The Corporate Tax Planning Law Review

Third Edition

Editors

Jodi J Schwartz and Swift S O Edgar

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PREFACE

We are pleased to present the third edition of *The Corporate Tax Planning Review*. This volume contains 21 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 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 states of Singapore and Monaco; and several nations in the Global South (Colombia, Venezuela, Malaysia and more). Echoing this geographical variety, *The Corporate Tax Planning Review* describes tax developments worldwide that respond 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 revenues. These complex and at times conflicting goals present opportunities for the well advised and traps for the unwary.

While 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 at times 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 Nick Barette, Gavin Jordan, Tommy Lawson and Adam Myers at Law Business Research Limited for their editorial acumen and dedication to this project.

Jodi J Schwartz
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New York, NY
April 2021

Appendix 1

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Jodi J Schwartz focuses on the tax aspects of corporate transactions, including mergers and acquisitions, joint ventures, spin-offs and financial instruments. Ms Schwartz has been the principal tax lawyer on numerous domestic and cross-border transactions in a wide range of industries. She was elected partner in 1990.

Ms Schwartz is recognised as one of the world's leading lawyers in the field of taxation, including being selected by *Chambers Global Guide to the World's Leading Lawyers*, *Chambers USA Guide to America's Leading Lawyers for Business*, *International Who's Who of Business Lawyers* and as a tax expert by *Euromoney Institutional Investor Expert Guides*. In addition, she is a member of the Executive Committee and past chair of the Tax Section of the New York State Bar Association, and also is a member of the American College of Tax Counsel.

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Chapter 8

ITALY

Fabio Chiarenza, Stefano Grilli and Vittorio Zucchelli[1]

I INTRODUCTION

During 2020, due to the covid-19 pandemic, the Italian legislator introduced a number of tax measures with the view to alleviating the financial stress caused by the contraction of the businesses.

The current economic scenario has prompted Italy to consider a significant review of its tax regulations, especially on the personal income tax side.

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 the following:

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

This chapter focuses mainly on the above corporate entities. Although less common, legal and tax transparent entities exist.

Finally, Italy has got 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, Stefano Grilli and Vittorio Zucchelli are partners at Gianni & Origoni. The authors wish to thank Carmen Adele Pisani and Giuseppe Francesco Patti for their support in writing this chapter.
2 These corporate forms have separate legal personality: no liability of their members.
3 The SpA is the corporate form used for medium- and large-sized businesses.
4 The Srl is used for small and medium-sized businesses. Compared with the joint stock companies, the limited liability company offers 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 the following:

a Italian corporate income tax (IRES),[8] currently applicable at the rate of 24 per cent (which may be increased by 3.5 per cent for banks and certain financial intermediaries);[9] and

b Italian regional tax on business activities (IRAP),[10] currently applicable at the basic rate of 3.9 per cent[11] (IRAP rate may 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 are included in the company's IRES taxable base;[12] and

b dividends received from non-resident entities are subject to the same tax regime under (a) provided that certain conditions are met.[13]

Italy has recently introduced a specific transparency rule with respect to dividends paid to Italian non-commercial partnerships (*società semplici*). In particular, for tax purposes,

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

7 Tax residence is identified via by (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 it 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 For fiscal years 2019, 2020 and 2021, IRES rate has also been increased by 3.5 per cent for entities managing motorway, airport management, port and railway concessions.

10 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.

11 IRAP rate may be varied (with a ceiling) by each Italian regions.

12 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).

13 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.

dividends are considered to be paid directly to the persons having an interest in the relevant Italian non-commercial partnership; accordingly, the tax treatment of the dividend payment is the one applicable to such persons.

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 are 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 (participation exemption regime also known as PEX). The PEX regime is subject to conditions.[14]

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

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 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 EBITDA); and (2) 30 per cent of the exceeding ROL carried forward from previous fiscal years.

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

14 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 said 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 (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.

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.

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 asset management companies and managers, Italy 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 issued in the context of carried interest schemes qualifies as financial income or capital gain (generally subject to a 26 per cent substitute tax), rather than employment income (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.

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.

Patent box regime

Under the Italian patent box regime,[19] 50 per cent of income[20] 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 that is legally protected (Qualifying Intangibles) is not included in the IRES and IRAP taxable bases.

Furthermore, any capital gain deriving from the transfer of Qualifying Intangibles is not included in the seller's IRES and IRAP taxable income, provided that at least 90 per cent of the consideration received by the seller is reinvested in the maintenance and development of other Qualifying Intangibles within the end of the second fiscal year following the transfer.

Tax credit for new investments

A tax credit varying from 6 per cent to 40 per cent is granted for investments carried out by Italian resident companies in new tangible and intangible assets between 16 November 2020 and 31 December 2021 (or by 30 June 2022 if a 20 per cent advance payment is made by 31 December 2020).[21] 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 6 per cent to 12 per cent of the investment depending on the nature of the investment itself.

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 SMEs (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.[22]

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19 The election for the Italian patent box 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 the above-mentioned activities in Italy through a permanent establishment, provided that they are resident in a jurisdiction: (1) having signed a double tax treaty with Italy; and (2) allowing an actual exchange of information.

20 The amount of qualifying income is calculated according to the ratio between the qualifying R&D expenses to develop the intangible and the total cost for the production of the latter. R&D costs may be increased up to 30 per cent by including those related to the acquisition of the qualifying intangible or to research contracts (involving the same intangible) signed with related companies.

21 For tangible assets, the tax credit amounts to 6 per cent of the investment (up to €2 million). For 4.0 tangible assets, the tax credit varies from 20 per cent to 40 per cent of the investment (up to €10 million). For 4.0 intangible assets, the tax credit amounts to 15 per cent of the investment (up to €700,000).

22 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 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.

Step-up of Italian participations

Under Italian tax law, it is possible to elect a step-up of participations in unlisted Italian resident companies held on 1 January 2021 through the payment of an 11 per cent substitute tax. Certain requirements must be met. The substitute tax applies to the value of the participations because it results from a third-party appraisal. Such option is granted, *inter alia*, to foreign entities investing in the mentioned companies. This election may be particularly advantageous for those foreign investors who, in the 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 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.[23]

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 recently amended to align the domestic legislation to the EU Anti-Tax Avoidance Directive.

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 having an effective tax rate lower than 50 per cent than the Italian one; and

b more than one-third of their income derives from 'passive income'[24] or from financial leasing, insurance, banking or other financial activities, or intra-group sales or supply of low value-adding goods or services.

23 The ROL excess can be transferred within the group.

24 e.g., dividends, interest and royalties.

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 (ITA) 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 prices are not in line with the fair market value.

Some limitations exist with respect to 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 having as a sole or main purpose 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.

Anti-profit shifting measures

In order to contrast profit shifting, on top of the CFC legislation described above, Italy has implemented a transfer pricing regulation which 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 has also enacted the ATAD II anti-hybrid measures. With respect to 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 treatments. Tax treatment of 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. Save for the PEX regime (see 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 either set out 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 MLI on the tax treatment of capital gains deriving from the disposal of shares or quotas in certain companies, see Section III.iii). The 2021 Italian Budget Law introduced an exemption with respect to capital gains on 'qualified' participations[25] in Italian resident entities derived by 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; and

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:
  - for the acquisition of quotas, a €200 lump sum transfer tax is due; and
  - 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 (*imposta di registro*), 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).

Reorganisation transactions

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

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

25 For the meaning of 'qualified participations' see note 28 below.

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).[26]

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 the participation received in exchange at the tax value of the contributed participation.[27]

As a result of the implementation of the EU Merger Directive, if certain requirements are met, the roll-over 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 either at the full rate of 26 per cent. A reduced rate (1.2 per cent) applies to dividends distributed to companies resident, and subject to corporate income tax, either in another EU member state or in a state of the European Economic Area. 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.

The 2021 Italian Budget Law introduced a specific exemption from withholding tax for dividends paid by Italian resident entities to collective investment funds (1) established

26 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. Furthermore, under certain conditions, a free tax step-up regime is granted for companies resulting from mergers or divisions occurring between 1 May 2019 and 31 December 2022.

27 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 roll-over 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.

in the EU or EEA, which allows for a satisfactory exchange of information; and (2) that are subject to regulatory supervision in their country of establishment pursuant to Directive No. 2011/61/EU (the exemption applies also in cases where the asset manager (rather than the relevant collective investment undertaking) is 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 it 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–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–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 institutional investors, a withholding tax exemption is available for interest paid out of loans, having certain features (the Loan WHT Exemption Regime).

Equity funding

With the view to strengthening the capitalisation of Italian companies, the Allowance for Corporate Equity[28] (ACE) has been recently 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.

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

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 while, for certain kind 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 having 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.

With respect to MLBO transactions carried out in Italy, ITA highlighted that the relevant BidCo needs to qualify has 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 BidCo P/L as expenses.[29]

Finally, Italy has recently introduced a plastic[30] and a sugar tax.[31]

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.

29 Depending on the relevant accounting principle.

30 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 kilogram of plastic contained in the relevant product.

31 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.

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'.[32]

The Budget Law 2020 provides for a 'new' Italian digital service tax effective as of 1 January 2020 (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:

a the total amount of their worldwide revenues during the calendar year is not lower than €750 million; and

b the total amount of revenues 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.

A recurring clause in the tax treaties signed by Italy is the one giving exclusive right to tax to the 'residence State' with respect to 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 will be 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.

Furthermore, Italy recently signed a new tax treaty with China.[33] This treaty mainly follows the OECD Model and some of its newest amendments, as:

a the new Article 4(3) of the 2017 of the OECD Model;[34]

b the new Article 13(4) of the 2017 of the OECD Model;[35] and

c the new preamble.[36]

32 As a consequence, in line with BEPS Action 1, the elements that could be considered for assessing the presence of a PE in Italy may also be: (1) the amount of revenues 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.

33 This treaty is going to replace the previous one signed in 1986.

34 Providing for a MAP in case of double resident entities.

35 Already described above.

36 Referring to the abuse of treaty law, as recommended by BEPS Action 6.

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 RECENT CASES

i Withholding interest exemption on certain foreign loans

The Italian tax authorities have recently issued a statement of practice (*risposta 125/2021*) clarifying some aspects related to the scope of the interest exemption provided for long-term loans made by (1) EU financial 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 clarifies the following:

a loans can be considered as having a 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 Implementation and entry into force of DAC6 Directive provisions

As of 2021, the Italian provisions implementing the DAC6 Directive have entered into force.

Pursuant to such rules, intermediaries and taxpayers are required to report to the Italian tax authorities that the set-up of certain cross-border transactions meets some specific hallmarks. The existence of such hallmarks has been deemed to be symptomatic of aggressive tax planning arrangements.

Even though the DAC6 reporting obligations have entered into force in 2021, such reporting obligations apply also with respect to arrangements set up from 25 June 2018.

iii Clarifications on the treatment of two-step transactions for registration tax purposes

In the past decade, ITA has been trying to recharacterise as sales of going concerns, for registration tax purposes, those transactions consisting of the transfer of a business unit into a newly established entity followed by a share deal (i.e., the transfer of the newco's participations to another entity). This recharacterisation has resulted in the application of the proportional registration tax (3–9 per cent of the value of the assets forming part of the business unit), as opposed to, in principle, a €200 lump sum registration tax applicable to each of the two transactions.

The above-mentioned practice was grounded on a broad interpretation of Article 20 of Presidential Decree No. 131/1986, which regulates how deeds subject to registration in Italy should be subject to registration tax. According to the interpretation of ITA, which was often upheld by the Italian tax courts, this provision would allow ITA to identify, for registration tax purposes, the nature of the deed to be registered taking into account also external elements (such as other deeds). Between 2018 and 2019, the Italian Legislator introduced certain amendments to the mentioned provisions with the aim of limiting its applicative boundaries by preventing ITA to infer the correct tax treatment of a deed based on external elements. By decision No. 158 of 21 July 2020, the Italian Constitutional Court confirmed the lawfulness of the mentioned amendments. As a result, absent any tax-abusive purposes to be counteracted by the specific Italian anti-abuse provision, the two-step transaction at stake represents a viable option.

iv Recent successful tax-efficient transactions

Italy has amended its securitisation law in order to, among the others, foster the NPLs market also by reducing the tax burden related to this kind of transaction.

Indeed, securitisation vehicles may set up a vehicle (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 now not taxed at the level of ReoCos or at the level of the securitisation vehicle.

Finally, under certain circumstances, these kinds of transactions also benefit from reduced indirect taxes with respect to, among the others, the acquisition and the sale of the real estate properties by ReoCos.

V OUTLOOK AND CONCLUSIONS

The covid-19 pandemic has highlighted the need for a deep-seated reform of the Italian tax system and the Italian government, in acknowledging the urgency, is expected to put forward important proposals for change in the coming years.

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., FACTA, CRS and DAC6).

Appendix 1

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Fabio Chiarenza is co-head of the tax department.

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