Italy: adoption of Pillar Two transitional safe harbours

Tax & Legal Alert
4 June 2024

Office

Milan
Via Vittor Pisani 31, 20124
T: +39 02 676441

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

Bologna
Via Innocenzo Malvasia 6, 40131
T: +39 051 4392711

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

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

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

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

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

Pescara
P.zza Duca D'Aosta 31, 65121
T: +39 085 4210479

Rome
Via Curtatone 3, 00185
T: +39 06 809631

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

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

The Ministry of Economy and Finance Decree of 20 May 2024 (the Transitional Safe Harbour Decree – "TSH Decree"), implementing article 39(3) of Legislative Decree no. 209 of 27 December 2023, regulates the transitional CbCR safe harbours for groups subject to the Global Minimum Tax ("GMT"), i.e. MNE groups and large-scale domestic groups with revenues of EUR750 million or more in at least two of the four fiscal years preceding the relevant fiscal year. The CbCR safe harbours are optional transitional regimes that can be applied in the initial phase of the complex new GMT rules – which is the first three fiscal years commencing by 31 December 2026 and ending by 30 June 2028, i.e. 2024, 2025 and 2026 for groups that have a calendar tax year – to mitigate the onerous administrative and compliance burdens placed on groups by the introduction of the GMT.

Under the simplified rules, passing at least one of the tests (three different alternatives) for a given jurisdiction in a given fiscal year is sufficient to consider that jurisdiction as a low-risk one and consequently reduce the group's top-up tax to zero (in that jurisdiction and for that fiscal year), without the need for the ordinary calculation of the ETR and any top-up tax.

The three tests

The de minimis test is passed if the MNE group or large-scale domestic group has Total Revenue of less than EUR10 million and Profit before Income Tax of less than EUR1 million in the tested year and in the tested jurisdiction. Both criteria (Total Revenue and Profit before Income Tax) must be met. The second one (Profit before Income Tax) is always satisfied when the group has a loss before income tax in the jurisdiction.

© 2024 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The simplified ETR test is passed if, in the tested year and in the tested jurisdiction, the MNE group or large-scale domestic group has an ETR of at least 15 percent in 2024, 16 percent in 2025 and 17 percent in 2026. The ETR is calculated by dividing the Simplified Covered Taxes by the Profit (Loss) before Income Tax reported in the MNE Group's CbC report. The Simplified Covered Taxes include both current and deferred income tax expense – minus any amounts that are not covered taxes or that are related to uncertain tax positions.

The routine profit test is passed if the MNE group or large-scale domestic group has, in the tested year and in the tested jurisdiction, a Profit (Loss) before Income Tax that is lower than the substance-based income exclusion (SBIE) in that jurisdiction. The SBIE is the sum of a gradually decreasing percentage of payroll costs and a gradually decreasing percentage of the average of the opening and closing carrying values of tangible assets.

The TSH Decree is also aligned with the OECD "once out, always out" approach, whereby failure to pass at least one of the three tests in one of the transition-period years means that the MNE group is disqualified from that safe harbour for the whole three-year period.

With regard to the ETR formula, the Adjusted Covered Taxes (the numerator) include the tax expense – both current and deferred – booked in the tested fiscal year. This numerator undergoes a certain number of adjustments – both additions and reductions and recasting at 15 percent rate for deferred tax expenses – in order to reflect the intended policy outcomes of the GloBE rules and to preserve the integrity of the system as a whole. One element that reduces the Adjusted Covered Taxes and, consequently, the numerator is the tax credits of the constituent entities. However, a tax credit designed to be refundable in cash or cash equivalents within four years of the date on which the conditions for receiving the tax credit have been satisfied ("Qualified Refundable Tax Credit") has the effect of increasing the denominator without affecting the numerator; therefore, such tax credits have less of an impact on ETR than other tax credits.

The net income or loss that constitutes the formula's denominator (GloBE income or loss) is calculated from the financial accounting net income or loss of each entity before any consolidation adjustments eliminating intra-group transactions (thus considering all revenues and all costs, including those deriving from intercompany transactions) but after elimination of items of income attributable to purchase accounting resulting from business combinations.

The financial accounting net income or loss undergoes nine obligatory adjustments that, generally, reflect certain permanent differences – the most common in OECD Member States – between book and tax results, plus further optional adjustments.

Data sources

The Qualified Financial Statements, which are either the accounts used to prepare the consolidated financial statements of the ultimate parent entity (i.e. the reporting package) or the audited separate financial statements of the constituent entities, will provide the current and deferred taxes as well as the payroll costs and tangible assets to be used in the tests.

The Total Revenue and Profit (Loss) before Income Tax will be taken from the Qualified CbC Report which large groups are already required to file annually in Italy and in other OECD jurisdictions (but which will now have to be prepared using data from Qualified Financial Statements).

When conducting the three tests, it is necessary to exclude from Profit (Loss) before Income Tax the net unrealised fair value loss arising from changes in the fair value of a non-portfolio shareholding if that loss is higher than EUR50 million.

Finally, the TSH Decree establishes the principle of consistency: in the various calculations, whether for each separate entity or for all the companies in the same jurisdiction, all the data must be taken from the same type of Qualified Financial Statements, i.e. all from the reporting packages or all from the entities' separate financial statements. Failure to adhere to this principle has serious implications as it will not be possible to use the transitional CbCR safe harbour in the tested jurisdiction.

Special cases and anti-avoidance rules

Large-scale domestic groups that do not submit CbC reports are also allowed to opt for the safe harbours; in this case they must use data corresponding to those that they would have presented had they been obliged to prepare a CbC report.

The safe harbours must be applied separately from the rest of the group to joint ventures and joint-venture groups.

Together with other rules targeting specific categories (permanent establishments, Non-Material Constituent Entities, investment entities, stateless entities, etc.), the TSH Decree introduces anti-avoidance rules designed to prevent large groups from spuriously meeting at least one of the three criteria by exploiting asymmetrical accounting and tax rules (so-called hybrid arbitrage arrangements).

© 2024 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Checks

Within 36 months of exercise of the option, the Italian Revenue Agency may ask groups for information demonstrating that they have correctly applied the transitional CbCR safe harbours. Groups must reply within six months or lose their right to the safe harbours.

Whenever checks reveal material errors (i.e. errors without which access to the safe harbours would have been precluded) the group will be unable to use the safe harbour in the jurisdiction affected by the errors, in that fiscal year and subsequent ones. However, the safe harbour remains valid in the event of errors in form but not of substance.

Recommended steps

For the most part, the TSH Decree is aligned with the international safe harbours; however, it is hoped that an official interpretation of the rules will be issued soon, to clarify certain doubts arising from the implementation of the OECD rules in Italy.

The rules as a whole have been considerably simplified. However, groups should review their CbC reports to ensure that they are Qualified CbC Reports. They must also plan how to manage compliance with the transitional CbCR safe harbour rules, which – although simplified – still involve a certain degree of complexity.

Contacts

KPMG in Italy, Tax & Legal
Transfer Pricing

Gianni De Robertis
Partner
giannideroberti s@kpmg.it

Filippo Bertoletti
Partner
fbertoletti@kpmg.it

Lucia Barone
Partner
lbarone@kpmg.it

kpmg.com/it

kpmg.com/it/socialmedia

© 2024 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

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 as of 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.