

The right of defence of the taxpayer in relation to the application of presumed income parameters¹

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1. The delicate balance between presumed income and the fundamental rights of the taxpayer

This article aims to investigate the fundamental rights of defence granted to the taxpayer, particularly the right to reply to the tax authorities, in the case of tax assessments based on the so-called "*studi di settore*" (hereinafter: presumed income parameters), introduced in the Italian system with decree law no. 331, 30 August 1993, converted into law no. 427, 29 October 1993³. In order to ensure substantial justice for the taxpayer, it is important to adopt proper procedures in the assessment carried out by the tax authorities, with a view to ascertaining the ability to pay of the individual/entity, even when the tax authorities make use of instruments such as presumed income parameters, one of a number of instruments for assessments based on rebuttable presumptions⁴.

More specifically, this instrument is the basis on which the tax authorities can make an assessment of corporate income or income from self-employment. In this way the tax authorities process various types of data relating to the income potentially earned by a certain business. The data considered in the analysis by the tax authorities include the location of the business, the number of employees (on open-ended or fixed-term contracts), the rent paid for property or the leasing of movable assets, expenses for the acquisition of tangible assets, annual turnover, and

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³ Law no. 427 of October 29, 1993.

⁴ Rebuttable presumptions are indications that cannot be used in isolation by the tax authorities to ascertain the taxable income of the taxpayer, but need to be supported by further evidence.

company profits. As a result, this method is based on presumed income, that does not necessarily reflect the actual income of the taxpayer.

From a burden-of-proof point of view, the tax authorities are under an obligation to justify the applicability of the parameters to the case under examination. The taxpayer, who is entitled to rebut the presumed income, is required (1) to provide a justification for the exclusion of their business from the categories subject to the parameters, or (2) to provide proof of special circumstances affecting the business in the period under assessment. Presumed income parameters are based on data derived from economic and statistical/mathematical analyses by which the tax authorities estimate the income of companies and professionals (notaries public, lawyers, and so on).

From the point of view of taxation and human rights, it is particularly interesting to examine two recent cases referred to the Italian Supreme Court of Cassation, examining the use of presumed income parameters. In these cases, the Court put forward significant arguments on whether the parameters could be considered to be useful, fair and just, provided they portray the actual situation of the taxpayer, assessing the effective ability to pay.

2. Judgment no. 17229, 28 July 2006, Supreme Court of Cassation

In examining this judgment, the starting point should be the statement of the Court according to which presumed income parameters merely represent a rebuttable presumption⁵. In order to ascertain the actual income of the taxpayer, for the purposes of systemic coherence, the presumed income parameters should conform to the other methods adopted by the system for the same purpose⁶.

⁵ Court of Cassation, tax division, judgment no. 17229 of 28 July 2006 available in DeJure database. The opinion acknowledging a presumptive nature to the parameters can be found in judgments no. 23602, 15 September 2008; no. 26459, 4 November 2008; no. 27648, 21 November 2008; no. 4148, 20 February 2009; no. 26635, 18 December 2009, all available on the DeJure database. See also the order of the Supreme Court, tax division, no. 14313, 15 June 2010, no. 15905, 6 July 2010 with note by L. Garibbo, *Studi di settore: presunzioni ed onere della prova*, in *Dir. Prat. Trib.*, 1/2011, p. 3.

⁶ In this sense, see Russo P., *La tutela del contribuente nel processo sui redditi virtuali o presunti: problemi generali* (Report for the seminar organised by the University of Salerno

Three points need to be considered in this connection.

First and foremost, every time a tax assessment is based on the implementation of presumed income parameters, the tax authorities need to establish the admissibility and reliability of the data collected with this method. In response to specific, circumstantial and complete data, the taxpayer is required to provide a detailed response to the claims made by the tax authorities⁷.

Second, since presumed income parameters are rebuttable presumptions, and considering that the burden of proof is on the tax authorities, the taxpayer should be able to establish the lack of any specific grounds put forward by the tax authorities, claiming that the authorities do not portray the actual situation of the taxpayer⁸.

Third, in procedural terms, since these are rebuttable presumptions, the Court should be bound only by the logical and systematic nature of the tax assessment based on presumed income parameters.

At this point, it may be useful to outline the facts of the case under examination. The court of first instance upheld the appeal filed by a company against a tax assessment notice. The tax authorities had challenged the income tax returns submitted by the company, ascertaining a significant difference between the income declared by the company and the estimated income based on the presumed income parameters.

The case was referred to the Supreme Court, which rejected the appeal filed by the fiscal authority, and underlined the importance of the lack of a hearing in relation to this instrument. The Court ruled that the regulations on the presumed income parameters require a prior hearing with the

on: "Il nuovo accertamento tributario fra teoria e processo", Salerno, 20-21 May 1994, in *Riv. Dir. Trib.* 1995, I, 17; Fazzini E., *L'accertamento per presunzioni: dai coefficienti agli Studi di settore*, in *Rass. Trib.* 1996, 309.

⁷ See L. R. Corrado, *Accertamenti standardizzati e motivazione dell'avviso di accertamento: l'atto è illegittimo in difetto di una adeguata replica alle deduzioni fornite dal contribuente in sede di contraddittorio endoprocedimentale*, in *Dir. Prat. Trib.*, 6/2008, 1078.

⁸ In this connection, see the guidelines to the presumed income parameters, available at www.agenziaentrate.gov.it, which states that: "The invitation to respond shall include the elements relevant for the assessment, in order to allow the taxpayer to submit potential evidence and arguments. The arguments submitted by the taxpayer in his response shall be carefully examined by the tax authorities, who have to justify in detail the rejection or the granting of such arguments" (our translation).

taxpayer⁹. This hearing is intended to enable the statistical estimates to be adjusted in light of the economic and financial situation of the taxpayer. Accordingly, when relying on presumed income parameters, the tax authorities, are required:

- 1) to hold a hearing with the taxpayer concerning the discrepancies between the tax returns of the taxpayer and calculations made by the tax authorities on the basis of the presumed income parameters;
- 2) to make an assessment on a case-by-case basis;
- 3) to provide evidence in support of the tax assessment explaining why the arguments put forward by the taxpayer should be rejected.

In light of the above, it may be argued that the absence of a hearing in relation to the implementation of the statistical calculations results in the illegitimacy of the tax assessment, pursuant to Articles 3, 24 and 53 of Italian Constitution. More specifically, Article 24 provides the most general and comprehensive protection of the right of defence, applicable also in the field of taxation. Accordingly, the tax regulations that do not provide the opportunity for the taxpayer to exercise the right of defence *vis-à-vis* the tax authorities fail to comply with these Constitutional safeguards. These provisions also safeguard the ability-to-pay principle, by means of an assessment by the tax authorities based on actual income and not on mere presumptions.

3. Ruling no. 15186, 18 June 2013

More recently, the Supreme Court of Cassation considered this question once again in ruling no. 15186, 18 June 2013. With this ruling, the Supreme Court recognised the strict obligation for the tax authorities to hold a hearing with the taxpayer when applying the presumed income parameters: any failure to comply with this requirement results in the invalidity of the tax assessment. The ruling, quoting previous case law,¹⁰ states that:

⁹ L. R. Corrado, *Il contraddittorio endoprocedimentale quale garanzia di attendibilità dell'accertamento fondato sugli studi di settore*, in Dir. Prat. Trib. 2/2007, p. 311.

¹⁰ Supreme Court of Cassation, judgment no. 26635, 18 December 2009 available on the DeJure database.

"The standard procedure for tax assessment with the application of presumed income parameters is based on mere rebuttable presumptions. Its reliability, precision and compliance is not automatically determined in cases in which the income declared is divergent from the said parameters. The reliability of the procedure is established only when a hearing with the taxpayer has taken place. Failure to hold such a hearing shall result in the invalidity of the procedure. During the hearing, the taxpayer is required to demonstrate, with no limits on the evidence produced, that the requirements to set aside the application of the presumed income parameters are met, or that the taxpayer's economic situation is different from the assessment based on the parameters. On the other hand, the tax assessment should provide evidence in support of the applicability of the parameters, and the reasoning based on which the arguments of the taxpayer were rejected.

However, the outcome of the hearing does not affect the possibility to file an appeal against the assessment. The tax tribunal in the judicial phase can freely assess both the application of the parameters by the tax authorities and the counter-evidence presented by the taxpayer.

The taxpayer is not subject to any limitations in this regard, and can resort to rebuttable presumptions, even if he did not appear at the hearing during the tax assessment procedure. In such cases, he shall accept the consequences of failing to appear at the hearing during the tax assessment procedure, since the fiscal authority can apply the parameters simply by establishing the impossibility of holding a hearing with the taxpayer who did not reply to the invitation to appear"¹¹. (Our translation)

Accordingly, by taking advantage of the right to reply during the tax proceedings, the taxpayer can demonstrate the factual elements that justify the discrepancies between the income in the tax returns and the income calculated on the basis of the presumed income parameters.

¹¹ See: Cassation, tax division, judgement no. 12558, 21 May 2010; no. 13594, 4 June 2010; no. 23015, 4 November 2011; no. 29185 28 December 2011; no. 5399 4 April 2012; no. 22599 11 December 2012, all available on the DeJure database.

4. Conclusions

The taxpayer's right to reply is the main instrument to challenge the calculations based on the presumed income parameters. Only by means of a hearing will the taxpayer be granted the opportunity to prove that the tax assessment is without foundation, as it is grounded on factual elements that do not correspond to reality, or because of data processing errors. The arguments on which the taxpayer can base his or her defence can include a demonstration of an operational error or illegitimate application by the tax authorities, evidence that the business is not related to the sector covered by the parameters, or the existence of specific elements which distinguish the business from others in the sector, considered to be "normal".

In light of the above-mentioned case law, it appears that the safeguard of the right of the taxpayer to take part in tax assessment proceedings on presumed income parameters is the sole means to ensure a fair assessment by the tax authorities and proper verification of the ability to pay, pursuant to the right to good administration set forth in Article 41 of the Charter of Nice (the Charter of Fundamental Rights of the European Union)¹².

¹² Article 41 of the Charter of Nice.