necessary in order to understand the above-mentioned documents;
(2) any business letters received;
(3) copies of business letters sent;
(4) records of entries; and
(5) any other tax-relevant documents.

With respect to both categories of documents, i.e. invoices and other documents containing tax-relevant data, the ruling mentions, in particular, that protocols have to be kept in respect of their entry, storage and conversion (if applicable), as well as on any other processing in the course of business.

Storage of documents generated and/or received in digital format

Under the general rules regarding storage of documents containing tax-relevant data the documents mentioned above under (1) have to be stored for a period of ten years. The documents mentioned above under (2) through (5) have to be kept for a period of six years.

According to the Fiscal Code, Sec. 146(5), they may be stored on data carriers. This is subject to the condition, however, that the data carrier may be read mechanically and evaluated mechanically. Hence, other forms of documents generated and/or stored by data processing systems of the taxpayer are only permitted if the documents conform to the above requirements, i.e. that they may be read and evaluated mechanically.

In particular, the tax authorities clarify their point of view regarding documents that are originally generated in a digital format. According to the interpretation of the tax authorities this includes documents containing data received directly by the data processing system of the taxpayer in an electronic form and data generated in an electronic form by the data processing system of the taxpayer. Such data must comply with the requirements in respect of storage on a data carrier that may be mechanically evaluated.

The tax authorities state expressly that the "possible mechanic evaluation" requirement is not fulfilled when tax-relevant data is stored by simply printing the data (i.e. on paper), stored on microfilm or stored in a file format that cannot be evaluated. In this context the ruling mentions that a pdf file is an example of a file format that may not be mechanically evaluated. As regards the use of microfilm, the ruling states that documents that are originally received in paper format may be further stored on microfilms. The ruling applies to invoices and other documents received and/or generated on or after 1 January 2002.

Italy

The New San Marino–Italy Tax Treaty

Dr Piergiorgio Valente* and
Dr Giovanni Rolle**

INTRODUCTION

On 21 March 2002 a tax treaty between Italy and the Republic of San Marino was signed in Rome. The treaty represents a significant development in the relationship between the states[1] and can be viewed as a result of the international campaign against harmful tax competition initiated by the 1998 OECD Report (the Report).[2]

San Marino was, indeed, one of the few states (among those that were initially considered to meet the "tax haven" criteria) to endorse the guidelines contained in the 1998 Report and to adopt a high-level political commitment ("advance commitment")[3] to remove harmful tax measures, in particular in respect of the effective exchange of information, transparency and "the elimination of those features of the tax regimes governing financial and other services that attract companies not engaged in any substantial activity within the country".[4]

Italy is naturally destined to play a major role in furthering the international integration of San Marino given that it is the (sole) neighbouring country, San Marino's most relevant business partner and the fact that it shares a common language (and a similar legal system).

The treaty thus has a significance that goes beyond the cross-border tax relationship between the two states. From San Marino's standpoint, it is indeed the first tax treaty ever signed and, as mentioned, the first foreign acknowledgment of the new ("OECD-compliant") tax policy. By signing the treaty, Italy, from its perspective, avoids the potential revenue threats of having a "tax haven" within its own borders, is enhancing integration with a small, dynamic economy and is providing an effective solution to the income tax issues of the numerous Italian frontier workers.

* Managing Partner, Studio Legale Tributario – GEB Partners Network, Milan.
** Partner, Studio Legale Tributario – GEB Partners Network, Turin.

1. The Republic of San Marino is an independent state belonging to the Customs Territory of the European Community (see EEC Regulation No. 2151/84). The Republic has been part of the Italian Customs Territory since the Treaty of Friendship and Neighbourhood between the Kingdom of Italy and the Republic of San Marino was signed on 31 March 1939.
2. OECD, *Harmful Tax Competition. An Emerging Global Issue* (Paris: OECD, 1998).
3. As reiterated in the OECD *Progress Report 2000*: "A small number of the jurisdictions reviewed by the Forum have, in advance of this reporting, made a public political commitment at the highest level (an "advance commitment") to eliminate their harmful tax practices and to comply with the principles of the 1998 Report. In recognition of this commitment, this Report does not include the names of jurisdictions that have made this advance commitment ("advance commitment jurisdictions") even if they presently meet the tax haven criteria."
4. Republic of San Marino, State Secretariat for Foreign Affairs, Letter of 4 April 2000 addressed to the Secretary General of the OECD.

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In general terms, the treaty follows the OECD Model Tax Convention (OECD Model).[5] Anti-avoidance provisions hold a prominent position in the treaty (beginning with the title, where "preventing tax fraud" is expressly mentioned as a purpose of the treaty). There is a limitation on benefits clause (LOBC) (Art. 29), some peculiar features in the exchange of information clause (Art. 26) and a special provision that safeguards the Italian anti-avoidance regulations (such as the recently enacted CFC legislation and rules relating to the deductibility of costs vis-à-vis foreign parties). The treaty also distinguishes itself from the OECD Model by including an innovative arbitration procedure within the context of the mutual agreement clause (Art. 25) and special provisions relating to the taxation of frontier workers (Art. 15(4) of the Additional Protocol).

The above-mentioned deviations will be briefly described in this article following some summary notes on the taxation of dividends (Art. 10), interest (Art. 11) and royalties (Art. 12).

TAXATION OF DIVIDENDS (ARTICLE 10)

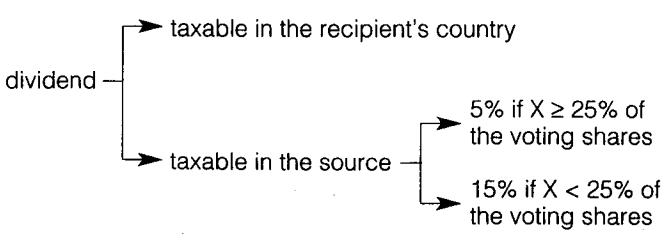
In accordance with the OECD Model, Art. 10 of the treaty provides for the taxation of dividends both in the country of residence of the beneficiary (Art. 10(1)) and in the source state (Art. 10(2)). The maximum withholding tax rates are:

- 5%[6] of the gross amount of the dividend if the effective beneficiary is a company that has held at least 25% of the voting shares of the distributing company for a period of 12 months up to the date of the resolution authorizing the distribution of a dividend;
- 15% of the gross amount of the dividend in all other cases.

In respect of withholding taxes it should be emphasized that San Marino's domestic tax laws do not envisage the application of any tax on dividends distributed to non-resident shareholders.[7]

Unlike the OECD Model,[8] this treaty establishes that, in order to benefit from the reduced 5% tax rate, there is a minimum holding period of at least 12 months prior to the date of the resolution authorizing the distribution of the dividend. This is an anti-abuse clause aimed at preventing artificial increases in shareholdings in conjunction with the distribution of the dividend solely for the purpose of taking advantage of the reduced rate of tax.[9]

Table 1 – Tax treatment of dividends

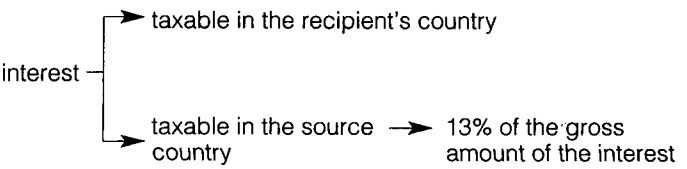


INTEREST (ARTICLE 11)

Similar to the OECD Model (and its rules on dividends described above), Art. 11 of the treaty provides for the taxation of interest both in the beneficiary's state (Art. 11(1)) and in the source state (Art. 11(2)), but subject to a specified maximum. The definition of interest does not differ from the one provided in the OECD Model.

As far as taxation in the source state is concerned, if the beneficiary of the interest is the beneficial owner,[10] the tax rate must not exceed 13% of the gross amount of the interest. The OECD Model suggests a maximum rate of 10%.[11]

Table 2 – Taxation of interest



Article 11(3) deviates from the OECD Model in that there is an exemption for interest due from the government or government institutions of the contracting states.

5. The treaty applies, in respect of Italy, to personal income tax (IRPEF), corporate tax (IRPEG) and the regional tax on productive activities (IRAP). In respect of the Republic of San Marino, the treaty relates to personal income tax and corporate tax.

6. The reduced rate of 5% has mostly been agreed to by Italy in respect of a limited number of trading partners and/or oil producing states (the United Arab Emirates, France, Kazakhstan, Kuwait, Lithuania, Mauritius, the Netherlands, Belgium, the United Kingdom, Russia, the United States, South Africa, Vietnam and Zambia). The 10% rate is more usual, present in 20 treaties.

7. If the parties had wished to establish a condition of symmetry and reciprocity of treatment by means of the treaty, they should have provided for an exemption from tax on dividends distributed by a company of one of the parties to a shareholder of the other party. Italy would have found this unacceptable since it has never renounced its powers of taxation in any of the treaties signed and currently in force.

8. With regard to the intercompany dividends allowance (subject to a 25% ownership requirement by the beneficiary company) Art. 10 of the OECD Model takes into account only the situation at the time the dividends become available to the shareholder. In other words, there is no provision regarding a minimum holding period.

9. This clause is present only in the tax treaties concluded by Italy with France, Japan, the Netherlands, the United States and South Africa. With respect to Japan, the holding period is reduced to six months. During the negotiations, Italy put forward a proposal that does not appear in the final text. An additional Para. 6 was envisaged, which read as follows: "the provisions of this article shall not apply if the principal purpose (or one of the principal purposes) of a person interested in the constitution or transfer of the shares or other rights in respect of which the dividends are paid is that of obtaining the benefits of this article by means of the said constitution or transfer". A similar clause, the LOBC, appears in Art. 29 of this treaty.

10. The treaty adopts the wording of the 1977 OECD Model, which was later abandoned. With regard to the application of taxation at source, the current version of the OECD Model establishes that the effective beneficiary must be a resident of the other contracting state. In the Italy–San Marino treaty, the application of the rate reduction provision depends on the recipient of the interest also being the effective beneficiary.

11. Most of the treaties signed by Italy establish a rate of taxation on outgoing interest of 10%. The treaty with Albania lays down a rate of 5%. The treaties with Bulgaria, Czechoslovakia (now applicable to the Czech and Slovak Republics), the United Arab Emirates, Kuwait and Hungary provide for a full source exemption.

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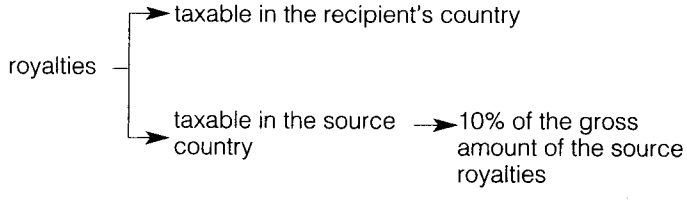
ROYALTIES (ARTICLE 12)

Art. 12(2) of the treaty states that the word "royalties" means payments of any type made for the use of, or the right to use, any copyright of literary, artistic or scientific works including software, films and radio or television recordings; patents; industrial or commercial trademarks; drawings or models; projects; formulae or secret projects; industrial, commercial and scientific equipment; and information concerning industrial, commercial or scientific experience ("know how").

As put forward by the Republic of San Marino during the negotiations, this paragraph also includes software among the intangible assets suitable to generate royalties. Such inclusion does not mean that any transaction concerning software will give rise to royalties: as set forth by the Commentary to the OECD Model (sub Art. 12), income accrued in a given operation concerning software (and, more generally, all operations with a digitalized content) are to be characterized on the basis of the accompanying rights acquired by the purchaser regarding the use and exploitation of the software.[12]

Unlike Art. 12 of the OECD Model[13] (which gives the right of taxation exclusively to the country of residence of the effective beneficiary of cross-border royalties) the treaty allows for the taxation of royalties in the source state, not to exceed 10%, if the effective beneficiary is a resident of the other contracting state.

Table 3 – Taxation of royalties



TAXATION OF SUBORDINATE EMPLOYMENT: TREATMENT APPLIED TO FRONTIER WORKERS (ARTICLE 15(4) OF THE PROTOCOL)

Art. 15 of the Treaty governs wages, salaries and other remuneration received by parties resident in one of the contracting states as payment for work as an employee. Generally speaking, such provisions are the same as those of the OECD Model, except for some differences related to employment carried out on vessels in internal waterways and "professors, teachers, researchers" and "students and apprentices".

Paragraph 4 of the additional protocol confirms the specific treatment of frontier workers,[14] that is to say employees who are resident in Italy and go abroad daily (to border areas or adjoining states) to work. This provision does not apply to employees who are resident in Italy and, on the basis of a specific contract for the carrying out of work abroad on a continuous and exclusive basis, are established abroad on a regular basis (even in a border/adjoining country).

The two contracting states will apply a concurrent taxation system to these parties resident in Italy, with final taxation in the country of residence. In other words, the Republic of San Marino may apply its own withholding tax to the income from subordinate employment earned by frontier workers resident in Italy. Italy will then tax the gross income earned by the border workers in the manner laid down in its domestic laws and may consider this income partially exempt from tax (in order to avoid double taxation).

This matter is dealt with differently in other tax treaties signed by Italy. The treaties with Austria and France attribute the power of taxation solely to the country of residence of the frontier worker. For Switzerland, the agreement signed in Rome on 3 October 1974, to which the treaty expressly refers, attributes the power of taxation exclusively to the country in which the work of the frontier worker is performed and establishes that the Swiss cantons of Graubünden, Ticino and Valais must pay out each year to the bordering Italian municipalities part of the tax revenues obtained from the taxation of the income earned by Italian frontier workers.

Even today, a special tax treatment is applied in Italy to frontier workers. Article 3 of Law 388 of 23 December 2000 establishes that, solely for the year 2001, income from subordinate employment performed continuously and exclusively abroad, in border areas and in other adjoining states, by persons resident in Italy is excluded from the tax base. This is a transitional provision that was extended to the year 2002 by Art. 9, clause 23, of Law 448 of 28 December 2001 (Finance Act 2002).[15] Therefore, currently, income earned in San Marino by frontier work-

12. Such a position is, at present, also shared by the Italian tax authorities, who issued on 30 July 1997 Ministerial Resolution No. 169/E. The Ministry of Finance stated that the sale of the software, jointly with the corresponding sale of all the related rights, has to be considered as an immaterial good's sale and, consequently, the related consideration must constitute business income for the seller. In addition, in circumstances where the "purchase" (*rectius*, licence) of the software is only for personal or business use, excluding any form of reproduction and marketing of same, the consideration will be characterized as business profit and not as a royalty.

13. With particular reference to the Italian network, very few states have agreed to provisions that comply with those of the OECD Model (Cyprus, Ireland, Russia, Hungary and the former U.S.S.R.). Different rates have also been established, even within the same treaty, as a function of the type of rights to which the royalties refer.

14. The preamble to the additional protocol emphasizes that the provisions of the protocol constitute an integral part of the treaty. With reference to frontier workers it states:

> In relation to the provisions of Art. 15, with regard to the taxation of subordinate employment of frontier workers resident in Italy, the two contracting states agree to apply a system of concurrent taxation, with final taxation in the country of residence. The Republic of Italy will tax the gross income of frontier workers resident in Italy earned in the Republic of San Marino in a manner to be established by ordinary law. Constitutional law may provide that a portion of the gross income of the frontier workers be tax exempt in Italy. In this event, the residual amount will be taxed by applying the current rates calculated with reference to the total income.

15. This statute partially reinstates for the 2001-2002 fiscal years the provision already established in Art. 3(3)(c) of the Italian Income Tax Act, later abrogated, with effect from the 2001 tax period (Art. 5(1)(a), No. 1, of Law 314/1997). The provision in question applies to income obtained by resident parties from work performed in the border areas of Italy such as, for example, France, Austria and San Marino and in other adjoining states that cannot really be called "border states", such as the Principality of Monaco (Italian Revenue Agency, Circular Letter No. 1/E of 3 January 2001).

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ers resident in Italy is taxed exclusively by the Republic of San Marino. The additional protocol to this treaty does not establish any provisions for frontier workers resident in San Marino as they are not subject to any type of taxation under the tax laws of San Marino.

MUTUAL AGREEMENT AND ARBITRATION (ARTICLE 25)

The mutual agreement procedure is governed by Art. 25 of the treaty.[16] The most relevant part of the provision is an arbitration procedure (which is not in the present OECD Model), found in Paras. 5 and 6 of Article 25. Paragraph 5 establishes that recourse can be made to arbitration if the contracting states fail to reach an agreement within two years from the beginning of the mutual agreement procedure as described in the preceding paragraphs of the same article. The setting up of an arbitration procedure is also conditional on an undertaking by the taxpayer to be bound by the relative decision and prior discontinuance (without reservations or conditions) of any actions pending in national courts.

The Arbitration Board that is called upon to give their opinion is made up of three members:
- one designated by each contracting state; and
- the president, designated jointly by the two members appointed by the contracting states within three months from the end of the two-year period within which the competent authorities should have settled the controversy amicably.

The rules of the arbitration procedure are established by the board which, in order to reach a decision, must comply with:
- the provisions of the treaty;
- the general principles of international law; and
- the applicable domestic laws of the contracting states.

The taxpayer has the right to be heard by the arbitration board or to be represented. Alternatively the board may invite the taxpayer to appear or to be represented. Para. 6 states that the board must hand down its ruling within six months from the date of appointment of the president. The ruling is made by a simple majority.

The ruling is not initially binding on the contracting states. They can adopt measures, by mutual agreement, to eliminate the cause of the double taxation, the source of the controversy, within a period of six months. If no action is taken within the six-month period the opinion of the arbitration board becomes binding on the parties.

THE LIMITATION ON BENEFITS CLAUSE (ARTICLE 29)

Article 29 of the treaty contains an LOBC,[17] widely utilized in US treaties. The rationale for these clauses is to prevent the benefits of the treaty from being applied to parties who, although formally resident in one of the contracting states, do not have a sufficient economic link with the contracting state nor a genuine non-tax interest in operating in that state. The clauses in the treaties signed by the United States are much more detailed and provide extremely specific tests for determining whether residence has been established in one of the contracting states with the intention of obtaining the benefits of the treaty.

The LOBC contained in Art. 29(1) of the treaty differs from the US Model in that it simply provides a general principle that denies treaty benefits if the principal purpose (or one of the principal purposes) of the constitution or existence of the persons who request the application (or any persons linked to them) is to obtain benefits under the treaty to which they are not entitled. The general nature of this provision and the absence of specific tests like those included in the US treaty allows a wide margin of discretion to the authorities of the contracting states, which may lead to numerous legal disputes.

Article 29(2) leaves untouched the application of the domestic laws of the contracting states with regard to limits on expenses and other deductions derived from transactions between companies resident or domiciled in the said states. The concept appears also in Para. 8 of the additional protocol, which states that domestic anti-abuse laws prevail over the provisions of the treaty.[18]

EXCHANGE OF INFORMATION (ARTICLE 26)

Article 26, dealing with the exchange of information, basically repeats the text of the OECD Model with a few variations. It should be pointed out that the objectives to be pursued by this exchange of information expressly include not only the prevention of tax evasion (like the majority of the treaties signed by Italy and unlike the OECD Model)[19] but also the prevention of tax fraud. The text of the Italian

16. The procedure has, so far, been rarely applied in Italian practice. In addition, Italian tax courts (see Italian Supreme Court Ruling No. 3610 Sec. I, civ. of 24 May 1988, with respect to the application of the Italy–France Treaty) have held that the enforceability of the outcome of the mutual agreement procedure is comparable to that of a circular, i.e. a document that cannot override legal provisions or court decisions.

17. The limitation on benefits clause is defined as a "plurality of restrictive provisions designed to deny the benefits of the Treaty to parties having certain characteristics or who are not qualified on the basis of the special anti-treaty shopping texts established in the agreement", P. Valente, *Convenzioni internazionali contro le doppie imposizioni* (Milan: IPSOA, 2001), p. 89 et seq.

18. The most relevant anti-tax haven provision of Italian tax law that relates to San Marino is the presumption of residence in Italy applicable to individuals who have emigrated to states or territories with a privileged tax system. In particular, Art. 2(2)-*bis* of the *Testo Unico delle imposte sui redditi* (Income Tax Code) states: "in the absence of proof to the contrary, Italian citizens whose names have been removed from the register of the resident population and have emigrated to states or territories with privileged tax systems, identified by decree of the Minister of Finance to be published in the Official Gazette, are also deemed to be resident". In relation to this law, the Ministerial Decree of 4 May 1999 identifies the states and territories with a privileged tax system (the blacklist for individuals) including the Republic of San Marino.
The Italian CFC legislation and other anti-avoidance provisions related to business income apply to the states and territories included in the list contained in the Ministerial Decree of 21 November 2001 and 23 January 2002. Both do not include the Republic of San Marino. To date, the Republic of San Marino does not have its own blacklist.

19. Some treaties make reference to the objective of preventing tax evasion and tax fraud but do not add tax avoidance (Algeria, Argentina, Belgium, Czechoslovakia (now in effect with respect to both the Slovak Republic and the Czech Republic), France, India, Malaysia, the United States, South Africa and Tanzania). In other cases, there is no reference to the objective of preventing tax evasion (Brazil, Ecuador, Japan, Ireland, Luxembourg, Morocco, Mexico, Portugal, Singapore, Switzerland, Thailand, Trinidad, the former U.S.S.R. and Zambia).

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proposal presented during the negotiations also included the exchange of information for the purpose of combatting tax evasion,[20] but this was not included in the final draft of the treaty.

In stating that "the exchange of information is not limited by Article 1", Art. 26(1) of the treaty acknowledges that the information can also relate to persons not resident in either of the contracting states.

Finally, Para. 6 of the additional protocol states that Art. 26 may be superseded by international agreements (reference is made to the OECD and EU processes on the matter) or by specific agreements between the contracting parties. The provision alludes to the current negotiation with non-EU states with respect to the adoption of the EC Savings Directive.

20. This approach can be found solely in the treaty concluded with Venezuela ("the competent authorities of the contracting countries shall exchange the information necessary for the application of the provisions of this treaty or those of the domestic laws of said countries regarding the taxes envisaged in the treaty, insofar as the taxation envisaged in said laws is not contrary to the treaty, and to the prevention of tax avoidance, evasion and fraud") and, apart from a few differences, the treaty with the United Kingdom (" (...) and in particular to prevent tax evasion or fraud and facilitate the implementation of the provisions against avoidance").

United Kingdom

The New UK Relief for Disposals of Substantial Shareholdings

Robert Newey*

INTRODUCTION

The United Kingdom has introduced a new relief from corporation tax. This relief applies where a company disposes of shares, or an interest in shares, in another company.[1] The relief consists of a main exemption and two subsidiary exemptions. In order for the main exemption to apply, the vendor company must hold, or have held, a "substantial shareholding" in the target company. A "substantial shareholding", in this context, essentially means a holding of 10% or more. Both the vendor company and the target company must be trading companies or belong to trading groups.

There are also two subsidiary exemptions. One covers the disposal of assets related to shares in the target company. The other applies to situations where the main exemption would have been available sometime during the previous two years.

The relief is contained in the Taxation of Chargeable Gains Act 1992, Sec. 192A and Schedule 7AC. These provisions were inserted into the Taxation of Chargeable Gains Act 1992 by the Finance Act 2002, Sec. 44 and Schedule 8. The relief applies to disposals made on or after 1 April 2002.[2]

The legislation frequently refers to shares or an interest in shares. An interest in shares means an interest as a co-owner of shares. It does not matter whether the shares are held jointly or in common, or whether the interests of the co-owners are equal.

THE MAIN EXEMPTION

This exempts gains accruing to the vendor company on a disposal of shares or an interest in shares in the target company.

The requirements in brief

There are several conditions for the main exemption, all of which must be satisfied:

(1) The vendor company must have held a substantial shareholding in the target company for a continuous 12-month period beginning not more than two years before the disposal. There are rules for calculating the period of ownership in various specific situations;
(2) From the beginning of the 12-month period mentioned above, and up to the time of the disposal, the vendor company must have been a sole trading company and/or a member of a "qualifying" group;
(3) From the beginning of the 12-month period, and up to the time of the disposal, the target company must have been a trading company or a holding company of a trading group or a trading subgroup; and
(4) Conditions (2) and (3) must still be satisfied immediately after the disposal.

Substantial shareholding

A vendor company holds a substantial shareholding in a target company if it holds shares or an interest in shares in the target company by virtue of which:

- it holds not less than 10% of the ordinary share capital of the target company;
- it is beneficially entitled to not less than 10% of the profits of the target company that are available for distribution to its "equity holders"; and
- it would be beneficially entitled, on a winding up, to at least 10% of the assets of the target company that are available for distribution to equity holders.

In certain situations involving the long-term insurance fund of an insurance company, the threshold for all the above purposes is 30% rather than 10%. "Ordinary share capital" means all issued share capital other than shares that are entitled to a dividend at a fixed rate but have no other right to share in the profits of the company.

* English Solicitor and Fellow of the Chartered Institute of Taxation; Visiting Fellow at the University of Essex.

1. In this article the company making the disposal is referred to as the "vendor company". The company whose shares are disposed of is described as the "target company".

2. In the interests of clarity and brevity, the interaction of substantial shareholding relief with other tax reliefs is not discussed in this article.

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EUROPEAN TAXATION

NETHERLANDS
Relevance of the New Netherlands Dividend-Stripping Rules in Tax Treaty Situations

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EC UPDATE

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DEVELOPMENTS IN
Germany
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VOLUME 42

NUMBER 11

2002

Official Journal of the Confédération Fiscale Européenne