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Tax Issues in Italian-Qatari Dealings



JIACC Tax Commission *e-Book*

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This *e-Book* is the first-ever addressing Tax Issues of Qatari-Italian dealings in a bilateral perspective. The present version is an off-print of a full version given to the participants of the JIACC Annual Business Forum held in Milan on 17 October 2019.

The main purpose is offering the Italian (and, widely speaking, non-Qatari) investors an overview of the Qatari tax system and, vice-versa, Qatari (and, in wider terms, non-Italian) investors a glimpse of the Italian tax system.

This *e-Book* is the result of the great efforts of the Authors, most of them Members of the JIACC Tax Commission. My gratitude goes to all of them.

It is, also, the outcome of the JIACC ‘vision’ that taxation in Arab States is increasingly a key factor for MNEs and, especially, for Italian MNEs.

This led, in Spring 2018, the JIACC Board to establish a Tax Commission and, since then, we have been delivering regularly Newsletters and Tax Insights, organising events and our Tax Commission steadily begun one of the most important network for Tax Experts around the GCC (counting now around 45 Members).

A special thanks goes to President Cesare Trevisani and vice-President Pietro Paolo Rampino for asking me to lead the Tax Commission and supporting our initiatives.

Roberto Scalia
JIACC Tax Commission Chairman

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SECTION 1

SELECTED QATARI TAX ISSUES

CHAPTER 1

QATARI INCOME TAX LAW

*Roberto Scalia**

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1. Foreword: An overview of the Qatari legal system

From 1916 until its independence in 1971, Qatar was a British protectorate. Qatar is currently a constitutional monarchy, with the hereditary ruler descending from the Al Thani family.

Its legal system is based on the Constitution of 8 June 2004 that embodies the general guiding principles of the legal system.¹ Arabic is the official language² and the Qatari legal sys-

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¹ See Scalia (2015.a), pp. 609-610.

² Meaning that English translations of the applicable laws and regulations are *not* binding.

tem should comply with the principles of Islam and, consequently, «*Shari'a law shall be a main source of its legislations*».

A remarkable rule, due to its importance for the state budget, is article 29 Constitution (2004), which states that natural wealth and its resources «*are the property of the State; and the State shall preserve and exploit the same in the best manner in accordance with the provisions of the law*».

As Qatar is deeply influenced by the civil law tradition, the core of its legislation is based on a Civil Code (Law No (22) of 2004) and a Commercial Code (Law No (27) of 2006).

2. Qatari tax system: Mainland, Free Zones and the QFC

When dealing with Qatari Income tax system one shall clearly divide between the Qatari “Mainland” and Free Zones.

Free Zones are regulated under Law 34 of 2005 (the IFZ Law, as amended by Decree Law No. 12 of 2017) holding that «*[t]he provisions of the tax law ... shall not be applicable to the Zone for a period of twenty years, renewable for one or more similar periods*» and «*[r]egistered Companies ... enjoy the following benefits ... [t]he profits of trade in transit goods in the Free Zone shall be exempted from all types of taxes*».³

It should, however, be noted that one of the primary drivers in attracting the attention (at least for International tax practitioners) has been *not* a free trade zone, but rather the Qatar Financial Centre (“QFC”).

Summarising, when dealing with tax issues of investments in and through Qatar, one shall carefully divide between the State (hereinafter, “Mainland Qatar”), on the one side, and the Free Zones and the QFC, on the other.⁴

In this Chapter, the author focusses mainly on Qatari Mainland Income Tax.

³ See, namely, Articles 7 and 15bis 1(a) (introduced in 2017) of Law No. 34 of 2005.

⁴ The issues was dealt with in Scalia (2015.a).

3. Qatari Income Tax

Qatari income tax system, dating back in 1954 was first amended and repealed by Decree-Law No. 11 of 1993 and later repealed by the Income Tax Law No (21) of 2009 (hereinafter, the “2009 ITL”).

Until late 2018, the Qatari income taxation was primarily embodied in the 2009 ITL and Ministerial Decree 10 of 2011.

In December 2018 a new Income Tax Law – repealing the 2009 ITL – was adopted and entered into force as of January 2019 (the “2019 ITL”).

The 2019 ITL resembles the main features of the 2009 ITL, however some major amendments were introduced and will be addressed in forthcoming paragraphs.

After adoption of the new Income Tax Law, the General Tax Authority has been issuing Circular Letters concerning filing tax return, transitional provisions concerning, e.g., penalties, application of withholding tax, etc⁵.

3.1. Subjective scope, Exclusions and Exemptions

Taxable persons are all natural and legal persons «*subject to tax*» under the 2019 ITL.

Although the 2019 ITL replaces 2009 ITL (and Law No (17) of 2014, as well) and any other Law that is inconsistent with 2019 ITL, the tax exemptions «*in force at the date of the Act shall continue to apply until the expiry of the period specified for them*».⁶

With respect to Qatari (and GCC) national the following set of exemptions apply.

Gross income of Qatari *natural persons* residing in the State is exempted from ITL. The same exemption applies to the gross income of *legal persons* wholly owned by Qataris and to the pro-quota part of profits of legal persons (whether resident or not) held by Qataris.⁷

⁵ GTA, Circular Letter No. (14) of March 4, 2019.

⁶ Article 4, second ind., Law No (21) of 2019.

⁷ See Article 4(7) and (8), 2019 ITL and Article 4, MOEF Resolution No. (10) of 2011. On the former regime, that is substantially unchanged, see Scalia (2015.b), p. 668.

3.2. Residence and PEs

Individuals qualify as resident in Qatar if they (i) have a “permanent home” in Qatar, (ii) are in Qatar for 183 consecutive or separate days in any 12-month period, or (iii) have their “centre of vital interests” in Qatar.

Body corporate are considered resident in Qatar if they (i) are incorporated under Qatari law, (ii) have their head office in Qatar or (iii) have their *place of effective management* in Qatar.⁸

For either individuals or bodies corporate to qualify as resident, it is sufficient that *any* of the above criteria is met.

According to the definition set forth in article 1 of the ITL, a Permanent Establishment (PE) is: a fixed place of business through which the business of a taxpayer is wholly or partly executed including a branch, an office, a factory, a place of exploration and extraction or exploitation of natural resources, etc.

The PE definition shall also include an activity carried by the taxpayer «*through a person*» acting on behalf of the taxpayer or in his interest other than an agent of an independent status.

The PE definition – that relies heavily on the definition provided for in articles 5 of the OECD and UN Models at least for sc. Material PE – apparently stems from the International standards, for the sc. agent PE, ultimately resulting in that a PE can arise only insofar as an “activity” is carried on by the independent agent.

However, as set forth in Chapter III, such differences begun immaterial due to compliance with International standards.

3.3. Taxable Income, Tax Rate and WHTs

The ITL applies on the gross income, deducted all business expenses,⁹ to be determined according to accounting based on the accrual principle, in accordance with International Accounting Standards,¹⁰ subject to the provisions of the 2019 ITL and

⁸ Article 1, 2019 ITL.

⁹ See Article 7, 2019 ITL and Article 9, MOEF Resolution No. (10) of 2011. Some expenses might *not* be deducted in whole or in part (if exceeding a said threshold) as per Article 8, 2019 ITL.

¹⁰ On the relevant issue *see*, above all, Al Asmakh (2008).

the Regulations. The taxpayer may *not* use other accounting methods unless obtaining previous approval.¹¹

The statutory income tax rate is 10%. However, the special tax rate stipulated in the agreements related to petrochemical industries and operation on the exploitation of natural resources and their resources applies, provided that the tax rate shall not be less than 35%¹² (the relevant issue is addressed, in more detail in Chapter 3).

A general 5% withholding tax applies on «*royalties, benefits, commissions and services*» rendered «*in whole or in part in the State*» and paid to non-residents for activities *not* connected to a PE in Qatar.¹³

The new general WHT applies to contracts concluded on or after December 13, 2018 while contracts signed before 13 December 2018 shall be assessed considering the date of payment.

The rules apply in consistency with Tax Treaties that shall take the precedence, where more favourable (on the relevant issue, *see* Chapter 3).

3.3.1. Exemptions

Objective exemptions¹⁴ are provided for in the following list of cases:¹⁵

- a. interest and bank charges payable to natural persons not engaged in taxable “activity” in the State (whether resident or non-resident);
- b. benefits and proceeds of public debt securities and Islamic securities, issued in accordance with the provisions of the law and bonds of public bodies and institutions.
- c. capital gains arising from the disposal of real estate or securities (not belonging to a taxable “activity”) obtained by natural persons;
- d. capital gains arising from the revaluation of the Company's assets in respect of the contribution to the capital of a Qatari

¹¹ *See* Articles 5 and 6, 2019 ITL.

¹² *See* Article 9(1), 2019 ITL.

¹³ Article 9(2), 2019 ITL.

¹⁴ That apply without prejudice to exemptions prescribed by special laws or international agreements

¹⁵ *See* Article 4(1) to (7), 2019 ITL.

- resident joint-stock company, upon fulfilments of some pre-requisites;
- e. dividends and other income arising therefrom if the amounts distributed during the tax year are deducted from:
 - e.1. profits which have been taxed under the provisions of the 2019 ITL;
 - e.2. dividends distributed by a company, the profits of which shall be exempt from tax under the 2019 or other Laws.
 - f. gross income from some craft activities, whose gross income does not exceed 200,000 QAR per year employing no more than 3 workers;
 - g. gross income from agriculture or fishing activities;
 - h. gross income earned by non-Qatari air or maritime companies operating in the State, subject to reciprocity that shall be proved filing a certificate issued by the State of residence of the company.

3.4. *The Qatari Mainland “territorial” system*

The Qatari Tax system is, in wide terms, a sc. “territorial” system of taxation.

Accordingly, Income Tax is levied on taxable income of the taxpayer arising from “sources” (مصادر) in the State¹⁶ including also (i) interest and bank revenues «*realized outside the State*», and (ii) commissions due under agency agreements, mediation or commercial representation, «*achieved outside the State for activities carried out there*».¹⁷

The list of income “from the State” is addressed in paragraphs 3.4.1. to 3.4.7. below.

3.4.1. *Income from “activity”*

Article 3(1) of the ITL states that an activity is the “source” of income when the activity is «*carried on in the State*».

An “activity” means any «*profession, trade, service, trade, industry, speculation, enterprise, or any action aimed at profit or*

¹⁶ Article 2, 2019 ITL.

¹⁷ Article 2, 2019, ITL.

*income, including the exploitation of movable and immovable property».*¹⁸

Conversely, the definition shall *not* include the activity undertaken by a supplier who «*supplies goods and equipment for the State*» unless the relevant contract of supply includes other accompanying services (such as transportation, installation, maintenance, etc.) in which case such ancillary services shall be deemed resulting from an activity in the State.

3.4.2. Income from contracts performed in the State

Income derived from contracts «*wholly or partly*» performed in Qatar is deemed to arise “from the State”. This definition includes services «*implemented wholly or in part in the State*» that entails that the business necessary for such implementation is carried on wholly or in part in the State.

3.4.3. Income from real estate

Income from real estate situated in the state (or shares in companies and/or partnerships whose assets are mainly real estate situated in the state) fall within the internationally accepted principle according to which the state in which immovable property is located shall *not* be restricted in exercising its taxing rights over its territory.

3.4.4. Income from sale of shares and consideration for services and Interests from loans obtained in the State

Taxation of income from shares in resident companies and companies listed on Qatari Stock Exchange, and income in respect of consideration for services to related companies is taxable in Qatar.¹⁹

¹⁸ Article 1, 2019 ITL

¹⁹ The latter – in the author’s opinion – is a *lex specialis* in respect of income from «*activities*».

Interest from loans obtained in the state is taxable in Qatar.²⁰ However, some exemptions apply with respect to natural persons (*see* paragraph 3.3. above).

3.4.5. Income from the exploration for and exploitation of natural resources situated in the State

This rule (that is fairly a *lex specialis* in respect of income from “activities”) holds that income from exploration and exploitation of natural resources shall be taxable in Qatar.

3.4.6. Income “subject to tax” under a tax treaty

Under a residual clause, also income that is “subject to tax” under a tax treaty shall be deemed to be an income from the State.

3.2. Compliance duties

Any taxpayers earning a taxable income (or engaged in an activity) shall: *(i)* register with the tax authority; *(ii)* notify of any change that may affect its tax obligations, and *(iii)* apply to obtain a special tax number.²¹

²⁰ Worth to underline that, in the author-s opinion the scope of this provision is quite vague and might entails different interpretations as for the “territorial” scope of the rule.

²¹ Article 10, 2019 ITL. For an overview on Qatari tax administration policy, *see* Abdellatif & Tran-Nam (2018).

CHAPTER 2

THE QFC TAX REGULATIONS

*Roberto Scalia**

TABLE OF CONTENT: 1. Foreword. – 2. Subjective scope, Exclusions and Exemptions. – 3. Residence and PEs. – 4. Taxable Income, Tax Rates and Withholding taxes. – 5. The QFC territoriality. – 6. A Brief on QFC Concessionary regime. – 7. Tax Treatment of Islamic Finance

1. Foreword

The Qatar Financial Centre Tax Regulations (the “QFC-TR”) is one of the backbone of Qatari financial policy and its attractiveness, in the International context, is reinforced by tax regulations that are fairly in line with international standards and updated to fit the newest international standards.

The QFC Law (in its English official version) prevails over any other Qatari act or regulation; accordingly, contracts, transactions and arrangements conducted by entities established or operating in the QFC are regulated by QFC Law, unless the parties agree otherwise.¹ If a transaction involves a QFC entity and a non-QFC Qatari entity, the taxing powers under the QFC Law and under the QFC-TR are limited to profits and/or losses arising from QFC-licensed activities, while those accruing in respect of other, unlicensed activities fall within the scope of 2019 ITL.

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¹ Another key issue is that, being the QFC Law separate from Qatari general laws and regulations, it permits companies and entities (QFC Entities) to be incorporated or formed notwithstanding the Qatari’s State Companies Law.

QFC Law has been modelled to a legislation existing in other jurisdictions, such as the UK and Hong Kong. It follows that the case law from these jurisdictions may be useful with regard to the interpretation of the QFC Tax Law. However, in considering the case law of other states, the Tax Department recognizes that «[c]onsiderable caution is... required».²

2. Subjective scope, Exclusions and Exemptions

Taxation in the QFC applies to the taxable profits of (i) “QFC Entities” *i.e.* Limited Liability Companies (LLCs), protected cell companies (PCCs), QFC partnerships and other permitted forms of QFC entities incorporated in Qatar, and (ii) branches registered under the QFC laws.

Any general partnership (GP), limited partnership (LP) or LLP (whether or not a QFC partnership) is «*liable to tax... as if it were a separate legal entity*» for the purposes of the QFC-TR. Although Partnerships are treated as opaque entities «*tax liability is attributed to the individual Partner*».

In order to duly and fully comply with International transparency standards, since 18 July 2019, the QFC-TR has been introducing a detailed and clear-cut regulation concerning Beneficial Ownership.

3. Residence and PEs

QFC Entities are resident for QFC-TR purposes, provided either of the following two requirements is fulfilled: (i) the QFC entity is incorporated under QFC Regulations; or (ii) the place of effective management is in Qatar.

4. Taxable Income, Tax Rates and Withholding taxes

Chargeable profits are assessed based on accounting profits, which should be prepared in accordance with IFRS, UK GAAP

² Scalia (2015.a), p. 613.

or US GAAP or AAOIFI or using a different accounting base (upon approval of the Tax Department).

Expenses and other costs may be deducted to the extent that they are reported in the P&L account and are incurred for the purposes of generating local source profits.

Depreciation in respect of fixed assets and the amortization of intangible fixed assets is also allowed. Losses can be carried forward (but not back), utilized by the successor in the transfer of a licensed activity, transferred within a group and, subject to certain conditions, refunded. Reorganizations and reconstructions (share and asset deals) are treated as tax neutral.

The tax rate is 10% and no withholding taxes apply in the QFC.

5. The QFC territoriality

As stated in paragraphs 2. and 4. above, the territorial ambit of the QFC-TR differs from the ITL one.

Since «*permitted activities [...] shall only be conducted in and from the QFC*»³ and such activities might be also be carried out outside the QFC but within Mainland Qatar, the question arises whether income should be subject to the ITL or the QFC-TR.

Article 6 of the QFC-TR states that QFC Entities are subject to tax on their “local source” profits and have only one category of taxable profits. Such a source of taxable profits is assessed according to article 10 of the QFC-TR.

The territorial scope of the QFC-TR is designed by including some sort of income and excluding other sources of income.

The following are included:

- interest derived by persons *other than* financial institutions; and
- interest derived by a financial institution to the extent that
 - (i) the profits are attributable to the initiation¹¹⁶ of the underlying loan in Qatar by, or on behalf of, the financial institution, and

³ Article 10(2) QFC Law.

- (ii) the risk of default in respect of (either, or both) the interest and principle of the loan is borne by the financial institution in Qatar.

Local Source profits are deemed *not* to include any profits derived from:

- immovable property located outside Qatar;
- the PEs of a QFC entity outside the QFC; or
- notwithstanding article 10(2)(a) of the QFC-TR, the receipt of interest by a non-financial institution where the borrower is not resident in Qatar and does not use a Qatari PE to substantially undertake the borrowing or, despite being resident in Qatar, the borrowing is substantially undertaken by or through a PE of the borrower located outside Qatar.

A new exclusion was added in 2017 stating that profits arising in or derived from Qatar by a QFC Entity *(i) that is not an Authorised Firm (ii) from the provision of services for use outside Qatar* are deemed not to be Local Source profit.

The latter rule applies «*[n]otwithstanding any other provisions*» in QFC-TR and conditional upon *(i)* the QFC Entity's accounts are audited and reported on by an external auditor; *(ii)* at least 30% of the income can be attributed to activities undertaken by the QFC Entity in Qatar; *(iii)* the QFC Entity employs at least three full time employees; and *(iv)* the Tax Department does not consider that the services are rendered under an arrangement the sole or main purpose of which is the avoidance of tax.⁴

6. A Brief on QFC Concessionary regime

One of the most important tax regime in the QFC, for entities engaged in the Insurance and Reinsurance sectors is the QFC Concessionary regime⁵ that, as of July 2019, has been widened so as to include also Investment Managers.⁶

The regime has been deeply amended in July 2019 in order to comply with International OECD standards and, namely, access to the regime is now conditional upon Core Income Generat-

⁴ QFCA Tax Rule 1A, added in 2017, as well.

⁵ An analysis through the regime and major amendments carried out in 2014 is done in Scalia (2016.a).

⁶ See Article 88(1)(d) QFC-TR.

ing Activities (CIGAs) are «*carried out in Qatar*»⁷ whereas CIGAs shall have the meaning «*set out in the rules provided for in the 2015 final report on BEPS Action 5 ... or any later rules in substantially the same or equivalent terms*».⁸

7. Tax Treatment of Islamic Finance

The QFC encourages and supports the development of Islamic Financial Institutions (IFIs), thereby giving rise to a level playing field compared to ‘conventional’ financial institutions.

Far from the scope of this Chapter giving a complete background for the topic, Islamic finance must comply with Sharia law and Islam’s main principles affecting financial matters (key in addressing tax issues) are the following:

- the prohibition on charging and receiving interest (*riba*);
- the prohibition on uncertainty (*gharar*) or speculation (*maysir*);
- the prohibition on financing certain economic sectors (e.g., the manufacture of weapons, the production of pork, and gambling);
- the principle of profit and loss sharing;
- the principle of asset backing; and
- money and commodities must be treated differently.

As Islamic finance should not be less advantageous than conventional finance, taxation should *not* give rise to any detrimental treatment for IFIs.

Where, due to the application of the AAOIFI, the profits declared by an IFI are materially (i.e. 5% or more) higher than the profits that would have been declared had IFRS been applied (or had the transactions been structured as a conventional finance transaction) the IFI may claim a “tax adjustment” under article 67 of the QFC Tax Regulations.⁹

Since IFIs are funded differently from conventional banks and, therefore, through *Murabaha*, *Mudarabah*, *Wakalah* or similar arrangements, instead of paying interest to customers on customer deposits and money market lending, the bank pays a “*profit share*”.

⁷ Article 88(9) and (10) QFC-TR in force as of July 2019.

⁸ See Article 153 QFC-TR in force as of 18 July 2019

⁹ See, for a more in-depth analysis, Scalia (2015.b), pp. 673-675.

The QFC Tax Regulations equalizes the tax treatment of the funding costs of IFIs with regard to conventional financial institutions, in providing that an “*equivalent funding amount*” is tax deductible where funding costs are lower than those that could be deducted by a conventional financial institution.

Furthermore, any entity established solely for the purposes of supporting or facilitating an IF Transaction may elect for special exempt status granted to registered funds, special investment funds, special funding companies, alternative risk vehicles and charities.

In the insurance and reinsurance sector, *Takaful* entities must set off the net surplus and/or deficit attributable to *Takaful* business against chargeable profits. The objective of the provision is to exclude from the chargeable profits of the TE any gain or surplus arising in respect of the policyholders’ fund and to charge to tax the profit, or relieve any loss, arising to the operator of the fund.¹⁰

¹⁰ See Scalia (2016.a).

CHAPTER 3

EXCISE TAX AND TAXATION OF O&G SECTOR IN QATAR

Maryam Al-Asmakh and Talal Al-Emadi***

TABLE OF CONTENT: 1. Excise Tax in Qatar. – 1.1. Taxed items and persons – 1.2. Qatari’s agenda in respect of GCC-tailored tax policies. – 2. Oil and Gas Taxes in Qatar. – 2.1. Treatment under Law No. 13 of 2000. – 2.2. The applicable taxes

1. Excise Tax in Qatar

Although Qatar is one of the wealthiest countries in the world in terms of Gross Domestic Product (GDP), it is still classified as a developing country. Given that it overwhelmingly depends on gas production as a source of government revenues, Qatar aspires to diversify its current carbon-based economy with the aid of its National Vision 2030.¹ Using innovation and knowledge, the ultimate aim of this vision is to transform Qatar from a rich developing country into an advanced country by 2030.

The introduction of Qatar’s second indirect tax in 2018, (after custom tax in 2002), namely, Excise Tax, is one important step for Qatar towards becoming an advanced country. In analysing Excise Tax, two important implications will be considered here.

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¹ See <https://www.psa.gov.qa/en/qnv1/pages/default.aspx>.

1.1. Taxed items and persons

First, the choice of harmful (or unhealthy) products such as carbonated drinks (50% tax rate), tobacco products (100% tax rate) and energy drinks (100% tax rate) not only is an innovative way to create new sources of wealth for Qatar's public services, but is also a long-term investment into a healthier Qatari society. Unlike the new Income Tax of 2019 that continues to exclude Qatari nationals and GCC citizens,² excise tax affects Qataris and non-Qatar alike.

Given the subsequent jump in retail prices of unhealthy taxed goods, it is the first time that Qataris were affected by any price increase as a result of tax.

It is argued here that the government's decision to introduce tax to Qataris through harmful products rather than the wide range of goods that could have been taxed under VAT is the correct means to introduce the notion of tax to Qataris.

Now, most Qataris – who had been for a long time immune from tax – not only find tax on harmful products acceptable but also they view it as a sign of development.

1.2. Qatari's agenda in respect of GCC-tailored tax policies

Second, instead of the anticipated Value Added Tax (VAT), Excise Tax was the first Qatari fruit of the Gulf Cooperation Council (GCC) deliberations towards a harmonized indirect tax regime.

With the aim of promoting the GCC economy and establishing «*economic unity amongst member states*», all six members of the GCC agreed upon a Unified VAT Agreement and a Unified Excise Tax Treaty in December 2015.³

Remarkably, in June 2017, three GCC countries – the Kingdom of Saudi Arabia (KSA), the United Arab Emirates (UAE) and Bahrain – together with Egypt enacted a blockade

² See R. Scalia, *Qatari Income Tax*, in this Book.

³ *The Excise Tax Treaty for the Gulf Cooperation Council* (9-10 December, 2015) Riyadh 1 and *Unified VAT Agreement for the Cooperation Council for the Arab States of the Gulf* (9-10 December, 2015) Riyadh 1

against Qatar through land, sea and air. The blockade not only shattered the sought-after unity between Qatar and the blockading countries but also violated World Trade Organization (WTO) trade and economic agreements.⁴

Despite the blockade, Qatar continues to honour both agreements, beginning with the Unified Excise Tax Treaty.

According to Qatar's Excise Tax Guide, the introduction of an excise tax system is consistent with «*the common excise tax system agreed by the GCC states by virtue of National Law [The Excise Tax No. 25 of 2018] and Executive Regulations*».⁵

It is still unclear when VAT will finally be introduced in Qatar, but it is clear that Qatar's excise tax will pave the way for a fruitful indirect tax regime in the country.

2. Oil and Gas Taxes in Qatar

There is often an oversight in the literature on Qatar's oil and gas agreements regime. Most writers have stated that the mechanism used to enter into agreements is the Production Sharing Agreement (hereinafter, "PSA").

The reality is that while PSAs in Qatar are hardly used for oil, the Joint Venture Agreements ("JVAs") are the dominated vehicle for the Qatari gas industry.⁶

Thus, in covering the Qatari tax regime for the oil and gas industry, I will separate the analysis as follows:

a. Gas JVAs

In this scenario, Qatar Petroleum (QP) which is the National Oil Company (NOC) establishes an incorporated joint venture, *i.e.* a company, often with various well-established multi-

⁴ See, in general, the in-depth analysis of the consequences of the blockade against Qatar by A.S. Al-Naemi, F.G. Usman, K.N. Al-Saegh, K.N. Al-Jassim, N.A. Al-Semaiti & S.I Al-Obaidli "The Blocade Imposed against Qatar: An Analytical Study of WTO Principles", *International Review of Law, TradeLab Special Issue*, 2018.

⁵ General Tax Authority, *Taxable Person Guide for the Excise Tax* (2019), 7.

⁶ See generally T. Al Emadi *Joint Venture Agreements in the Qatari Gas Industry* (Springer Nature 2019).

national and giant oil and gas companies (IOCs) and based on an agreed-upon type and applicable laws. Here, the tax is defined in a Development & Fiscal Agreement (DFA) which would be between this established company and the government of Qatar.

b. Oil PSAs

Production Sharing Agreements (PSAs) are often used in the Qatari oil arena with IOCs who now have branches in Qatar. The applicable taxes are, therefore, decided in accordance with the provisions of each relevant PSA.

2.1. Treatment under Law No. 13 of 2000

Law No 13 of 2000, as amended several times, regulates the Investment on Non-Qatari Capital in the Economic Activity.

The main feature of this law is to attract investments and, therefore, grants incentives.

The incentives are dependent on the fiscal negotiations with the Qatari government. One notable incentive is tax exemption (tax holiday).

However, petroleum operations generally are taxable in Qatar.

These operations are defined under Article 1 in the Qatari Law No 3 of 2007 on Exploration of Natural Resources as: development of petroleum fields; drilling and maintenance of wells; petroleum production, treatment, refining, storage, transportation, and shipment; the construction of the necessary utilities for energy, water, accommodation and camps as well as the installation and operation of utilities, in addition to any other utilities, installations or equipment required for the abovementioned purposes, including all facets of administrative or supplementary activities, and activities necessary in achieving the aforementioned purposes.

2.2. The applicable taxes

2.2.1. Corporate Income Tax

Any company conducting a petroleum operation, as defined above, is subject to Corporate Income Tax (“CIT”) at a 35% rate. This rate is regulated in accordance to Law No 24 of 2018 Qatari Income Tax Law. Thus:

a. Taxable Gas JVs

As mentioned above, the tax here would be defined in the DFA, and the tax would be calculated at the level of the joint venture company and in line with the above-named tax law.

b. Taxable Oil PSAs

The tax under PSA would be defined in the agreement itself which would usually be calculated as the total sums gained from petroleum revenue.⁷

2.2.2. Withholding Taxes

As mentioned above, IOCs investing in Qatar’s petroleum operations usually have branches in Qatar. However, IOCs that do not have permanent establishment Qatar would be subject to a final withholding tax (on royalties and services). This is the case for both gas JVs and oil PSAs.

2.2.3. Royalties

Based on each JVA’s DFA and PSA, a royalty rate is paid to Qatar based on the total sales.

⁷ See generally Global Oil and Gas Tax Guide (2018).

2.2.4. *Bonuses*

Only in PSAs bonuses are paid at signature and subject to production goals. In the case of JVA's DFA, bonuses are not included.

CHAPTER 4

QATARI DOUBLE TAX TREATIES

*Pietro Paolo Rampino**

TABLE OF CONTENT: 1. Foreword: Qatari Tax Treaties; policy. – 2. Objective and Personal scope. – 3. Immovable Property Income and Capital Gains. – 4. Airline and Shipping enterprises. – 5. Business Profits and PE. – 6. Dividend, interest, Royalties and Capital Gains. – 7. Elimination of Double Taxation. – 7.1. Elimination of Double Taxation in the Italian-Qatari DTC

1. Foreword: Qatari Treaty Policy

Qatar's treaty network has been created in a relatively short period. Specifically, in less than 25 years, since the very first one signed with France in 1990, Qatar has concluded 59 tax treaties.¹

Nowadays, Qatar counts around 65 Double Tax Conventions (shortly, "DTCs") fitting widely into the OECD Model, with selected issues overlapping with the UN Model's approach (that can be employed as useful interpretative tools).²

Italy and Qatar have in place a DTC, signed in 2002.

Worth to underline that, due to the importance devoted to Islamic Finance³ in the QFC, also DTCs' impact is a key factor to be considered.⁴

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¹ See Scalia (2015.c), pp. 731-732.

² Scalia (2015.c), p. 734.

³ See, on the relevant issue, Miglietta & Rampino (2017).

⁴ See Gueydi (2014) and Scalia (2015.c).

2. Objective and Personal scope

Although the Qatari tax system was amended since its first adoption (first in 2009, than in 2019) and a ‘parallel’ income tax system was introduced as of 2005 (the QFC Tax Regulation), there is little doubt that Qatari DTCs apply to all such tax laws.

Qatari DTCs apply to *persons*, as defined (individual, company and other body of persons) that are “*liable to tax*” (and, hence, *resident*). Obviously Qatar nationals can gain DTCs’ benefits, despite their being exempted by taxation.

Where a conflict on residence of individuals arises, the usual tie-breaker rules apply and, when it comes to entities, the residence conflict is solved resorting to the “*place of effective management*” criterion.

Selected Qatari DTCs provide special rules addressing some investment vehicles; e.g. Collective Investment Vehicles and Schemes (CIVs and CISs).

3. Immovable Property Income and Capital Gains

Articles 6 of Qatari DTCs provide that income from immovable property situated in one contracting state, derived by a resident of the other contracting state, may be taxed in the first state (sc. *situs* principle).

Capital Gains on Immovable Property shall be taxable in the State where the immovable property is situated, as well.

The same rule applies in case of “indirect” holding of immovable property. Shares and interests in Immovable Property companies and entities should be taxable in the state where the immovable property is situated. This rule applies to the alienation of shares, stocks or other rights in companies or other entities, more than 50% of whose assets consist of immovable property or rights over such property.⁵

⁵ The scope of article 13(4) of DTCs does *not* include, in calculating the values of shares, any immovable property used by the company for its own business.

4. Airline and Shipping enterprises

Qatari practice in respect of Airlines and Shipping enterprises' income is fairly consistent with the OECD Model and UN Models, providing for the exclusive taxation of income where the POEM of an enterprise is situated. Some differences can be highlighted comparing older and more recent DTCs.

5. Business Profits and PE

Business profits shall be taxable only in the State of residence of an enterprise, unless the activity is carried on, in whole or in part, in the other contracting State.

The definition of PE widely fits the OECD Model with few remarkable aspects concerning, e.g. the mines and oil or gas wells and any other place of extraction (wider than the OECD approach) and selected clauses tackling specifically the insurance and reinsurance sector.

6. Dividend, Interest, Royalties and Capital Gains

The allocative rule concerning dividend widely fits the OECD Model holding that dividends may be taxed both in the residence state and in the source state and the source state may apply a withholding ("WHT") tax (typically up to a maximum of 5%).

Interest should, in general, be taxable in the residence state, and the source state may apply a WHT tax that, apart from some exceptions, should not exceed 5%. Interest should be exempt from tax if it is derived and beneficially owned by the Government of a contracting state or by the central bank, or where it is derived in connection with a loan or credit extended, endorsed or guaranteed by the Government of a state.

The Qatari definition of Royalties widely fits the OECD Model and UN Models, with minor deviations. Despite some Qatari DTCs recognize the exclusive taxing right of the residence a number of Qatar's tax treaties, in corresponding to the approach

used in the UN Model, provide for limited taxation (generally 5%) in the source state.⁶

Capital Gains rules widely fit the OECD Model and UN Models. Consistently, Article 13 last paragraph DTC holds that Capital Gains derived from the alienation of property “*other than those*” listed in other paragraphs of article 13 shall be taxed *only* in the state where the alienator is resident.

7. Elimination of Double Taxation

Qatari DTCs eliminate double taxation by way of the deduction or the credit method, while others use the exemption method.

A switch from the exemption method to the credit method is provided for in respect of income that “may be taxed” in Qatar, unless Qatar exempts such income in the furtherance of its treaty obligations (the latter should *not* apply to the profits attributable to a PE in Qatar that “*has benefited from tax incentives under Qatari laws*”).

7.1. Elimination of Double Taxation in Italian-Qatari DTC

Elimination of double taxation in the Italian-Qatari DTC is dealt with in a quite peculiar way providing for a 35% notional tax credit for the business income of Italian enterprises arising in Qatar, regardless of whether such income is taxed in Qatar.⁷

That is clearly a favourable driver for Italian businesses undertaking investments in Qatar as the foreign tax credit shall be granted in Italy at the DTC (*not* domestic) tax rate “*when taxes are levied by the source country at a rate ... either higher or lower than the source country rate*”.⁸

⁶ See Scalia (2015.c), p. 743.

⁷ See Scalia (2015.c), p. 745.

⁸ As stressed by Scalia (2015.d), p. 344 footnote 7, analysing the Italian-Qatari DTC *in conjunction* with an Italian Tax Authorities’ Circular Letter addressing foreign tax credit.

CHAPTER 5

COUNTRY-BY-COUNTRY REPORTING IN QATAR

*Hany Elnaggar**

TABLE OF CONTENT: 1. Foreword. – 2. Entities subject to CbCR obligations. – 3. Effective date. – 4. Notifications and filing requirements. – 5. Content of the CbCR to be filed with the GTA. – 6. Penalties for non-compliance.

1. Foreword

The Qatar Ministerial Decision No. 21 of 2018 on Country by Country Reporting (“CbCR”)¹, with applicability for reporting fiscal years beginning on or after 1st January 2017.

The CbCR rules outlined under the Decision were in line with the OECD guidance on CbCR.

On 28 November 2018, Qatar’s Ministry of Finance published Circular No 6 of 2018 providing further guidance on the implementation of the CbCR obligations.

However in December 2018, the Qatar Tax Authorities suspended the CbCR notification and filing obligations for all constituent entities, and for all Ultimate Parent Entities (“UPE”) that are resident in Qatar.

On 16 June 2019, the General Tax Authority in Qatar issued a notice with respect to CbCR obligations in Qatar, which will now be effective for financial years beginning on or after 1 January 2018.

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¹ Published in the Official Gazette, becoming effective as of 10 September 2018.

The notice requires mandatory CbCR submission for UPE that are a tax resident in Qatar, and reported consolidated revenues equal to or more than QAR 3 billion (approx. EUR 700 million or USD 824 million) in the preceding financial year. The CbCR submission will need to include all qualifying constituent entities.

For the time being, no CbCR reporting or notification obligations, apply to a constituent entity that is tax resident in Qatar, if the Ultimate Parent Entity is resident outside Qatar.

The General Tax Authority, in collaboration with the Qatar Financial Centre (“QFC”) Tax Department where applicable, will monitor the non-compliance with the CbCR obligations and apply penalties in accordance with the Income Tax Law

2. Entities subject to CbCR obligations

Entities that meet the following conditions are required to file their CbC notifications and CbC reports in Qatar:

- Entities resident in Qatar for tax purposes
- “Ultimate parent entities” of multinational enterprise (MNE) groups
- Total revenue of the MNE group is at least QAR 3 billion (approximately €700 million or U.S. \$824 million) in the preceding financial year based on consolidated financial statements of that preceding year

As of September 2019, Qatar has signed the *Multilateral Competent Authority Agreements* (MCAAs) for the automatic exchange of information with 56 countries. Accordingly, an MNE group with operations in a country (other than the countries with existing MCAA) will need to consider that their reporting obligations are satisfied with the other signatory country.

3. Effective date

The CbCR obligations will be effective for financial years beginning on or after 1 January 2018. The CbCR notification and the CbCR will be due within 12 months as of the last day of the MNE’s financial reporting period. This means that for financial

years ending on 31st December, 2018, CbCR notification and reporting will be due by no later than 31 December 2019.

4. Notification and filing requirements

Only ultimate parent entities that are tax residents in Qatar are required to file a CbC notification and CbC report using the form which was attached to Circular 6/2018, issued last year .

With respect to the CbCR filing, the CbCR shall be submitted using the XML schema format as per the guidance provided by the OECD. In this regard, the General Tax Authority will issue an announcement, in due course, that will include the electronic link for the submission of the report.

5. Content of the CbCR to be filed with the GTA

The notice issued by the General Tax Authority requires Ultimate Parent Entities that are required to file a CbCR to include the information as described in the CbCR model in the OECD's Action 13 Final Report. As such, the OECD CbCR template should be followed for CbCR preparation and submission purposes.

The notice emphasizes that the CbCR submission will need to include all qualifying constituent entities. Constituent entities are defined in the notice in a manner consistent with the OECD guidance on CbCR, as outlined below

“To be a separate business unit of the MNE group that is included in its consolidated financial statements for the purpose of financial reporting or that shall be included in the financial statements if the shares thereof are listed on the stock exchange;

to be a business unit that is excluded from the consolidated financial statements of the MNE group only for reasons related to its size; or

to be a permanent establishment of a separate business unit that is described in the two previous bullet points on the condition that the business unit prepares separate financial statements for that permanent establishment for regulatory or tax purposes, financial reporting purposes or internal management and supervisory purposes.”

The notice further asserts that any constituent entity resident in Qatar for tax purposes and that is part of a MNE group the UI-

imate Parent Entity of which is resident outside Qatar shall not be required to file the group CbCR to the General Tax Authority for the time being. In addition, the respective constituent entity shall not be required to submit a notification with respect to the identity of the reporting entity of its place of residence.

6. Penalties for non-compliance

The notice includes details on non-compliance and related penalties. The General Tax Authority will monitor non-compliance and apply penalties on failure to notify, failure to submit the CbCR, or any notifications with missing or incorrect information. Entities which fail to comply with the CbCR obligations will be subject to the financial sanctions provided under Article 24 (8) of Income Tax Law. For QFC entities, monitoring of compliance and enforcement will be carried out in coordination with the QFC Tax Department.

There are penalties for non-compliance with CbC reporting obligations and, namely

1. A penalty of QAR 100 for each day when there is a failure to submit a timely CbC notification or when the submission includes false or incomplete information
2. A penalty of QAR 500 for each day when there is a failure to submit a timely CbC report or when the submission includes false or incomplete information in the report

CHAPTER 6

(PREDICTABLE) ISSUES ON FORTHCOMING QATARI VAT

*Roberto Scalia**

TABLE OF CONTENT: 1. Foreword. - 1.1. Taxable Persons, taxable supplies and deduction. - 1.2. “First time” duties. - 1.3. Transitional rules. - 2. Cross-border scenario. - 2.1. Importing in Qatar. - 2.1. Exporting from Qatar. - 3. Free Zones. - 3.1. Treating Free Zones alike Designated Zones

1. Foreword

At the outset, worth to underline that Qatar has **not** adopted a **Value Added Tax** so far.

However, since January 2017, VAT has been introduced in some other GCC States, in furtherance of the GCC VAT Agreement (hereinafter, the ‘GCC VAT’) with the purpose of introducing a ‘uniform’ VAT across the GCC. Only three out of six GCC States have implemented VAT, so far (UAE, KSA and Bahrain).

This being said, worth to underline that the discussion around implementation of a Value Added Tax (“VAT”) in Qatar was undertaken immediately afterwards the signature of the GCC VAT Treaty in half 2017.¹

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¹ In late 2017, the Qatar University organised the *1st Annual Conference on Fiscal Policy and Economic Development* (<http://www.qfcra.com/en-us/MediaCentre/Documents/Conference%20Agenda-%20Dec%202017.pdf>).

Roberto Scalia was proud to deliver a lecture in the panel on “The Determinants in Drafting VAT Law in Qatar”. See Scalia (2017).

Against this background, in this Chapter the author aims at addressing all such rules that are already provided for in the GCC VAT Agreement and in the three ‘early’ implementer States VAT (that perhaps could be introduced in forthcoming Qatari VAT).

1.1. Taxable Persons and taxable supplies

Taxable Persons are natural and entities (either public or private) carrying out an ‘economic activity’ that is defined as an activity that is conducted in an “*ongoing and regular manner*” including commercial, industrial, etc. and any other similar activity.

The GCC VAT Agreement, also, provides that each Member State may treat the VAT Group as a “single Taxable Person” in compliance with the rules and conditions put in place for that purpose.²

VAT will apply to supplies of goods and services provided for by taxable persons and import of goods or services into Qatar at a 5% tax rate (while export of such Goods or Services outside Qatar will be zero-rated).

Intra-GCC supplies will be regulated according with the ‘reverse-charge’ mechanism, according to which the supply is zero-rated in one GCC State and ‘reverse-charged’ in the other GCC State.

Supplies shall be divided in taxable (and zero-rated), exempted and out-of-scope. GCC VAT shall be neutral for Taxable Persons and neutrality is ensured through the mechanism of deduction of Input VAT from Output VAT (for taxable and zero-rated supplies while deduction is *not* allowed for exempt supplies).

1.2. “First time” duties

² See Scalia (2018.a), par. 3.4.

Non-residents engaged in business in Qatar (or planning to enter into new deals) shall keep in mind that carrying out an activity in Qatar would imply fulfilling VAT duties.

VAT legislation require fulfilling many duties such as registration (and de-registration), invoicing, filing tax return, etc.

Management of such duties, in the “first phase” of VAT implementation through the GCC proved to be quite challenging, also due to the establishment of new units within Tax Authorities.

Worth to underline that Qatar has been working on setting-up such units since the signature of the GCC VAT Treaty and preparing for the first implementation for almost 2 years, so it is easy to foresee that VAT first phase implementation will be smooth and an easy task for the General Tax Authority.

1.2. Transitional rules

A remarkable aspect will be the “transitional rule”.

The GCC VAT Agreement provides for “minimum standards” concerning transitional rules³ and, namely, forthcoming Qatari VAT will have to provide “at least”:

1. that VAT is due on any supply of goods/services and imports as from the date on which the Law will come into effect;
2. timelines for registration duties on the date on which Qatari’s law will comes into effect; and
3. that in respect of invoices issued (or consideration paid) before the date of application of Qatari’s VAT if the supply occurs after the date of entry into force of the VAT Law, Qatar could ignore such date of invoice or payment and consider the moment in which the supply takes place.

Borrowing from other GCC States’ VAT, maybe Qatar will be implementing also some sort of “grandfathering” rules for a transitional phase (e.g. in the first year of implementation) zero-rating selected supplies.

Other rules might provide for different timelines for registration, according to the turnover or regulate VAT exclusive

³ Leaving Member Countries some room for their own approaches in specific areas. *See* Scalia (2019), p. 22.

contract (*i.e.* those contract that do *not* provide for any VAT or tax-related clause).

A special regulation – again, borrowing from other States’ experience – may be provided for regulating contracts entered into with the Qatari Government before the entry into force of the VAT law holding that supplies – wholly or partly done in fulfilment of such contracts – could be zero-rated for VAT purposes.⁴

2. Cross-border scenario

For the purposes of addressing the VAT treatment of international supplies of goods in the GCC, a distinction is made between imports, exports and intra-GCC supplies whereas the latter will be implemented at a later stage.

For the limited purpose of this Chapter will be considered only the issues of (i) import; (ii) export; and (iii) VAT treatment of Free Zones.

2.1. Importing in Qatar

Imports of goods relate to the “*entry of goods into*” the territory of the State in accordance with the provisions of the GCC Common Customs Law.

VAT is due upon the import of goods “*by any person*” (not only taxable persons) who is “*appointed or acknowledged as an importer pursuant to the Common Customs Law*”. As per the GCC Customs Law and Regulations, the importer is “*the natural or legal person importing the goods*” and the person liable for customs duties upon import may also be the person who “owns” the goods (irrespective of the legal title) and who submits the customs declaration.⁵

Arguably, Qatari VAT will be providing some sort of postponement of VAT payment for goods imported by a VAT-registered person (settling the VAT by means of a self-assessment in the subsequent VAT return, where VAT is pre-populated).

⁴ See Scalia (2019), pp. 24-25

⁵ See Hull & Scalia (2018.a), p. 52.

“Inbound services” are “taxable supplies” and the method of taxation depends, in the first place, on whether the supplier is or is not VAT registered within the state of the supply.⁶

2.1. Exporting from Qatar

Exports refer to the “*supply of goods from any Member State to outside the territory of the GCC States*”. As a general rule, the export of goods is a “zero-rated” supply (and, accordingly, input VAT attributable to exports is fully deductible).

Borrowing from other GCC States’ VAT experience, Qatar might also divide between ‘direct’ and ‘indirect’ exports.

3. Free Zones

In general terms, the GCC VAT Agreements does *not* address the issue of Free Zones.

Free Zones could become an issue, insofar treated in *two* different ways in the forthcoming Qatari VAT legislation (fitting the UAE approach, in this respect).

Noteworthy, the UAE, has been dividing the ‘territorial’ scope of VAT between *(i)* Mainland and *(ii)* Designated Zones.

While in the former case (Mainland and “simple” FZs) the supply is deemed to be “inside” the State and VAT applies straightforward, in the latter case (FZ that is also a DZ) the analysis requires further attention (*see* par. 3.1. below).

3.1. Treating Free Zones alike Designated Zones

DZ could be, than, treated as being ‘outside’ the State, (while DZ business – *i.e.* FZ branches and legal entities – called to comply with registration (and other) VAT duties).

The entry of goods into a DZ would *not* entail an “Import” as such and, than, would *not* be charged VAT.

Consistently, an exit of an item (previously entering into the DZ from outside Qatar) would *not* entail an “Export”.

⁶ *See* Hull & Scalia (2018.b), pp. 105-106.

In the event goods exported by Qatari mainland would “pass through” a DZ, the forthcoming legislation might provide for a *lex specialis* according to which such “*movement of goods*” from the State towards a DZ shall *not* be considered an ‘export’ (and, than, shall be charged VAT, accordingly as it was a domestic supply). Accordingly, the subsequent exit of items from the DZ towards final destination outside Qatar would be zero-rated.

Transfer between two DZ might be relieved VAT (e.g. considered as being entirely outside the Qatari territory).

SECTION 2

SELECTED ITALIAN TAX ISSUES

CHAPTER 9

TAX INCENTIVES FOR COMPANIES INVESTING IN ITALY [1]

Francesca Fracassi

TABLE OF CONTENT: 1. Foreword. – 2. The sc. Mini-CIT. – 3. Tax credit for R&D. – 4. The Patent Box regime. – 5. Super-depreciation and hyper-depreciation.

1. Foreword

This Chapter is a very high level analysis¹ on the main incentives granting tax benefits in Italy. To this token, any foreign company can easily obtain a direct benefit if having a branch in Italy. Such benefit will be indirect gained for the foreign companies who hold a participation in Italian subsidiaries.

2. The sc. Mini-CIT

Legislative Decree April 30, 2019, n. 34 (sc. "Growth Decree 2019") implemented sc. "Mini-Corporate Income Tax" (hereinafter the "Mini-CIT"), repealing the original regulation provided for by the Law No. 145 of 2018, that did not apply and replacing the sc. "ACE" (Allowance for Corporate Equity). This benefit introduces the application of a mitigated CIT rate, graduated over the years, on taxable corporate income, for the part corresponding to the profits derived starting as of FY 2018 and

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¹ More details on www.agenziaentrate.it

set aside to reserves other than those not available since FY 2019. *See* Table 01 below.

However, mitigated CIT rate can be gained up to the increased shareholders' equity, determined as the difference between the net equity resulting from the FY (for which the calculation is made) without considering the result of the same year, net of the profits set aside to reserves and subsidized in the previous tax periods, and the net assets of the FY 2018 balance sheet, without considering the result of the same financial year.

In the following table are detailed the reduced "CIT" rates applicable starting from FY 2019:

Table 01

Fiscal Year	CIT rates' trend decrease
2019	22,5%
2020	21,5%
2021	21%
2022	20,5%
from 2023	20%

For each tax period, the part of the profits set aside as eligible reserves, which exceeds the amount of the total net declared income, is calculated as an increase in the profits set aside in the subsidized reserve for the following year.

Below is an example in order to clarify the application mechanism of the tax incentive in question:

Table 02:

Description	(K€)	2018	2019	2020
		[ref yr]		
IRES tax rate incentive		-	22.5%	21.5%
Share capital	1,400	1,400	1,400	1,400
Available reserves			100	250
Year result	100	150	170	
Dividend distribution	0	0	0	
Equity		1,500	1,650	1,820
<i>Taxable income</i>		<i>150</i>	<i>180</i>	<i>200</i>

The concession takes FY 2018 data as a reference and starts from FY 2019.

In FY 2019:

- The total profits realized in FY 2018 and allocated to reserves available in FY 2019 (€ 100k) shall be compared to the increase in the relevant net assets, corresponding to € 100k = [(€ 1,650k - € 150k) - € 1,400k], considering the minor between the two;
- assuming that the taxable income is equal to € 180k and considered eligible for the calculation the profit allocated to the reserve, equal to 100k €, the CIT will be calculated as follows: $CIT = 100k \text{ €} \times 22.5\% + 80k \text{ €} \times 24\% = \text{€ } 41.7k$ (instead of € 43.2k calculated at statutory 24% rate on 180).

In FY 2020:

- the total profits allocated to the reserve (€ 100k + € 150k = € 250k) shall be compared to the increase in the relevant net assets, equal only to € 150k = [(€ 1,820k - € 170k - € 100k) - € 1,400k €] because € 100k are already subsidized profits in FY 2019/20, considering the minor of the two;
- assuming that the taxable income is € 200k, and the increase in shareholders' equity, equal to € 150k, is considered eligible and relevant for the calculation, the CIT will be calculated as follows: $CIT = \text{€ } 150k \times 21.5\% + 50k \text{ €} \times 24\% = \text{€ } 44.25$ (instead of € 48k calculated at 24% on € 200k) .

The Mini-CIT also applies to companies opting for (both domestic and worldwide) tax consolidation regime.

In this case the amount, on which the reduced rate is due, is determined by each participant in the consolidation according to the previous rules and is used by the controlling company, for the purposes of the settlement of the tax due, up to the income exceeding the computed losses decreasing .

The Mini-CIT can be combined with other benefits eventually granted, with the exception to CIT tax rate already reduced to 50% for some categories of subjects, such as for example social welfare institutions and bodies, mutual aid societies, hospital bodies, aid and charity organizations (art. 6 Presidential Decree No. 601 of 1973).

3. Tax Credit for R&D

The R&D tax credit is aimed at stimulating private investments in qualified research and development activities, *i.e.* fundamental research, industrial research and experimental development, the costs of which were incurred between 2015 and 2020.

The benefit consists in the recognition of a tax credit (in relation to a wide range of taxes and contributions, such as for example income taxes, IRAP and VAT) on the incremental expenses incurred in each fiscal year in which the favorable measure is usable, compared to the average of the same investments made in the 2012, 2013 and 2014 tax reference periods.

From 2019, due to the Law of December 30, 2018, n. 145, a differentiation of the rates is envisaged according to the following scheme:

- 50% for expenses of the subordinate research personnel, as well as for expenses related to extra muros relations relating to contracts stipulated with universities, research institutes, start-ups and innovative SMEs;
- 25% for all remaining types of expenses.

The credit is recognized up to a maximum annual limit of 10 million euros per beneficiary, on condition that research and development costs are incurred for an amount of at least 30,000 euros a year.

All the holders of business income (companies, non-commercial entities, consortia and business networks) can take advantage of the credit, regardless of their legal form, company size and the economic sector in which they operate, as well as companies that operate in the national territory (residents or foreigners with permanent establishments in Italy) on the basis of contracts with foreign companies, universities or other localized research body or organization:

- in other EU Member States;
- in the States adhering to the agreement on the European Economic Area (EU members, Norway, Iceland and Lichtenstein);
- in countries that allow an adequate exchange of information .

It is a measure that belongs to the genus of tax incentives, but more precisely to the so-called "tax incentives" automatic: the tax payer, in fact, has the right to immediately offset the accrued credit, indicating it in the tax year declaration in which research and development costs were incurred. The control by the financial administration is optional and takes place ex post, being aimed at verifying compliance with the formal and substantive compliance of the discipline. In particular, the tax credit can only be used in compensation starting from the tax period subsequent to that in which research and development costs were incurred, subject to the fulfillment of the required certification obligations.

In fact, for the purposes of recognizing the tax credit, the actual payment of the eligible expenses and the correspondence of the same to the accounting documentation prepared by the company must result from a special certification issued by the person in charge of the legal audit of the accounts. For companies that are not required to carry out a statutory audit, the certification is issued by a statutory auditor or a legal auditing company.

For the purposes of subsequent controls, the companies benefiting from the tax credit are required to draw up and maintain a technical report illustrating the aims, contents and results of the research and development activities carried out in each tax period.

Furthermore, the tax credit does not contribute to the formation of income, nor to the IRAP tax base.

The R&D tax credit is not subject to the maximum limit set for the compensation c.d. "Vertical" of € 700k for each calendar year, as well as the limit of € 250k euros envisaged for the use of tax credits to be indicated in the RU framework of the income tax return. This facility can be combined with any other tax relief except for the law referred to the latter does not explicitly exclude its cumulation.

4. The Patent Box regime

The Patent Box regime, referred to in paragraphs 37 to 45, art. 1 of Law 23 December 2014, n. 190 (2015 Stability Law) consists of facilitated taxation of income deriving from the use of certain intangible assets.

In particular, this is an optional regime that provides for a partial exemption (up to 50%) from CIT (the IRES) and local business tax (the IRAP) of income deriving from the use of original works such as software protected by copyright, industrial patents, drawings and models, as well as processes, formulas and information relating to legally protectable industrial, commercial or scientific experience .

Once opted, the option is valid for five tax periods and is irrevocable and renewable.

The extent of the deduction is calculated by determining the economic contribution that the use of the intangible asset has made to the total income.

According to the art. 2 of the Decree of 30 July 2015 (so-called “Patent box”), it is possible to opt for this favourable regime, on condition that they carry out research and development activities aimed at developing, maintaining, increasing the aforesaid intangible assets. Such regime is available for companies, individual entrepreneurs, others bodies - other than companies - that carry out commercial activities, as well as non-resident tax payers with a permanent establishment in Italy to whom the intangible assets in question are attributable, provided they reside in a country with which an agreement is in force to avoid double taxation and with which the exchange of information is effective.

As regards the procedure to be followed to access the benefit, in the case of direct use of the eligible intangible assets, the calculation of the eligible income should have been carried out beforehand in contradiction with the Revenue Agency (so-called ruling procedure).

In this regard it is specified that with the D.L. n. 34/2019 (so-called Growth Decree) an important change was introduced, applicable starting from FY 2019, which provides that the tax payer can proceed with the direct determination of the benefit, postponing control by the AF to a time after the presentation of the tax return - without therefore the need to reach a prior

agreement with the Financial Administration - (so-called «self-determination» or «do-it-yourself» option).

In particular, it is possible to deduct the eligible income in three years and in annual instalments of the same amount.

To this end it is necessary to determine and declare the “reduced” income indicating the necessary information in suitable documentation prepared according to what will be provided for by a future provision by the Director of the Revenue Agency .

The decrease must be indicated in the corporate tax return and in the IRAP return relating to the FY in which the option is exercised and in those relating to the two subsequent FYs.

With regard to the sanctioning regime, the Growth Decree also provides that in the event of adjustment of the business income determined directly by the subjects opting for the Patent Box regime, the penalties from 90% to 180% of the greater tax due or of the difference of the credit used (as per article 1, paragraph 2, Legislative Decree No. 471/1997) does not apply IF:

- during accesses, inspections, verifications or other investigative activity, the tax payer delivers to the Financial Administration all the relevant documentation required to determine the eligible income;
- the tax payer presents a supplementary tax return before having formal knowledge of the start of any control activity relating to the regime referred to in paragraphs 37 to 45 of the art. 1, Law n. 190/2014.

5. Super-depreciation and hyper-depreciation

All the persons producing business profits (including permanent establishments in the State of non-resident persons), regardless of their legal form, company size and the economic sector in which they operate can gain Super-depreciation and hyper-depreciation benefits (*see* par. 5.1 of Circular Letter No. 4/E of March 30, 2017).

Super-depreciation is a tax allowance that provides for the increase in the depreciation of instrumental assets, used to incentivize investments in new instrumental material assets .

Article 1 of the Legislative Decree April 30, 2019, No. 34 widens the scope by providing that for the purposes of income taxes, for persons producing business profits and for those performing arts and professions who make investments in new in-

strumental tangible assets from 1 April 2019 to 31 December 2019 (or by 30 June 2020 provided that by 31 December 2019 cumulatively it is proved that the delivery order has been accepted by the seller and that down payments have been made at least equal to 20% of the purchase cost).

The facilitation consists, in particular, of the 30% increase in the purchase cost of the asset for the purpose of determining the fiscal depreciation rates and the financially deductible financial lease payments.

However, the increase does not apply to the part of total investments exceeding the limit of € 2.5 M.

The following is a simulation of the expected tax benefit for a person with a business income :

Table 03

	2019	2020	2021	2022	2023	2024	2025	2026	2028	Tot.
Super-depreciation (in K€)	47	94	94	94	94	94	94	94	47	750
<i>Tax benefit CIT (24%)</i>	<i>11</i>	<i>23</i>	<i>11</i>	<i>183</i>						

On the other hand, **hyper depreciation** consists in increasing the cost of purchasing high-tech equipment for the purposes of calculating depreciation, in order to support and incentivize companies that invest in new capital goods (software and IT systems) functional to the technological and digital transformation of production processes .

The Law of 30 December 2018, No. 145 (sc. “Budget Law 2019”) has widened the allowance to investments in new instrumental tangible assets pursuant to Annex A of the Law of 11 December 2016, n. 232 (for the most part, they coincide with

the enabling technologies pertaining to the field of industry 4.0), destined for production facilities located in the State territory, carried out by 31 December 2019 (or by 31 December 2020 provided that by as of December 31, 2019, the relevant order is accepted by the seller and down payments have been made at least equal to 20 percent of the acquisition cost).

The current regulation provides for three different percentages of cost increase depending on the amount of the investment made. In particular, the surcharges beyond the "basic" depreciation are defined based on the brackets:

- a) 170% hyper-depreciation for investments up to 2.5 million euro;
- b) 100% hyper-depreciation for investments in addition to the amount of 2.5 million euro and up to 10 million euro;
- c) 50% hyper-depreciation for investments in addition to the amount of 10 million euro and up to 20 million euro.

On the other hand, over the 20 million euro threshold there is no concession.

Furthermore, for those who benefit from the aforementioned increase and who, in the same period, make investments in instrumental intangible assets included in the list referred to in Annex B of the law of 11 December 2016, n. 232 (software, systems and system integration, platforms and applications), the acquisition cost is increased by 40%.

To benefit from hyper-depreciation, it is necessary to prepare a substitutive tax return of an affidavit made by the legal representative or, for assets whose acquisition cost exceeds € 500k, a sworn technical appraisal by an expert or engineer registered in the respective professional registers or a certificate of conformity issued by an accredited certification body, certifying that the asset has technical characteristics such as to include it in the lists referred to in the aforementioned attachments and, likewise, the successful interconnection of the asset to the system production management or supply network.

The calculation of the tax benefit of the hyper-depreciation, considering for example the 170% increase for an investment in a tangible asset as per Annex A of € 2.5 Mio with depreciation rate of 10%, can be represented in the table:

Table 04

<u>Iper-D.</u>	<u>19</u>	<u>20</u>	<u>21</u>	<u>22</u>	<u>23</u>	<u>24</u>	<u>25</u>	<u>26</u>	<u>28</u>	<u>29</u>	<u>30</u>	<u>Tot.</u>
<u>(in K€)</u>	212,5	425	425	425	425	425	425	425	425	425	212,5	4.250
<i>Tax benefit CIT (24%)</i>	51	102	102	102	102	102	102	102	102	102	51	1.020

CHAPTER 10

TAX INCENTIVES FOR COMPANIES INVESTING IN ITALY [2]

*Francesca Fracassi*¹

TABLE OF CONTENT: 1. Foreword. – 2. Tax incentives for investments in start-up and innovative SMEs, carried out by Corporate tax companies

1. Foreword

Innovative start-ups enjoy a dedicated framework in matters such as administrative simplification, labor market, tax incentives and bankruptcy law. A large part of these measures are also extended to innovative SMEs, that is, to all small and medium-sized enterprises operating in the field of technological innovation, regardless of the date of incorporation or the corporate purpose.

Focusing on tax incentives the Decree of 7 May 2019 contains the procedures for access to tax incentives for investments in start-ups and innovative SMEs , carried out by both individuals and companies.

2. Tax incentives for investments in start-up and innovative SMEs

The incentives applies to IRPEF (Personal Income Tax) and IRES (Corporate Income Tax) taxpayers undertaking a subsidized investment in one or more innovative start-up or innova-

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tive SMEs eligible in the tax periods subsequent to the one in progress at 31 December 2016.

The benefits apply to cash contributions recorded under the item of the share capital and of the share premium reserve of shares or quotas of innovative start-ups, of eligible innovative SMEs or of corporate entities investing mainly in innovative start-ups or eligible innovative SMEs, as well as investments in units of collective investment savings institutions.

Innovative SMEs are joint-stock companies with less than 250 employees, whose annual turnover does not exceed €50 M euros or whose total annual assets do not exceed € 43M - as established by recommendation 2003/361 / EC - and fulfilling the following requirements:

a) residence in Italy pursuant to Article 73 of the TUIR, or in one of the EU Member States or in States party to the agreement on the European Economic Area, provided they have a production site or a branch in Italy;

b) certification of the last financial statements and any consolidated financial statements prepared by an auditor or an auditing company registered in the register of auditors;

c) their shares are not listed on a regulated market;

d) the absence of registration in the special register provided for by article 25, paragraph 8, of the decree-law 18 October 2012, n. 179 (special section in the Business Register for innovative start-ups);

e) at least two of the following requirements:

1. volume of expenditure in research, development and innovation in an amount equal to or greater than 3% of the largest entity between cost and total value of the production of the innovative SME (the costs result from the last approved balance sheet and are described in the explanatory notes);
2. employment as employees or collaborators in any capacity, in a percentage equal to or greater than 1/5 of the total workforce, of staff holding a research doctorate degree or who is carrying out a research doctorate at an Italian or foreign university, or with a university degree and who has carried out, for at least three years, certified research activity in public or private research institutes, in Italy or abroad, or, in a percentage equal to or greater than 1/3 of the total workforce, of personnel in possession of a master's degree pursuant to arti-

cle 3 of the decree of the Minister of Education, University and Research 22 October 2004, n. 270;

3. ownership, also as custodian or licensee of at least one industrial patent, related to an industrial, biotechnological invention, to a topography of a semiconductor product or to a new plant variety or ownership of the rights relating to an original computer program registered with the Registry special public for computer programs, provided that this right is directly related to the corporate purpose and business activity.

Furthermore, innovative SMEs are eligible to the extent that they must receive the initial investment before the first commercial sale on a market or within seven years of their first commercial sale.

Tax incentives for investments in start-ups and innovative SMEs consist, for corporations, in a deduction from the taxable amount for IRES purposes equal to 30% of the relevant investment, with a threshold set at €1.8 M for each tax period. If the deduction is greater than the total declared income, the surplus can be calculated by increasing the amount deductible from the total income of the subsequent tax periods, but not beyond the third, up to its amount.

The concessions are up to a total amount of eligible contributions not exceeding € 15 Mn for each innovative start-up or eligible innovative SME. For the purposes of calculating this maximum amount, all the facilitated contributions received by the innovative start-up or innovative SME admissible in the tax periods in force of the concession scheme are taken into account.

To benefit from the benefits in question, the transferring company must receive and keep (i) an innovative start-up certification that the overall contribution does not exceed the amount of € 15M, or, if exceeded, the amount for the which is the deduction; (ii) copy of the investment plan of the innovative start-up containing detailed information on the object of the transferor's activity, on the related products and on the expected or actual trend in sales and profits.

Finally, it should be noted that the 2019 Budget Law (article 1, paragraph 218) has brought two new elements to the benefits in question (these are temporary changes, valid only for 2019):

- increase, for the year 2019, from 30 to 40% of the benefit measure.
- for IRES – corporate income - taxpayers, the benefit is increased, for the year 2019, from 30% to 50% in cases of acquisition of the entire share capital of innovative start-ups, provided that the entire share capital is acquired and maintained for at least 3 years.

The investments made starting from January 1, 2017, directed towards start-ups and innovative SMEs, duly registered in the relevant special section of the Business Register, are therefore eligible.

To ensure full compliance with European legislation on state aid, the methods of using the incentive for innovative SMEs foresee some differences with respect to what is foreseen for start-ups, in particular for companies active on the market for more than seven and ten years.

To obtain the benefit, innovative start-ups shall meet the following requirements (art. 25 co. 2 of Legislative Decree 179/2012):

A. Joint-stock companies also established as co-operatives, whose shares or quotas representing the share capital are not listed on a regulated market or on a multilateral trading system, operating in the field of technological innovation production, which meet the following requirements:

- a) consists of no more than 60 months;
- b) is fiscally resident in Italy (pursuant to Article 73 of the TUIR), or in one of the EU Member States provided it has a production site or a branch in Italy;
- c) starting from the second year of activity, the innovative start-up must have a total annual production value, as resulting from the last approved balance sheet within 6 months from the end of the year, not exceeding € 5M;
- d) does not distribute nor has distributed profits;
- e) has, as the exclusive or prevalent corporate purpose, the development, production and marketing of innovative products or services with high technological value;
- f) was not constituted by a merger, demerger or following the sale of a company or business unit. Among the operations that preclude the assumption of the innovative start-up qualification are also the operations of business conferral or business unit;
- g) at least one of the following requirements:

1. research and development costs must be equal to or greater than 15% of the greater value between production cost and production value. The costs must be shown in the last approved balance sheet and must be described in the explanatory notes. In the absence of financial statements in the first year of life, their execution is assumed by a declaration signed by the legal representative of the company;

2. employment as employees or collaborators for any reason, in a measure equal to or greater than one third of the total workforce, of personnel holding a research doctorate degree or who is carrying out a research doctorate, or in possession of a degree and who has carried out certified research for at least three years, or, in a percentage equal to or greater than two thirds of the total workforce, of personnel holding a master's degree;

3. is the owner or custodian of an industrial patent relating to an industrial, biotechnological invention, a topography of a semiconductor product or a new plant variety or must be the owner of the rights relating to an original computer program registered with the special public register for computer programs, provided that such rights are directly related to the corporate purpose and business activity.

B. The innovative start-up is characterized by the corporate purpose, represented by the development, production and marketing of innovative products or services with high technological value. By virtue of the broad definition provided by the legislator, the scope of activity of innovative start-ups is likely to find application in many and different economic sectors. Among these are, for example, the following: software production and IT consulting, retail trade, furniture manufacturing, forestry, rental business, food, textile and manufacturing industries.

CHAPTER 11

ITALIAN “CONTROLLED FOREIGN COMPANIES” RULES

*Marcello Moretti*¹

TABLE OF CONTENT: 1. Introduction. – 2. Subjective requirements. Control. – 2.1. Type of control. – 2.1.1. Legal control. – 2.1.2. Economic control. – 2.1.3. “De facto” control. – 2.2. Indirect control. – 3. Objective requirements. – 3.1. Tax rate test. – 3.2. Passive income test. – 4. CFC application. – 4.1. Rules for computing income. – 4.2. Rules for attributing income. – 4.3. Rules to eliminate double taxation. – 5. CFC exemption (Advance ruling). 6. Branch exemption

1. Introduction

Controlled foreign company (CFC) rules are aimed to preserve national tax bases from erosion and profit shifting. Taxpayers with a controlling interest in a foreign subsidiary, located in a Country with a low effective tax rate, in fact can strip the base of their residence Country by allocating income to the foreign subsidiary by means of tax planning practices. This allows, on the one side, a reduction of the current overall tax liability of the group and, on the other side, long-term deferral of taxation.

It should be noted that the income shifted to the subsidiary is usually mobile passive income.

CFC rules work in a way to reattribute the income of a low-taxed controlled foreign subsidiary to its parent company.

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As a result, consequently, the parent company is subject to tax on this income in its State of residence. It should be noted that the reattribution is made during the fiscal year in which the income is produced, without waiting its distribution to the parent

The Italian CFC rule is encompassed in art. 167 of the Italian Income Tax Code (IITC)² and this anti-abuse provision has been modified lots of times during the last years, lastly was amended by the Legislative Decree n. 147/2015, by the Law n. 208/2015³ and more recently by the Legislative Decree n. 142/2018⁴.

2. Subjective Requirements. Control

CFC rules generally apply to foreign companies that are controlled by shareholders in the parent jurisdiction.

Are encompassed by the application of this anti-avoidance provision the following persons, subject to either IRPEF or IRES, as long as they are considered fiscally resident in Italy:

- a. individuals (art. 2 IITC);
- b. companies and trusts (art. 73 IITC);
- c. transparent entities (art. 5 IITC).

Are also included collective investment vehicle (CIV) and Italian permanent establishment (PE) of non-resident entities⁵.

2.1. Type of control

Control can be established in various ways and art. 167 IITC directly refers to art. 2359 of the Civil Code which includes three different kind of control. Light should be shed on the fact that the control condition must be assessed at the end of the subsidiary fiscal year.

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² DPR n. 917/1986.

³ About the amendments introduced by the Legislative Decree n. 147/2015 and by the Law n. 208/2015, for a detailed and exhaustive analysis see M. Moretti (2017), pp. 750-784.

⁴ The Legislative Decree n. 142/2018 represents the transposition into national law of the Anti Tax Avoidance Directive (Directive (EU) 2016/1164).

⁵ PE inclusion is of course limited to controlling interest that are contained in the PE statement of assets and liabilities.

2.1.1. Legal control

Legal control looks at a resident's holding of share capital to determine the percentage of voting rights held in a subsidiary.

It reflects the fact that the majority of the voting rights, i.e. 50% plus 1 vote, enables residents to elect the board of directors or an equivalent body responsible for the affairs of the foreign entity and thus ensure that a CFC acts in accordance with their instructions.

2.1.2. Economic control

Economic control focuses on rights to the profits. Such a test, that requires the entitlement to more than 50% of the subsidiary profits, recognises that a resident can control an entity through an entitlement to the underlying value of the company even where they do not hold the majority of the shares.

2.1.3. "De facto" control

"De facto" control look both at the holding of share capital and other factors. This approach focuses on particular contractual ties with the company located in low-tax jurisdiction that allow taxpayers to exert a dominant influence over it.

With regard to the holding of share capital, situations in which a shareholder holds a sufficient degree of voting rights, even if the majority is not ensured, in order to establish the subsidiary governance must be noticed.

With reference to other aspects, this approach focuses on particular contractual ties with the company located in the low-tax jurisdiction that allows taxpayers to exert a dominant influence over it.

2.2. Indirect control

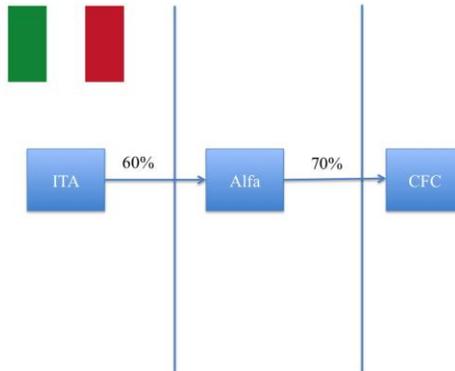
The anti-avoidance rule tackles not only direct controlling interest in companies located in low-tax jurisdiction but also in-

direct ones held through trustee company, interposed person or chain control.

In case of chain control, the control condition must be evaluated taking carefully into account all the chain (Table 01).

Table 01

Calculation of indirect control interest



1

ITA has a 60% interest in Alfa, which holds a 70% interest in CFC. There is then more than 50% control at each tier. However ITA only holds an interest of 42% (60% x 70%) in CFC. Despite that, ITA has enough economic control on CFC, that the anti-avoidance rule must find application also in this case.

3. Objective requirements

CFC provision applies to non resident controlled companies, as explained above, which fulfil both the following conditions⁶.

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⁶ It should be underlined that CFC rules are compatible with the EU framework. On this point see European Court of Justice, 12 September 2006, causa C-196/04, *Cadbury Schweppes vs. Commissioners of Inland Revenue*, in Racc., I-07995.

3.1. Tax rate test

The first condition is connected with the effective tax rate borne by the subsidiary located abroad.

CFC rule only applies to controlled foreign companies that are subject to effective tax rates that are meaningfully lower than those applied in the parent jurisdiction, more exactly only when the taxation is lower than the 50% of the taxation that the company should have suffered if located in Italy.

It must be stressed that the reference is made to the effective tax rate and not to the nominal one. Then the comparison has to be made taking into account the foreign effective corporate income tax and the Italian one. About the latter, after years of discussion, now it has been clarified that only the Italian corporate income tax (IRES) must be taken into account for this purpose. Then the regional tax on productive activities⁷ (IRAP) it must be considered totally irrelevant.

To calculate the effective foreign taxation, the actual income tax suffered abroad must be divided by the gross income before taxation resulting from the subsidiary balance sheet.

To calculate the Italian theoretical effective taxation, the hypothetical income tax suffered in Italy must be divided by the gross income before taxation resulting from the subsidiary balance. About this point, it should be stressed that the hypothetical income tax suffered in Italy has to be determined following some rules that should allow to simplify the computation⁷.

If the effective foreign taxation is less than 50% of the Italian theoretical effective taxation, this one calculated in a simplified manner, the CFC rules find application.

On the contrary, if the effective foreign taxation is at least equal to 50% of the Italian theoretical effective taxation, this one calculated in a simplified manner, the anti-abuse measure does not find application.

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⁷ The simplified rules are identified in the Provision by the Director of the Italian Revenue Agency n. 143239, published on 16 September 2016.

3.2. Passive income test

The second condition is related to the subsidiary income qualification.

CFC rule only applies to controlled foreign companies whose income consists for more than one third of passive income.

Into the passive income category, for example, fall:

- a. interest;
- b. royalties and IP income;
- c. dividend;
- d. insurance income;
- e. services income, with no or low added-value, realized to related entities.

4. CFC application

Once established that all the conditions required for the CFC application are met, there is a need to understand:

- a. how the income must be computed;
- b. how the computed income is attributed to the controlling shareholder;
- c. how the system eliminates double taxation arising from the CFC application.

4.1. Rules for computing income

Computing the income of a CFC requires two different steps:

- a. determine the applicable jurisdiction,
- b. understand if specific rules for computing CFC income apply.

Art. 167(7) IITC states that CFC income must be determined taking into account Italian tax rules on business profits and, more specifically, it is stated that some exceptions must be observed. In determining CFC income, for instance, does not find application neither the anti abuse provision named “società

di comodo” nor the possibility to divide into instalments capital gains taxation on tangible assets held by more than 3 years⁸.

4.2. Rules for attributing income

Income attribution can be divided into at least three steps:
 define which taxpayers should have the income attributed to them;

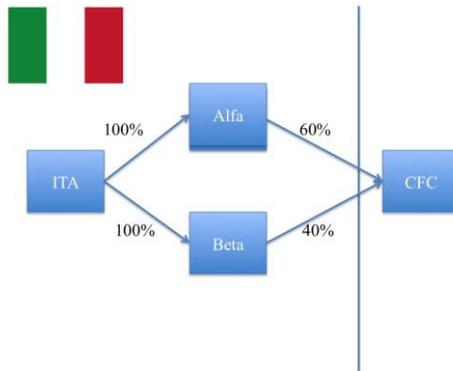
understand how much income should be attributed;

determine how the income should be included in the returns of the taxpayers.

In order to allocate the income correctly, jurisdictions must first define to whom the income must be attributed. The Italian CFC opted for attributing the income to the first Italian resident company who holds a holding interest in the CFC. It must be stressed that, in case of chain control involving more Italian resident companies, the obligation to declare the income can be separate from the obligation to calculate it (Table 02).

Table 02

Obligation to declare the income vs. obligation to calculate it



⁸ Also the ACE, deduction connected with the hypothetical equity remuneration, does not find application. However, this measure was repealed by the Law n. 145/2018. Right now, from the 2019 tax year onwards, the resident companies can not benefit from this deduction anymore.

ITA has a 100% interest in both Alfa and Beta, Italian companies resident too, which hold respectively a 60% and a 40% interest in CFC. In this case the CFC income must be calculated by the Parent of higher level. Differently, the CFC income must be declared by the Italian resident companies closer to the CFC. Then, in the case at hand, the income must be declared by both Alfa and Beta.

Once it has been established which taxpayers have CFC income attributed to them, it must be understood how much of that income has to be attributed. The Italian CFC opted for attributing the income in proportion to each taxpayer's ownership. It must be underlined that the control requirement must be evaluated looking at the last day of the CFC accounting year.

Recalling the above-mentioned example (Figure 2), Alfa must declare the 60% of the CFC income and Beta the 40% of it.

Finally, attribution of income raises the question of how that income is taxed once it is attributed. Art. 167(8) IITC states that CFC income is subject in the hands of the shareholders to separate taxation. It means that losses of the Parent can not be offset with the CFC income and the opposite, losses of the CFC can not be used to offset Parent income.

Secondly, about the tax rate, CFC income is taxed using the average taxation applicable to the Parent in such a fiscal year to. Then, dealing with Parent companies, it means the the CFC income suffers a taxation equal to 24%, that is the proportional income tax rate provided for resident companies.

4.3. Rules to eliminate double taxation

A fundamental issue to consider when designing effective CFC rules is how to ensure that these anti-abuse rules do not lead to double juridical taxation.

About this aspect, on the one side, art. 167(10) IITA states that dividends distribution is not subject to tax in the hands of the recipient up to the amount already attributed to its resident shareholders under the CFC rules.

Art. 167(9) IITA, on the other side, allows a tax credit for foreign taxes actually paid abroad by the non-resident according

to the rules enshrined in Art. 165 IITA (Tax credit for taxes paid abroad).

Art. 167(10) IITA, in addition, states that taxes paid abroad on the inbound dividends can be deducted from taxes due according to art. 167(8) IITA.

It should be noted that the deduction provided by art. 167(10) IITA cannot exceed the difference resultant from taxes due according art. 167(8) IITA less the credit granted by art. 167(9) IITA for taxes actually paid abroad by the non-resident.

5. CFC exemption (Advance ruling)

CFC rules, due to the fact that are aimed to prevent abusive practices, must apply when the situation is not genuine, in order to counteract only illegitimate behaviour.

According to art. 167(5) IITA, the anti-abuse rule does not find application if the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances⁹.

Any situation must be evaluated carefully in order to understand if the exemption can apply or not.

It is worth stressing that art. 167(5) IITA gives the possibility to taxpayers to address tax administration in advance in order to know the fiscal authority opinion on a specific situation.

6. Branch exemption

Art. 168-ter IITA, introduced by the Legislative Decree n. 147/2015, provides an option that allows taxpayers to treat Permanent establishments (PE) as independent separated entities.

That means that a PE is treated for tax purposes as a different company.

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⁹ It is worth mentioning that, in relation to the EU framework, primary Community law is hierarchically superior to secondary Community law. Because of that, the exemption must be consistent with the EUCJ case law on this matter. On this point see Court of Justice, 12 September 2006, Cause C-196/04, *Cadbury Schweppes v. Commissioners of Inland Revenue*, in Racc., I-07995.

Then branch exempted income (as well branch exempted losses) are not subject to tax (are not deductible) in Italy in the hands of the head office.

It must be underlined that in such a case the option must be exercised for all the branches of the Italian resident taxpayers (so called “all in option”). This provision aims at avoiding interest arbitrage, that is opting in for branches realizing profits, in order to benefit from the foreign fiscal regime, and opting out for branches realizing losses, in order to reduce the taxable base in Italy.

It must be stressed that branches, when taxpayers exercise option for the branch exemption, are treated as separated entities. That means that all the problems illustrated at the beginning of this chapter concerning profit shifting can be faced in such a situation too.

Because of that art. 167(3) IITA states that CFC rules find application also with reference to branches when it has been exercised option provided by art. 168-ter IITA. Then if taxpayers exercise the branch exemption option, Italy lose taxing power on the income attributable to the branches, so CFC rules find application in order to counteract not genuine arrangements¹⁰.

¹⁰ This is consistent with both BEPS, Designing Effective Controlled Foreign Company Rules (Action 3), 2015, Paris and art. 7 of the Directive (EU) 2016/1164.

CHAPTER 12

ITALIAN PERMANENT ESTABLISHMENT

*Aaron Meneghin**

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1. Legal Framework of the Permanent Establishment in the Italian Tax Law

According to the first definition of permanent establishment (PE) adopted by the Italian Income Tax Code (IITC)¹ that was a fixed place of business through which the business of a non-resident company is carried out in Italy.

Basic requirements for the creation of a PE were:

- (i) a permanent structure / place
- (ii) a business carried out
- (iii) a functional independency from its foreign company.

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¹ Art. 162 of the Presidential Decree no. 917 of December 22, 1986 (*Testo Unico delle Imposte sui Redditi* or *TUIR*)

1.1. Fixed place PE

Unless evidence of the contrary provided by the taxpayer, the following fixed places of business were presumed to constitute a PE in Italy:

- a place of management;
- a branch;
- an office;
- a factory
- a workshop;
- a mine, an oil or gas fields, a quarry or other place for the extraction of natural resources.

On the other hand, there were a list of exceptions based on which there was not a deemed PE:

- (i) in case a fixed place of business used only to perform certain preparatory or auxiliary activities²;
- (ii) in case of maintenance of electronic processors and auxiliary equipment used for the collection and transfer of data and information aimed to the sale of goods and services.

1.2. Agency PE

Beside the lists of conditions that constituted or excluded the existence of a fixed place PE, the old definition provided also the identification of an agent PE: this happened in case of a person habitually

² Activities not deemed to constitute a PE were:

- the use of an installation solely for the purpose of storage, display, or delivery of goods belonging to the enterprise;
- the maintenance of a stock of goods belonging to the enterprise solely for the purpose of storage, display, or delivery;
- the maintenance of a stock of goods belonging to the enterprise solely for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or collecting information for the enterprise;
- the maintenance of a fixed place of business solely for the purpose of carrying out any other preparatory or auxiliary activity for the enterprise;
- the maintenance of a fixed place of business solely for a combination of any of the activities indicated above, provided that the resulting overall activity of the fixed place of business is of a preparatory or auxiliary nature.

concluding contracts in Italy on behalf of a non-resident company, unless the person concluding the contracts in Italy was a broker, a general commission agent, an independent³ agent or where acting in the ordinary course of his/her business.

2. The new amendments to the old PE definition

The 2018 Budget Law introduced a new concept of Fixed Place PE enacted in the context of tax measures for the digital economy.

With the Budget Law for 2018⁴ Italy amended the definition of PE foreseen by article 162 of the ITC and implemented some of the guidelines set forth by the OECD in its Final Report on BEPS Action 7 to prevent the artificial avoidance of PE status through:

- i. the introduction of a new item within the (positive) list of fixed places of business constituting a PE;
- ii. the amendment of the (negative) list of activities regarded as auxiliary and preparatory;
- iii. the introduction of an “anti-fragmentation rule”;
- iv. the amendment of the definition of Agency PE.

2.1. The new (positive) list of Fixed Place PE

Under the new Art. 162 of the ITC, a non-resident entity’s significant and continuous economic presence in Italy may constitute a fixed base that could give rise to an Italian PE even if it does not result in a physical presence.

This new PE definition seems to be based on Action 1 of BEPS project, in particular on the notion of “significant economic presence”, so that non-resident digital company business models - that are not uncommon in the digital economy - may now trigger taxable presence in a country even without their material or personal physical presence.

At the same time 2018 Budget Law repealed Art. 162, par. 5, with regard to “availability of electronic processors and other auxiliary

³ Where the meaning of the adjective “independent” shall be interpreted from a financial, an economic or even a legal point of view.

⁴ Law n. 205 of December 27, 2017.

equipment used for the collection and transfer of data and information aimed to the sale of goods and services”.

The elements triggering nowadays the significant and continuous economic presence are:

- (i) the earning of revenues from customers situated in the country,
- (ii) the presence of a local digital platform;
- (iii) the frequency of digital transactions; and
- (iv) the number of customers.

2.2. The (negative) list of auxiliary and preparatory activities

The list of activities not subject to PE has been amended in order to provide that a fixed place of business will not constitute a PE if the taxpayer can prove that both each single activity and a combination of them have a preparatory or auxiliary nature with respect to business of the foreign entity.

Consequently an activity will not be anymore automatically disregarded as Fixed Place PE just for the fact to be included in the (negative) list, but a case-by-case analysis shall be carried out in order to assess the importance and essentiality of that activity within the business.

2.3. The new Anti-Fragmentation Rule

The 2018 Budget Law introduced an anti-fragmentation rules aimed from preventing any fragmentation of non-resident company business into minor activities executed the same or in different locations and/or using other related legal entities or PE's to benefit from the preparatory or auxiliary exemption.

Consequently the new Art. 162 of the IITC now provides that the specific activity exemption shall *not* apply to a fixed place of business that is used or maintained by the foreign enterprise if the following conditions are met:

- i. the same enterprise, or a closely related enterprise, carries on business activities at the same location or another location in Italy;

- ii. the location(s) constitutes a PE for either enterprise under the provisions of Art. 162 of the IITC, or the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the enterprise(s) at the two locations, are not of a preparatory or auxiliary character;
- iii. the business activities carried on by the two enterprises at the same place, or by the enterprise(s) at the two locations, constitute complementary functions that are part of a cohesive business operation.

Though this new provision will bring more clarity in applying PE identification rules, some commentators have now highlighted that this new an anti-fragmentation approach is recognizing what Italian case law already applied in the past.⁵

2.4. The new definition of Agency PE

Under the new Art. 162 of the IITC, a PE is deemed to exist “were a person acts in Italy on behalf of a foreign enterprise and, in so doing, habitually concludes or is involved in the conclusion of contracts that are routinely approved by the foreign company without material changes.

The new rules foresees that an Italian PE is deemed to exist where the contracts are:

- i. in the name of the enterprise,
 - ii. for the transfer of ownership or of the right to use property owned or used by the enterprise, or
 - iii. for the provision of services by that enterprise,
- unless the activities performed under the contract signed by the person acting in Italy on behalf of the foreign enterprise are limited to the activities included in the negative list.

⁵ The Italian Supreme Court Decision no. 20597 of October 7, 2011 ruled that, for the purpose of ascertaining whether non-resident parent companies have a PE in Italy, it is not relevant whether activities are carried out by several entities, rather than by a single one. Instead, the determination shall be made by reference to facts and circumstances in order to demonstrate whether the entities carried out a business as parts of an economically integrated and unitary structure that achieved an overall business purpose of the group.

Consequently, agreements that are negotiated and signed by a person that are not binding until accepted abroad will be attributed to a PE and taxed in Italy as if the contract were legally binding prior to acceptance abroad.

Another exception to the PE rule foreseen by art. 162, par. 7, of the IITC applies when the person acting in Italy on behalf of a foreign enterprise carries out its own business in Italy as an independent agent and acts for the enterprise in the ordinary course of his/her business. When, however, a person acts exclusively - or almost exclusively - on behalf of one or more enterprises to which it is closely related, that person will not be considered to be an independent agent with respect to any such enterprise.

In any event, the requisite degree of control will exist when (i) one person or enterprise directly or indirectly possesses more than 50% of the beneficial interest in the other or, in the case of a company, more than 50% of the aggregate vote and value of the issued and outstanding share capital; or (ii) another person directly or indirectly possesses more than 50% of the beneficial interests in both persons or enterprises or, in the case of a company, more than 50% of the aggregate vote and value of the share capital in both companies.

It is worth to note that Italian case law contains a broad interpretation of the Agency PE concept.⁶

⁶ In the sc. “Phillip Morris-case” the Supreme Court affirmed, *inter alia*, the following principles:

- the participation of officers or representatives of an Italian company in phases of the negotiation or conclusion of contracts on behalf of a related company abroad constituted an Agency PE even if it was not granted a formal power of representation. In this respect, the Supreme Court observed that the Italian company was not acting in the ordinary course of its business when providing services to related non-resident companies that were not included in its statutory business purpose and were performed without any formal mandate by the non-resident group companies;
- a local structure carrying out management of business transactions for the benefit of a non-resident company should be deemed to constitute a PE in Italy;
- the existence of a PE in Italy shall be assessed based on the substance rather than exclusively on the mere legal form of the business transactions;
- a company situated in Italy may be deemed to be a PE of multiple foreign companies within the same group that pursue a common business strategy;

3. PE and Tax Treaties signed by Italy

The new PE definition under domestic tax law is currently much broader than the previous one and covers several scenarios where a non-resident company enterprise, even not having a physical presence in Italy, has a business model that may create the existence of a PE in the Country.

It is important to highlight that the domestic law definition of the PE does not overrule that one within article 5 of the tax treaties signed by Italy because under the Italian constitution law, tax treaties prevail over domestic law, having the source of international law a higher hierarchy within the different legal sources.

Although the new definition of the PE term in the IITC does not overrule article 5 of Italy's existing tax treaties, foreign investors shall consider that Italy will move towards a renegotiation of its tax treaties pursuant to the Multilateral Instrument, ultimately enforcing the same concept and achieving consistency between international tax law and domestic tax law.

Nevertheless, in the meantime, the Italian tax authority may be tempted to apply the new PE provisions disregarding the in Italy's current Tax Treaties, pursuant to a general anti abuse principle already applied by the Supreme Court, also on judicial cases law previously cited.

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- with reference to the activities performed in Italy, the legal relationships between different group companies should be analyzed a whole;
 - group companies which are part of an unified strategy aimed at maximizing Italian profits for all non-resident companies involved have an Agency PE in Italy.

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