

# COMMENTARY



## Italy: Tax News for 2017

With the new year, a set of tax measures for corporate taxpayers, mainly enacted with the budget law for 2017, which was approved by the Italian Parliament on December 7, 2016 (the “2017 Budget Law”), becomes effective in Italy. Apart from revenue goals, the measures are also aimed at rendering Italy more attractive for foreign investments, supporting domestic investments by Italian companies, and promoting economic growth in general.

### Corporate Income Tax Rate Reduction and Surtax for Certain Financial Institutions

As of 2017 tax year, the Italian corporate income tax (“CIT”) standard rate is reduced from 27.5 percent to 24 percent. Banks, parent companies of banking groups, individual asset management companies, financial intermediaries, electronic money institutions, payment institutions, and financial companies are, however, subject to a 3.5 percent surtax, so that the effective CIT rate for such entities will remain 27.5 percent. The surtax does not apply to insurance companies and parent companies of insurance groups and to management companies of undertakings of collective investments (e.g., investment funds).

As a consequence of the CIT rate reduction:

- (i) The withholding tax rate applicable to outbound dividends paid by Italian companies to European Union (“EU”) or European Economic Area (“EEA”) corporate shareholders resident in countries that allows an effective exchange of information with Italy, included in the so-called White List, is reduced from 1.375 percent to 1.2 percent; and
- (ii) A ministerial decree will proportionally re-determine the taxable portion of dividends and capital gains on substantial shareholdings realized by private taxpayers and by sole proprietors (currently at 49.72 percent).

### Repeal of Limitation on Deduction of Interest Payable by Banks and other Financial Institutions

As a rule, banks, parent companies of banking groups, asset management companies, financial intermediaries, electronic money institutions, payment institutions, financial companies, insurance companies, and parent companies of insurance groups are not subject to the 30 percent earnings before interest, tax, depreciation, and amortization (“EBITDA”) limitation on deduction of interest payable that generally applies to corporate taxpayers for CIT purposes. However, until

2016, they encountered a cap on deduction of interest payable equal to 96 percent of the amount of the interest payable incurred in the tax year. This limitation applied for both CIT and regional tax on value of production (“IRAP”) purposes.

As of 2017, banks, parent companies of banking groups, individual asset management companies, financial intermediaries, electronic money institutions, payment institutions, and financial companies are no longer subject to the 96 percent cap, while such cap continues to apply to insurance companies and parent companies of insurance groups, and to management companies of undertakings of collective investments (e.g., investment funds).

## Transfer of Tax Losses Between Affiliates

The Italian tax system provides for domestic and worldwide tax consolidation regimes applicable (under certain circumstances) to members of a group whereby they are allowed, for CIT purposes, to offset taxable income of the members of the group against the tax losses generated by other members of the same tax group. In addition, Italian tax law allows (under certain circumstances) corporate taxpayers to be treated, for CIT purposes, as partnerships and, therefore, as tax transparent.

The 2017 Budget Law introduces new rules whereby companies can transfer to affiliates the tax losses generated in the first three-year period of operation (outside any tax consolidation or tax transparent regime) provided that:

- (i) The shares of the transferee or the shares of the company that directly or indirectly controls the transferee are traded in a regulated market or negotiated in a multilateral trading facility in an EU or an EEA country included in the so-called White List;
- (ii) The transferor is not involved in real estate business;
- (iii) The transferor and the transferee have the same financial year;
- (iv) The transferor and the transferee are affiliate. For this purpose, a company is deemed to be an affiliate of another company if the latter has an equity interest granting 20 percent of the voting rights that can be exercised at the ordinary shareholders' meeting of the former and of the right to participate in the former's

profits. Such requirement must exist at the end of the tax year when the transfer of the tax losses is made; and

- (v) The transfer is finalized within the deadline for the filing of the tax return.

As mentioned, the tax losses that can be transferred are only those that are generated in the first three-year period of operation of the transferor and must be transferred in full (and not partially). The tax losses transferred may be then entirely used by the transferee to offset the taxable income of the tax year when the transfer is made and of the following tax years.

The transferee must remunerate the transferor for the benefit obtained with the transfer of the tax losses. Such remuneration should be computed by applying the CIT rate applicable in the year when the losses are generated to the amount of the losses transferred. The remuneration for the transfer of the tax losses, however, does not constitute taxable income for the transferor and is not tax deductible for the transferee. Finally, the transferor cannot adhere to any tax consolidation regime or opt for any tax transparency regime in the tax years when it has transferred tax losses under the above rules.

## Deduction of the Allowance on Corporate Equity Deduction Regime (Notional Interest Deduction)

The 2017 Budget Law has provided a reduction of the allowance on corporate equity deduction regime (“ACE”) rates and introduced some anti-avoidance provisions that limit the utilization of ACE.

ACE is an additional deduction—for CIT purposes only—corresponding to the notional return on capital. This notional return is equal to the aggregate net equity increase that has occurred as of the fiscal year 2011 (the so-called “ACE Base”)<sup>1</sup>, by a rate of return, set at 4.75 percent until fiscal year 2016. It is sometimes referred to as “notional interest deduction.” In particular, the ACE rate has been reduced to 2.3 percent for fiscal year 2017 and 2.7 percent as of 2018.

The 2017 Budget Law also extended the limitation provided for the carrying forward of tax losses and non-deductible

interest expenses to the ACE. In particular, unless certain tests are passed, the ACE cannot be carried forward in the case of (i) a change of control and a change of the main business activity; or (ii) domestic and cross-border merger and demerger transactions.

In addition, for taxpayers other than banks and insurance companies, the increase of the stock in securities and financial instruments, other than shares and other equity interests, compared to the amount held at December 31, 2010, will reduce the ACE Base.

## **Enhanced Depreciation of Tangible and Intangible Assets**

The budget law for 2016 had introduced a tax incentive, the so-called “enhanced depreciation,” applicable to new tangible assets and/or vehicles purchased by business taxpay-  
ers between October 15, 2015 and December 31, 2016. Such tax incentive consisted in an increase by 40 percent of the acquisition cost on which the depreciation allowances were calculated. The incentive did not apply to investments in (i) tangible assets for which the depreciation installments were lower than 6.5 percent; (ii) buildings; and (iii) tangible assets listed in the budget law for 2016 (e.g., pipelines).

The 2017 Budget Law has extended the above tax incentive also to new investments (with the exclusion of vehicles) made by December 31, 2017 or by June 30, 2018 provided that, in the latter case, the purchase order is accepted by the seller and, 20 percent of the purchase price is paid by the purchaser, by December 31, 2017.

In addition to the above, the 2017 Budget Law provides for further tax incentives aimed at facilitating investments made in those technological assets included in the projects so-called “Industry 4.0.” In particular, for the purpose of the enhanced depreciation, the acquisition cost of those tangible technological assets listed in the 2017 Budget Law is increased by 150 percent (instead of 40 percent). Moreover, business tax-  
payers which already benefit from the enhanced depreciation are also allowed to benefit from an “enhanced amortization” of those intangible assets (e.g., software, operating systems or platforms) listed in the 2017 Budget Law calculated on 140 percent of the purchase costs of such assets.

## **Step-Up of Corporate Assets**

The 2017 Budget Law has extended the step-up of corporate assets for accounting and tax purposes for the tax year current at December 31, 2016. In particular, companies adopting Italian Generally Accepted Accounting Principles (“GAAP”) may opt for the step-up of corporate tangible and intangible assets (excluding real estate assets booked as inventory) and of controlling equity interests that were already booked in the financial statements of the tax year current at December 31, 2015 by paying a substitute tax.

The step-up applies to all the assets which belong to the same “homogeneous” category. The substitute tax rate is 16 percent for depreciable assets and 12 percent for other assets. The substitute tax has to be paid in a single installment by the deadline for the payment of the CIT balance due for the same tax period when the step-up is made (i.e., June 30, 2017).

The equity reserve created as a consequence of the step-up can be freely distributed provided that a further 10 percent substitute tax is paid on the amount of such reserve.

The stepped-up value is relevant for depreciation and amortization purposes as from the third tax year after the one when the step-up is made and, for capital gains purposes, as from the fourth tax year after the one in which the step-up is made. With reference to real estate assets (other than inventory), the stepped-up value is relevant as from December 1, 2018.

Companies adopting International Financial Reporting Standards/International Accounting Standards (“IFRS/IAS”) GAAP may benefit from the step-up on certain conditions. These companies shall pay the substitute tax for the higher value resulting from the step-up and, consequently, a tax-suspended reserve must be recorded for an amount equal to the stepped-up value. Such equity reserve can be freely distributed provided that a further 10 percent substitute tax is paid.

## **Amendments to the Tax Credit for R&D Expenses**

In 2013, a tax credit for certain Research & Development (“R&D”) expenses was introduced. The rules applicable to such tax credit were subsequently amended by the budget law for 2015 and now are again revised by the 2017 Budget Law.

In particular, the 2017 Budget Law has (i) extended to December 31, 2020 (previously December 31, 2019) the term within which the expenses in R&D can be incurred; (ii) fixed to 50 percent of all the eligible increased R&D costs (previously 25 percent or 50 percent, depending on the type of expenses) the amount of the tax credit; (iii) increased to EUR 20 million (previously EUR 5 million) the maximum annual amount of the tax credit available; (iv) extended to all staff expenses (previously limited to certain costs only) the tax credit; and (v) clarified that the tax credit is available also in relation to the R&D expenses incurred to supply R&D services by an Italian resident company (or an Italian permanent establishment of a non-resident company) to non-Italian residents principals provided that they are resident in a EU or EEA country included in the so-called White List.

## Vat Group

In accordance with Article 11 of EU Directive 2006/112, the 2017 Budget Law introduces, the elective group of companies regime for VAT purposes ("VAT Group").

The VAT Group allows the treatment of individual Italian-based companies (and/or Italian permanent establishment) as a single VAT taxpayer provided that at least from July 1 of the previous year the following requirements are met:

- (i) Direct or indirect control relationship between the entities or, alternatively, such entities must be controlled directly or indirectly by the same entity provided that it is resident in Italy or in a State having an actual exchange of information with Italy ("Financial Requirement");
- (ii) The entities must all perform a business activity of the same nature or, alternatively, a complementary activity or an activity that supports that of one or more entities ("Economic Requirement"); and
- (iii) A coordination, in accordance with Italian Civil Code or *de facto*, between the management bodies of the same entities, even if carried out by a third entity, must exist ("Organizational Requirement").

Unless evidence is given to the contrary, the Economic Requirement and the Organizational Requirement are deemed to be met in cases where the Financial Requirement exists.

The election for the VAT Group must be made by all the eligible entities and is binding for a three-year period automatically renewed until the revocation of the option.

In case of election for the VAT Group, (i) the transactions carried out between the entities of the VAT Group are not deemed to be sale of goods or supply of services from a VAT purposes; and (ii) transactions carried out between an entity of the VAT Group and a third party are deemed to be carried out by the VAT Group as a single entity. The VAT rights and obligations in the VAT matter are of the VAT Group; such rights and obligations are exercised and fulfilled, respectively, by the representative of the VAT Group which is the entity having the control under the Financial Requirement or, if the latter cannot exercise the election, by the entity having more revenues in the year preceding the one of the election.

The VAT Group regime will be available starting from January 2018.

This regime does not replace the existing VAT consolidation scheme that allows the consolidated entities to transfer and consolidate their VAT debit/credit position at the level of the group. Under the VAT consolidation regime, differently from the VAT Group regime, the group does not act as a single VAT taxpayer but the consolidated entities continue to keep their VAT number.

## Purchase of Real Estate Assets at a Court Auction

The tax benefit consisting of fixed registration, mortgage and cadastral taxes at EUR 200 each (in lieu of the proportional rate) applicable in case of purchase of a real estate asset at a court auction has been extended until June 30, 2017. This rule applies to the purchase of businesses as well as residential real estate assets.

Such tax benefit applies to the extent that the real estate asset is resold within five years. The ordinary indirect tax regime, as well as a 30 percent penalty and interest apply, if the purchaser fails to re-sell the real estate asset within the above mentioned term.

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com/contactus/](http://www.jonesday.com/contactus/).

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## Endnotes

- 1 Briefly, the ACE Base is computed as follows: (a) the sum of (x) cash equity contributions actually made by the shareholders; (y) waivers of financial receivables that the shareholders had towards the company; and (z) undistributed profits set aside to reserves other than non-disposable reserves, less (b) the decreases of the company's net equity triggered by distributions or assignments to the shareholders, whether in cash or in kind and irrespective of the legal title upon which such distributions or assignments are based.