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ARTICLE

Operating Base and Taxation for Foreign Airline Companies Operating in Italy

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Article 38 of the so-called Development Decree provided a definition for 'operating base' for airline companies operating in the passenger traffic sector by means of an operating bases system.

The said provision aims to prevent controversies that had already arisen in the past with airline companies, which adopted the above business model, assimilating operating bases equipped with infrastructures and service staff to a permanent establishment and, therefore, compelling the said companies to comply with national tax and social security rules and regulations.

1 Permanent establishment and VAT

With regard to Value Added Tax (hereinafter 'VAT'), Article 7 of Pres. Dec. No. 633/1972 merely refers to the concept of permanent establishment – for territorial aspects of the supply of services – without providing any specific definition, nor was any definition provided by the VI EU Directive (Directive 77/388/EC of 17 May 1977) which, ex Article 9, paragraph 1, refers to the so-called *permanent activity center* different from the seat, which – pursuant to the interpretation of the Court of Justice – requires that *it exhibits a sufficient degree of stability and a suitable structure, from the standpoint of human and technical equipment, such to provide independently the supply of services under consideration*.

Pursuant to the Court of Justice, the characterizing element of what constitutes a *permanent activity center* is without a doubt, in addition to being the fixed place of business available to the non-resident taxpayer, the permanent presence of human and technical means having the purpose to carry out operations that are VAT relevant; within a direct taxation system, instead, such elements may also occur severally.

Furthermore, under VAT legislation, the existence of a permanent activity centre is linked to the carrying out of an economic activity, whether it involves an enterprise, the arts or a profession, differently from treaty provisions (and from national legislation), which impart relevance to the permanent establishment for the unique purpose of taxing business incomes.

Article 11 of EEC Regulation 282 of 15 March 2011, providing implementing rules of Directive 2006/112/EC, designates the permanent establishment as:

– any organization, different from the seat of economic activity, characterized by a sufficient degree of permanence and a structure that is sufficiently suitable in terms of human and technical means such to provide and receive services supplied to the same for own requirements of the said organization;

– any organization, different from the seat of economic activity, characterized by a sufficient degree of permanence and a structure that is sufficiently suitable in terms of human and technical means such to allow the same to provide the services, which supply it guarantees.

Paragraph 3 of Article 11 under examination establishes that the mere fact of owning a VAT ID number is not in itself sufficient to deem that a taxpayer owns a permanent establishment.

2 Permanent establishments of airline companies for direct tax purposes

With reference to income tax, ascertaining the presence in Italy of a permanent establishment of a foreign airline company should follow the criteria set forth ex Article 162 of the Italian Income Tax Code (Hereinafter, TUIR); in the absence of a permanent establishment, no tax should be due in Italy.

Notes

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Furthermore, it would be appropriate to underline that, for direct tax purposes, Article 8 of the Organisation for Economic Co-operation and Development (OECD) Model Convention against double taxation[1] (hereinafter, 'OECD Model') involves incomes deriving from activities carried out by means of watercrafts or aircrafts within an international traffic context.

The definition of *international traffic* is set forth under Article 3, paragraph 1), LTR. d), of the OECD Model, which states that the said expression refers to any kind of transportation (by sea or by air) carried out by an enterprise which has its place of effective management in a contracting State, save for the case in which transportation by ship or airplane occurs solely between the locations of the other contracting State.

Paragraph 1 of the above Article 8 provides, on the basis of general criteria, that profits deriving from an international transportation business, irrespective of the means of transportation used, are taxable in the State in which the place of the enterprise's effective management is located.

Therefore, just to provide an example, income realized by the Italian permanent establishment of a foreign airplane company, residing in Germany, which sells in Italy a passenger transport service for the Italy-Germany route, or the Italy-France route, will be exclusively taxable in Germany; income realized by the permanent establishment will be taxed exclusively in Italy for the sale of a ticket relating to an internal route within national territory (e.g., the income deriving from the sale of an airplane ticket from Rome to Milan).

Point 2 of paragraph l of the Commentary to Article 8 of the OECD Model provides that States are allowed to choose, as an alternative, to establish that such incomes be taxable in the enterprise's State of residence.

The subsequent point 3 of paragraph 1 of the Commentary provides that States may opt for the adoption of a *mixed* criterion (principle of effective place of management and principle of residence), by virtue of which the State where the effective place of management is located would have the right to subject to taxation the said incomes, whereas the provision set forth under Article 23 (regarding the elimination of double taxation) of the OECD Model would apply to the State of residence (where this latter is different from the first one).

Nevertheless, some Treaties against Double Taxation (hereinafter 'DTTs') stipulated by Italy (such as for example, the one with the United States (US)) provide ex Article 8 that *the profits of an enterprise of one contracting State deriving from the carrying out of activities – within an international traffic context – of watercrafts or aircrafts are taxable only in the said State*.

Ultimately, it should be noted how the mentioned DTT between Italy and the US, under point 6 of the Supplementary Protocol provides that:

> (f)or the purposes of Article 8 (Marine and air navigation) of the Treaty and that notwithstanding any other provision under the Treaty, profits realized by a United States citizen who is not resident in Italy or by a United States company from the exercise of activities relating to watercrafts or aircrafts registered pursuant to U.S. laws, are not taxable in Italy.

3 The concept of operating base

Article 38, paragraph 1, of Decree-Law 179/2012 (hereinafter Development Decree) introduced a provision defining *operating base* for airline companies.

In particular, the above provision establishes that:

> (for) the purposes of aeronautical laws, the expression «base» identifies a complex of premises and infrastructures by means of which an enterprise carries out a permanent, habitual and ongoing air transportation activity, by availing itself of employees whose center of professional activities is therein located, in the sense that they work therein, start their service and return there upon having carried their own activities out. An air carrier owner of a permit to carry out its business activity issued by an EU Member State different from Italy is deemed as being established on national territory when it carries out air transport activities in a permanent, or ongoing, or habitual way starting from a base such as defined under the foregoing paragraph (…).

The said rule may have implications, especially when referring to those so-called *low-cost* carriers, which may be working through an operating bases system.

The difference between the so-called *traditional carriers* and low-cost airlines consists in the fact that:

– the traffic of traditional carriers converges on large continental hubs and close their last evening flights in various airports where they take off from on the following day;

– low-cost air carriers organize their traffic, by taking off from several operating bases from which all of the day's flights originate and close: each base avails itself of a given number of aircrafts, personnel, and ground services, but aircrafts as well as personnel are expected to return to the same operating base at the end of the day.

Notes

[1] For further details on Double Tax Conventions, cf. Valente P., "*Convenzioni internazionali contro le doppie imposizioni*", Milan, Ipsoa, 2012.

The introduction of the said rule would, therefore, assimilate an operating base equipped with infrastructures and staff to a permanent establishment, compelling airline companies operating on national territory through operating bases to comply with tax requirements in Italy.

Some particular issues might arise from the provision set out under the last paragraph of Article 38, paragraph 1, of Decree-Law 179/2012 as it establishes that *in derogation from Art. 3 of Law 212 of 27 July 2000, the paragraph hereof is applicable starting from the tax period in progress as at 31 December 2012*.

Please note that the mentioned Article 3 of Law No. 212/2000 (Taxpayer's Statute) establishes that tax provisions are not retroactive.

It might be worth underlining how, with reference to the so-called *service bases* even the INPS (i.e., 'Italian Social Security Office') issued, on 19 September 2012, Circular 115, which – under Chapter 1 – sets out *Special rules for employees for enterprises operating within the sector of civil aviation*.

To facilitate the application of European Community (EC) rules regarding laws on the question of flight and cabin crews, employed by enterprises operating in the civil aviation sector, the EC Legislator amended a number of provisions ex (EC) regulation 883/2004.

In particular, EU Regulation 465/2012 established that the EC definition for *service base* represents the criterion for the determination of the regulation that is applicable to flight and cabin crews.

Annex III of (EEC) Regulation 3922/91 defines *service base* as *the place, designated by the operator for each member of the crew, wherefrom the crew member usually starts and concludes a service period or a number of service periods and during which, under normal conditions, the operator is not liable for the supply of accommodations to the relevant crew member.*

Furthermore, (EU) Regulation 465/2012 amended Article 11 of (EC) Regulation 883/2004 by adding a new paragraph establishing that *an activity carried out by flight and cabin crew members in charge of passenger air transport or freight is deemed as an activity being carried out in the Member State in which the service base is located, such as defined under Annex III of (EEC) Regulation 3922/*91.

In order to define which legislation is applicable, Article 14, paragraph 5-*bis*, of (EC) Regulation 987/2009, as amended by (EU) Regulation 465/2012, provides that: (…) *flight and cabin crew members generally assigned to air transport services of passengers or freight that carry out an employment activity in two or more Member States, are subject to the laws of the Member State in which the service base is located (…)*.

Hence, it appears that the objective is to prevent and eliminate any possible controversies which might arise with air carriers operating through an operating bases system (Ryanair is one of the most famous cases), by identifying in this latter a territorial link with the Italian State.