



# Italy: Draft Budget Law 2018 - Higher taxation of capital gains on 'qualifying' shares for non-resident investing entities

## Tax Alert

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### 1. The proposal

The draft Budget Law 2018 (to be approved by the end of this year) proposes an increase of taxes applicable to gains realized on the disposal of 'qualifying shares' of Italian companies.

If approved, the provision will be effective as of 1 January 2019 and will hit non-resident entities in particular.

### 2. Definition of 'qualifying shares'

Shares are defined as 'qualifying shares', when representing more than 20% of the voting rights or 25% of the share capital of a non-listed Italian company or, in the case of a public company, when incorporating more than 2% of the voting rights or representing more than 5% of the share capital.

### 3. Current Tax treatment upon non resident entities

The Italian domestic Law provides that capital gains arising from qualifying shares owned by foreign entities are taxed as follows (except for shares owned through an Italian permanent establishment):

- Gains realized within 2017 are taxable limitedly to 49.72%, at a 24% rate (CIT rate) - effective tax rate (ETR) is therefore 11.93%;
- Gains realized from 1 January 2018 are taxable limitedly to 58.14%, at the above rate of 24% (CIT rate) - ETR should consequently raise to 13.95%.

### 4. Proposed Tax treatment

The draft Budget Law 2018 proposes to replace the taxation described above with a flat 26% substitutive taxation, aligned with the capital gains tax of 'non qualified shares' and gains realized by physical persons.

## 5. Tax differential

The change should be particularly relevant for non resident entities that a) are non-Treaty protected (Treaties with Italy generally attribute taxation right of these gains to the State of residence), or b) are resident in a Treaty Country but might run the risk that the Italian Authorities deny treaty protection for the lack of business substance, or c) are resident in a State whose Treaty with Italy explicitly allows the latter to tax these gains (e.g. France - according to art. 8 of the Protocol, with respect to 'substantial', i.e. greater than 25%, participations).

Should the proposal pass as it is, the tax differential would in fact be significant, from 14% to 26% ETR.

## 6. Proposed step up

The same draft Budget Law 2018 includes a provision, however, that allows a 'step-up of the tax value of the shares' in non-listed resident entities.

The required conditions are: a) shares should be owned as of 1 January 2018, b) a value appraisal should be finalized by an expert within June 2018 and c) an 8% substitute tax should be paid within the same date (payment might be deferred with interest) on the so appraised value. The step up should be beneficial when 8% of current market value is lower than 26% of a potential gain from disposal of said qualifying shares of non listed Italian Companies.

In conclusion, if approved, this draft Budget Law offers a window of opportunity, within June 2018, to step up the value of qualifying shares in non-listed Italian companies, in order to avoid future heavier capital gains.

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