THE

Corporate Tax Planning Law Review

Fourth Edition

Editors

Jodi J Schwartz and Swift S O Edgar

THE LAWREVIEWS

THE CORPORATE TAX PLANNING LAW REVIEW

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Editors
Jodi J Schwartz and Swift S O Edgar

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CONTENTS

PREFACE

We are pleased to present the fourth edition of *The Corporate Tax Planning Review*. This volume contains 19 chapters, each devoted to a different country and each providing expert analysis by leading practitioners of the most important aspects of tax planning for multinational corporate groups in that country, with a particular focus on recent developments.

The jurisdictions represented in this volume are diverse and include established major economies (e.g., the United States, Germany and Korea), EU countries (both those that have become popular destinations for new business organisations and those where multinationals tend to form entities to facilitate local operations or investments), the city-state of Singapore and several nations in the Global South (Colombia, Malaysia and more). Echoing this geographical variety, *The Corporate Tax Planning Review* describes tax developments worldwide that are a response to different challenges in different places. At the same time, many countries share goals of preventing jurisdiction shopping, protecting against erosion of the tax base, promoting local investment and raising revenue. These complex and at times conflicting goals present opportunities for the well advised and traps for the unwary.

Although each chapter discusses issues at the cutting edge of tax law, the authors have contextualised their analyses with sufficient background information to make this volume accessible and useful to generalists and to tax practitioners outside each particular jurisdiction. Although *The Corporate Tax Planning Review* is by its nature an abbreviated overview, we hope it will at least serve as a workable compass to in-house counsel and outside advisers as they attempt to navigate their clients through the unsteady and sometimes uncharted waters of contemporary corporate tax planning.

We are extremely grateful to the contributors who have assiduously distilled a wealth of expertise to create this volume and to Isabelle Gray, Nick Barette and Adam Myers at Law Business Research Ltd for their editorial acumen and dedication to this project.

Jodi J Schwartz
Swift S O Edgar
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Chapter 7

ITALY

Fabio Chiarenza, Vittorio Zucchelli and Carmen Adele Pisani[1]

I INTRODUCTION

During the course of 2021, the government, led by Mr Draghi, concentrated its efforts on approving a wide range of measures to limit the damage caused by the covid-19 pandemic and to kick-start recovery. The government estimated the total value of these measures for 2021 at €73 billion (4.1 per cent of GDP).

In the context of the EU framework, the government laid down its national recovery and resilience plan, which includes critical structural reforms and investments, to support a faster transition towards a greener, more digitalised economy. A set of legislative and administrative reforms aimed at improving civil justice, tax administration and public investment have been implemented and more are to come.

II LOCAL DEVELOPMENTS

i Entity selection and business operations

Italian entities

No significant changes have been introduced. The most commonly used corporate entities[2] are:

a joint stock companies (SpA);[3] and
b limited liability companies (Srl).[4]

This chapter focuses mainly on the above corporate entities.

Although less common, legal and tax-transparent entities exist.

Finally, Italy has specific regulations for investment funds and real estate investment funds that have a contractual form;[5] however, they cannot carry on a pure business activity.

1 Fabio Chiarenza and Vittorio Zucchelli are partners and Carmen Adele Pisani is a senior associate at Gianni & Origoni.
2 These corporate forms have separate legal personality: no liability of their members.
3 The SpA is the corporate form used for medium-sized and large businesses.
4 The Srl is used for small and medium-sized businesses. Compared with the joint stock companies, limited liability companies offer more flexibility and autonomy in terms of the governance system.
5 Certain dedicated types of limited liability companies can also be used to carry on the same activities of investment funds and real estate funds (i.e., SICAVs and SICAFs).

Tax residency

In principle, resident and non-resident corporate entities are subject to tax.[6] Italian-resident[7] corporate entities are subject to:

a Italian corporate income tax (IRES),[8] currently applicable at the rate of 24 per cent (which might be increased by 3.5 per cent for banks and certain financial intermediaries); and

b Italian regional tax on business activities (IRAP),[9] currently applicable at the basic rate of 3.9 per cent[10] (which might be increased to 4.65 per cent for banks and other financial institutions and to 5.9 per cent for insurance companies).

As a general rule, Italian permanent establishments of non-resident companies have the same tax treatment as Italian corporate entities.

Italian collective investment schemes are liable to IRES, though exempt.

Inbound dividends

Dividends received by Italian-resident companies are subject to IRES in the year of payment as follows:

a only 5 per cent of the amount of the dividends distributed by Italian-resident companies is included in the company's IRES-taxable base;[11] and

b dividends received from non-resident entities are subject to the same tax regime under (a), provided that certain conditions are met.[12]

Italy provides for a specific transparency rule in respect of dividends paid to Italian non-commercial partnerships (*società semplici*). In particular, for tax purposes, dividends are considered to be paid directly to the persons with an interest in the relevant Italian non-commercial partnership: accordingly, the tax treatment of the dividend payment is the one applicable to such persons.

6 A resident entity is taxed in Italy on its worldwide income, whereas a non-resident entity is taxed in Italy only on items of income that are deemed to have been generated therein.

7 Tax residence is identified via (1) the legal seat, (2) the place of effective management or (3) the principal business activity being in the Italian territory for more than 183 days in a given year.

8 The IRES-taxable base is the worldwide income that results from the profit and loss account of the Italian-resident company for the relevant fiscal year (determined in accordance with law or the relevant articles of association and the applicable accounting principles) and adjusted according to the tax law provisions. All income derived by an Italian-resident company qualifies as business income. Positive and negative components are generally determined according to the accrual method; however, certain exceptions apply (e.g., dividends).

9 IRAP is levied on the net value of the production derived by a company in each Italian region. The relevant taxable base depends on the actual activity carried out by the company.

10 IRAP rate may be varied (with a ceiling) in Italian regions.

11 Assuming that IRES applies at the ordinary rate of 24 per cent, the overall tax burden is equal to 1.2 per cent (i.e., 24 per cent x 5 per cent).

12 In order to benefit from the partial exemption on dividends, the following conditions have to be met: (1) the distributing company is not resident in a preferential tax jurisdiction; or (2) if the distributing company is resident in a preferential tax jurisdiction, the recipient proves that the participation in the distributing company has not been held to shift profits in a country with a preferential tax regime; and (3) the amount distributed is not deductible (even partially) from the distributing company's taxable income.

For companies resident in a country with a preferential tax regime, see 'Anti-profit shifting measures' in Section II.ii.

Under certain circumstances, dividends may also be subject to IRAP.

Capital gains

Capital gains deriving from disposals of participations by an Italian-resident company is subject to IRES. However, Italian tax law provides for a specific partial exemption according to which 95 per cent of the capital gain is exempt from IRES (the 'participation exemption regime', also known as PEX). The PEX regime is subject to conditions.[13]

In principle, for IRES tax purposes, (1) capital losses deriving from disposals of PEX participations are not deductible, whereas (2) those deriving from disposals of non-PEX participations are deductible.

Italy provides for a specific exemption in respect of capital gains on 'qualified participations'[14] in Italian-resident entities realised by collective investment funds (1) resident in the EU or the EEA (which allows for a satisfactory exchange of information) and (2) subject to regulatory supervision in their country of establishment pursuant to Directive No. 2011/61/EU.

Deductibility of interest expenses

In principle, an Italian-resident company is allowed to deduct interest and similar expenses[15] for each fiscal year up to the sum of (1) the amount of interest income (and similar income) received in a given fiscal year and (2) the amount of exceeding interest income (and similar income) carried forward from the previous fiscal year and not yet offset (the net interest expenses).[16] Net interest expenses are in turn deductible up to (1) 30 per cent of the Italian company's gross operating margin, determined on the basis of the values provided for by the Italian tax law (ROL, which is similar to earnings before interest, taxes, depreciation and amortisation), and (2) 30 per cent of the exceeding ROL carried forward from previous fiscal years.

13 To benefit from the partial exemption on capital gains, the following conditions have to be met: (1) the participation has been held, continuously, at least from the first day of the 12th month preceding the disposal (minimum holding period); (2) the participation was initially accounted as a long-term investment in the first financial statement closed after the acquisition; (3) the participating company is tax resident in Italy or in a country that does not have a preferential tax regime, as defined under Italian tax law, since the financial year in which the company has been acquired; and (4) the participated company has been carrying out an actual commercial activity from the first day of the third financial year preceding the transfer of the participation. Note that for participations in a holding company, the tests under points (3) and (4) must be verified at the level of the holding company's subsidiaries (the 'look through' approach). In particular, the two tests are deemed to be satisfied if they are met by subsidiaries representing the majority of the value of the holding company.

14 For the meaning of 'qualified participations', see footnote 29 below.

15 Note that the limitations illustrated in this paragraph do not apply to (1) Italian financial intermediaries (as defined by Italian tax law), for which interest expenses are fully deductible from the IRES-taxable base, and (2) certain entities (e.g., insurance companies and asset management companies), for which interest expenses are deductible from the IRES-taxable base up to 96 per cent of their amount.

16 As a general rule, Italian tax law provides for the deduction of costs and expenses in accordance with the 'inherence' and 'imputation' principles: these items have to be (1) related to positive items concurring to the determination of the taxable income of the year and (2) recorded in the relevant profit and loss account.

Excess ROL can be carried forward with a time limit of five fiscal years, and any excess of interest income not used against interest expenses in a given fiscal year can be carried forward without time limits.

Specific rules apply, among others, to Italian-resident companies electing for the domestic tax consolidation regime (see Section II.ii at 'The IRES consolidation regime').

Tax losses relief

Tax losses may be carried forward by Italian companies without time limit. Tax losses incurred in a given fiscal year can offset the corporate tax base of subsequent tax years up to 80 per cent of the latter amount. Tax losses cannot be carried back. The 80 per cent limitation does not apply to tax losses incurred in the first three fiscal years. Certain tax losses relief exclusions apply.[17] No tax losses can be carried forward for IRAP purposes.

Certain tax incentives for Italian companies and investors

Special tax regimes are available.

Carried interest regime

To make Italy more attractive to fund management companies and managers, Italian tax law provides for an irrebuttable presumption under which the 'carried interest' derived by Italian employees and managers (eligible persons) of funds, management companies and other companies from financial instruments with enhanced economic rights qualifies as financial income or capital gain (generally subject to a 26 per cent substitute tax), rather than employment income (which is taxed at marginal rates up to 43 per cent). Such presumption applies only if certain requirements are met.[18] If one or more requirements are not met, the carried interest is not automatically treated as employment income for tax purposes. Indeed, an analysis on the actual terms of the scheme is required to assess the nature of the carried interest.

Research and development super-deduction

Italy has recently repealed the Italian patent box regime[19] and introduced a cost-based incentive regime that grants, upon election, a super-deduction for qualifying research and development (R&D) expenses incurred by companies for the creation or development of intangible assets. Under this regime, 210 per cent of R&D expenditure incurred in relation to copyrighted

17 For not applying these exclusions, the Italian company has to obtain a positive tax ruling from the Italian tax authorities.

18 The presumption under analysis applies provided that (1) the actual investment made by all the eligible persons requires an effective disbursement greater than or equal to 1 per cent of the total investments of the relevant fund or company, (2) the carried interest is payable once all the fund investors or company shareholders have received an amount equal to the invested capital plus a hurdle rate and (3) the relevant investment has to be held for at least five years or, if earlier, until the date of a change of control of the relevant company or entity or a change of the management company of the fund.

19 Under the Italian patent box regime, if certain conditions were met, 50 per cent of income deriving from the exploitation or the direct use of a software protected by copyright, patents, designs, models, processes, formulas and information relating to industrial, commercial or scientific know-how (legally protected) (qualifying intangibles) was not included in the IRES and IRAP-taxable bases. Furthermore, any capital gain deriving from the transfer of qualifying intangibles was not included in the seller's IRES

software, patents, trademarks, designs and models may be deducted for purposes of IRES and IRAP.[20] The election[21] for the mentioned regime may be made by (1) Italian companies carrying on R&D activities, even if outsourced to non-related companies, universities, research institutions or equivalent entities, aimed at producing qualifying intangibles; and (2) non-Italian-resident companies carrying on the above-mentioned activities in Italy through a permanent establishment, provided that they are resident in a jurisdiction that has signed a double tax treaty with Italy and that allows an actual exchange of information.

A company electing for the regime at stake may simultaneously claim a further 20 per cent R&D tax credit on eligible costs incurred up to an annual maximum of €4 million[22] (see 'Tax credits for new investments' below).

Tax credits for new investments

A tax credit is granted for investments carried out by Italian-resident companies in new tangible and intangible assets. The tax credit varies from 6 per cent to 40 per cent of the acquisition cost, depending on the nature of the investment itself and the tax period in which it is made.[23] Certain exclusions apply.

As of 2020, a tax credit is also granted for investments carried out by Italian-resident companies in R&D, ecological transition, high-technological innovation and designs. The tax credit varies from 5 per cent to 20 per cent of the investment, depending on the nature of the investment itself and the tax period in which it is made.

and IRAP-taxable income, provided that at least 90 per cent of the consideration received by the seller was reinvested in the maintenance and development of other qualifying intangibles within the end of the second fiscal year following the transfer.

20 If a deduction under the regime at stake is challenged by Italian tax authorities, the taxpayer can benefit from an exemption from tax penalties (ranging from 90 per cent to 180 per cent of the higher corporate income tax assessed) provided that it (1) fulfils certain documentation requirements and (2) declares in its income tax return that it fulfils these requirements.

21 The election is irrevocable for a five-year period and can be renewed for subsequent five-year periods.

22 For financial years from 2023 to 2031, the research and development tax credit is equal to 10 per cent with a maximum annual amount of €5 million.

23 For tangible assets, the tax credit amounts to 6 per cent of the investment (up to €2 million), provided that the investment is made between 1 January 2022 and 31 December 2022 (or by 30 June 2023, if the purchasing order is accepted by the seller and a 20 per cent advance payment is made by 31 December 2022). For 4.0 tangible assets, the tax credit varies from (1) 10 per cent to 40 per cent of the investment (up to €20 million), provided that the investment is made between 1 January 2022 and 31 December 2022 (or by 30 June 2023, if the purchasing order is accepted by the seller and a 20 per cent advance payment is made by 31 December 2022), and (2) from 5 per cent to 20 per cent of the investment (up to €20 million), provided that the investment is made between 1 January 2023 and 31 December 2025 (or by 30 June 2026, if the purchasing order is accepted by the seller and a 20 per cent advance payment is made by 31 December 2025). For 4.0 intangible assets, the tax credit amounts to (1) 20 per cent of the investment (up to €1 million) if it is made between 16 November 2020 and 31 December 2023; (2) 15 per cent of the investment (up to €1 million) if it is made between 1 January 2024 and 31 December 2024; and (3) 10 per cent of the investment (up to €1 million) if it is made between 1 January 2025 and 31 December 2025.

Tax incentives for entities investing in innovative start-ups and SMEs

Certain tax incentives are granted to, among others, entities investing in innovative start-ups and small and medium-sized enterprises (SMEs)[24] (as defined under Italian law). IRES-taxable entities benefit from a deduction of 30 per cent of the invested amount (up to €1.8 million) per year from their IRES-taxable income (with a maximum tax benefit of €129,600 per year), provided that certain conditions are met.[25]

Step-up of Italian participations

Under Italian tax law, it is possible to elect for a step-up of participations in unlisted Italian-resident companies held on 1 January 2022 through the payment of a 14 per cent substitute tax. Certain requirements must be met. The substitute tax applies to the value of the participations, as it results from a third-party appraisal. Such option is granted, inter alia, to foreign entities investing in the mentioned companies. This election may result in being particularly advantageous for those foreign investors who, in case of divestment of the mentioned participations, are not eligible for any tax exemption relating to capital gains.

ii Common ownership: group structures and intercompany transactions

The IRES consolidation regime

Italian tax law provides for the possibility of opting for a tax consolidation regime in the context of a group.

Italian-resident companies controlling other Italian-resident companies may elect, together with the relevant controlled entity, to include one or more of the controlled subsidiaries in a domestic tax consolidation regime. The tax consolidation regime is also available to Italian-resident companies that are controlled by the same non-resident company; in this case, the foreign holding company must appoint one of its Italian-resident subsidiaries as the consolidating company.

The tax consolidation regime allows for IRES income and losses of the adhering companies to be calculated on an aggregate basis (i.e., a consolidated taxable base is created for IRES purposes). This system allows taxable income to be offset with tax losses of companies that are party to the same perimeter of consolidation, giving the opportunity to reduce the overall tax due by the group.

Moreover, if certain conditions are met, the tax consolidation regime also allows companies to offset interest expenses against interest income of other companies and to transfer the 30 per cent ROL company's excess.[26]

24 Several tax incentives apply at the level of innovative Italian start-ups and SMEs with the aim of helping these companies to attract, motivate and retain employees. Among others, Italy provides for a tax and social pension contribution exemption regime for employment income that relevant employees derive from the assignment of financial instruments, as well as from the exercise of option rights assigned for the purchase of financial instruments, issued by innovative start-ups and SMEs.

25 Qualifying investments are those injections allocated to share or corporate capital or to share premium of the company upon its incorporation. Subsequent capital increases may also be relevant provided that certain conditions are met. The eligible investment must not exceed an overall amount of €15 million over a five-year time frame and the participations in the innovative start-up must be held for a minimum period of three years.

26 The ROL excess can be transferred within the group.

The transactions occurring between companies that are party to the tax consolidation regime remain subject to their ordinary tax regime.

The Italian controlled foreign companies regime

The Italian controlled foreign companies regime (the CFC regime) was amended to align the domestic legislation to the EU Anti Tax Avoidance Directive (ATAD).

The CFC regime applies if Italian tax-resident individuals, partnerships, companies and entities (as well as permanent establishment of foreign entities) control, directly or indirectly, foreign companies that:

a are resident for tax purposes in countries with an effective tax rate lower than 50 per cent of the Italian one; and

b more than a third of their income derives from 'passive income'[27] or from financial leasing, insurance, banking or other financial activities, or intra-group sales or supply of low value-adding goods or services.

If the conditions above are met, then the income of the CFC is attributed to the Italian controlling person (in proportion to its interest in the CFC) and taxed in its hands. The subsequent dividend distributions are not considered to be relevant for tax purposes up to the amount of income taxed by transparency. The CFC legislation does not apply where the relevant CFC carries out an economic activity in its country of establishment.

The branch exemption regime

Italian companies can exempt income and losses made by their permanent establishments (conditions apply). The option for the branch exemption regime applies to all the foreign permanent establishments and cannot be revoked. Profits of the foreign permanent establishment are taxed as dividends when distributed to the headquarters.

Domestic intercompany transactions

In principle, there is no law provision allowing the Italian tax authorities to challenge the price of domestic intercompany transactions for IRES purposes; however, there is case law stating that prices of intercompany transactions may be challenged where those prices are not in line with the fair market value.

Some limitations exist in respect of the possibility of carrying forward losses in the context of domestic mergers if certain requirements are not met. This rule is meant to discourage mergers with the sole or main purpose being the combination of profit-making companies, from one side, with companies that have tax losses, on the other side.

Italian tax law also provides for some measures to foster group restructurings. In particular, under certain specific conditions, the contribution of certain non-portfolio interest, the contribution of going concerns and the exchange of interest granting control over companies are tax neutral.

27 For example dividends, interest and royalties.

Anti-profit shifting measures

In order to contrast profit shifting, in addition to the CFC legislation described above, Italy has implemented a transfer pricing regulation that is consistent with the relevant OECD guidelines.

Other measures to avoid profit shifting relate to inbound and outbound flows of passive income. For example, dividends received by Italian-resident shareholders from subsidiaries resident in low-tax jurisdictions are fully subject to tax (instead of benefiting from a 95 per cent exclusion).

The effects of the above-mentioned provision may be mitigated to the extent that the Italian shareholder is able to prove that:

a the foreign company carries out a real economic activity (through the use of personnel, assets and premises) in its jurisdiction; or

b the holding in the foreign company does not have the effect of shifting or localising profits in low-tax jurisdictions.

Italy also has enacted the ATAD II anti-hybrid measures. In respect of profit shifting and outbound flows, this means that, for example, under certain circumstances, where a payment is deductible for an Italian taxpayer base but not included in the taxable base of the foreign recipient, then the deduction is denied in Italy.

iii Third-party transactions

Acquisition of participations or assets for cash

Share deals and assets deals are subject to different tax treatment for the acquisition of shares or quotas.

a The buyer may not be able to deduct for tax purposes depreciation of the shares or quotas.

b The seller realises a capital gain or a capital loss, depending on whether the sale price is higher or lower than the tax value of the disposed shares or quotas. Except for the special regimes illustrated in Section II.i at 'Capital gains', the relevant gain or loss becomes part of the IRES-taxable base of the seller. Under certain conditions, IRAP may also apply. Non-Italian tax residents may benefit from certain specific exemptions that are set out either in the domestic provisions or in the relevant tax treaty in force between Italy and the investor's country of residence (for the impact of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (Multilateral Instrument) (MLI) on the tax treatment of capital gains deriving from the disposal of shares or quotas in certain companies, see Section III.iii).

c For the acquisition of shares, a 0.2 per cent financial transactions tax (IFTT) applies to the value of the transaction (i.e., the sale price of shares). A 0.1 per cent IFTT applies if the acquisition is executed on regulated markets or multilateral trading facilities. Certain exemptions apply.

d For the acquisition of quotas, a €200 lump sum transfer tax (*imposta di registro*) is due.

e Transfers of quotas and shares are exempt from VAT.

Tax treatment of the acquisition of a going concern

Regarding tax treatment of the acquisition of a going concern:

a the transaction is not tax neutral;

b the buyer enters all the relevant assets of the going concern at their current transaction values; tax amortisation will start again on the basis of the new values. The buyer may also become secondarily liable for the tax liabilities of the seller up to the value of the going concern;

c the seller, where a capital gain is realised, is subject to full taxation; no IRAP applies; and

d the transaction falls outside the scope of the VAT but it is subject to an *ad valorem* transfer tax, which is payable on the value of the assets net of any liabilities; registration tax rates vary depending on the assets (e.g., a 3 per cent transfer tax is due on the goodwill, and 9 per cent transfer tax is due on real estate assets. A €200 lump sum transfer tax applies to transfers of instrumental properties occurring in the context of the transfer of a going concern, provided that the relevant business and employment-level continuity is ensured).

Reorganisation transactions

A reorganisation between Italian-resident companies may be carried out via:

a a sale against consideration of shares or quotas (see above);

b a merger or a demerger; and

c a contribution of participations.

Mergers and divisions

Mergers and divisions carried out by Italian-resident companies are neutral for tax purposes (i.e., they neither represent a realisation of capital gains or losses on the assets owned by the participating company nor give rise to any taxable capital gain in the hands of the shareholder of the companies involved).[28]

For mergers and demergers, tax losses carry-forward and interest deductibility may be limited under certain anti-avoidance rules.

If certain further requirements and conditions are met, the tax neutrality regime depicted above also applies to intra-EU mergers and demergers.

Contribution of participations

In principle, the transaction under analysis is not tax neutral. Nonetheless, for a contribution of a participation under which the receiving company acquires, reaches or increases the control over the contributed company, in exchange for its own participation, no capital gain or capital loss arises, provided that the contributing company accounts for the participation received in exchange at the tax value of the contributed participation.[29]

28 The company resulting from a merger or a demerger may elect to obtain partial or full recognition for tax purposes of the step-up in the book values of tangible and intangible assets (included goodwill) arising from the corporate restructuring by paying a substitute tax ranging from 12 per cent to 16 per cent.

29 Under certain conditions, the same tax treatment applies also to a contribution of a minority participation as a result of which the Italian receiving company does not acquire, reach or increase a controlling participation in another company. In particular, the rollover regime applies if: (1) the transferred participation either attributes more than 20 per cent of the voting rights in the ordinary shareholders' meeting of the acquired company (2 per cent if the shares of the acquired company are traded on a regulated market) or represents more than 25 per cent of the acquired company's share capital (5 per cent if the shares of the acquired company are traded on a regulated market) ('qualified participation') and (2) the receiving company is fully owned by the contributing company.

As a result of the implementation of the EU Merger Directive, if certain requirements are met, the rollover regime applies to intra-EU contribution of participations. As a result, no capital gain or capital loss arises.

Tax treatment of outbound flows of income

Outbound dividends

Dividends distributed by Italian companies to non-resident companies are, in principle, subject to withholding tax in Italy at the full rate of 26 per cent. A reduced rate (1.2 per cent) applies to dividends distributed to resident companies and subject to corporate income tax either in another EU Member State or in a state of the EEA. The full domestic withholding tax rate may (1) turn out to be zero under the Parent–Subsidiary Directive or (2) be reduced or zeroed under according to the applicable double tax treaty.

Italy provides for a specific exemption from withholding for dividends paid by Italian-resident entities to collective investment funds (1) resident in the EU or EEA (which allows for a satisfactory exchange of information) and (2) subject to regulatory supervision in their country of establishment pursuant to Directive No. 2011/61/EU.

Outbound interest payments

Any interest payment (other than those that are paid in connection with bank deposits or accounts) made by an Italian company to a foreign entity is subject to a final 26 per cent withholding tax. The full domestic withholding tax rate may, however, (1) turn out to be zero under the Interest and Royalties Directive or (2) be reduced or zeroed according to the applicable double tax treaty.

Outbound royalty payments

Any royalty payments made by an Italian company to a foreign entity are subject to a final withholding tax rate of 30 per cent. In certain cases, the taxable amount of the royalty payments is reduced by 25 per cent (with an overall tax burden of 22.5 per cent – i.e., 30 per cent of 75 per cent of gross royalties). The full domestic withholding tax rate may, however, (1) turn out to be zero under the Interest and Royalties Directive or (2) be reduced or zeroed under any applicable double tax treaty.

Funding structures

As to the choice between debt and equity as sources of funds for investing in Italy, the following points of attention should be considered from an Italian tax law perspective.

Debt financing

In principle, interest expenses borne by the Italian-resident company may be deducted from the IRES-taxable income in accordance with the limitations illustrated above.

For EU intra-group debt financing, the withholding tax exemption under the Interest and Royalties Directive (the I&R WHT Exemption) applies to interest payments made by the Italian-resident company to its EU participated company, provided that the relevant requirements are met.

For debt financing granted to Italian enterprises by, among others, EU banks, EU insurance companies and certain white-listed[30] institutional investors, a withholding tax exemption is available for interest paid out of loans with certain features (the Loan WHT Exemption Regime).

Equity funding

With the view to strengthening the capitalisation of Italian companies, the Allowance for Corporate Equity[31] (ACE) has recently been reinstated. ACE allows Italian-resident companies to deduct from their IRES-taxable income a 1.3 per cent 'notional return' on certain equity increases. Excess notional return can be either carried forward without time limits or converted into an IRAP tax credit. Certain anti-avoidance provisions apply.

Anti-avoidance rules

In addition to specific anti-abuse rules, Italian tax law provides for a general anti-abuse rule aimed at counteracting those transactions that, although formally in line with Italian tax law, do not have any economic substance and have been put into place for the essential purpose of obtaining undue tax benefits.

iv Indirect taxes

The Italian VAT system is in line with the relevant European directives. VAT applies to all the supplies of goods and services that are deemed to be carried out within the Italian territory.

The standard VAT rate in Italy is equal to 22 per cent, whereas, for certain kinds of goods and services, the reduced rates of 10 per cent or 4 per cent apply.

Under certain conditions, Italian VAT law allows VAT-taxable persons with financial, economic and organisational links to be treated as a single taxable person (i.e., to become a VAT group). The VAT group has a single VAT registration number, and supplies of goods and services occurring between members of a group are not considered to be relevant for VAT purposes.

In respect of merger leverage buyout transactions carried out in Italy, the Italian tax authorities highlighted that the relevant bid company needs to qualify as an 'active' holding company in order to deduct the input VAT charged on transaction costs. Should the holding company qualify as a 'passive' holding, the VAT will not be recoverable and it will represent a cost to be capitalised or recorded in the bid company's profit and loss as an expense.[32]

Finally, Italy has recently introduced a plastic tax[33] and a sugar tax,[34] both of which will enter into force starting from 1 January 2023.

30 For the purposes of the exemption, institutional investors must be established in a country that recognises the Italian tax authorities' right to an adequate exchange of information.

31 Note that the 2019 Budget Law repealed the ACE regime effective as of 1 January 2019. However, the ACE regime has been restored by Budget Law 2020 effective as of fiscal year 2019.

32 Depending on the relevant accounting principle.

33 The plastic tax is a tax on the consumption of single-use products that have – or are intended to have – a containment, protection, handling or delivery function of goods or food products and is set at €0.45 per kg of plastic contained in the relevant product.

34 The sugar tax, on the other hand, will be levied on the sale of sweetened soft drinks and will amount to (1) €10 per hectolitre for products ready to be consumed and (2) €0.25 per kg for the products that need to be diluted.

III INTERNATIONAL DEVELOPMENTS AND LOCAL RESPONSES

i OECD-G20 BEPS initiative

The Italian tax system is in line with the OECD-G20 BEPS guidance and recommendations. To a certain extent, part of the anti-avoidance recommendations were already present before the BEPS project.

Italy is also in the process of ratifying the MLI (see Section III.iii).

ii EU proposals on taxation of the digital economy

Several measures have been adopted by Italy in recent years to counteract the base erosion issues of the digital economy.

The Budget Law 2018 broadened the Italian 'permanent establishment' definition by including 'a continuous and significant economic presence of a foreign company in Italy, organised in such a way that it does not give rise to a physical presence in Italy'.[35]

The Budget Law 2020 provides for a 'new' Italian digital service tax effective as of 1 January 2020 (the Italian DST). The Italian DST is an indirect tax applying at the rate of 3 per cent on the gross revenues (net of VAT) deriving from certain digital services supplied to users located in Italy. It applies to both resident and non-resident entities that meet the following requirements: the total amount of their worldwide revenue during the calendar year is not lower than €750 million; and the total amount of revenue generated in Italy during the calendar year from certain digital services is not lower than €5.5 million. Italian DST is mostly aligned with the European Commission's proposal (2018/0073).

iii Tax treaties

Italy has a very extensive tax treaties network (more than 100).

The treaties signed by Italy are based on the OECD Model Tax Convention.

A recurring clause in the tax treaties signed by Italy is the one giving exclusive right to tax to the 'residence State' in respect of capital gain on shares and *similia* (a provision in line with Article 13(5) of the 2017 OECD Model).

However, significant changes in the taxation of capital gains from the sale of shares could occur as result of the ratification of the MLI. Indeed, Italy is a party to the MLI and has signed the instrument but has not ratified it yet, but it seems that Italy will elect to amend its existing treaties and implement the rule now contained in Article 13(4) of the 2017 OECD Model (to the extent that the other relevant treaty partner makes the same choice).

In a nutshell, this paragraph provides for taxation in Italy on the capital gains on shares that derive 50 per cent or more of their value from immovable properties. In other words, when the MLI is ratified (and subject to the election of the other treaty partners), differently from what happens with capital gains on other kinds of shares, capital gains on Italian real estate companies will be subject to tax (also) in Italy.

Among others, Italy signed a new tax treaty with China.[36] This treaty mainly follows the OECD Model and some of its newest amendments, such as:

35 As a consequence, in line with BEPS Action 1, the elements that could be considered for assessing the presence of a permanent establishment in Italy may also be (1) the amount of revenue realised in the Italian market, (2) the use of a local digital platform to carry out its business, (3) the number of Italian customers per month and (4) the conclusion of online agreements with Italian customers on a regular basis.

36 This treaty will replace the previous one signed in 1986.

a the new Article 4(3) of the 2017 OECD Model;[37]
b the new Article 13(4) of the 2017 OECD Model;[38] and
c the new preamble.[39]

Article 10 provides for a 5 per cent withholding tax on dividend distributions if the recipient holds more than 25 per cent in the distributing company for more than 365 days and a 10 per cent withholding in all the other cases.

Article 11 provides for a general 10 per cent withholding on interest payments that can be reduced to 8 per cent or zeroed in specific circumstances.

Finally, Article 12 provides for a 10 per cent withholding on royalties. This 10 per cent withholding is applied to a tax base that can be halved in certain cases (leading to an actual 5 per cent taxation).

iv Implementation and entry into force of DAC6 Directive provisions

As of 2021, the Italian provisions implementing the DAC6 Directive entered into force. Pursuant to the implemented rules, intermediaries and taxpayers are required to report to the Italian tax authorities the set-up of certain cross-border transactions meeting some specific hallmarks. The existence of such hallmarks has been deemed to be symptomatic of aggressive tax planning arrangements.

IV RECENT CASES

i No look-through approach can apply to the Loan WHT Exemption Regime

The Italian tax authorities have recently issued a statement of practice (*Risposta* 125/2021) clarifying some aspects relating to the scope of the Loan WHT Exemption Regime provided for by medium to long-term loans granted by, among others, (1) EU credit institutions, (2) EU insurance companies and (3) institutional investors subject to regulatory supervision in their country of establishment to Italian enterprises.

In particular, the statement of practice clarified that:

a loans can be considered as having a medium to long term if the repayment date falls after 18 months;
b the regulatory supervision has to be verified either at the entity level or at its management company level; and
c no look-through approach can be applied (i.e., the eligible entity needs to be the direct recipient of the interest paid).

ii UK and other non-EU banks do not qualify for the Loan WHT Exemption Regime

With statement of practice No. 839 of 21 December 2021 (*Risposta* 839/2021), the Italian tax authorities clarified that credit institutions established in the UK cannot benefit from the Loan WHT Exemption Regime for the following reasons:

37 Providing for a mutual agreement procedure in case of double-resident entities.
38 Already described above.
39 Referring to the abuse of treaty law, as recommended by BEPS Action 6.

a as a result of Brexit, the UK is no longer an EU Member State; thus, UK credit institutions cannot be considered as EU credit institutions for the purposes of the exemption; and
b non-EU credit institutions, such as UK credit institutions, cannot be considered as white-listed institutional investors for the purposes of the exemption at stake because, by making reference to EU credit institutions, the relevant legislation makes apparent the intention of the Italian legislator to exclude non-EU banks from the scope of application.

iii Clarifications on the tax treatment of dividends paid by Italian companies to tax-transparent entities

With statement of practice No. 258 of 19 April 2021, Italian tax authorities clarified the treatment applicable, for Italian withholding tax purposes, to dividends paid by an Italian-resident company to a Swiss *Fond Commun de Placement*, a fiscally transparent entity, which was participated by a Swiss foundation.

Italian tax authorities specify that the Swiss *Fond Commun de Placement* cannot have access to the benefits set forth in the tax treaty between Italy and Switzerland because the entity, being a fiscally transparent entity, did not qualify as a Swiss-resident person for the purposes of the tax treaty. However, Italian tax authorities confirm that, in accordance with the principles set forth by the OECD in its 1999 Report on The Application of the OECD Model Tax Convention to Partnerships, participants in foreign investment vehicles (FIVs) are entitled, with regard to dividends paid by Italian-resident companies to FIVs, to claim the benefits granted by the tax treaty signed between their state of residence and Italy (being the state of source) in cases in which:
a these dividends are attributed to FIV participants and taxed in their hands, regardless of any actual distributions; or
b FIV income (which includes these dividends) is actually distributed to the participants at least once a year pursuant to specific by-law provisions and taxed in their hands.

Based on the above, Italian tax authorities concluded that the Swiss foundation could claim the application of Article 10 of the tax treaty between Italy and Switzerland because, under Swiss law, income of the *Fond Commun de Placement* was attributed to the foundation and taxed in its hands, regardless of any actual distribution.

iv Tax-efficient transactions

Italy has amended its securitisation law to, among other things, foster the non-performing loan (NPL) market also by reducing the tax burden related to this kind of transaction.

Indeed, securitisation vehicles may set up a vehicle (a real estate operating company ('ReoCo')) to purchase, manage (including renting out) and also sell the real estate properties that were used as collateral for the NPLs. By doing so, the securitisation vehicles may use the flows deriving from such real estate properties to repay their noteholders. This also gives the opportunity to avoid real estate properties being sold at auction for a value lower than the fair market one.

From a direct tax perspective, in principle, all the flows deriving from the management and sale of the real estate properties are not taxed at the level of ReoCos or at the level of the securitisation vehicle.

Finally, under certain circumstances, this type of transaction may benefit also from reduced indirect taxes in respect of, among other things, the acquisition and the sale of the real estate properties by ReoCos.

V OUTLOOK AND CONCLUSIONS

The pandemic and resulting healthcare crisis have highlighted the need for a deep-seated reform of the Italian tax system. The Italian government has acknowledged this urgency, and important proposals for change are expected in the coming years. The important amount of grants and loans that will be granted to Italy in the next six years will also help to back the impact of the expected tax reform. The few changes introduced in 2021, other than those aimed at offering real and immediate support to the sectors most affected by the pandemic, nonetheless kept the aim of attracting foreign investors (especially in respect of real estate and private equity investments).

Italy is strengthening its legal framework, being one of the most advanced countries in the implementation of anti-abuse laws in compliance with BEPS guidelines and the EU directives and reporting duties (e.g., the Foreign Account Tax Compliance Act, the Common Reporting Standard and DAC6).

Appendix 1

ABOUT THE AUTHORS

FABIO CHIARENZA

Gianni & Origoni

Fabio Chiarenza is the head of the tax department.

He has extensive experience in all areas of taxation, with particular focus on M&A, corporate and structured finance, real estate, private equity and planning for individuals. He advises domestic and foreign investment banks and companies in connection with the structuring of investments. Fabio is frequently involved in the tax aspects of cross-border M&A transactions, innovative securitisations, structured financial products and derivatives, and also advises clients during audits and assessments and assists them in relation to litigation and tax rulings.

VITTORIO ZUCCHELLI

Gianni & Origoni

Vittorio Zucchelli specialises in tax matters relating to domestic and international M&A transactions as well as transfer pricing and supply chain restructurings. He advises large domestic companies with reference to their Italian and foreign tax matters. Prior to joining the firm, he worked for a leading international tax firm.

CARMEN ADELE PISANI

Gianni & Origoni

Carmen Adele Pisani specialises in tax matters relating to domestic and international M&A transactions as well as private equity investments, structured finance and securitisations. Her areas of expertise also include tax litigation.

GIANNI & ORIGONI

Via delle Quattro Fontane 20
00184 Rome
Italy
Tel: +39 06 478751
Fax: +39 06 4871101
fchiarenza@gop.it
vzucchelli@gop.it
capisani@gop.it
www.gop.it

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