loss shall be deductible in a later tax year where:

- The taxpayer has not derived exempt income and the total assessable income exceeds the total deductions including carry forward losses
- There is net exempt income and the current years assessable income is greater than deductions (i.e. net assessable income), carry-forward losses are first offset against net exempt income, and then any remaining loss is deduced from net assessable income for the current year
- There is net exempt income and for the current year total deductions exceed assessable income (i.e. there is a tax loss), the current year loss is first deducted from net exempt income and then carry forward losses are deducted from any net exempt income that remains. Where there are two or more tax losses, the losses are taken into account in the order in which they were incurred (s. 36-15(5)).

Section 165-10 of ITAA 1997 provides that for a company to claim a deduction for a tax/capital loss, it must satisfy either the continuity of ownership test or the business continuity test. Companies are generally able to choose the amount of prior year tax loss they wish to deduct in a later tax year (ITAA 1997, Section 36-17) with some restrictions applied.

A temporary loss carryback measure applies to companies with an aggregated turnover of less than AUD 5 billion in the form of a refundable tax offset (i.e. cash back), subject to satisfying certain conditions. Tax losses incurred in the 2019/20, 2020/21, 2021/22, and/or 2022/23 income years are eligible for the loss carryback for offset against taxed profits from the 2018/19 or later income years only.

Italy

Tax losses can be carried forward for IRES purposes and used to offset income in the following tax periods without any time limitation, similar to that applied in Australia.

Tax losses can only be offset with taxable income for an amount not exceeding 80% of the taxable income. Thus, corporations are required to pay IRES on at least 20% of taxable income.

Losses arising in the first three years of activity can be offset with 100% of taxable income.

In Italy, tax losses may not be carried back. Specifically, for IRAP purposes, tax losses may not be carried forward.

2.7. Tax rates and incentives

Unlike developing countries where elaborate tax incentive schemes can be in the form of incentivised tax rates, both Australia and Italy, as mature tax regimes, possess a straightforward scheme of business income tax rates. The business income tax rate in Italy (24% for IRES and around 3.9% for IRAP) is generally lower than Australia in the recent years, whose standard rate is 30%. The effective tax rate in Australia is also higher than that in Italy, being 28.5% and 21.3% respectively as estimated in 2021[17]. Australia has a reduced tax rate specialised for qualified small and medium companies while no such scheme is currently available in Italy, where small and medium companies already account for a significant portion of the economy.

Apart from tax rate, each country may provide certain business income tax-related incentives, which are considered as reflection of the country's fiscal policy. Australia currently offers incentives focusing on a number of business sectors representing its core strength and those it wants to encourage, such as petroleum, minerals, shipping, digital games, early stage investment, venture capital, and R&D activities. Italy, on the other hand, offers tax credit for reorganisations, technological and digital innovation and ecological transition, R&D, analog and digital daily press and magazines.

Tax collection in both countries may experience further changes brought about by the impact of global minimum tax under OECD's Pillar 2, details of which will be discussed in Chapter 3.

Australia

All companies are subject to a federal tax rate of 30% on their taxable income.

Small or medium companies are subject to a reduced tax rate of 25%, which applies to those that together with certain connected entities, fall below the aggregated turnover threshold of AUD 50 million. A company will not qualify for the reduced rate unless the specifically defined passive income (including, among other things, interest, rents, and net capital gains) that it derives represents no more than 80% of its total assessable income for the year.

Australia currently offers certain incentives for innovation which are available for eligible early stage investors and venture capital investors. Other industry specific incentives are also provided

[17] https://stats.oecd.org/ Effective Tax Rates

to sectors that the government wishes to promote or maintain such as petroleum, minerals, shipping, digital games.

Italy

The standard rates are currently as follows:

- 24% for IRES (Up to FY 2016, the IRES rate was 27.5%). Specific rules apply for bank and financial entities.
- 3.9% for IRAP. Different IRAP rates are applicable for certain entities (i.e. banks and financial entities, insurance corporations, entities with a determined governmental exclusive right to provide services). Regions have the power to slightly increase or decrease IRAP rates up to 0.92%.

Of note, in August 2023, the new Enabling Law was passed which introduce a dual corporate income tax system aimed at attracting investments in Italy and boosting the capitalisation of Italian businesses.

Under this proposed measure, a reduced corporate income tax will apply to companies' profits if both of the following conditions are met within two years from the end of year in which they were generated:

- A sum corresponding, in whole or in part, to company profits is used for qualifying investments, new hires or stable employee profit-sharing schemes.
- The profits are not distributed or used for purposes other than the exercise of the companies' business.

It is expected that Italian tax incentive regimes will be revised and simplified in accordance with the above-mentioned dual income tax system. This could potentially create a switch from a tax incentive system mainly based on tax credits and extra deductions to a new system mainly based on a reduced corporate income tax rate (or alternatives incentives) rewarding companies that will follow qualifying behaviors.

In terms of tax incentives, some are currently offered in line with the Industry 4.0 national strategy, innovative companies as well as R&D. This represents the policy that Italian government focuses on building around restructuring and stirring innovation.

2.8. Tax administration

Both Australian and Italy adopt electronic filing and self-assessment system coupled with post-filing audit where the statute of limitations are often in the range of five to seven years.

From a compliance perspective, both countries (i) provide flexible policy in terms of tax year end, with longer filing deadline applied in Italy in comparison with Australia and (ii) a tax instalment payment regime in order to spread out the tax collection revenue more evenly.

Australia initiated the cooperative compliance regime in 2001, from which example the relevant model has been adopted to other countries, including Italy 15 years later. The introduction of the Enabling Law in August 2023 highlights an attempt of Italy to reform its tax system including the administrative aspect, although the actual impact is still in the future.

Australia

Tax returns

A corporation files a tax return under a self-assessment system. Where it is in doubt with regards to the tax liability of a specific item, it is eligible to consult with the ATO and obtain a binding private ruling.

Taxable period

The Australian tax year runs from 1 July to 30 June. A company, however, may apply to adopt a substitute year of income, for example, 1 January to 31 December. Generally, the tax return for a corporation is due to be filed with the ATO by the 15th day of the seventh month following the end of the relevant income year or a later date if allowed by the Commissioner of Taxation. Additional time may apply where the tax return is lodged/filed by a registered tax agent.

Payment of tax

A Pay as you go (PAYG) instalment system applies to companies (other than those whose annual tax is less than AUD 8,000 that are not registered for GST). Most companies are obligated to pay instalments of tax for their current income year on a monthly or quarterly basis. All companies with turnover of AUD 20 million or more pay instalments on a monthly basis. Instalments are calculated by applying an instalment rate to the amount of the company's actual ordinary income (ignoring deductions) for the previous quarter. The instalment rate is notified to the taxpayer by the ATO and determined by reference to the tax payable for the most recent assessment. The ATO

may notify a new rate during the year on which subsequent instalments must be based. Taxpayers can determine their own instalment rate, but there may be penalty tax if the taxpayer's rate is less than 85% of the rate that should have been selected.

Final assessed tax is payable on the first day of the sixth month following the end of that income year or a later date if permitted by the Commissioner of Taxation via published notice.

Statute of limitations

From the end of the 1980s, Australia changed to a self-assessment tax system, which places a greater responsibility on taxpayers to assess their own tax liabilities and obligations correctly. Self-assessment system means the ATO would accept an income tax return submitted without detailed scrutiny.

An assessment is deemed to have been given to the company on the day on which it lodges its tax return. A taxpayer's final tax liability however is open for assessment until the relevant review period has lapsed. The statute of limitations in Australia in the case of business income tax assessment ranges from two to seven years. Generally, the Commissioner of Taxation may amend an assessment within four years after the day of which an assessment is given to a company. The four-year time limit does not apply where the Commissioner is of the opinion there has been fraud or evasion, or to give effect to a decision on a review or appeal, or as a result of an objection made by the company, or pending a review or appeal. For certain small business entities and, for assessments for income years commencing on or after 1 July 2021, medium business entities (i.e. those with aggregated turnover of between AUD 10 million and AUD 50 million), a two-year amendment period generally applies. A seven-year period of review applies to an assessment to give effect to a transfer pricing adjustment raised for an income year commencing on or after 29 June 2013.

The penalty system is split into two, composing of (i) actual administrative and criminal penalties and (ii) a system of interest charges on unpaid or late tax payments. Accordingly, Part 4-25 of Schedule 1 of the TAA imposes administrative and criminal penalties, and penalty interest on taxpayers who fail to meet their tax obligations. Other penalties are imposed by the Crimes Act 1914 and related legislation.

Italy

Tax returns

As a general rule, IRES and IRAP returns must be filed by the end of the 11th month following the tax year-end. Due to the COVID-19 emergency, the deadlines for tax periods 2016, 2017, 2018, and 2019 will be extended by 85 days.

Taxable period

The ordinary taxable period is equal to 12 months. Conformity with the calendar year is not requested. In particular cases, the duration of the taxable period can be different from 12 months (e.g. newly established companies may be allowed to have taxable periods of up to 18 months; companies that are involved in extraordinary transactions e.g. merger, de-mergers, as well as companies that are liquidated, may have taxable periods shorter than 12 months).

Payment of taxes

For IRES and IRAP purposes, the tax law provides for both advance payments and settlement payments. As a general rule, the advance payments are equal to the net tax liability for the previous tax period and are due during the tax period to which they refer. The advance payments due are equal to 100%.

Corporate income tax is normally paid as follows:

- A first advance payment of the IRES due for the current fiscal year must be paid at the same time as the balance due for the previous fiscal year (i.e. the last day of the sixth month following the end of the previous year) and is equal to 40% of the tax due for the previous fiscal year
- A second advance payment of the IRES due for the current fiscal year must be paid by the last day of the eleventh month following the end of the previous fiscal year and is equal to 60% of the tax due for the previous fiscal year
- The balance (if any) must be paid by the last day of the sixth month following the end of the fiscal year.

Tax payments should be performed through a specific form to be electronically filed to the tax authorities.

Statute of limitations

The Italian tax authorities are entitled to make an assessment in relation to corporate taxes (IRES and IRAP), VAT, and WHT returns up to:

- the end of the fifth calendar year following the year in which the tax return was filed (previously up to the end of the fourth calendar year), or
- the end of the seventh calendar year following the year in which the tax return would have been filed, for an omitted return (previously up to the end of the fifth calendar year).

Cooperative compliance regime

Co-operative compliance is an extension of a risk-based approach to tax compliance. It can be described as a voluntarily enhanced relationship between a revenue body and business taxpayers based upon mutual increased transparency, cooperation and collaboration.

Australia was the first country to introduce a formal co-operative compliance model in 2001.

The Italian government introduced into the domestic tax system a cooperative compliance regime (so-called Adempimento Collaborativo) by Legislative Decree 128/2015 in order to promote cooperation between the tax administration and taxpayers.

The regime can be accessed by qualified taxpayers, including:

- Resident and non-resident entities having a permanent establishment in Italy with a total turnover or operating revenues exceeding €5 billion (or €1 billion for 2022, 2023, and 2024);
- Resident and non-resident entities having a permanent establishment in Italy with a total turnover or operating revenues equal to at least €1 billion, which applied for the pilot project launched in 2013;
- Entities granting execution to the opinion of the Italian Revenue Agency in response to the advance ruling on new investments, notwithstanding threshold of turnover or revenues;

Eligible taxpayers are required to implement an effective Tax Control Framework compliant with the OECD guidelines with the following features:

- A clear attribution of roles and responsibilities implemented according to the best corporate governance practices at the national and international level.
- An organisational model containing effective procedures for the detection, measurement, management, and control of tax risks ensuring compliance with all company levels.
- Effective procedures aimed at remedying any deficiencies found with consequent activation of corrective actions.

In order to be admitted to the program, taxpayers should file with the Italian tax authorities an application using the model named Participation to the cooperative compliance regime. After the submission of the application, the preliminary investigation of the tax authorities begins, aimed at verifying the existence of subjective requirements. The assessment process is defined within a term of 120 days from the receipt of the submission of the application.

Admission to the cooperative compliance regime allows taxpayers to benefit from several advantages, such as:

- Continuous cooperation with the tax administration based on trust and transparency (e.g. fast track rulings).
- Tax penalties reduced by 50% and, in any case, applied to an amount not exceeding the minimum provided by law.
- Exemption from the guarantees required to obtain refunds of direct and indirect taxes.

With the Enabling Law passed in August 2023, an aim was set to review the tax audit and seeking ruling process as well as simplifying tax reporting obligations. Impacts of such Enabling Law are still to be assessed as and when the relevant tax regulations are amended.

CHAPTER III: COMPARATIVE ANALYSIS REGARDING RECENT CHANGES IN ITALIAN AND AUSTRALIAN BUSINESS INCOME TAX REGULATIONS

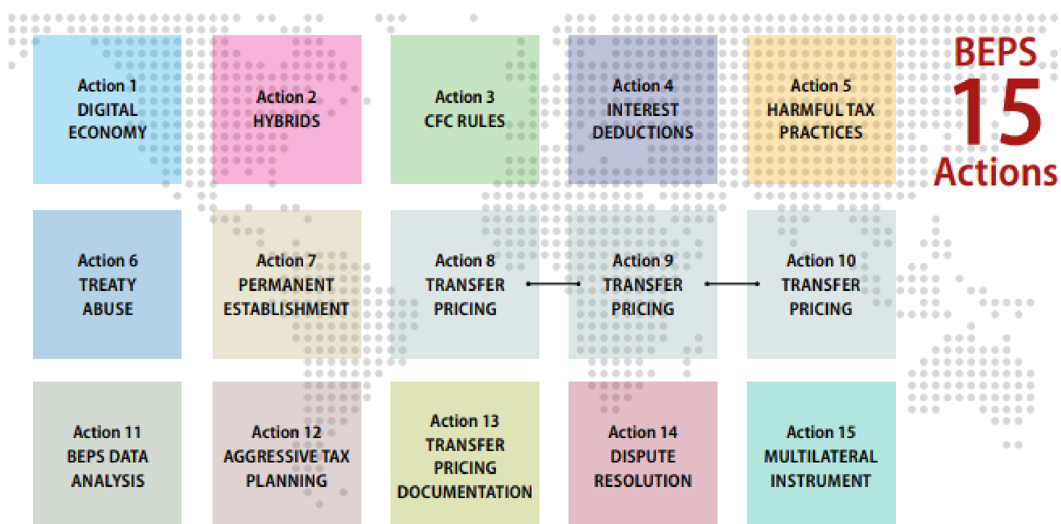
Globalisation, the integration of economies and digitalisation in recent years has been putting a strain on the domestic and international tax rules, which were designed up to a century ago. Weaknesses in the current rules enable opportunities for base erosion and profit shifting, especially in big corporates. This requires countries to take action and reform its tax system where necessary. This chapter focuses on discussing how international context (e.g. OECD's BEPS action plan, COVID-19 or the rise of digitalisation) has been affecting and navigating recent changes in Italian and Australian business income tax regulations.

3.1. Impact of OECD's BEPS action plan

Throughout its history, with its aims to (i) achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability; (ii) contribute to sound economic expansion in Member as well as non-member countries; and (iii) contribute to the expansion of world trade, the OECD has played a central role in supporting international dialogue and exchange on tax policy.

One of the critical issues that OECD is helping to tackle is base erosion and profit shifting (BEPS), which refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity or to erode tax bases through deductible payments such as interest or royalties. EPS practices are estimated to cost countries USD100 to 240 billion in lost revenue annually, equivalent to 4 to 10% of global corporate income tax revenue. Although some of the schemes used are illegal, most are not. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

Working together within OECD/G20 Inclusive Framework on BEPS, over 135 countries and jurisdictions are collaborating on the implementation of 15 measures (Actions) to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment (BEPS package). Such 15 Actions are summarised in the below graph.



Source: OECD's website

The next sections discuss how a number of Actions, specifically Action 15 – Multilateral Instrument, Action 3 – CFC rules and Action 2 – Hybrids, have been driving the recent changes in Australian and Italian business income tax regulations.

3.1.1. Multilateral instrument

As part of the OECD/G20 BEPS project, in June 2017, 76 countries and jurisdictions signed or formally expressed their intention to sign the Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS, also known as the Multilateral Instrument (MLI). MLI is a multilateral treaty that enables jurisdictions to swiftly modify the operation of their tax treaties to implement measures designed to better address multinational tax avoidance, close loopholes in existing tax treaties and resolve tax disputes more effectively.

How the MLI works

Jurisdictions that sign the MLI are required to identify which of their tax treaties they want the MLI to apply to and modify. The tax treaties which are covered by the MLI are called Covered Tax Agreements (CTAs).

For a bilateral tax treaty to be modified by the MLI, both treaty partners need to have:

- signed and ratified the MLI (i.e. the MLI needs to have entered into force for both treaty partners); and

- identified that particular bilateral tax treaty as a treaty to be covered by the MLI. That means in the event that only one jurisdiction (or neither jurisdiction) identifies a tax treaty as a CTA, the provisions of that treaty will remain un-modified.

The MLI incorporates flexibility that allows jurisdictions to tailor their adoption to fit their particular national circumstances and accommodate unique aspects of their treaty network.

Each jurisdiction is required to notify the OECD Secretariat of its set of provisional choices (referred to as that jurisdiction's MLI position) at the time of signature (of the MLI), and confirm them at the time of ratification.

Main features of the MLI

While some MLI articles are mandatory (minimum standards), most are optional. Jurisdictions can choose to adopt the minimum standards only, or they can choose to also adopt some, or all, of the optional articles. If there is a bilateral match, the MLI will modify, but not directly amend, nominated tax treaty clauses. Other unrelated parts of the treaties will remain unchanged. That means the extent to which the MLI will modify on country's bilateral tax treaties will depend on the final adoption positions taken by the counter partner country.

Main features of the MLI are as summarised in Appendix I.

Australia and Italy are among the first signatory countries to this convention in 2017. Nevertheless, the ratification and implementation process since then vary among the two countries as summarised below. While Australia has less extensive network of DTT, it has taken more effort in ratifying MLI in comparison to Italy, process of which has been held back as of date.

	Australia	Italy
BEPS MLI Signature	07/06/2017	07/06/2017
BEPS MLI Ratification	26/09/2018	-
BEPS MLI Entry into Force	01/01/2019	-
Status of List	Definitive	Provisional

Source: OECD's website

Australia

Australia currently has 45 tax agreements in force. After being signed on 7 June 2017, the MLI was given the force of law in Australia by the Treasury Laws Amendment (OECD Multilateral

Instrument) Act 2018. It subsequently received Royal Assent on 24 August 2018 and the instrument of ratification was deposited with the OECD Depositary on 26 September 2018 accordingly.

The MLI entered into force for Australia on 1 January 2019. The date of entry into effect for Australia for each of Australia's tax treaties modified by the MLI depends on the actions of the treaty partner jurisdiction, specifically when the MLI has been ratified, accepted or approved for the treaty partner's domestic purposes and when the relevant notifications have been lodged with the OECD.

Based on current MLI positions or jurisdictions that have not signed the MLI, treaties not modified by the MLI for Australia's case include those with Austria, Germany, Israel, Kiribati, Philippines, Sri Lanka, Sweden, Switzerland, Taiwan, and the United States.

Italy

Italy has an extensive tax treaty network with around 103 treaties in force[18], only four of which currently comply with the minimum standard. With the signing of the Multilateral Instrument, Italy's listed agreements under the MLI will start to be compliant after Italy's ratification of the MLI. In comparison with other EU countries and Australia, Italy is not as active in implementing the convention. Noteworthily:

- For the time being, Italy has included in the CTA list only jurisdictions being members of the Ad Hoc Group on MLI at the date of the signature of MLI by Italy. As a result, its agreements with Albania, Congo, Montenegro, North Macedonia, Oman, Panama and Trinidad and Tobago has not been listed and thus will not be modified by the MLI until further action is made. According to the Third Peer Review Report on Treaty Shopping - Inclusive Framework on BEPS: Action 6 released by OECD[19] in March 2021, jurisdictions that have not signed or ratified the MLI have still generally made no or very little progress in implementing the minimum standard. As of March 2023, the fifth edition of such report acknowledged that Italy has plan to expand list of CTA.

[18] https://www.finanze.gov.it/it/Fiscalita-dellUnione-europea-e-internazionale/convenzioni-e-accordi/convenzioni-per-evitare-le-doppie-imposizioni/
[19] https://www.oecd-ilibrary.org/taxation/prevention-of-tax-treaty-abuse-third-peer-review-report-on-treaty-shopping_d6cecbb8-en

- As of August 2023, Italy has not ratified the Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS. Italy indicated in its response to the Peer Review questionnaire that steps have been taken (other than under the MLI) to implement the minimum standard in its agreements with Brazil, Norway and Uzbekistan. The foreseeable date of ratifying the MLI is yet unknown.
- For its agreements listed under the MLI, Italy is implementing the preamble statement (Article 6 of the MLI) and the PPT (Article 7 of the MLI). Italy has made a reservation pursuant to Article 7(15)(b) of the MLI not to apply Article 7(1) of the MLI with respect to agreements that already contain a PPT (covering thirteen agreements). Once ratified, Italy will have adopted the minimum provisions of the MLI as well as Article 9 (capital gains), Article 13 (artificial avoidance of permanent establishment status, option A) and Articles 18-26 (arbitration).

3.1.2. Controlled Foreign Company (CFC) rules

CFC rules are measures in response to the risk that taxpayers can strip the tax base of their country of residence and by shifting income into a foreign company that is controlled by the taxpayers. In essence, they require some or all of the foreign company's applicable profits to be included in the income of the resident shareholder, and thus in effect protecting the tax base of the source country and discouraging investments that erode its tax base or that are designed to shift profit to low-tax jurisdictions. In other words, they can be viewed as a category of anti-avoidance rules, or an extension of the tax base, targeted at tax shareholders with passive or highly mobile income derived by non-resident companies in circumstances where, in the absence of such rules, that income would otherwise have been exempt from taxation (e.g. under a territorial system) or only taxed on repatriation (e.g. under a worldwide tax system with a deferral regime).

CFC rules were first enacted in 1962 and the number of jurisdictions implementing these rules has increased since then. However, CFC rules vary substantially among the countries in approach. With the fast-moving international business environment and digitalisation, existing CFC rules are often out-paced, with many of them starting to show design features that hinder effective tackling against base erosion and profit shifting risks (e.g. in the case of U.S. technology companies).

In response to the challenges faced by existing CFC rules, the BEPS Action Plan called for the development of recommendations regarding the design of CFC rules. The OECD 2015 Action 3 report set out recommendations in the form of building blocks for the design of effective CFC

rules, which include the definition of a CFC, exemptions and thresholds, approaches for determining the type of income subject to the rule, computation of CFC income, the attribution of CFC income to shareholders and measures to eliminate the risk of double taxation. These recommendations are not minimum standards, but are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from inappropriately shifting income into foreign subsidiaries.

Both Australia and Italy has long introduced CFC rules in its domestic regulations before the advent of Action 3. Following the adoption of European Directive 2016/1164/EU, Italy has updated its CFC rules accordingly. Meanwhile, Australian CFC rules are considered to be stronger than the OECD standards. As a result, no further significant update has been made to Australian CFC regulations in light of Action 3.

Australia

Under Australia's CFC rules, non-active income of foreign companies controlled by Australian residents (determined by reference to voting rights and dividend and capital entitlements) may be attributed to those residents under rules that distinguish between company resident in 'listed countries' (e.g. Canada, France, Germany, Japan, New Zealand, the United Kingdom, and the United States) and in other 'unlisted' countries. In general, if the CFC is resident in an unlisted country and it fails the active income test (typically because it earns 5% or more of its income from passive or tainted sources), the CFC's tainted income (very broadly, passive income and gains, and sales and services income that has a connection with Australia) is attributable. If a CFC is resident in a listed country, a narrower range of tainted income is attributed even if the CFC fails the active income test.

When income previously taxed on attribution is repatriated, it is not assessable again for tax purpose.

The Australian CFC rules are considered to be stronger than the OECD standards, so no action is expected with regards to Action 3 report.

Italy

The CFC rule is stipulated in Article 167 of the TUIR. It regulates a transparent allocation on head of the Italian controlling company of any income generated by foreign, directly or indirectly, controlled entities located in countries that provide a nominal level of taxation lower at least by

50% with respect to the Italian one. The rule allows to disregard the application of the CFC provision if the following conditions are met (paragraph 5 of Article 167):

- the controlled entity performs an effective industrial/commercial activity on the country of establishment;
- the controlling relation does not realise the effect of de-localise income in a foreign country with a lower level of taxation.

If the controlled company is established in an EU Member State or a country part of the EES, the CFC rule activates only if:

- the effective (and no more nominal) taxation is lower for more than 50% with respect to the Italian one;
- the foreign entity realised, for more than 50%, passive income (such as income deriving from interest, royalties, dividends and income from intragroup services)

European Directive 2016/1164/EU, known as the Anti-Tax Avoidance Directive, provides a number of tools in order to fight the so called "aggressive fiscal planning schemes" which can obtain advantages exploiting the existing differences between single national tax systems. The purpose of the Directive is to remove regulatory differences existing within different national systems by adopting a common strategic approach, mandatory for each country, in order to prevent market fragmentation and to stop misalignments and distortions. The Italian Government approved the draft of the Decree through which the European Directive 2016/1164/EU will be transposed in the Italian Law system. The ultimate deadline for the implementation has been set on 31 December 2018, with effects starting from 1 January 2019.

The Decree amends the current CFC rules in order to make them more compliant with Articles 7 and 8 of ATAD. Firstly, there won't be any more difference based on the country in which the foreign entity is located (within the EU or not). In fact, the CFC treatment will trigger if both of the following requirements are met:

- The effective taxation in the foreign country of establishment of the controlled entity is lower for more than 50% with respect to the Italian one;
- The Entity realised more than one-third of its income as passive income (e.g. interest, royalties, dividends and income from intragroup services).

A safe-harbor rule is still available for non-resident entities which carry out an effective economic activity, supported by staff, equipment and physical assets.

3.1.3. Hybrid mismatch rules

Hybrid mismatch arrangements are used in aggressive tax planning to exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term taxation deferral.

These types of hybrid mismatch arrangements were widespread and resulted in a substantial erosion of the taxable bases of the jurisdictions concerned. These risks were highlighted in the context of international banking in the 2010 OECD report Addressing Tax Risks Involving Bank Losses and a subsequent review by various OECD member countries identified examples of tax planning using hybrid mismatch arrangements which led to the 2012 OECD report of Hybrid Mismatch Arrangements: Tax Policy and Compliance issues. The 2012 report identified that hybrid mismatch arrangements, in addition to their impact on tax revenues, also have an overall negative impact on competition, efficiency, transparency and fairness.

BEPS Action 2 recommendations target mismatches resulting from differences in the tax treatment of financial instruments or entities. The work on hybrid mismatches was subsequently expanded to deal with similar opportunities that arise through the use of branch structures, resulting in a 2017 OECD report Neutralising the Effects of Branch Mismatch Arrangements.

Since announcement of the Action 2 recommendations, a number of Inclusive Framework countries have rapidly adopted rules to address a comprehensive range of hybrid and branch mismatches. The United Kingdom, Australia and New Zealand have enacted legislation consistent with the common approach in Action 2. European Union Member States adopted Council Directive (EU) 2017/952 which requires hybrid and branch mismatch rules to be effective in member states no later than the beginning of 2020.

Australia

Australia has comprehensive hybrid mismatch rules that generally apply to income years beginning on or after 1 January 2019. If a mismatch arises from differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions, the law operates to neutralise the mismatch in Australia by:

- Preventing entities that are liable to income tax in Australia from being able to avoid income taxation, or obtain a double non-taxation benefit, by exploiting differences between the tax treatment of entities and instruments across different countries by disallowing a deduction or including an amount in assessable income.
- Limiting the scope of the exemption for foreign branch income and preventing a deduction from arising for payments made by an Australian branch of a foreign bank to its head office in some circumstances.
- Denying imputation benefits on franked distributions made by an Australian corporate tax entity if all or part of the distribution gives rise to a foreign income tax deduction; and preventing certain foreign equity distributions received, directly or indirectly, by an Australian corporate tax entity from being exempt if all or part of the distribution gives rise to a foreign income tax deduction.

In addition, there is an integrity rule that has the potential to impose additional Australian tax on interest and derivative payments to foreign interposed zero or low-tax rate entities, irrespective of whether the arrangement involves a hybrid element.

Italy

Legislative Decree No. 142/2018 was issued to implement the EU's anti-tax avoidance directives (ATAD) in consideration of the OECD BEPS report(s) on Action 2 (the OECD Report). ATAD provides two different levels of intervention: the primary level, that consists in the denial of the deduction of a cost / expense in one Member State. If the primary level is not applicable, the secondary level is activated, providing the compulsory inclusion as taxable income in the country of receipt. If the mismatch results in a deduction without inclusion, the deduction must be denied in the Member State of the payer.

On 26 January 2022, the Italian Tax Authorities published the final version of the interpretative Circular Letter on hybrid mismatch arrangements rules. Key topics addressed and clarified in the Circular include:

- The relevance of deductions related to a broad range of negative items of income in multiple scenarios, e.g., a deduction in a 'deduction, no inclusion' scenario can include cost of goods sold, amortisation, and depreciation.

- A grandfathering rule limited to specified transactions (i.e., transactions that involve amortisation or the use of tax losses that are due to hybrid deductions) carried out within the fiscal year that includes 28 December 2018.
- The application of reverse hybrid entity rules without any investors threshold and limitation based on the qualification of the funds.
- The application, under certain conditions, of anti-imported hybrid mismatch rules to arrangements where the payee is in an EU Member State.
- The applicability of the hybrid rules even when a taxpayer decides to neutralise the mismatch on a voluntary basis, in the absence of an anti-hybrid rule in the taxpayer's jurisdiction.

3.2. COVID-19 and mitigating measures from business income tax perspective

With the impacts of COVID-19, a number of measures have been introduced from business income tax perspective in both Australia and Italy in order to help businesses in needs and stimulate the economy. Both countries implemented temporary measures for such purposes including monetary measures and non-monetary ones (e.g. delay tax payment). Australia's measures focuses on temporary accelerated deductions, wage subsidy and loss carry back tax offset while Italy offers tax credit and partial waiver of IRAP. Italy also introduced some measures for tourism and health industry, which is also a reflection of what considered as importance in the eyes of the lawmaker.

Australia

In 2020, a series of temporary tax-related economic stimulus packages were introduced by the Federal Government to support businesses during the pandemic with the aim of stimulating economic activity. These included temporary accelerated deductions concessions for depreciating assets, which can be divided into three categories:

- instant asset write-off
- accelerated depreciation of new assets
- full expensing of eligible assets.

As part of the COVID-19 business stimulus package announced in the 2020-21 Federal Budget, eligible corporate entities can choose to claim a refundable tax offset (loss carry back tax offset) for current tax losses against tax paid in previous years. If the taxpayer chooses not to claim the loss carry back tax offset, any tax losses will be carried forward as previously discussed.

The Australian government announced on 12 March 2020 that, as part of its Economic Stimulus Package (in response to the economic impact due to the COVID-19 pandemic), the threshold for being able to immediately deduct the full cost of an income-producing asset will apply to assets that cost up to $150,000 (up from $30,000), and this will apply to businesses with turnover of up to $500 million (up from $50 million). Although the relevant legislation that enacted these changes did not receive Royal Assent till 24 March 2020, this final enacted legislation stated that the measures were to retrospectively apply from the date of the announcement of the package, 12 March 2020, notwithstanding that the legislation came into force 12 days after this.

On 30 March 2020, the Federal Government announced the introduction of the JobKeeper Payment. The JobKeeper Payment is a wage subsidy that is paid by the government to eligible businesses significantly impacted by the COVID-19. Under the scheme, eligible businesses receive gross payments per fortnight per eligible employee and/or for one eligible business participant (i.e. an eligible sole trader, partner, company director or shareholder or trust beneficiary). This payment is required to be passed on to the relevant employee in the form of salaries and wages. JobKeeper payments received by a business from the ATO are considered assessable income under either s. 6-5 of ITAA 1997 (as ordinary income) or s. 15-10 of ITAA 1997 (as a subsidy received by a business).

To assist businesses that have been impacted by COVID-19, the ATO will also not apply penalties and interest on excessive PAYG instalment variations for the 2020-21 income tax year, if a best attempt is made to estimate the end of year tax.

Italy

A number of decrees have been issued during the waves of the COVID-19, including:

- The “Liquidity Decree” (released on 8 April 2020 and converted into Law No. 40/2020) includes measures that are intended to assist businesses by providing loan guarantees, government assumption of non-market risks, and certain targeted tax relief.
- The “Relaunch Decree” (released on 19 May 2020 and converted into Law. No 77/2020) includes urgent measures to support healthcare, employment and the economy, and social policies.
- The “August Decree” (released on 14 August 2020 and converted into Law No. 126/2020) includes measures to support, inter alia, employment and economy.

- The Law Decree No. 129/2020, released on 20 October 2020, containing “Urgent provisions on tax collection”, postponed the “final” term of suspension of the collection activity previously fixed to 15 October 2020 by the “August Decree”.

The measures taken in such regulations include:

- A partial waiver of IRAP for companies and self-employed workers with revenues not exceeding €250 million in 2019 active in all sectors with some exceptions (such as banks and other financial institutions).
- 20% tax credit for recapitalisation for companies with a turnover of between €5 and €50 million, and a tax credit of 50% of capital losses (exceeding 10% of shareholders’ equity). In order to benefit from these measures, companies must have suffered a 33% drop in revenues compared to the previous year and must have approved a capital increase of at least €250,000. Companies must be up to date with their social security contributions and tax payments and as at 31 December 2019, must not fall within the category of ‘companies in difficulty’.

3.3. Taxing digital services

Digitalisation, in the recent decades, has proved to be a source of innovation, improvement of efficiency and enhancement of economy. However, the spurring and light-speed of its development poses challenges in many aspects of traditional policy making, including taxation. Upgrading the tax system and regulations to address the key challenges arising from digitalisation has therefore been a priority of many countries and international community in general, including the OECD/G20.

A race towards digital services taxation has been observed among many countries worldwide, with more than 30 governments having introduced or planning national digital services tax. This raises both unilateral cooperation and disputes among the countries.

In a more unified attempt, on 8 October 2021, Australia, along with Italy and over 130 other countries endorsed proposed international corporate tax reforms to address the challenges arising from the digitalisation of the economy. These reforms were developed by the OECD Inclusive Framework on BEPS and presented as a two-pillar solution aiming at ensuring that multinational corporations pay their fair share of tax in the jurisdictions in which they operate. In a nutshell,

Pillar One is designed to focus on nexus and profit allocation while Pillar Two is focused on a global minimum corporate tax rate of 15%.

As analysed below, in terms of digital services tax, it appears that Australia takes a more holistic approach in comparison with Italy while Italy is relatively quicker in adopting the OECD's Pillar Two. However, both countries' tax policy may start to converge as and when OECD two pillar approach is adopted.

Australia

Australia's Treasury had the intention to introduce digital services tax and has released a Discussion Paper on the digital economy and Australia's corporate tax system in 2018. However, in 2019, the Australian Government decided not to proceed with an interim digital services tax but will engage in a multilateral process with other OECD countries. Therefore, digital services tax was never officialised or took effect in Australia.

On 9 May 2023, the Australia's Treasurer announced in the 2023-24 Budget that the Australian Government will implement the OECD's Pillar Two. The Australian Taxation Office (ATO) is subsequently undertaking a targeted consultation with significant global entities and their advisors on the implementation of the OECD global anti-base erosion (GloBE) rules under Pillar Two in Australia, with a focus on potential administration issues. As to date, this measure is not yet law and new legislation will be introduced.

Italy

In terms of digital services tax, with the delays in finding a common global solution, the Italian Budget Law 2020 introduced a digital services tax for Italy itself, which replaces the "Web Tax" introduced by the Italian Budget Law 2019. Such digital services tax aims at those, individually and at group level, that have total amount of revenues equal to or exceeding €750,000,000 and an amount of revenues from digital services (arising in Italy) equal to or exceeding €5,500,000. The tax rate is equal to 3% and applies on the revenues from digital service generated on a calendar year basis, starting from 2020 with the first payment due by 16 February 2021. Subsequently, with the plan for Pillar One, Italy along with the UK, France, Spain, and Austria have released a joint statement with the US setting out an agreed transitional approach to the removal of existing digital services taxes before Pillar One comes into effect.

In terms of implementing Pillar Two, on 14 December 2022, the Directive No. 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union was adopted by the Council of the European Union, which would be transposed by EU Member States by the end of 2023. Compared with other Member States, Italy is comparatively slow in the transposition process.

In the latest development, in August 2023, the Italian Parliament has approved the so-called Enabling Law which takes effect from 29 August 2023 and provides general principles and criteria enabling the Government to implement a full reform of the Italian tax system. Apart from the objectives of reducing the tax burden of corporations and individuals, increasing the degree of legal certainty, reducing litigation, improving the relationship between tax authorities and taxpayers, and ultimately outlining a system capable of attracting foreign capital, the Enabling Law also serves as a bridge to align domestic rules to international tax principles (including Pillar Two).

CONCLUSION

In general, as members of OECD/G20, Australia and Italian business income tax legislations are in line with those of developed countries, which continue to evolve to adapt to the new challenges of digitalisation and based erosion and profit shifting.

Although both share the core framework, the key difference that set the two apart stems from the political history and structure. While Italian business income tax legislations are more rule-based, common law still plays an import role in that of Australia. Both governments use the business income tax legislations as a tool to fine tune its policies e.g. areas or sector to encourage.

On a number of fields e.g. tax administration, MLI or CFC rules, Australia seems to have taken a step ahead of Italy in terms of updating its legal framework. However, with the newly passed Enabling Law in 2023, the Italian Government also shows commitment to reform the tax system to reduce the tax burden, increase the degree of legal certainty, improve the relationship between tax authorities and taxpayers, and ultimately attract foreign capital through more transparent tax policies.

With OECD's Actions, it is interesting to see how the two countries' legislation continue to adapt to the agreed framework and whether there is a point where certain convergence can be reached.

APPENDIX I - Main features of the MLI

Article 3 - Transparent entities (optional article)

Treaty benefits will be granted for income derived through fiscally transparent entities, such as partnerships or trusts, but only where one of the two countries treats the income as income of one of its residents under its domestic law. These rules will not prevent either country from taxing its own residents.

Article 4 - Dual resident entities (optional article)

Most treaties use an entity's place of effective management as the key tiebreaker test to determine a dual resident's country of tax residence for treaty purposes. This test will be expanded to include other factors and authorise the two tax administrations to agree on a single country of residence.

Article 5 - Application of methods for elimination of double taxation (optional article)

Three options will ensure that countries relieve double taxation by crediting foreign tax against domestic tax rather than by exempting foreign income from domestic tax.

Article 6 - Purpose of a covered tax agreement (mandatory article)

A new treaty preamble will clarify that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.

Article 7 - Prevention of treaty abuse (mandatory article)

New anti-abuse rules will enable tax administrations to deny treaty benefits in certain circumstances: the Principal Purpose Test (PPT) and the Simplified Limitation on Benefits (S-LOB) rule. Adopting the PPT is mandatory. The S-LOB is a supplementary and optional rule.

Article 8 – Dividend transfer transactions (optional article)

Shares will be required to be held for 365 days before dividends payable in respect of those shares become eligible for reduced tax rates applicable to non-portfolio intercorporate dividends under tax treaties. This holding period will be added to treaties that do not already include a minimum holding period and replace existing holding periods in treaties that do.

Article 9 - Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property (optional article)

Countries will be able to tax capital gains derived by foreign residents from the disposal of shares or other interests in 'land-rich' entities (where the underlying property is located in that country) if the entity was land-rich at any time during the 365 days preceding the disposal.

Article 10 - Anti-abuse rule for permanent establishments situated in third jurisdictions (optional article)

Treaty benefits will be denied where an entity that is a resident of one country derives 'passive' income from the other country through a permanent establishment located in a third country, and that income is both exempt in the entity's home country and subject to reduced taxation in the third country.

Article 11 - Application of tax agreements to restrict a Party's right to tax its own residents (optional article)

A tax treaty will not generally restrict a country's right to tax its own residents. This rule will replace existing bilateral rules that give effect to this principle, some of which have more limited application.

Article 12 - Artificial avoidance of permanent establishment status through commissionnaire arrangements and similar strategies (optional article)

Where an intermediary plays the principal role in concluding substantively finalised business contracts in a country on behalf of a foreign enterprise, that arrangement will constitute a 'permanent establishment' of the foreign enterprise in that country. Genuine independent agency arrangements will not be affected.

Article 13 - Artificial avoidance of permanent establishment status through the specific activity exemptions (optional article)

Most tax treaties include a list of exceptions to the definition of permanent establishment where a place of business is used solely for specifically listed activities such as warehousing or purchasing goods. Only genuine preparatory or auxiliary activities will be excluded from the definition of permanent establishment. In addition, related entities will be prevented from fragmenting their activities in order to qualify for this exclusion.

Article 14 - Splitting-up of contracts (optional article)

Most tax treaties include rules that deem building or construction projects that exceed a specified time period (e.g. 12 months) to constitute a permanent establishment. Related entities will be prevented from avoiding the application of the specified time period by splitting building or construction-related contracts into several parts.

Article 15 - Definition of a person closely related to an enterprise (optional article)

A 'person closely related to an enterprise' will be defined for the purpose of establishing whether or not a permanent establishment exists under articles 12, 13 and 14.

Article 16 - Mutual agreement procedure (mandatory article)

New rules will ensure the consistent and proper implementation of tax treaties, including the resolution of disputes regarding their interpretation or application. This will provide taxpayers with a more effective tax treaty-based dispute resolution procedure.

Article 17 - Corresponding adjustments (mandatory article)

Transfer pricing adjustments can result in double taxation when one country makes an adjustment to an entity's profits and the other country does not make a compensating adjustment to the profits of the relevant related entity. A country will be required to make a downward adjustment to the profits of a resident entity, as a result of an upward adjustment by the other country to the profits of an associated entity which is a resident of that other country (provided both countries agree that the upward adjustment is justified).

Articles 18-26 - Arbitration (optional article)

Taxpayers will be able to refer Mutual Agreement Procedure disputes that remain unresolved after two years to independent and binding arbitration.

(Source: ATO’s website)

APPENDIX II – List of abbreviations

ACE	Allowance for Corporate Equity
ATAD	Anti-tax avoidance directives
AUD	Australian Dollar
ATO	Australian Tax Office
BEFIT	Business in Europe: Framework for Income Taxation
BEPS	Base Erosion and Profit Shifting
CBIT	Comprehensive Business Income Tax
CFC	Controlled Foreign Company
CGT	Capital gains tax
CTA	Covered Tax Agreements
DTT	Double tax treaties
EC	European Council
EU	European Union
EUR or €	Euro
GAAP	Generally Accepted Accounting Principles
GloBE	Global anti-base erosion
GST	Goods and services tax
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IP	Intellectual property
IRAP	Imposta Regionale Attività Produttive
IRES	Imposta sul Reddito delle Società
ITAA	Income Tax Assessment Act
MLI	Multilateral Convention to Implement Tax Treaty Related Measures
NANE	Non-assessable non-exempt income
NPO	Non-profit organisations
OECD	Organisation for Economic Co-operation and Development
PAYG	Pay as you go
PCG	Practical Compliance Guideline
PE	Permanent establishment
PEX	Participation exemption
R&D	Research and development
TFEU	Treaty on the Functioning of the European Union
TR	Taxation Ruling
TUIR	Testo Unico Delle Imposte sui Redditi

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