

Italian Parliament enacts new budget law for 2023

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Introduction

The Italian Parliament has enacted the 2023 Budget Law. The law⁽¹⁾ was published in the *Official Journal* on 29 December 2022 and came into force on 1 January 2023.

Among other things, the law provides a new substitute tax regime applicable to the profits and profit reserves from the financial statements of foreign companies, a new opportunity to increase the purchase value of participation, land and agricultural activity.

The following article addresses some new provisions included in the law.

Profits from foreign companies

Article 89 of the Corporate Tax Act (CTA) provides for a 95% exemption of dividends that would trigger an actual tax burden of 1.2% considering the corporate income tax (IRES) rate of 24%. Nevertheless, different provisions are applicable to foreign source dividends from low tax jurisdictions⁽²⁾ (ie, blacklisted companies).

Under domestic tax rules, "blacklisted companies" are entities resident or located in jurisdictions other than EU or European Economic Area (EEA) member states, whose ordinary or special tax regime grants a nominal tax rate that is 50% lower than the Italian one.

A foreign entity is not considered a blacklisted company if the resident taxpayer can demonstrate:

- that it is a legitimate structure which does not intend to obtain an unjustified tax benefit, known as the "second safe-harbour rule"⁽³⁾;
- or that the foreign subsidiary carries out an actual business activity in the market in which it is established, known as the "first safe-harbour rule".⁽⁴⁾

Under the described scenario, dividends paid by blacklisted entities are fully taxable (24% rate for companies) in the hands of the Italian receiving company should neither of the safe harbour rules be applicable. Moreover, if the first safe harbour is satisfied, the ordinary IRES rate is applied on 50% of the distributed dividend, triggering an actual tax burden of 12%.

According to the new rule, the profits and profit reserves resulting from the financial statements of blacklisted companies, closed in 2021 and not yet distributed at the date of entry into force of the law, may be subjected to a substitute tax of 9% for Italian companies.

The substitute tax is due in a single instalment, without the possibility of offsetting with available tax credits, within the deadline for the payment of the tax balance for fiscal year 2022 (for most calendar year taxpayers, 30 June 2023).

The tax rate is additionally reduced to 6% should the dividend of the foreign entity be paid within the deadline for the income tax balance payment for fiscal year 2023 and the amounts are set aside for at least two years in a specific equity reserve. Such election shall be included in the tax return relating to the tax period in progress as of 31 December 2022 (ie, tax return 2023) and may be exercised separately for each foreign entity and with respect to all or part of the relevant profits and profit reserves.

A recapture mechanism is foreseen if the two conditions set out above are not met.

Finally, the tax basis of the equity interest in the foreign entity is increased (up to a maximum threshold of the market value) by the amount of profits and retained earning reserves subjected to substitute tax and decreased by the amount of the distributions of the same profits and retained earning reserves.

A ministerial decree should be issued within 90 days of the entry into force of the law.

Revaluation of participations and land for building and agriculture

The law (re)introduced an elective temporary regime providing for the revaluation of the tax basis of land, building and agricultural land and participations (ie, shares, quotas and rights) held as of 1 January 2023.

The step-up, now extended to the participations in listed companies, is available only if the owners are resident individuals, non-commercial partnerships or non-resident persons.⁽⁵⁾

The step-up is executed according to the market value of the relevant asset as of 1 January 2023, pursuant to an appraisal sworn before 15 November 2023. For listed participations, the substitute has to be paid on the average value determined with reference to December 2022 (ie, 'based on the arithmetic average of the prices reported in the last month').⁽⁶⁾

The tax rate is 16% and the substitute tax can be paid in a one-off payment by 15 November 2023 or in three annual instalments of the same amount (interest at 3% a year will be due on the second and third instalments).

SMEs listing bonus

The law extended the 50% tax credit into 2023. The credit was originally introduced by the 2018 Budget Law for advisory costs incurred by small and medium-sized enterprises (SMEs)⁽⁷⁾ for the purpose of initial public offering (IPOs); the tax credit is only due to the extent that the IPO procedure is successful.

The maximum amount of the tax credit is calculated on costs incurred until 31 December 2023 up to €500,000 (the previous threshold was €200,000).

Blacklist expenses

The law contains new limitations concerning the deduction of expenses and other negative items of income from transactions carried out with unrelated parties resident or located in non-cooperative jurisdictions for tax purposes.

The maximum amount deductible should be consistent with the arm's length value of the relevant goods and services. Nevertheless, these costs would be entirely deductible if the Italian taxpayer can demonstrate that the relevant transaction is consistent with a true economic interest and that it has actually been executed. Such limitation should not apply to transactions with subsidiaries included in the purposes of the Italian provision on controlled foreign corporations.

It is worth noting that the scope of the described provisions will be very limited since it will apply to a limited number of states that are considered as non-cooperative under the Organisation for Economic Co-operation and Development's practice.⁽⁸⁾

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Endnotes

(1) Italian Law No. 197/2022

(2) Individual entrepreneurs' regime will not be considered in the present contribution.

(3) Pursuant to article 47 bis (2) (b) of the CTA.

(4) Pursuant to article 47 bis (2) (a) of the CTA.

(5) There may be limits for non-residents applying to be involved in the election.

(6) Pursuant to article 9 (4) (a) of the CTA.

(7) Small and medium-sized enterprises as defined in the EU Recommendation 2003/361/EC of 6 May 2003.

(8) American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos, US Virgin Islands and Vanuatu.