KPMG

Italy: Budget Law 2018 - News of interest to HNWIs

Tax Alert

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1. Capital gains and dividends from qualifying shareholdings

Article 1 (999-1006) of the Budget Law 2018 changes the tax treatment of capital gains and dividends from qualifying shareholdings held (not in the course of a business) by individuals.

In the case of unlisted companies, qualifying shareholdings are those where shareholders hold (i) 20 percent or more of the voting rights that can be exercised at the shareholders' meeting or (ii) 25 percent of the capital. In the case of listed companies, the thresholds are 2 percent and 5 percent respectively.

Capital gains realized from 1 January 2019 will be subject in their entirety to a substitute tax of 26 percent.

Dividends received by individuals from 1 January 2018 will be subject to a substitute tax of 26 percent. However, paragraph 1006 makes an exception for profits formed by the end of FY 2017 and distributed by 31 December 2022: in such cases the old rules will apply.

To summarize:

- Capital gains realized on qualifying shareholdings by individuals resident in Italy:
  - Realization by 31 December 2017: 49.72 percent of the gains are taxable.
  - Realization between 1 January and 31 December 2018: 58.14 percent of the gains are taxable.
  - Realization from 1 January 2019: 100 percent of the gains are subject to a 26% substitute tax.
- Capital gains realized on qualifying shareholdings by individuals not resident in Italy:
  - One hundred percent of the gains are subject to a 26% substitute tax.
- Dividends received by resident individuals from qualifying shareholdings: irrespective of the date of receipt, distributions are presumed to be formed first by profits of previous years (FIFO method).

- Receipt by 31 December 2022
  - Profits produced by the end of FY 2007: 40 percent are taxable
  - Profits produced by the end of FY 2016: 49.72 percent are taxable
  - Profits produced in FY 2017: 58.14% percent are taxable
  - Profits produced from FY 2018: substitute tax of 26 percent

2. Step-up regime for land and shares

Article 1 (997) of the Budget Law 2018 extends the deadline for the optional step-up of the cost (tax basis) of land and, provided they are not traded on regulated markets, qualifying and non-qualifying shares.

The first requirement is to obtain an appraisal of the value of the land or shares as at 1 January 2018. This appraisal must be made by a qualified professional and certified by 30 June 2018. To complete the step-up, the taxpayer must pay an 8 percent substitute tax on the full current value indicated in the appraisal. The deadline for full payment of the tax, or the payment of the first of three instalments, is 30 June 2018. By stepping up the cost and paying the substitute tax, the taxpayer validates any capital gain realized during the future sale of the land or shares and calculated as the difference between the new stepped-up value and the sale price. Validation means that the capital gain will be recognised for the purposes of article 67 of the Italian Income Tax Code.

The following examples show how this mechanism works.

Sale after a step-up

A taxpayer holds an equity interest. Its acquisition cost is 10 and, according to the appraisal, it is now worth 50. In order to validate any future capital gain, the taxpayer must pay 4 (8 percent of 50). If the equity interest is then sold for 60, the difference between the sale price and the new stepped-up value constitutes the IRPEF base, 58.14 percent of which must be taxed at the marginal rate. If we assume that the IRPEF rate is 43 percent, the overall cost would be 6.5 (4 would be the substitute tax on the step-up, while 2.5 would be the IRPEF due on the capital gain). However, should the equity interest be sold in 2019, the capital gain would be taxed in full at a rate of 26 percent. In this case, the overall cost of the sale would be 6.6 (4 would be the substitute tax on the step-up and 2.6 would be the tax on the capital gain).

Sale without a step-up

If the same taxpayer were to sell the equity interest at a price of 60, without stepping up the acquisition cost of 10 first, the overall tax burden would be heavier. The IRPEF base to be taxed at the marginal rate would be 58.14 percent of 50, i.e. the difference between the sale price and the acquisition cost. If we assume that the IRPEF rate is 43 percent, the overall cost would be 12.5. If, instead, the sale were to be made in 2019, the capital gain would be taxed in full at a rate of 26 percent. In this last case, the overall cost of the sale would be 13.

Should the sale price be the same as the value resulting from the appraisal, there would be no capital gain subject to IRPEF at the marginal rate.

3. Amnesty for cross-border workers and those previously resident abroad

Article 5-*septies* of the Tax Decree ('Article 5') makes it easier to regularise income produced abroad. However, it applies to fewer individuals and items than the Voluntary Disclosure programme.

It is only possible to regularize:

(i) sums deriving from employment or self-employment abroad, deposited in foreign current accounts and savings books and breaching the rules on tax monitoring;

(ii) sums and assets deriving from the sale of real estate held in the country where the individual has worked on a permanent basis.

This measure applies only to (a) tax residents of Italy who used to be enrolled in AIRE (the register of Italians resident abroad) or (b) those who used to work permanently in a neighbouring country.

To regularize their position, such individuals must pay – by way of tax, penalties and interest – an amount equal to 3 percent of the value of the assets that they held on 31 December 2016 and that were in breach of the rules on tax monitoring.

Taxpayers entitled to remedy mistakes through Article 5 may, by 31 July 2018, submit an application to do so and, by 30 September 2018, voluntarily pay the full amount due or the first of three monthly instalments.

Solely for sums and assets regularized under Article 5, the time limit for assessments that have normally expired by 31 December 2018 will be extended to 30 June 2020.

4. New concept of permanent establishment

Article 1(1010) of the 205/2017 Budget Law amends the concept of permanent establishment. The main changes are described below.

- A permanent establishment is also deemed to be a 'significant and continuous economic presence in the territory of Italy, built in such a way that it will not result in a physical presence in Italy'.
- The preparatory and auxiliary activities of a non-resident enterprise that do not give rise to a permanent establishment are specifically defined.
- Activities performed by closely-related enterprises at a fixed place of business are analysed together for the purpose of evaluating whether they may qualify as preparatory or auxiliary, provided that the business activities of the closely-related enterprises constitute complementary functions that are part of a cohesive business operation.

— An agency PE may also arise if a person, acting on behalf of a non-resident enterprise, concludes contracts in the name of that enterprise, without any material modifications being made to the contracts by the enterprise. An independent person acting in Italy exclusively or almost exclusively on behalf of one or more enterprises to which the person is closely related, does not qualify as an independent agent and therefore gives rise to a permanent establishment of the non-resident enterprise.

5. Dividends arising from tax havens

Article 1 (1007-1009) of the Budget Law 2018 amends the taxation of income from investments in companies resident in countries or territories offering a preferential tax regime. For this purpose, preferential tax regimes are those of non-EU/EEA countries where the nominal corporate income tax rate is less than half of that applied in Italy.

The changes introduced by the Budget Law 2018 are outlined below.

— Dividends received by residents from FY 2015 onwards but accrued in an earlier year, in which the foreign company was not resident in a tax haven (under the rules in force at that time, i.e. Ministerial Decree of 21 November 2001), are not subject to the CFC rules. Therefore, 95 percent of the dividends are exempt from tax.

— Dividends distributed by a non-resident company are presumed to be formed first by profits generated in fiscal years in which the country or territory of the subsidiary was not considered to be a tax haven.

— Fifty percent of dividends distributed by a non-resident company will be excluded from the taxable income of the resident shareholder, if the latter can prove, even following a tax ruling, that the core business of the foreign company is an industrial or commercial activity in the state or territory where it is established. In this case, the recipient of the dividends can claim a tax credit equal to 50 percent of the final tax paid abroad.

6. Interpretation of deeds for registration tax purposes

Article 1(87) of the Budget Law 2018 amends article 20 of the Registration Tax Act. The newly worded article establishes that registration tax should be applied according to the details emerging from a deed, regardless of any external factors or the scope of other transactions that might be linked to the deed to be registered.

Most tax courts used to rule that deeds presented for registration in relation to a particular transaction should be defined by their common underlying economic purpose. Therefore, in cases involving a contribution of a business to a NewCo, followed by a sale of NewCo shares, transactions used to be redefined as a sale of business, subject to proportional registration tax.

As clarified in the explanatory report, '*No importance can be attached, (…) for the purposes of correct taxation of the deed, to the interests objectively and concretely pursued by the parties in cases where those interests may lead to legally separate contractual arrangements being treated as one*'.

The new wording has replaced '*deeds presented*' with '*deed presented*' and adds that the deed must be interpreted '*according to the details emerging from it, regardless of any external factors and regardless of any deeds connected with it, subject to that laid down in the following articles*'. However, in cases where this results in a tax advantage for the taxpayer, the Revenue Agency reserves the right to evaluate the 'legal effects' of the transaction in the context of the rules combating abuse of law.

7. New deadline for the submission of income tax returns

Article 1(932) of the Budget Law 2018 establishes a new deadline for the submission of income tax returns: 31 October.

8. Treatment of income from online 'peer-to-peer lending' as capital income

In compliance with article 1 (43-45) of the Budget Law 2018, the capital income referred to in article 44 of the Italian Income Tax Code now includes interest received by individuals from loans they have made via special on-line platforms managed by registered financial intermediaries authorised by the Bank of Italy. The manager will be the withholding agent and will levy a final withholding tax of 26 percent.

9. Capital gains on performance-linked bonuses paid in shares

According to article 1(161) of the Budget Law 2018, if workers sell shares that they have received as a performance-linked bonus, any capital gain will be subject to IRPEF at a fixed rate of 26 percent. There is no change to the rule that such shares are not taxable at the moment when they are granted to workers.

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