Corporate Tax - Italy

New measures to support economic growth and internationalisation

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Authors

Marco Abramo Lanza

Franco Pozzi

Introduction

On April 21 2015 the Cabinet approved the implementation of three tax reform decrees (Act 23/2014), which are now before the lower house of Parliament for approval. The approval procedure will entail the release of an opinion by the appropriate commission, after which the provision will be submitted to Parliament for the final vote.

The decrees relate to:

- the electronic filing of value-added tax transactions;
- assessment based on the abuse of law principle; and
- measures to support economic growth and internationalisation.

This update focuses on relevant changes to corporate income tax law provisions that are included in the third decree. The third decree aims to create a favourable environment for foreign investors and Italian enterprises that want to grow their international business. Thus, the changes aim to simplify the existing rules based on international compliance standards. Comments on how the third decree should be implemented have been provided by Italian business associations.

Costs deductible from blacklisted countries

Under existing legislation, costs incurred by Italian resident companies and by the permanent establishments of foreign companies in Italy from transactions carried out with companies – regardless of whether they are related or unrelated parties – located in tax havens (ie, blacklisted countries) are deductible if two requirements are met by the Italian taxpayer bearing the cost:

- blacklisted resident company conducts real and genuine business; and
- The relevant transaction was of economic interest to the Italian taxpayer.

Providing evidence of these requirements is extremely difficult and has resulted in relevant tax litigation.

Blacklisted countries are selected based on a low level of standard taxation and/or for an exchange of information with Italy which is not in line with Organisation for Economic Cooperation and Development (OECD) standards.

The proposed amendments will identify blacklisted countries taking into account the exchange of information criterion only, while the costs deductible will be determined by reference to the arm's-length value of the relevant transaction. The question is whether the identification of a blacklisted country defined under this provision will also apply in other cases (eg, controlled foreign company (CFC) income rules).

According to the new provision, the deduction of costs incurred through transactions with companies located in tax havens will not be subordinated to the two compliance requirements; rather, it will be automatically granted up to the amount of the arm's-length value of the relevant transaction.

The third decree also proposes to remove the exemption test which requires the taxpayer to prove that the blacklisted resident company conducts real and genuine business.

Entertainment costs (*spese di rappresentanza*)

The third decree provides for an increase in the entertainment costs deductibility threshold, depending on the amount of revenue earned by a company, as follows:

- 1.5% up to €10 million;
- 0.6% between €10 million and €50 million; and
- 0.4% above €50 million.

Controlled foreign companies

The existing CFC rules attribute the profits of a non-resident company to an Italian resident where the resident controls – directly or indirectly – the non-resident company and the latter is resident in a low-tax jurisdiction (ie, a blacklisted country).

The same rules apply when the non-resident entity is resident in a whitelisted country if both of the following conditions are satisfied:

- More than 50% of the non-resident entity's income is 'passive income', meaning that it is derived from:
  - the management of or holding or investment in securities, participations, receivables or other financial investments;
  - the disposition or exploitation of intangibles relating to industrial, artistic or literary rights; or
  - services, including financial services, that are provided to entities belonging to the same group; and
- The non-resident entity is subject to an effective tax rate of less than 50% of the Italian corporate tax rate on the same item of income.

The regime is mandatory, but need not be applied by the taxpayer where the tax authorities release a positive ruling.

The third decree eliminates the requirement to apply this regime in order to avoid the application of the CFC rules - which are also applicable for blacklisted resident companies - in the case of associated entities (ie, which are not subject to the control test). The draft decree also provides for additional reporting requirements in corporate tax returns. These include a requirement to provide details of corporate interests held in non-resident companies that meet the conditions outlined in the bullets above.

In addition, the third decree introduces a new penalty regime that applies where the above compliance requirement is not met. The penalty proposed would be equal to 10% of the foreign income to be charged on the resident corporate interest holders.

Permanent establishments

The third decree introduces a new set of rules to determine the profits earned by permanent establishments located in Italian territory. The decree refers to the OECD's separate entity approach, which has been applied by practitioners and the Revenue Agency based on the latter's Circular Letter 1980. According to the new provision, a permanent establishment's endowment fund must be calculated to take into account the functions performed, assets used and risks assumed as per the OECD Report on Attribution of Profits to Permanent Establishments 2010.

Entry tax

The third decree introduces a new rule in relation to companies that have transferred their income tax residence to Italy, stating that they should be assessed for income tax purposes according to the arm's-length principle. A different assessment procedure applies regarding the country from which a company is transferring. In particular, in the case of countries with no exchange of information with Italy, assets and liabilities will be assessed at an arm's-length value according to a ruling procedure to be determined together with the Revenue Agency. Should the Revenue Agency and the foreign transferring company fail to reach an agreement, the assets will be assessed at the lower value of:

- the purchase cost;
- the financial statement figure; and
- the arm's-length value.

The liabilities will be assessed at the higher value of the three.

The third decree will be effective from the start of the fiscal year that follows its final approval.

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

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