



# Taxation of cross-border mergers and acquisitions

**Italy**

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# Italy

## Introduction

Italy has no special tax regulations for mergers and acquisitions (M&A), which are principally governed by Presidential Decree no. 917/1986 (the Italian Consolidated Income Tax Code — ITC).

As a general rule, resident companies are subject to corporate income tax (*imposta sul reddito delle società* — IRES) and regional tax on productive activities (*imposta regionale sulle attività produttive* — IRAP). The basic IRES rate is 27.5 percent (24 percent for 2017 and later tax periods). The basic IRAP rate is 3.9 percent, although IRAP rates vary according to the region where the company operates. Higher rates apply to banks, financial institutions and insurance companies, and to certain other industries.

This report describes the main tax issues to be considered when structuring a cross-border acquisition and is based on the tax rules applicable up to February 2016.

Accounting and legal issues are outside the scope of this report, but some of the key points to be considered when planning a transaction are summarized.

## Recent developments

The following summary of Italian tax issues includes the amendments introduced by Law Decrees no. 128/2015 (Legal Certainty Decree), no. 147/2015 (Internationalization Decree) and Law no. 208/2015 (Budget Law). The most significant amendments are as follows:

- IRES rate reduction, controlled foreign companies (CFC) rule, dividend withholding tax (WHT) reduction, introduction of country-by-country reporting (Budget Law)
- formalization of the abuse-of-law rule (Legal Certainty Decree)
- tax consolidation regime (Internationalization Decree).

How these tax changes affect M&A deals is summarized in the following sections.

## Asset purchase or share purchase

Generally, an acquisition may be structured as an asset deal or a share deal. The tax implications of these two structures are different.

### Purchase of assets

In an asset purchase, a person buys a business<sup>1</sup> from another person for a cash consideration.

Even if an appraisal of the business is not mandatory, it is often useful to have one.

The buyer may step up the tax basis of the assets to the price paid for them under the acquisition agreement and then amortize and depreciate these assets based on their new tax basis.

A taxable capital gain or deductible tax loss arises from the sale of a business and is the positive or negative difference between the sale price and the tax basis of the business. The capital gain (loss) is included in (deducted from) the seller's overall IRES base in the year in which it is realized. The ordinary IRES rate (27.5 percent) applies. If the seller has held the business for more than 3 years, the seller may elect to spread the capital gain in equal installments over a period of up to 5 years. The capital gain or capital loss is not included in the IRAP base. However, a capital gain/capital loss realized from the sale of a single asset is relevant for IRAP purposes.

The buyer of a business will be jointly and severally liable with the seller for any tax liabilities connected with the business and originating from any breaches of tax rules:

- committed in the year of acquisition or in the 2 previous years, or
- emerging from a tax audit that has taken place before the transaction.

The buyer's maximum liability will be equal to the value of the business acquired. In order to limit the buyer's liability, both parties may apply for a certificate from the Italian tax authorities attesting any tax debts existing on the acquisition date. The buyer's exposure can then be limited to the liabilities shown on the certificate. The buyer will not be responsible for any tax liability of the seller if the Italian tax authorities do not issue the certificate within 40 days of the application or if no liabilities are indicated on the certificate.

<sup>1</sup> Or a business unit — the rules on asset deals are the same for the acquisition of a business (*azienda*) and a business unit (*ramo d'azienda*).

### Purchase price

There are no specific rules for allocating the purchase price to the individual assets forming the business. The buyer and the seller agree the overall consideration to be paid for the business. If they wish, they can then apportion the total consideration among the assets in order to identify, insofar as commercially justifiable, the price paid for any individual asset belonging to the business, including goodwill.

### Goodwill

The portion of the consideration paid to acquire the goodwill of the business is recognized for tax purposes. Therefore, the purchaser may book the goodwill at that value and amortize it for tax purposes.

Goodwill may be amortized for IRES and IRAP purposes over 18 years; consequently, the deductible amortization allowance may not exceed one-eighteenth of the value per year.

### Depreciation

Deductible amortization allowances may not exceed 50 percent of the cost per year in the case of copyrights, patents, methods, formulae and industrial, commercial or scientific knowhow. In the case of trademarks, the annual amortization allowance may not exceed one-eighteenth of the cost.

Tangible assets may be depreciated from the tax year in which they go into operation. Tax depreciation charges cannot be higher than:

- the charges resulting from the application of the tax depreciation rates published in a Ministry of Finance decree, or
- the charges calculated in the statutory accounts, if lower than the previous threshold.

In the first tax year of use, these charges are halved. These rules do not have to be applied to assets priced lower than 516.46 euros (EUR) because they can be fully depreciated in the tax year of purchase.

### Tax attributes

Tax losses and other possible tax attributes are not transferred in an asset deal; they remain with the seller.

On certain conditions, value added tax (VAT) credits may be transferred to the buyer along with the business.

### Value added tax

Business acquisitions are not subject to VAT. Instead the sale of single assets by a VAT payer is generally subject to VAT at the ordinary rate is 22 percent (increasing to 24 percent in 2017 and to 25 percent in 2018).

### Registration taxes

According to the Registration Tax Code (RTC), the transfer of a business is subject to registration tax, generally paid by the purchaser (although the parties may agree otherwise). However, both parties are jointly and severally liable for the payment of the registration tax.

The tax rate depends on the type of asset transferred:

- accounts receivable: 0.5 percent
- buildings: 9 percent
- land: 9 percent (15 percent for agricultural land)
- movable and intangible assets, including goodwill, patents and trademarks: 3 percent.

If the assets are subject to different registration tax rates, the liabilities of the business must be allocated to the various assets in proportion to their respective values. If the purchase price is not apportioned to the various assets, the registration tax is levied at the highest rate of those applicable to the assets (generally, the rates for any buildings or land). Thus it is recommended that the purchase price be clearly allocated to each asset so that there is separate taxation based on the different tax rates.

The RTC provides that the tax basis of a business is its fair market value (not its purchase price). The fair market value is subject to assessment by the registration tax office. Therefore, it is often advisable to obtain an appraisal from an independent expert in advance.

### *Purchase of shares*

No special issues arise for the purchaser, except for the classification of the shares in the balance sheet (as inventory or fixed financial assets), which may have an impact on the tax treatment of their subsequent sale.

In principle, the company retains the tax attributes it had before the share acquisition. However, tax losses may be jeopardized if there is a change of control.

### Tax indemnities and warranties

In a share deal, the purchaser takes over the target company together with all its liabilities, including contingent liabilities. Therefore, the purchaser normally requires more extensive indemnities and warranties compared to an asset deal.

### Tax losses

A company cannot carry forward its tax losses if it undergoes a change of control and its business activity also changes. This punitive regime, aimed at tackling the abusive trading of tax losses, does not apply if both the following conditions are met:

- The company employed a minimum of 10 employees throughout the 2 years preceding the year of the ownership change.
- The company's profit and loss account for the tax year preceding the year of the ownership change shows revenues (and other proceeds from the main activity) and labor costs (and related social security contributions) that are at least 40 percent of the average in the 2 preceding years.

If the above conditions are not met, the taxpayer may apply for a tax ruling on whether it may not apply the rule.

### Indirect taxes

Transactions involving shares, quotas, bonds and other securities are VAT-exempt.

Notarial deeds and private deeds with notarized signatures are subject to a fixed registration tax of EUR200 when they concern the trading of shares.

No stamp duty is applicable.

A financial transaction tax (FTT) is levied on transfers of shares issued by Italian companies. The FTT is due by the final purchaser. The standard FTT rates are:

- 0.20 percent for over-the-counter transactions
- 0.10 percent for transactions executed on regulated markets.

Certain exemptions may apply.

### Share-for-share deal (contribution of a significant shareholding)

Article 177(2) of the ITC establishes how to calculate capital gains when shares are contributed. For example, Company A contributes shares in Company C to Company B and Company B thereby acquires or increases (pursuant to an obligation imposed by law or articles of association) a controlling interest in Company C. In return for the contribution, Company A receives shares in Company B. To determine Company A's gain, reference must be made to the increase in Company B's equity as a result of the contribution. Company A's capital gain is the difference between:

- the equity increase of Company B
- the tax basis of the shares in Company A's accounts.

### Step-up of values

In a share deal, the acquired company's assets retain the same book value and tax basis that they had prior to the share acquisition. Thus, no step-up for tax purposes is usually allowed. However, the tax basis may be stepped up to the book value by levying a 16 percent substitute tax on the difference between the book value and the tax basis of controlling equity interests in other companies consolidated for accounting purposes. This rule applies if these interests are acquired in the context of mergers, demergers, share acquisitions and asset acquisitions.

For goodwill and trademarks, the step-up regimes used to allow tax amortization over 10 years for both IRES and IRAP purposes. For reorganizations in 2016 and later years, the 2016 Budget Law reduced the amortization period to 5 years (from 10 years) for the higher carrying values of these intangibles.

It is possible to step up the tax basis of the target's underlying assets if, after closing, there is a merger between the acquisition vehicle and the target company. In this case, the step-up of the tax basis of the underlying assets is possible if the following substitute taxes are paid:

- 12 percent on the first EUR5 million of the higher amount
- 14 percent on the next part, up to EUR10 million
- 16 percent on the part exceeding EUR10 million.

### Choice of acquisition vehicle

A foreign company that intends to acquire a business or shares in a company located in Italy may do so:

- directly from abroad
- through a vehicle incorporated in a third jurisdiction
- through an existing permanent establishment in Italy
- through an Italian resident subsidiary, newly incorporated or already existing.

### Local holding company

The most common forms of company in Italy are limited liability companies (Srl) and joint-stock companies (SpA).

If the asset is acquired through an Italian subsidiary (newly incorporated or already existing), repatriation of profits is subject to the domestic WHT on dividends, unless the requirements for the European Union (EU) Parent-Subsidiary Directive exemption are met or a lower (or nil) treaty rate applies. If a double tax treaty applies, any subsequent disposal of the shares in the Italian subsidiary is not generally taxed in Italy.

Typically, an Italian holding company is used where the purchaser wishes to ensure that interest expenses are offset against the target's taxable profits through a tax consolidation or merger, in accordance with the earnings-stripping rules.

### Foreign parent company

A foreign purchaser may choose to make the acquisition itself, perhaps to shelter its own taxable profits with the financing costs.

Under Italian tax law, if a non-resident seller (individual or company) realizes a capital gain on the disposal of a qualifying<sup>2</sup> equity interest in an Italian resident company and the seller does not have a permanent establishment in Italy, the seller has to pay IRES or IRPEF on 49.72 percent of the gain.

On the disposal of a non-qualifying equity interest in an Italian resident company, gains realized by a non-resident seller (without a permanent establishment in Italy) are exempt in Italy if the shares are listed on a regulated market and the seller is resident in a state that allows an adequate exchange of information with Italy. They are subject to a 26 percent capital gains tax in other cases.

<sup>2</sup> Qualifying shares in non-listed companies represent more than 20 percent of the voting rights or 25 percent of the stated capital. Qualifying shares in listed companies represent more than 2 percent of the voting rights or 5 percent of the stated capital.

If the foreign parent is an EU company, there is no WHT on dividends distributed by the Italian target company, provided that the requirements of the EU Parent-Subsidiary Directive are fulfilled.

### Local branch

The target company (assets or shares) can also be acquired through a branch of a foreign company. Under Italian law, a foreign company may establish one or more branches (permanent establishments) in Italy; however, branches cannot be considered as autonomous legal entities. From a corporate tax perspective, branches of non-resident companies are normally treated as resident corporations and taxed on their local profit.

## Choice of acquisition funding

A purchaser using an Italian acquisition vehicle needs to consider whether to use debt and/or equity.

### Debt

The principal advantage of debt is the potential deductibility of interest, as dividend payments cannot be deducted for tax purposes. Another potential advantage is the deductibility of expenses, such as guarantee fees, when computing income for tax purposes.

When they absorb another company (or when they are members of a tax group), companies may offset — against the income of the target (or other companies in the tax group) and to the extent that the target (these other companies) still has (have) unused earnings before interest, taxes, depreciation and amortization (EBITDA) — any interest expenses that they cannot deduct from their own income. Under the rules applicable from tax period 2016, however, companies resident abroad are no longer considered; therefore, 'virtual' EBITDA is no longer applicable.

Recently, the tax authorities have aggressively challenged the deduction of interest in leveraged buyouts, mainly when the acquisition is indirectly made by a foreign entity. However, the tax authorities do not seem to be on firm ground. Therefore, as things stand now, there should be strong arguments to support the deductibility of interest, also in light of a recent case addressed by the Supreme Court<sup>3</sup>.

### Deductibility of interest

Interest expenses are fully deductible, to an amount equal to the interest income accrued in the same tax period. Any surplus is deductible to the extent of 30 percent of gross operating income (roughly, EBITDA).

Under the rules introduced by the Internationalization Decree, as of tax year 2016, dividends received from non-resident controlled companies must be added to EBITDA.

Any interest expenses exceeding 30 percent of EBITDA may be carried forward for deduction in subsequent tax

periods, to the extent that the net interest expenses (i.e. those exceeding interest income) accrued in future tax periods are less than 30 percent of each period's EBITDA.

The portion of EBITDA not offset against interest expenses and financial charges pertaining to a period may be added to the EBITDA of subsequent tax periods.

Where a company is part of a domestic tax consolidation arrangement, any non-deductible interest expenses (i.e. the portion exceeding 30 percent of EBITDA) may be used to offset the taxable income of another company within the tax group, if that company's own EBITDA has not been fully offset against its own interest expenses.

The above limits do not apply to the deductibility of interest expenses incurred by:

- (i) banks and holding companies of bank groups
- (ii) insurance companies and holding companies of insurance groups
- (iii) other financial institutions, with the exception of companies whose exclusive or main business activity is the holding of equity interests in companies other than banks or financial institutions
- (iv) certain consortia and SPVs involved in public works.

Entities (i), (ii) and (iii) above may deduct up to 96 percent of interest expenses. As of 2017, this limit will remain only for insurance companies and holding companies of insurance groups.

### Withholding tax on interest

No WHT is due on interest payments made by Italian companies to Italian banks.

If the lender is a non-resident, a 26 percent WHT is levied, unless a lower treaty rate is available. A WHT exemption on interest payments may apply if the following conditions are met.

- The loan is a medium- or long-term loan (i.e. more than 18 months).
- The borrower is an enterprise.
- The lender is a bank established in the EU, an EU insurance company, or a foreign institutional investor subject to regulatory supervision in the country where it is established.

The EU Interest and Royalties Directive exemption may also apply if the following conditions are met.

- The intercompany financing is between an Italian parent company and its EU subsidiary or EU affiliate directly held by the same EU parent company.
- The EU parent/affiliate is the beneficial owner of the interest payment and not merely an intermediary or an agent.

<sup>3</sup> Supreme Court decision no. 1372 of 21 January 2011.

WHT generally does not apply to corporate bonds listed on a regulated market or multilateral trading facility.

### Equity

A purchaser may use equity to fund an acquisition. Contributions in cash do not give rise to taxable income for the recipient company.

Cash and in-kind contributions to the capital of resident companies are subject to a fixed registration tax of EUR200. Registration, mortgage and cadastral taxes are due on contributions of real estate.

Under domestic law, there is a 26 percent WHT rate on dividends paid by Italian companies to foreign companies.

The ordinary withholding rate is reduced to 1.375 percent if the recipient of the dividend is a company resident within the EU or EEA. As of the tax period 2017, the WHT will be reduced to 1.20 percent.

If the EU Parent-Subsidiary Directive requirements are met (e.g. the EU parent company holds at least 10 percent of the shares for more than 1 year), there is no WHT on dividend payments.

### Deductibility of the notional cost of equity

Italian companies can benefit from an additional deduction from their tax base: the allowance for corporate equity (ACE). The allowance is equal to the aggregate qualifying equity increase since fiscal year 2011, multiplied by a notional rate of return of 4.5 percent for fiscal year 2015 and 4.75 percent for fiscal year 2016. As of 2017, the Ministry of Finance will set the ACE rate by 31 January of each year. The qualifying equity increase of listed companies is increased by a further 40 percent (this additional benefit is subject to authorization by the European Commission).

### Dividends not deductible for Italian tax purposes.

Dividends paid by Italian companies to their shareholders may not be deducted from the IRES base.

Although equity offers less flexibility if the parent subsequently wishes to recover the funds it has injected, the use of equity may be more appropriate than debt in certain circumstances. For example:

- The target is loss-making, and it may not be possible to obtain immediate tax relief for interest payments.
- An appropriate mix of debt and equity is required in order to maximize interest deductions under earnings-stripping rules.
- There are non-tax grounds for preferring equity, e.g. a higher level of equity may be preferable for commercial reasons.

Mergers, demergers and contributions of business units are neutral transactions that do not trigger corporate income tax for companies or their shareholders.

## Other considerations

### Concerns of the seller

The tax position of the seller can have a significant influence on any transaction. If the seller of shares is a company and if the shares are booked as inventory, any gain from the disposal of the shares must be included in full in the taxable income of the seller and taxed at the ordinary 27.5 percent IRES rate (24 percent from 2017), as it is treated as revenue and not a capital gain. If the shares are booked as fixed financial assets in the financial statements (at least those for the fiscal year in which the shares were bought), any capital gain realized by the seller is 95 percent tax-exempt (participation exemption) if the shares:

- have been held continuously for at least 12 months
- are in subsidiaries that engage in an actual business activity.

This requirement must be satisfied from the first day of the third fiscal year preceding the year in which the shares are sold. Real estate companies are excluded from this regime if more than 50 percent of their aggregate asset value is represented by real estate other than assets built or purchased by the same company for resale or use in the business activity.

Conversely, capital losses on the disposal of shares that qualify for the participation exemption are not deductible by a corporate seller.

According to the Italian tax authorities, even if all the pre-conditions for the participation exemption are met, the regime does not apply to shares transferred in the context of a business transfer because the assets and liabilities included in that business must be considered as a 'whole' and cannot be unbundled (Circular Letter 6/E of 13 February 2006).

### Company law and accounting

M&A deals usually include transactions such as mergers, demergers and contributions in kind.

According to the Italian Civil Code, a merger involves the absorption of one or more companies by another company, resulting in the termination (without liquidation) of the absorbed companies and the transfer of their assets and liabilities to the absorbing company.

There are two types of mergers in Italy:

- All the companies are absorbed and their assets and liabilities are contributed to a newly incorporated company (*fusione propria*). The shareholders of the absorbed companies receive shares in the new company in exchange for their shares in the absorbed company.
- An existing company absorbs one or more companies (*fusione per incorporazione*). The shareholders of the absorbed companies receive new shares from the absorbing company.

In the demerger of a company, all or some of its businesses are contributed to one or more other companies. The beneficiary companies may be newly incorporated or they may already exist.

The shareholders of the demerged company receive new shares issued by the companies to which the assets and liabilities are contributed.

In a contribution in kind (e.g. contribution of business units or shareholdings), a company transfers assets to another company and receives shares issued by the recipient in return.

A sworn appraisal by a court-appointed expert is a prerequisite for contributions of business units (for limited liability companies, the contributing company can appoint the expert). The appraisal should describe the contributed assets and liabilities, the value assigned to each item and the criteria used for the appraisal. A notary public must execute the contribution deed.

With regard to accounting, under Italian generally accepted accounting principles (GAAP), the above three transactions are normally recorded at book value without any step-up.

When preparing their financial statements, Italian companies should generally use Italian GAAP, as set out in the Italian Civil Code and interpreted by the Italian Accounting Organization (OIC). In some cases, Italian companies may adopt International Financial Reporting Standards (IFRS) to prepare their accounts. These accounting standards provide for a step-up of the book values of the assets involved in a business combination, where certain conditions are met.

Finally, a common issue in transaction structuring is financial assistance. Broadly speaking, it is illegal for a company (or one of its subsidiaries) to give financial assistance, directly or indirectly, for the acquisition of that company's shares. Therefore, it is necessary to evaluate the rules carefully when structuring the financing of the deal and its security package. Indeed, the Italian tax authorities have a tendency to see any transaction as abusive and only (or mainly) driven by tax savings. However, the Italian Supreme Court considered a case concerning a leveraged buyout and held that the transaction was not abusive in itself and, therefore, the Italian tax authorities could not challenge it based on anti-avoidance or abuse-of-law provisions (see footnote 3 above).

### **Group relief/consolidation**

Italian groups can opt for a domestic tax consolidation regime if the Italian companies are controlled by an Italian company. A non-resident company can only be head of the tax group if all the following conditions are met.

- It is resident in a tax-treaty country.
- It carries on a business activity in Italy through a permanent establishment.
- The Italian subsidiaries are registered in the accounting books of its permanent establishment.

The main advantage of tax consolidation is that 100 percent of the tax losses incurred by one or more companies of the tax group can be immediately offset against the taxable income of other companies of the tax group. Any consolidated tax losses can be used to offset up to 80 percent of consolidated taxable income in subsequent years. However, losses incurred before consolidation cannot be offset against the taxable income of other tax-group companies. These tax loss carry forwards can only be offset against the taxable income of the company that incurred them.

Another advantage of tax consolidation is that the portion of interest expenses exceeding 30 percent of EBITDA (see above on the deductibility of interest) and generated after a company's inclusion in the tax group may be used to offset the taxable income of another group company. This only applies where that other company's EBITDA has not been offset by its own interest expenses.

To join a tax group, a subsidiary must have been directly or indirectly controlled by the parent company since the beginning of the financial year in which the option for tax consolidation is exercised (control requirement). As group membership is optional, it is possible that not all the Italian subsidiaries potentially qualifying for tax consolidation will join the group.

The domestic tax consolidation regime is irrevocable for a period of 3 years, and there are specific rules on its termination. For example, it is terminated where the control requirement is no longer met or there are certain merger/demerger transactions during the 3-year period.

Each consolidated company is liable for any tax liabilities, penalties and interest assessed by the tax authorities on its income. However, the controlling company is liable not only for its own tax liabilities but also — jointly and severally — for the tax liabilities, penalties and interest of each of the consolidated companies.

The tax consolidation regime was recently amended by the Internationalization Decree in order to make it compliant with recent decisions of the European Court of Justice. According to these decisions, a member state cannot refuse to apply a special tax regime to resident subsidiaries of a sole non-resident parent company that is located in another EU or EEA member state and that does not have a permanent establishment in the first member state.

Under the new rules, a non-resident company without a permanent establishment in Italy and resident in an EU or EEA member state that has entered into a double tax treaty with Italy may also appoint an Italian resident company or a permanent establishment to opt for the domestic tax consolidation regime together with each resident company or permanent establishment that has the same non-resident parent company.

## Transfer pricing

Transactions between residents (individuals or corporations) and non-residents must be valued at fair market value if the non-resident:

- is controlled (directly or indirectly) by the resident
- controls (directly or indirectly) the resident, or
- is controlled (directly or indirectly) by the same person that controls the resident.

The fair market value is basically the arm's length price. In other words, the price of each intercompany transaction, if it implies an increase in the tax base, should be equal to the consideration that would have been applied for goods and services of the same or similar type, in free market conditions and at the same stage in the distribution chain and at the same time and place as the goods and services in question (or, if no such criterion is available, at the nearest time and place).

Since 2010, a group can prepare documentation supporting its transfer pricing even if it is not mandatory. If such documentation is prepared and is compliant with the standards set by the Italian tax authorities, then a penalty protection system applies and the group will not be subject to penalties if the tax assessment results in a transfer pricing adjustment. If the documentation is not compliant with the Italian tax authority's guidelines or is not deemed to be complete, administrative penalties ranging from 90 to 180 percent of the maximum tax assessed will be imposed for any transfer pricing adjustment.

As of 2016, certain multinational enterprises should file a country-by-country report, which must include their by-country revenues, gross profit, paid and accrued taxes, and additional indicators of actual economic activities.

## Foreign investments of a local company

The 2016 Budget Law introduced a new CFC rule, which establishes a general criterion by which tax havens can be identified, that is, a nominal level of taxation (tax rate) that is lower than 50 percent of that in Italy. Therefore, the CFC rule now applies to controlled companies that are resident or established in a country whose ordinary or special tax regime establishes such a level of taxation. However, the CFC rule does not apply to controlled companies established in an EU member state or in an EEA state that allows an effective exchange of information with Italy (i.e. Norway and Iceland).

The CFC rule continues to apply to controlled companies resident or established in an EU member state, Norway or Iceland when both of the following conditions apply:

- Certain income, such as interest, dividends, royalties or revenues from intercompany services, exceeds 50 percent of their total income.
- The effective tax rate is lower than 50 percent of the rate that would apply if the company were resident in Italy.

The 2016 Budget Law also states that CFC income will be taxable in Italy in the hands of the resident shareholder and subject to the standard IRES rate of 27.5 percent (24 percent as of 2017), while the previous rule imposed a tax rate of not less than 27 percent.

## Anti-avoidance rules

On 1 October 2015, the Legal Certainty Decree introduced a new anti-avoidance rule that formalizes the prohibition on abuse of law. A transaction may constitute abuse of law if it has no economic substance and is essentially aimed at obtaining undue tax savings. Even if it is formally compliant with Italian tax law, it is at odds with the purposes of the provisions and/or the principles of the Italian tax system.

A transaction has no economic substance if it involves facts, acts and agreements (even interconnected ones) that have no significant effects other than tax savings or, in general, tax advantages. Transactions cannot be defined as abusive if they are justified by sound business reasons; these reasons include shake-ups or management decisions to improve the structure or operations of a business.

The taxpayer is allowed to submit an application for a tax ruling on whether a transaction constitutes unfair tax behavior.

## Dormant company rule

A company is deemed to be dormant if, in a fiscal year, its revenues are lower than the sum of the following items:

- 2 percent of the average tax basis of the company's financial assets in the fiscal year and the previous 2 years
- 6 percent of the average tax basis of the company's real estate assets in the fiscal year and the previous 2 years
- 15 percent of the average tax basis of the company's remaining assets in the fiscal year and the previous 2 years.

If the vitality test is not passed, the company's minimum taxable income is deemed to be the sum of certain specific items. A dormant company may carry forward its tax losses but can only offset them against the portion of its income that exceeds the minimum taxable income.

If a company is considered dormant, a higher IRES rate of 38 percent is applied to a notional income computed on the basis of the assets recorded in the company's balance sheet. In a tax group, the notional income cannot be offset against losses of other group companies.

A calculation similar to the vitality test is used for IRAP purposes. Other limits also apply for VAT purposes.

An entity is also considered dormant in a fiscal year if it has had tax losses in 5 consecutive previous years (certain exemptions may apply).

Companies are allowed to apply for a tax ruling and to give evidence in their application of the circumstances that have prevented them from passing the vitality test.

## Comparison of asset and share purchases

### Advantages of an asset purchase

- Step-up in the tax basis of the assets allows higher depreciation/amortization (including goodwill).
- Previous tax liabilities of the seller are only partially transferred to the purchaser; in certain cases they may be fully eliminated.
- Possible to acquire only part of a business.
- Possible for the seller to shelter the capital gain against any tax loss carry forwards of its own.

### Disadvantages of an asset purchase

- Possibly unattractive to the seller, especially if a share sale would be partially exempt.
- Usually, higher registration tax.
- Higher corporate income tax on capital gains.
- Benefit of any residual losses incurred by the target company remains with the seller.

### Advantages of a share purchase

- Likely to be more attractive to the seller from a tax perspective (because the disposal may be partially exempt).
- Buyer may benefit from the tax losses of the target company.
- Usually, lower registration tax.

### Disadvantages of a share purchase

- Buyer becomes liable for any claims or previous liabilities of the entity.
- No free step-up in the tax basis of the purchased assets.



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Designed by Evalueserve.

Publication name: Italy: Taxation of cross-border mergers and acquisitions

Publication number: 133201-G

Publication date: April 2016