

## **SERVER AND PERMANENT ESTABLISHMENT: TAXATION IN ITALY OF INCOME PRODUCED BY A NON-RESIDENT COMPANY THAT KEEPS ITS OWN SERVER IN ITALY**



### **1) DESCRIPTION OF THE CASE**

We report the outcomes of our analysis of a case recently submitted to us by a non-resident client company, which carries out online sales of goods and services in the Italian territory where it maintains its own server.

Like our client company, all non-resident companies operating in Italy through their own servers should carefully assess the risk that such a server may constitute a permanent establishment, such as to make the business income produced on our territory subject to Italian taxation.

From the analysis we carried out for the preparation of the opinion given to our client, it emerged that the conclusion of sales contracts for the supply of goods and services with Italian resident clients through the use of servers and computers located in Italy is suitable to integrate a physical permanent establishment (i.e. a fixed place of business through which the non-resident company fully or partially carries out its activity).

### **2) ANALYSIS OF THE CASE**

#### **2.1) The OECD indications**

The OECD has repeatedly dealt with the issue of whether or not electronic commerce may result in the existence of a permanent establishment. According to the OECD, the same principles and conditions for the existence of a physical permanent establishment apply to electronic commerce.

According to the OECD, a server can result in a physical permanent establishment according to the general principles set out in Article 5.1 of the Double Taxation Convention Model, as it alone can constitute a fixed place of business.

In particular, the requirement of "fixedness" is met whenever the server:

- a) does not undergo movement;



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- b) is in the full availability of the non-resident company (i.e. the non-resident company is the owner or lessee of the server and manages it directly);
- c) generates significant and essential activities in relation to the core business of the non-resident company.

### 2.2) Italian legislation and indications of the Revenue Agency

The Italian tax legislation (i.e. Article 162 of the TUIR), in accordance with the OECD, identifies the permanent establishment in a "fixed place of business through which the non-resident company fully or partially carries out its activity on the territory of the State".

The Revenue Agency, with Resolution No. 119 of 2007, issued in response to a request submitted by a French company offering online access to video games through a server located in Italy and used exclusively, clarified that if a non-resident company carries out its business through a server of its exclusive use, installed for an indefinite time in Italy, then there is permanent establishment.

In order to better identify when the availability of a server on the Italian territory constitutes permanent establishment, see the following Court rulings.

The Regional Tax Commission of the Marche region, with ruling 44 of 24/06/2011, acknowledged the nature of permanent establishment in the hands of a server located in Italy, albeit limited to the time period in which it was physically located in the territory of the State.

The Court of Cassation, with ruling 5649 of 20/03/2015, specified that the mere introduction of an IT system for the collection and processing of data does not in itself constitute a sufficient element to integrate a permanent establishment in Italy of a non-resident company. To this end, the non-resident company must be able to carry out, through the server, a wider marketing activity on the national territory.

The so-called "Netflix investigation" opened last October 2019 by the Milan prosecutor is going in the same direction.

The American streaming giant Netflix does not currently maintain any headquarters or contact person in Italy. The entertainment content is developed abroad and is broadcasted to Italy through a network of servers and computers, for exclusive use, which, in addition to processing the data relating to the aforementioned content, also process the algorithms that profile the customers and elaborate the specific sales offers for the Italian market.

According to the Public Prosecutor's Office of Milan, cables, optical fibres, computers, servers and algorithms represent, in the era of digitalising the economy, the new production factors available to the non-resident company and are suitable for creating a permanent establishment.

Precisely in the era of digital economy, the Italian Legislator in 2018 made changes to the domestic definition of a permanent establishment, stating that permanent establishment is also identified by "a significant and continuous economic presence in the territory of the State even if built in such a way as not to make its physical consistency appear in the territory itself".

This new notion leads to extending the possible cases of permanent establishment since, by eliminating the requirement of physical and material presence in the territory as a prerequisite for the taxation of business income, it gives greater importance to the economic substance, quantifiable on the basis of other factors, such as the volume of revenue generated in a country or the number of users online or the use of virtual platforms.

### 3) CONCLUSION

In the final outcome and in cases similar to the one in question, two basic parameters can be considered to resolve the doubt as to whether the server integrates permanent establishment or not:



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- If the activities constituting the core business of a non-resident company, such as the promotion of goods and services, the conclusion of sales contracts, as well as the management of payments and the delivery of goods and services (e.g. digital content), take place all automatically through the use of the server located in Italy, then a permanent establishment exists;
- If, on the contrary, the server located in Italy is used only and exclusively to carry out activities of a preparatory and auxiliary nature compared to the core business of the non-resident company, such as, for example, the activity of mere collection of data and preparatory information for the sale of goods and services, but the conclusion of sales contracts takes place through ordinary channels and is managed directly abroad by the non-resident company, then no permanent establishment exists.

This is obviously valid provided that the collection and transmission of data and information is not really the core business of the non-resident company.

It remains understood that the assessment on whether the activities carried out through the server constitute a permanent establishment in Italy of the non-resident company must be made on a case-by-case basis, considering the type of business of the non-resident company as a whole and the actual conduct put in place by the same, also in light of the current international debate on the taxation of the digital economy which, in the near future, could lead to a significant increase in the cases of permanent establishment from server or digital.