Italian Revenue Agency rulings on the ‘realizzo controllato’ tax regime

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The following document takes a brief look at five tax rulings issued this year (Tax Rulings no. 309, no. 314, no. 315, no. 381 and no. 429). In these rulings the Italian Revenue Agency commented again on the requirements that have to be satisfied in order to qualify for the ‘*realizzo controllato*’ regime governed by article 177(2) and (2-*bis*) IITC.

To sketch in the background: in 2019 the Economic Growth Decree[1] introduced a second case in which it is possible to apply the ‘*realizzo controllato*’ regime. The first case is governed by the pre-existing article 177(2) IITC (‘**Paragraph 2**’) while the new second case is governed by article 177(2-*bis)* IITC (‘**Paragraph 2-*bis***’).

In the first case the contribution (or several contributions constituting a single transaction) of an equity investment will be a tax-neutral transaction if it results in the transferee company acquiring control of the transferred company. In the second case, contributions of qualifying equity investments[2] to companies fully owned by the transferor will be tax-neutral.

Tax Rulings no. 309, no. 314 and no. 315

In all three of these tax rulings issued in 2020, the Revenue Agency responded to the following query: whether Paragraph 2-*bis* could be applied in the context of a corporate reorganization in which equity investments in one or more companies were being transferred as contributions to holding companies fully owned by the parties making the contribution.

The Revenue Agency, employing arguments similar to those already used in its earlier Tax Ruling no. 229, ruled that the shareholders making the contribution could not benefit from Paragraph 2-*bis* in the cases described in the tax ruling applications.

The crucial element was the fact that, in each of the three reorganization processes, the equity interests were being transferred to a holding company owned by more than one shareholder and not just one[3] (even though the holding company was fully owned by the equity investment transferors).

(1) Decree Law no. 34/2019.

(2) According to paragraph a of article 177 (2-*bis*), qualifying equity investments are those that represent, in total, more than 2 percent or 20 percent of the voting rights or more than 5 percent or 25 percent of the capital/equity (depending on whether the investments are in listed or unlisted companies).

(3) One being the number stipulated in paragraph b of article 177(2-*bis*)(b) IITC.

The Revenue Agency pointed out that the purpose of Paragraph 2-*bis* is to facilitate reorganizations and generational handovers in cases which would otherwise be excluded from the tax-neutral system because of the insufficient size of the equity investment. This is provided that the transaction is implemented through the creation of a holding company owned by a single shareholder – the transferor of the equity investment.

In particular, the Revenue Agency observed that, based on a strict and literal interpretation of Paragraph 2-*bis*, the reference in this paragraph to the 'transferor' meant that the legislator intended to facilitate the establishment of single-owner holding companies only.

Tax Ruling no. 381

In this case the applicant asked the Revenue Agency whether the transfer of a usufruct in shares to a newly established single-owner holding company set up by the applicant could benefit from Paragraph 2-*bis*.

The Revenue Agency, adopting the same stance taken in earlier tax rulings on Paragraph 2[4], dismissed the possibility that Paragraph 2-*bis* could be applied.

It based its decision on the fact that, in its opinion, article 177 IITC, headed 'Exchanges of equity instruments', could apply only in cases where contributions involve equity investments that enable the transferee to become the permanent shareholder of the company.

In the Revenue Agency's opinion, a right such as a usufruct in shares, even if it includes the right to vote, only entitles the holder to receive dividends from those shares; it does not result in an actual exchange of shares.

Tax Ruling no. 429

The Revenue Agency was asked whether any aspects of a particular corporate organization could constitute an abuse of law. The final stages of the operation in question would involve the transfer by two parties of two equity investments in a holding company to two newly set up companies, fully and separately owned by the two parties making these contributions. When doing so, the parties intended to apply Paragraph 2-*bis*.

Since the equity investments were in a holding company it was necessary to comply with the Paragraph 2-*bis* holding company rules: in order for the contribution to qualify as a tax-neutral transaction, the transferors had to own (indirectly) a qualifying equity investment in all the commercial companies[5] owned by the holding company, taking into account the effect on their ownership share of any intermediate shareholders in the chain.

In the case in question this condition was not satisfied since, among the 19 commercial companies held (directly and indirectly) by the holding company, there were actually four in which the transferors held an indirect equity investment that was lower than the qualifying percentage indicated in Paragraph 2-*bis*.

To overcome this problem, the tax ruling applicant proposed the following solution. Before the equity interests in the holding company were transferred as contributions to the two newly set up companies, steps would be taken to ensure, in relation to the above four commercial companies, that the qualifying equity investment requirement had in the meantime been satisfied and that Paragraph 2-*bis* could therefore be applied to both contributions. In particular, three of these four commercial companies would be sold in full to third parties, while the transferors' equity interests in the fourth would be increased to a level giving them the qualifying percentage required by Paragraph 2-*bis*.

The Revenue Agency ruled that this series of transactions would not constitute an abuse of law, since it could not see that any undue tax advantages would arise from the business reorganization. It therefore allowed the parties making the contributions to apply Paragraph 2-*bis*.

However, the Revenue Agency added that it might redefine the reorganization as an abuse of law if, later on, it were to turn out that:

— the transactions implemented by the applicants were not definitive, i.e. if the transferred equity investments were to once more be at the disposal, even partially, of the transferors; or

— the steps taken by the transferors were not independent business initiatives, taken with the intent of leaving the group, but were influenced by the wider group of original shareholders[6].

(4) Tax Rulings no. 147 and no. 290, issued in 2019.

(5) A commercial activity as defined in article 55 IITC.

(6) Revenue Agency Legal Principle no. 20/2019 has clarified that, with regard to a merger-levered cash out, an undue tax advantage arises when a transferor retains particular powers in the target company. These include the power to participate in the running of the company, to veto decisions affecting the company, and to reacquire control over the company in the event that, in the board of statutory auditors' opinion, there are inefficiencies that could endanger its governance and/or financial and/or economic stability.

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