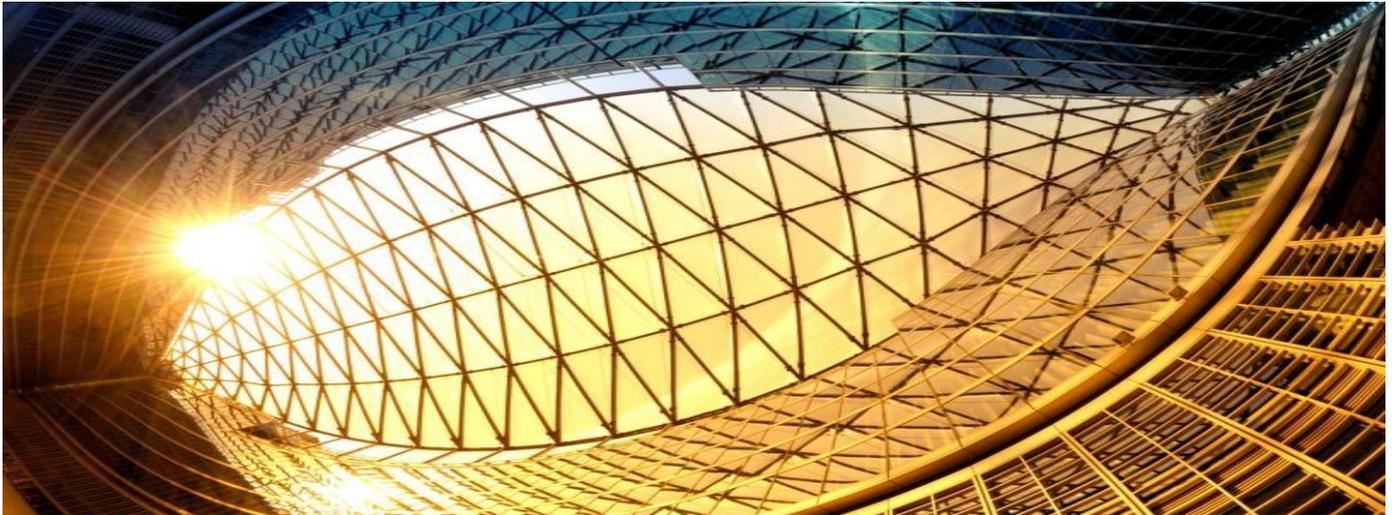


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Italy - Implementation decree on growth and internationalization of companies



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On September, 14th 2015 Italy approved the legislative decree n. 147, aimed at growth and internationalization of companies, enacted on September, 22nd 2015 via publication on Official Gazette n. 220. The decree, in force since October, 7th 2015, substantially confirms the provisions contained in the first draft of 21 April (see also our [Tax Alert of 30 April 2015](#)).

As mentioned in the report accompanying the decree, the purpose of these provisions is basically to attract new foreign investments. The decree does not contain any Beps-inspired measure.

The main provisions of the decree, including some amendments to the initial proposal, are summarized below.

Advance agreements for Multinational Enterprises (MNEs) (art. 1)

The decree confirms that companies with international operations will be entitled to enter into a five year binding agreement with the Italian Tax Administration with respect to the following cross-border tax issues:

- transfer pricing;
- definition of values in case of inbound and outbound transfer of residence;
- existence of a permanent establishment and attribution of profits;
- domestic and Treaty taxation of cross-border payments of interest, dividends and royalties
- in some circumstances, the definition of arm's length value for the purpose of black list costs.

This form of agreement is already recognized by our tax system in a special law provision (the 'International Standard Ruling'). The new provision, that will be included in the tax assessment Code, clarifies certain matters. Specifically, the new measures cover the objectives of the legislation, clarify mutual agreement procedures, clarify the possible effects of an agreement on prior years and confirm its validity for regional income tax (IRAP) purposes. A statement of practice to be issued by the Director of the Italian Revenue Agency in 90 days (i.e. by January, 5th 2016) will set out rules for implementation and will indicate when the new provisions come into force.

Ruling for substantial investments (art. 2)

A new form of ruling will be available for companies that intend to invest in Italy. The new system is aimed at providing them with certainty about the income tax and indirect tax consequences arising from their investment plan. The investor, either resident or non-resident, must file a business plan, detailing the amount of the investment, the industry, the timing and implementation phases and the expected number of new hires. The ruling may include, among other aspects, the likelihood of application of abuse of law or other anti-avoidance measures, tax profiles of reorganizations and whether certain asset purchases will amount to a going concern. The procedure applies to investments of not less than euro 30 million. Tax Authorities should provide the investor with a written answer in 120 days, binding as long as the facts and circumstances set out in the application do not change.

A decree by the Ministry of Economics and Finance and a statement of practice by the Director of the Italian Revenue Agency will set out the implementation rules. The new ruling procedure will come into force from the date of publication of the statement of practice. The final version of the decree reduces (from 90 to 60 days, after October, 7th 2015) the deadline for the publication of the first of such implementation measures.

Taxation of black listed dividends amended (art. 3)

Prior to the decree, dividends received either directly or indirectly by a resident taxpayer (e.g. also through non controlled Italian or foreign non-black listed intermediate companies) from an affiliate located or operating in a 'black list' Country were fully subject to corporate income tax in Italy and could not be 95% exempt. The only exceptions were:

- a) the amount of dividend corresponding to the CFC income previously imputed to and taxed upon the Italian shareholder or
- b) the whole dividend if the relevant income is taxed at an acceptable level before being received by the Italian shareholder (e.g. if said dividend is taxed upon an intermediate white list holding company).

The decree partially amends the above, by providing that:

- said black listed dividends are taxed as above described only if received from intermediate holdings that are under the Italian shareholder's control;
- a foreign tax credit is available for underlying tax paid by black listed controlled entities which carry out an active business in the market of the Country where they are located (so called 'first CFC safe harbor rule' which avoid the CFC income imputation to the Italian shareholder). This amendment aims at eliminating the disparity of treatment with respect to the situation where the CFC income imputation operates (and the resident taxpayer is entitled to a foreign tax credit);
- said black listed dividends must be separately reported in the income tax return if no advance ruling is required

to benefit from 'safe harbor' (or the answer to the ruling request is negative). Penalties apply if such reporting is not done;

- the same treatment is extended to capital gains on disposal of a directly or indirectly owned black listed affiliate.

The final version of the decree specifies that the above provisions are applicable to dividends paid and gains realized since 2015 (for calendar year taxpayers).

Broader interest expense allowance (art. 4)

Under art. 96 of the Italian Income Tax Code (IITC), a deduction for net interest (interest expense net of interest income) is allowed provided that it does not exceed 30% of the adjusted EBITDA of the borrower. Any excess is carried forward without time limitation. The adjusted EBITDA is currently computed as the difference between (i) revenues (item A of the P&L scheme) and (ii) costs of production (item B of the P&L scheme), excluding depreciation, amortization and financial leasing instalments relating to business assets.

The decree amends the adjusted EBITDA computation by allowing the inclusion of dividends paid from foreign controlled entities.

In addition, the decree repeals the provision according to which, for the only purpose of offsetting the interest expenses within a domestic tax group, it is possible to benefit of the EBITDA of selected foreign affiliates, under certain conditions (a sort of 'virtual inclusion into the tax group').

Finally, the decree provides a specific definition of 'real estate companies' for the purposes of deduction of interest expenses on loans guaranteed by a mortgage on real estate to be rented, that are outside the scope of the EBITDA limitation (and are therefore fully deductible).

The new provisions of art. 4 are applicable as of January 1, 2016 (for calendar year taxpayers).

Black list expenses scrutinized only above arm's length (art. 5, par. 1)

Expenses of transactions with related and unrelated suppliers - resident or established in low tax jurisdictions - (reference is to the black list of States as per decree of 23 January 2002) are disallowed if the Italian taxpayer cannot evidence either (i) the business substance of the supplier, or (ii) the genuine business reason for the transaction and the way it was carried out.

The decree provides that starting 2015 (for calendar year taxpayers), expenses relating to such transactions are allowed up to 'arm's length'. The excess will be allowed only if the Italian resident can prove ii) above.

No arm's length on domestic transactions (art. 5, par. 2)

The final version of the decree provides that, contrary to Case Law, the 'arm's length' rule does not apply to transactions between Italian resident companies. Because this is an interpretation of a provision of Law, it should apply also retrospectively.

No automatic assessment based on values declared or assessed for registration tax purposes (art. 5, par. 3)

The Italian tax administration often challenged capital gains calculations on disposal of real estates or going concerns, utilizing values declared for registration or cadastral and mortgage tax purposes (fair market value, irrespective of actual consideration paid). The Italian Supreme Court supported said tax challenges. The decree now clarifies the situation and states that the values declared for registration tax purposes will only be a hint, not sufficient by itself, to calculating the gain for income tax purposes.

Tax consolidation regime extended (art. 6)

To align to the European Court of Justice's judgment C-40/13 of 12 June 2014, the decree extends, as of January 1, 2015, the option for domestic tax consolidation to:

- a) Italian resident entities that are under the direct control of an EU or EEA Parent (previously, it was required a direct control of an Italian resident company or branch of an EU/EEA Parent) and
- b) Italian PEs of EU and EEA Companies whose assets do not include shares/quotas of Italian consolidated entities (previously, such Italian PEs could only be part of a domestic tax consolidation if they directly owned Italian consolidated entities).

In both cases, the EU or EEA Parent appoints an Italian resident controlled company as the consolidating entity.

A statement of practice, to be issued by the Director of the Italian Revenue Agency in 30 days after October, 7th 2015, will set out rules for implementation of these new provisions.

Profit attribution to Italian permanent establishments (art. 7)

The new provision repeals the domestic so called 'force of attraction rule', currently providing for taxation of the permanent establishment of certain income realized in Italy although not effectively connected with it (this domestic provision is overridden by applicable Treaty provisions).

It is now stated that the attribution of profit to the permanent establishment follows the approach of art. 7, par 2 of the OECD MC ('as it were a separate and independent enterprise') and the OECD Report on attribution of profits to permanent establishments of 2008 and 2010. It is finally provided that also the so called 'internal dealings' between a permanent establishment and its own foreign headquarter must be at arm's length.

Simplified CFC rules (art. 8)

As of 2015 (for calendar year taxpayers):

- Advance rulings, currently required to exclude the application of CFC rules, are no longer mandatory, provided that the taxpayer can provide evidence of 'safe harbor' conditions during a tax audit. It is however required that, if an advance ruling was either not requested or denied, the relative investment must be

separately reported in the income tax return. If the taxpayer fails to comply with this reporting requirement, specific penalties apply;

- Before issuing a CFC income assessment, the tax authorities allow the taxpayer to provide evidence of 'safe harbor' conditions by responding to a formal request for information. A tax assessment, if any, can be issued only after 90 days, otherwise it is null and void. The tax assessment notice, if issued, must include specific comments regarding the information provided by the taxpayer;
- the CFC regime no longer applies to 'affiliated companies' (companies that are less than 51% owned and not under 'control');
- As for the CFC rules applicable to controlled entities located in non-black list jurisdictions (including EU Member States), a specific statement of practice will identify simplified criteria to assess if the effective level of taxation on the foreign entity is lower than 50 percent of the one applicable if the latter was resident in Italy (condition for the CFC rules to apply).

Broader entertainment expenses allowance (art. 9)

As of January 1st, 2016 (for calendar year taxpayers), entertainment expenses are allowed up to greater amounts, and namely up to the following limits:

- 1.5% of gross revenues and other income up to 10 million euro (currently, 1.3%);
- 0.6% of gross revenues and other income for the amount exceeding 10 million and up to 50 million euro (currently, 0.5%);
- 0.4% of gross revenues and other income for the amount exceeding 50 million euro (currently, 0.1%).

New 'white list' (art. 10)

A new 'white list' of Countries will be issued, selected on the basis of an adequate exchange of information agreement in place with the Italian authorities. Such a list will be relevant to exempt certain income from Italian source taxation (e.g. interest on Italian Treasury bonds and other) when received by residents of the Countries of the list (see also below under Inbound transfer of tax residence).

Outbound transfer of tax residence (art. 11)

Rules concerning exit taxation upon transfer of tax residence (aligned with National Grid Indus B.V. case) are extended, as of January 1, 2016, to Italian Companies that merge upstream into another EU company, or are wholly de-merged into an EU company, or whose whole business is hived down into an EU receiving Company in exchange of the shares of this latter, when no permanent establishment of the EU Company is left in Italy (to host all assets and liabilities formerly owned by the Italian Company). The final version of the decree further clarifies that the regime is applicable also to the same cross-border transactions (mergers, demergers, hive downs), when the receiving Company resides in the EEA.

Inbound transfer of tax residence (art. 12)

The decree clarifies that, as of January 1st 2015, if a non-resident entrepreneur transfers its residence in the territory of the State from a 'white list' Country, the tax value of the business assets and liabilities for Italian tax purposes will be the current market value. If the transfer takes place from a non-white list country, then the market value must be determined by way of advance clearance from the Tax Authorities. Absent such clearance, the basis is determined as follows:

- the lower between purchase cost, book value and market value, as for the assets;
- the higher of purchase cost, book value and market value, as for the liabilities.

Until now, in the absence of a specific law provision, taxpayers could only rely on interpretations by Italian Tax Authorities.

Losses on receivables clarified (art. 13)

Waiver of a shareholder(s) receivable is exempt only up to the tax value of said receivable (in case of purchase, the tax value will be the purchase cost paid by the shareholder and not the face value).

Losses on receivables from customers subject to bankruptcy procedure, or similar foreign procedures, and of de-minimis amount (lower than euro 2,500 or 5,000) are allowed when accounted for, but before the tax year when they must be derecognized from the financial statement, under the relevant accounting standards.

Finally, losses on receivables are automatically allowed when the debtor/s achieve a debt settlement agreement or similar foreign procedure, with their respective creditors.

The new provisions are applicable since January 1, 2015.

Foreign branch exemption introduced (art. 14)

As of January 1st 2016 (for calendar year taxpayers), resident taxpayers will be allowed to opt for foreign branch exemption, as an alternative to the taxation with credit system. The election does not trigger exit taxation, is 'all or nothing' and cannot be revoked.

Income of the branch in any event must be separately indicated in the tax return and computed according to the functionally separate entity principle.

Should a branch be either located in a black list jurisdiction or low taxed and producing certain 'deemed passive income', it will not qualify for the exemption.

Certain claw back rules apply for branches that produced losses during the five years preceding the exemption.

A statement of practice to be issued by the Director of the Italian Revenue Agency in 90 days (i.e. by January, 5th 2016) will define practical aspects of the new regime.

Foreign tax credit expanded (art. 15)

As of January 1st 2015, foreign tax credit will include taxes paid on foreign source income until when the Italian Company files its income tax return (currently 30 September of the following year).

In addition, the carry backward option allowed today only for taxes paid by a foreign PE, is extended also to foreign taxes paid on all types of income earned by the Italian Company.

Tax credits are granted for all types of foreign income taxes paid, either if they fall within the definition provided by the applicable Tax Treaty in force with Italy, or not (uncertain cases should be cleared in advance with the tax authorities, via a ruling).

Special regime for certain immigrant workers (art. 16)

Employment income of workers that transfer their residence into Italy is 30% exempt from taxation (IRPEF). The benefit is conditional upon the following:

- a) the worker was tax resident abroad and not in Italy in the five years preceding the transfer;
- b) once in Italy, an employment contract is concluded with a resident Company;
- c) the employment activity is mainly conducted in Italy;
- d) the worker has an university degree and his job in Italy requires high qualifications and specialization.

The benefit, in force since October, 7th 2015, is applicable from the fiscal year in which the transfer of residence occurs and for the following three. A decree, to be issued by the Ministry of Finance in 90 days since October, 7th 2015, i.e. by January, 5th 2016, will contain the rules for implementation of the new regime.

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