KPMG

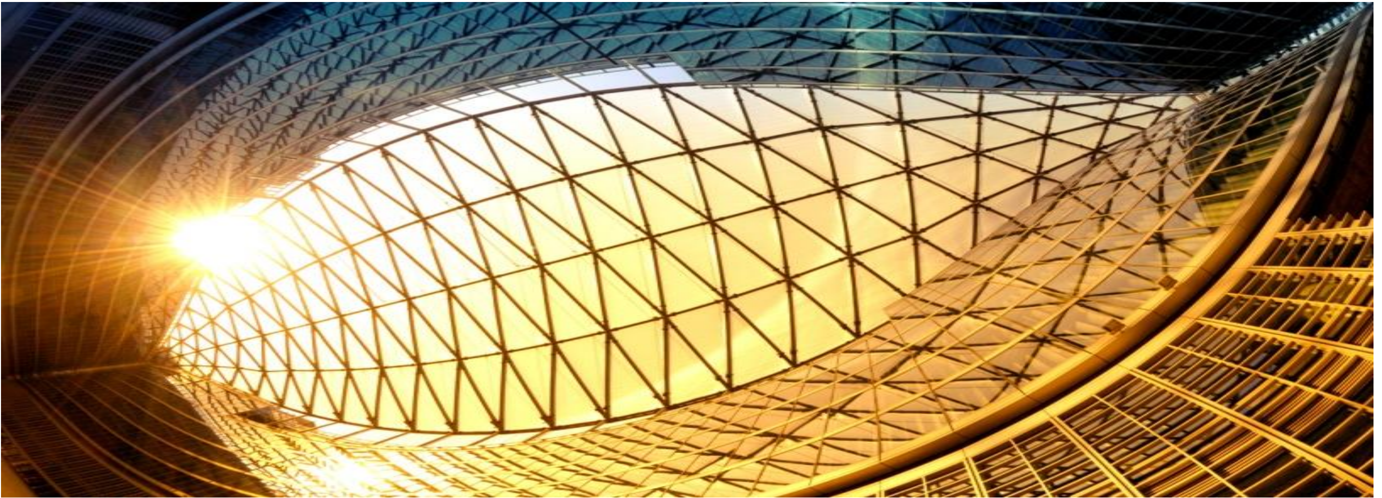
cutting through complexity

Tax Alert

KPMG in Italy

30 April 2015

Italy - Delegation Law for the reform of the Italian Tax System: draft of implementing decree on growth and internationalization of companies



Offices

Milan
Via Vittor Pisani 27, 20124
T: +39 02 676441 - F: +39 02 67644758

Ancona
Via I° Maggio 150/a, 60131
T: +39 071 2916378 - F: +39 071 2916221

Bologna
Via Andrea Costa 160, 40134
T: +39 051 4392711 - F: +39 051 4392799

Florence
Viale Niccolò Machiavelli 29, 50125
T: +39 055 261961 - F: +39 055 2619666

Genoa
P.zza della Vittoria 15/12, 16121
T: +39 010 5702225 - F: +39 010 584670

Naples
Via F. Caracciolo 17, 80122
T: +39 081 662617 - F: +39 081 2488373

Padua
Piazza Salvemini 2, 35131
T: +39 049 8239611 - F: +39 049 8239666

Perugia
Via Campo di Marte 19, 06124
T: +39 075 5734518 - F: +39 075 5723783

Pescara
P.zza Duca D'Aosta 34, 65121
T: +39 085 4210479 - F: +39 085 4220295

Rome
Piazza delle Muse 8, 00197
T: +39 06 809631 - F: +39 06 8077459

Turin
C.so Vittorio Emanuele II 48, 10123
T: +39 011 883166 - F: +39 011 8395865

Verona
Via Leone Pancaldo 68, 37138
T: +39 045 8114111 - F: +39 045 8114390

Delegation Law No. 23 of 11 March 2014, in force since 26 March 2014, contains measures aimed at reforming the Italian Tax System. One of the aspects dealt with is the amendment of tax provisions concerning international transactions. Law No. 23 delegates the Government to issue implementing decrees by the deadline of 15 months since its entry into force (26 June 2015).

On 21 April 2015 the Italian Ministry Council approved the draft legislative decree aimed at growth and internationalization of companies. We briefly summarize below the main provisions contained in the draft that is currently under examination of the Italian Parliamentary Commissions. As mentioned above, the deadline for final approval should be the end of June 2015 and therefore the provisions described may still be subject to amendments before their entry into force.

Advance agreement for Companies with international operations (art. 1)

Companies with international operations will be entitled to enter with Italian Tax Administration in five-year binding agreements with respect to the following cross-border tax issues:

- transfer pricing
- definition of inbound and outbound values in case of transfer of residence
- existence of a permanent establishment and attribution of profits
- domestic and Treaty taxation of cross-border payments of interest, dividends and royalties.

© 2015 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

This form of agreement is already provided by our tax law and is contained in a special tax law provision. The new draft provision, that should be included in the context of the tax assessment Code, better clarifies the objective scope, the relations with mutual agreement procedures and possible backdated effects of the agreement. It also confirms the scope of this procedure also includes regional tax on productive activities (IRAP).

Ruling on new significant investments (art. 2)

Art. 2 of the decree bill introduces a new form of ruling for companies that intend to invest in Italy, aimed at providing them with certainty about the income and indirect tax consequences of their investment plan (ruling). The investor, either resident or non-resident, must file a business plan with a description of the amount of the investment, the timing and mode of implementation and the expected number of new hires. The ruling can concern, among other aspects, the likelihood of application of abuse of law or other anti-avoidance measures, tax profiles of a Group reorganization and whether certain asset amount to a going concern. The procedure concerns investments of a minimum of €30 million, and which may also apply for the restructuring of companies in default, provided that positive effects on employment are foreseen. Tax Authorities should provide the investor with a written answer in 120 days. The answer is binding as long as facts and circumstances do not change.

Interest expenses (art. 4)

Under art. 96 of the Italian Income Tax Code (IITC), yearly deduction of net interest (interest expense net of interest income) is allowed up to 30% of the EBITDA (‘risultato operativo lordo’ or ‘ROL’) of the borrower. Excess of net interest (i.e. greater than 30% of EBITDA) is carried forward without time limitation. ROL is currently computed as the difference between (i) the value of production (item A of the P&L scheme) and (ii) costs of production (item B of the P&L scheme), excluding depreciation, amortization and financial leasing instalments relating to business assets. The draft of decree amends this provision by including in the ROL computation also dividends paid from foreign controlled entities.

In addition, under art. 96 IITC, an Italian domestic tax group could benefit of the ROL of selected foreign affiliates, although under certain conditions. It was a sort of ‘virtual inclusion into the tax group’, only made to compute the amount of interest expenses cumulatively allowed within such domestic tax group. Now, art. 4 of the draft decree repeals this provision.

Expenses from Black list jurisdictions allowed if at arm’s length (art. 5)

Expenses arising from transactions with counterparts resident or established in low tax jurisdictions (art. 110 par. 10 and 11 of IITC) are today disallowed if the Italian taxpayer could not give evidence of either the business substance of said counterpart, or of the genuine business reason to conclude the transaction together with proof of its actual execution. The draft decree now provides that expenses from such transactions are deductible if transfer pricing is at arm’s length. Only if this is not the case, there will still be the need to give separate indication in the tax return and to demonstrate the economic rationale for the transaction; there will be no more need to give evidence of the business substance of the foreign counterparty though.

Tax consolidation regime (art. 6)

The draft decree amends certain rules of the domestic tax consolidation, by allowing additional subjects to be part of it, in compliance with European Court of Justice judgments (C-40/13 of 12 June 2014).

Under current provisions, non-resident companies may opt for an Italian tax consolidation regime only as consolidating entities, if they are resident in a Treaty Country and have a permanent establishment in Italy whose assets include shares/quotas of the Italian consolidated entities.

Art. 6 of the draft repeals this latter condition and, in addition, allows also ‘sister’ companies to be consolidated for tax purposes, including also permanent establishments in Italy of companies resident in a State of the European Union or party of the EEA agreement and granting adequate exchange of information, controlled by the same non-resident Company. This form of consolidation requires that the non-resident controlling entity appoints an Italian resident controlled Company as the consolidating entity of the tax Group.

Permanent establishments in Italy (art. 7)

The new provision defines rules for the attribution of income and losses to permanent establishments in Italy of non-resident companies.

It is repealed our internal, so called ‘force of attraction rule’, currently providing for the taxation upon the permanent establishment of certain income realized in Italy although not effectively connected with it (such domestic provision is ordinarily overridden by Treaty provisions).

It is clarified that the attribution of profits to the permanent establishment must follow the approach of art. 7,par 2 of the OECD MC (‘as it were a separate and independent enterprise’) and that transfer pricing rules apply to the so called ‘internal dealings’, i.e. operations between the permanent establishment and the headquarter.

Controlled foreign companies (CFC) regime (art. 8)

Article 8 of the draft decree amends current CFC provisions (art. 167 and 168 IITC) as follows:

- advance rulings, currently required to exclude the application of the CFC income regime, are no longer be mandatory
- the taxpayer can provide evidence of the ‘safe harbor’ conditions also during a tax audit. However, the investment in CFCs must be separately reported in the income tax return (penalties apply if such reporting is not done)

© 2015 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

- before assessing CFC income, the tax authorities must send to the taxpayer a formal request of information. A tax assessment can be issued only 90 days after said request or otherwise it is null and void; the tax assessment notice, if issued, must include specific comments regarding the information provided by the taxpayer
- the CFC regime more applies to 'affiliated companies' (art. 168 IITC), i.e. those Companies which, although resident in a black listed Country are directly or indirectly owned 20% (10% in the case of listed companies) or more (but below 51%, as at this stage they become 'controlled') by the Italian resident taxpayer.

'White list' of States that allow an adequate exchange of information with Italy and 'black list' (art. 10)

The article introduces in decree No. 239/96 (the law provision concerning taxation of interest on bonds) the main criteria under which the 'white list' of States, for income tax purposes, can be identified. The current list (provided, by statement of practice, by decree 4 September 1996) will be replaced by a list of States, identified as having an adequate exchange of information with Italian authorities. Future implementing decrees will contain this list.

Moreover, the article clarifies that, where a tax law provision mentions a 'black list', reference will be to the list of States mentioned by the CFC law provision (art. 167 (4) IITC) and related implementing decrees.

Outbound transfer of tax residence (art. 11)

The implementation in Italy of the National Grid Indus B.V. case (judgment C-371/10 of 29 November 2011) provides (art. 166 IITC) that exit taxation on transfer to the EU/EEA of the tax residence of an Italian Company is either immediately effected, or deferred until when the transferred assets are deemed 'realised' according to domestic tax rules, or split in equal installments over 10 years (subject to conditions and exception made for certain assets).

It is now acknowledged that such regime is applicable also to a) the transfer out of Italy of Italian permanent establishments owned by foreign Companies, and, b) to EU mergers (of an Italian Company upstream into an EU one), EU de-mergers (of an Italian Company's assets towards an EU beneficiary Company), EU hive downs (of Italian business owned by an Italian Company, in exchange for shares of an EU receiving entity), which are not followed by the allocation of all the Italian assets concerned into a permanent establishment in Italy of the EU receiving Company.

Inbound transfer of tax residence (art. 12)

Should a non-resident entrepreneur transfer its residence in the territory of the State from a 'white list' Country, the basis of the business assets and liabilities for Italian tax purposes will be the current market value. If the transfer takes place from a non-white list country, then the market value must be fixed by way of advance clearance from the Tax Authorities.

Foreign branch exemption (art. 14)

As an exception to the worldwide principle of taxation generally adopted by our Law, resident taxpayers will be able to opt for the exemption of all their foreign branches (all or nothing). Required conditions are that the branches:

a) are established in non-black listed jurisdictions; b) have an appropriate level of business substance (non-artificial)

b) are subject to an acceptable level of foreign taxation (greater than 50% of the rate of the Italian corporate income tax, IRES, 27,5%); and

c) are not primarily engaged in certain passive income, or infra-group activities. The current text of the draft suggests that future dividend sourced from such profit of the exempted foreign branch should not deserve participation exemption in the hands of the Italian shareholders of the Company.

The same election for exemption is possible with respect to branches established in black listed jurisdictions, under condition that they are actively engaged in a true business activity and have appropriate level of substance, locally. Missing this condition, the income of such foreign branches (located in a tax haven and not running an active business locally) will be taxed upon the Italian headquarter Company like a CFC income, separately from the rest of the Company's income.

Certain claw backs rules apply if such branches were loss making before the election (and therefore the Italian Company offsets such losses, although computed following tax Italian rules from its world-wide taxable income).

Foreign tax credit (art. 15)

Foreign tax credits are granted to Italian Companies if foreign taxes are paid until when the relevant Italian income tax return is filed (currently the deadline is 30 September of the following year).

In addition, the carry back option for foreign tax credit, allowed today only for taxes paid by a foreign permanent establishment, is extended also to all other types of foreign income earned by an Italian Company.

© 2015 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Finally, it is stated that foreign tax credits are now granted for all types of foreign income taxes paid, either if they fall within the definition provided by the applicable Tax Treaty in force with Italy, or not (uncertain cases should be cleared in advance with the tax authorities, via a ruling).

Contact us

Studio Associato - Consulenza legale e tributaria

Domenico Busetto
KPMG, Tax & Legal
T: +39 045 8114111
E: dbusetto@kpmg.it

Paola Sella
KPMG, Tax & Legal
T: +39 045 8114111
E: psella@kpmg.it

Giulia Marcone
KPMG, Tax & Legal
T: +39 045 8114111
E: gmarcone@kpmg.it

TAX ALERT / KPMG in Italy / 30 April 2015

© 2015 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International Cooperative (“KPMG International”).

Studio Associato - Consulenza legale e tributaria is a leading Italian law firm and a member firm of KPMG International for tax and legal services.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate on the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.