Impact of Anti-tax Avoidance Directive on Italian CFC legislation

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Corporate Tax, Italy

- **Italian CFC regulation**
- **New definition of 'control'**
- **Safe-harbour rule**

With Legislative Decree 142 of 29 November 2018, the government transcribed the EU Anti-tax Avoidance Directive (2016/1164/EC) into Italian law. The decree's new controlled foreign corporation (CFC) rules are applicable from the fiscal year following that in progress on 31 December 2018 (ie, from 2019 for calendar-year taxpayers).

Italian CFC regulation

Under the new Article 167 of the Tax Code, a foreign jurisdiction is deemed to be tax privileged if the following conditions are met:

- the effective tax rate (any reference to a nominal tax rate no longer applies) in the foreign jurisdiction (ie, the foreign effective tax rate) is lower than 50% of the tax that would have been charged had the company been resident in Italy (ie, the internal virtual tax rate); and
- more than one-third of the company's revenue derives from 'passive income' – namely:
  - interest and any other income deriving from financial assets;
  - royalties and any other income deriving from IP use;
  - equity investments (capital gains or dividends);
  - income from financial leasing;
  - insurance, banking and other financial activities;
  - revenues deriving from intra-group services; or
  - the sale of goods with little or no added economic value.**(1)**

In light of the above, the recent tax rules introduced by Legislative Decree 142 have removed the distinction between a tax haven CFC and a white list CFC. The decree has therefore unified the terms under which the CFC rules apply if the abovementioned conditions are jointly met independently from the country in which the company is resident for tax purposes.

New definition of 'control'

Legislative Decree 142 extends the concept of 'control' to include:

- 'profit control' (ie, the Italian controlling entity is entitled to receive more than 50% of the foreign company's profits); and
- 'juridical control', as provided for under Article 2359 of the Civil Code. A company is deemed to be under juridical control if:
  - another company directly or indirectly holds the majority of votes at the shareholders' meeting;
  - another company directly or indirectly has sufficient votes to exercise a dominant influence in the shareholders' meeting; and
  - the company is under the dominant influence of another company by virtue of a specific contractual relationship.

Safe-harbour rule

An exemption from the new CFC rules is available to controlling companies that can prove that an actual business is carried out by the foreign entity in another jurisdiction by way of local personnel, equipment, other assets and premises, also by means of an advance ruling from the Tax Authority. Thus, the advance ruling is optional and the exemption can be demonstrated by the taxpayer during a tax assessment.

Where these safe-harbour conditions are duly met, the subsequent dividend distributed by a CFC will benefit from a 50% exemption in addition to a foreign tax credit computed on the remaining 50% taxable dividend.

For further information on this topic please contact Franco Pozzi or Fabrizia Orsillo at Studio Legale Tributario Biscozzi Nobili by telephone (+39 02 763 6931) or email (franco.pozzi@slta.it or fabrizia.orsillo@slta.it). The Studio Legale Tributario Biscozzi Nobili website can be accessed at www.slta.it.

Endnotes

(1) In order for the sale of goods or services to be deemed to have little or no added economic value, reference must be made to the Ministerial Decree of 14 May 2018 concerning the implementation of the base erosion and profit shifting transfer pricing principles in Italy. Under the decree, services are deemed to have 'a low added value' when they:

- are supportive in nature;
- are not part of the group's main activities;
- require no use and create no unique or valuable intangible assets; and
- do not require the service provider to assume significant risk.

Franco Pozzi

Fabrizia Orsillo