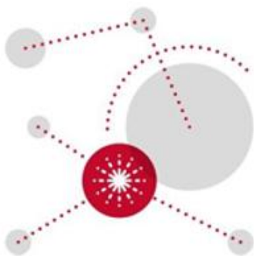
Infrastructure, Energy & Ecological Transition Focus Team



Focus Team Leader
Catia Tomasetti
catia.tomasetti@belex.com
Tel. +39 06 84551 284

Authors

Michele Dimonte
michele.dimonte@belex.com
Tel. +39 02 771131

Francesco Olivieri
francesco.olivieri@belex.com
Tel. +39 02 771131

Data centres and permanent establishments in Italy: recent developments and practical considerations for multinational groups

Italy's expanding enforcement faces treaty limits

Key takeaways

The Italian tax authority is increasing its scrutiny of multinational groups operating digital infrastructure in Italy.

Servers may create a permanent establishment even in the absence of local personnel.

The key factors remain permanence, control of the infrastructure and the functions performed by the servers.

The Italian concept of "significant economic presence" continues to raise interpretative issues and may have limited application where a double tax treaty applies.

Multinational groups should review their hosting and co-location arrangements and consider whether advance engagement with the Italian tax authority might be appropriate.

1. Introduction

The profound changes brought about by the technological revolution in production processes have progressively weakened the traditional link between the territory in which businesses generate economic value and the parameters on which a state's taxing powers are based. In an economic environment increasingly characterised by digital platforms and infrastructure, data centres (consisting of IT equipment, network systems and power and cooling infrastructure dedicated to the storage, processing and transmission of digital information) represent the physical nexus through which otherwise dematerialised economic activities anchor themselves to a specific territory[1], thereby acquiring tax relevance.

[1] In this respect, see the guide on the regulatory framework prepared by the Best Friends Power and Place: A Regulatory Guide to Data Centre Developments in Europe.

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According to the Data Centre Observatory of the Polytechnic University of Milan, investments of approximately EUR 25 billion are expected over the 2026–2029 period for the construction and fit-out of new data centres and related IT infrastructure, with a significant share dedicated to facilities supporting AI applications.

At the same time, the Italian tax authority appears to have intensified its auditing of multinational enterprises operating in the digital economy, increasingly examining whether technological infrastructure located in Italy gives rise to undeclared permanent establishments, even where the infrastructure operates without local personnel.

For multinational groups investing in cloud infrastructure, AI capacity and digital delivery networks, permanent establishment risk can no longer be assessed solely by reference to personnel and traditional business premises.

Against this backdrop, multinational groups operating digital infrastructure in Italy face increasing scrutiny regarding both the possible existence of permanent establishments and the allocation of taxable profits.

For many multinational groups, understanding where the Italian tax authority is drawing the line has become a practical rather than merely theoretical issue.

This newsletter provides an overview of the current legal framework, recent developments and practical considerations for multinational groups with a digital presence in Italy.

2. When can a data centre create a permanent establishment?

The **traditional notion of permanent establishment has historically been based on the concept of a "fixed place of business**", namely, a criterion of physical permanence and territorial presence. Art.162(1) of the Italian Consolidated Income Tax Act (TUIR) and Art. 5(1) of the OECD Model Tax Convention define a permanent establishment as a fixed place of business through which the business activities of a non-resident enterprise are wholly or partly carried on within a state.

Because this framework was developed for traditional business models, the **growth of the digital economy has challenged its underlying assumptions**. Digital business models often generate substantial revenues within a market without requiring a corresponding physical presence in the jurisdiction concerned.

To address this issue, the OECD considered various alternative nexus models under Action 1 of the BEPS project, including the notion of "significant economic presence". However, that concept was ultimately not incorporated into Art. 5 of the OECD Model, which continues to rely on the concept of a fixed place of business even after the 2025 update.

Against this backdrop, **Italy adopted a more innovative position** through the 2018 Budget Law,[2] introducing Art. 162(2)(f-bis) of the TUIR and expanding the notion of permanent establishment to include a **"significant and continuous economic presence" structured in a manner that does not necessarily result in a physical presence in Italy**.

The same legislation also implemented the anti-fragmentation rule and removed the exclusion previously applicable to computer equipment, further narrowing the circumstances in which digital infrastructure may fall outside the scope of a permanent establishment analysis.

Although innovative, the reform has not produced fully satisfactory results in practice. As highlighted by Assonime and subsequently confirmed by the Italian Supreme Court in Decision 33390/2023, the provision leaves several interpretative issues unresolved and may have limited practical application where international treaty obligations apply.

2.1 *When can a server constitute a fixed place permanent establishment?*

Within this framework, international tax practice has historically identified servers as the principal connecting factor between the permanent establishment concept and e-commerce.

In contrast, websites and software applications have generally not been regarded as capable, in themselves, of constituting a fixed place of business.

Based on OECD guidance and Italian administrative practice, a server is more likely to constitute a material permanent establishment if the following conditions are met:

1. The server is fixed in Italy for a sufficiently long period – regardless of the possibility of moving the server.
2. The foreign enterprise owns, leases or otherwise has the server at its full disposal, controlling the hardware.
3. The server performs core business activities rather than merely preparatory or auxiliary functions.

[2] Law 205/2017.

The **distinction between core and auxiliary activities remains central.**

A permanent establishment is more likely to arise where the server operates as a genuine automated operational centre capable of carrying out substantial elements of the commercial cycle without significant human intervention, including the receipt of orders, processing of transactions, collection of payments and delivery of digital services. Conversely, risk is generally lower where the server performs only ancillary functions such as storage, caching, content hosting or data-routing.

Whether the server is at the disposal of the enterprise is of decisive practical importance.

Where a non-resident enterprise merely accesses shared hosting services and exercises no meaningful control over the underlying hardware, the likelihood of a permanent establishment is generally lower.

By contrast, **dedicated servers operated under arrangements granting extensive management and configuration rights** are **more likely to attract scrutiny.**

International practice reflects this approach. In Denmark[3] and Canada[4], servers located at data centers of local subsidiaries operated through hosting arrangements without direct control by the foreign enterprise were held not to constitute permanent establishments. Conversely, a Swedish ruling found a permanent establishment where the foreign enterprise exercised extensive control over servers located in Sweden for a prolonged period (i.e., over 6 months).

These cases demonstrate that the decisive factor is often not the mere location of the infrastructure but the degree of control exercised over it by the foreign enterprise.

[3] See, among others, Danish cases SKM2016.188.SR and SKM2020.390.SR.
[4] See Canadian Tax Authority Decision 2012-0432141R3.

Practical implications

Multinational groups using servers located in Italy should assess:

- the degree of operational control exercised over the infrastructure,
- whether the servers perform core business functions,
- the contractual allocation of rights and responsibilities,
- whether the infrastructure is effectively at the disposal of the enterprise, and
- the protection afforded by any applicable double tax treaty.

3. Recent developments

3.1 *The Netflix case: a turning point in Italian enforcement*

The Netflix case remains the most significant enforcement example in this area and provides an important indication of the direction of Italian enforcement activity.

The investigation focused on a content delivery network (CDN) consisting of more than 350 servers located in Italy.

Despite the absence of local employees, Italian authorities argued that these servers were functionally indispensable to the delivery of Netflix's streaming services to Italian subscribers and therefore gave rise to a taxable presence in Italy.

The matter was ultimately settled through the payment of approximately EUR 55.8 million in taxes, penalties and interest for the period 2015–2019. Netflix subsequently established an Italian operating company for the direct invoicing of Italian customers.[5]

Following the Netflix case, the Italian tax authority significantly expanded its audit activity. Particular attention has been directed towards Italian providers of co-location, web-hosting and cloud services with foreign corporate clients.

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[5] As stated in a note signed by the Milan public prosecutor Marcello Viola:

> [The] multinational group, at the end of the tax assessment phase conducted by the Italian tax authority, made a single overall payment of EUR 55,850,513 in the form of taxes, penalties and interest to settle all matters outstanding with the Italian tax authority for the period October 2015–2019.

As reported by G. BARBAGELATA and A. DELLA CARITÀ, "*Stabile organizzazione "virtuale": una ricostruzione a valle del caso Netflix*", in Fiscalità finanziaria, 2022.

This has important implications for both foreign enterprises and Italian data-centre operators.

Foreign groups may face assessments for failure to file tax returns, potentially accompanied by penalties and, in certain cases, criminal exposure. Italian operators must also manage contractual risks and respond to information requests from the tax authority.

The Netflix case marked the beginning of a trend that has seen the Italian tax authority devote increasing attention to permanent establishment risks arising from digital infrastructure, with subsequent audit activity extending well beyond digital platforms to data centre operators, hosting providers and cloud-service providers.

Practical implications

- The Netflix case marked the beginning of a trend that has seen the Italian tax authority devote increasing attention to permanent establishment risks associated with digital infrastructure, with subsequent audit activity extending well beyond digital platforms to data centre operators, hosting providers and cloud-service providers.
- The absence of local personnel does not, in itself, eliminate permanent establishment risk where digital infrastructure performs economically significant functions.
- Groups operating dedicated servers or co-location arrangements in Italy should reassess their risk profile in light of current enforcement trends.

3.2 *Italian Supreme Court Decision 33390/2023: limits of the "significant economic presence" concept*

This decision is one of the most important recent developments.

The Supreme Court clarified that the domestic concept of "significant and continuous economic presence" operates on a different level from treaty-based permanent establishment rules and acknowledged its potentially limited application where international treaty obligations apply.

Where a tax treaty based on the OECD Model is in force, the domestic provision may operate only in residual or anti-abuse contexts. This reflects the constitutional principle that treaty obligations generally prevail over conflicting domestic provisions.

Under the current legal framework, significant economic presence has not been incorporated into Art. 5 of the OECD Model as an autonomous taxable nexus.

Consequently, in a treaty context, the analysis remains anchored to the traditional requirements of a material fixed place of business or the configuration of a personal permanent establishment.

This remains one of the most significant legal constraints on Italy's increasingly expansive enforcement approach.

3.3 *The 2025 OECD update and the bill on data centres (2026)*

From an international perspective, the OECD's 2025 update to the Commentary on Art. 5 did not materially alter the framework applicable to servers and e-commerce activities.

The updated Commentary substantially confirms the traditional approach.[6]

The United Kingdom has maintained its reservation that a server used by an e-tailer should not, in itself, constitute a permanent establishment.

At domestic level, legislative developments have likewise provided little additional clarity.

The bill approved by the Chamber of Deputies on 24 February 2026 introduces a statutory definition of data centres but does not establish specific permanent establishment rules.

During the parliamentary process, provisions to align the tax treatment of data centres with OECD principles were removed. The stated objective was to avoid limiting the ability of the tax administration to assess economically significant activities connected with data management.[7]

The resulting position remains uncertain.

The legislative debate could be read as reflecting a desire to preserve the ability of tax authorities to assert permanent establishment status in relation to economically significant activities linked to data management and digital infrastructure while avoiding interpretations considered unduly restrictive.

This reflects the same tension visible in enforcement practice: the desire to address modern digital business models without tying interpretation too closely to traditional OECD concepts.

[6] see paras 122–131.
[7] Concerning the delegation to the Government for the organisation, construction, development and enhancement of data centres.

3.4 *The continuing challenge of attributing profits*

Even where a digital permanent establishment can be identified, significant uncertainty remains regarding the attribution of profits.

The current framework relies on the Authorised OECD Approach, which focuses heavily on significant people functions, decision-making processes and risk assumption.

The limitations of the Authorised OECD Approach become particularly evident where a significant digital presence operates through automated infrastructure in the absence of locally performed significant people functions.

In these circumstances, the profits attributable to a server-based permanent establishment may remain limited, even when the infrastructure itself is considered sufficient to establish a taxable presence. In some cases, the profit attributable to the hardware alone could be negligible compared with the overall value generated by the digital business.

Several European initiatives have attempted to address this gap by treating user participation, data collection and digital engagement as economically significant functions.

By way of example (COM(2018) 147 final), proposed by the European Commission, was an initiative aimed at facilitating the recognition of economically relevant activities carried on through digital interfaces by focusing on data and users, rather than functions performed by personnel.

The initiative in question, which required a modification of the applicable profit determination criteria, would have allowed for the capture of certain intangible value-creating activities (e.g., the development, enhancement, and exploitation of intangible assets) even in the absence of personnel in the same Member State.[8]

None of these proposals were adopted.

The current framework could change significantly with the implementation of Pillar One.

Pillar One rules recognise that traditional nexus concepts – first and foremost the permanent establishment threshold – are increasingly ill-suited to capturing value creation in highly digitalised business models. It therefore seeks to allocate taxing rights to market jurisdictions irrespective of physical presence, focusing instead on the role of market jurisdictions and

[8] By attracting new users to a social network, for example, the set of intangible activities attributable to the underlying enterprise plays a key role in ensuring positive network externalities (the same can be said of network expansion and user data processing). Each economically relevant activity uniquely contributes to value creation in digital business models and is an integral part thereof. From this standpoint, the profit-split method is often considered the most appropriate because it uses factors such as R&D, marketing expenses, the number of users, and the data collected per Member State.

granting them taxing rights on a residual portion of multinational profits regardless of physical presence.

Although potentially transformative, implementation remains dependent on a complex international agreement process that has yet to be completed.

Key risk indicators

Higher PE risk	Lower PE risk
Dedicated or exclusive-use servers	Shared hosting arrangements
Infrastructure at the enterprise's disposal	No control over underlying hardware
Servers performing core business functions	Preparatory or auxiliary functions
Automated transaction processing	Storage, caching or routing activities

Recommended actions

Multinational groups should consider:

- reviewing co-location, hosting and cloud-services arrangements;
- assessing whether infrastructure located in Italy could be regarded as being at the enterprise's disposal;
- evaluating the protection available under applicable double tax treaties;
- considering advance engagement with the Italian tax authority where material uncertainty exists; and
- reassessing whether current structures remain appropriate in light of recent enforcement activity.

4. Concluding remarks and practical recommendations

The absence of a clear and internationally harmonised framework governing the taxation of digital infrastructure remains one of the principal shortcomings of the current international tax system.

The lack of clear rules regarding both the existence of a permanent establishment and the attribution of profits creates significant uncertainty for multinational groups and tax administrations alike.

This uncertainty makes it difficult for businesses to predict their tax position while simultaneously increasing the risk of overlapping tax claims by multiple jurisdictions.

In practice, this creates a risk of juridical or economic double taxation where multiple jurisdictions seek to tax the same income.

Against this backdrop, multinational groups should carefully assess their permanent establishment profile in light of their existing infrastructure arrangements, operational model and treaty position.

Italy's legal system also offers various instruments for advance engagement with the tax authority, including:

- advance pricing agreements under Art. 31-ter of Presidential Decree 600/1973;
- rulings for new investments under Legislative Decree 147/2015; and
- admission to the cooperative compliance regime under Legislative Decree 128/2015.

These mechanisms can provide valuable certainty, but their use generally requires careful technical preparation and specialist international tax advice.

Where the factual circumstances indicate a material permanent establishment risk, multinational groups might also wish to evaluate the benefits of operating through a declared permanent establishment or an Italian subsidiary. Such an approach can enhance tax certainty, facilitate the deductibility of infrastructure costs and reduce controversy risk.

Conclusion

Italy's approach to data centres and permanent establishments sits at the intersection of two competing trends. Tax authorities are increasingly scrutinising digital infrastructure as a potential source of taxable presence, while OECD-based treaty rules continue to impose important limits on how far traditional permanent establishment concepts can be extended.

For multinational groups investing in cloud infrastructure, AI capacity and digital delivery networks in Italy, the challenge is no longer whether these issues matter but how to manage them proactively before they become the subject of an audit.

Infrastructure, Energy & Ecological Transition Focus Team

The Focus Team is a constellation of skills in different practice areas, with a focus on infrastructure, energy and ecological transition.

Catia Tomasetti
Banking & Finance

Enrico Chieppa
Litigation & Dispute Resolution

Paolo Daino
Corporate

Anna Di Vilio
Banking & Finance

Giorgio Frasca
Banking & Finance

Sara Lembo
EU law & Antitrust

Gabriele Malgeri
Banking & Finance

Marco Giovanni Mancino
Legal Risk, Compliance & Investigations

Giuseppe Manzo
Corporate

Francesca Marchetti
Banking & Finance

Fulvio Marvulli
Corporate

Massimo Merola
EU law & Antitrust

Francesca Peruzzi
Corporate

Augusto Praloran
Corporate

Alessandro Rosi
Administrative

Alberto Saravalle
Corporate

Giovanna Zagaria
Banking & Finance

Roberto Flammia
Banking & Finance

Francesca Di Carpegna Brivio
Corporate

Biagio Giliberti
Administrative

Michele Dimonte
Tax

Emanuela Spinelli
Criminal Law