Italy implements the EU directive on global minimum taxation

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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

Legislative Decree no. 209 of 27 December 2023, approved and published in the Official Gazette on 28 December 2023 (the “Decree”), brings into Italian law the provisions of Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for MNE groups and large-scale domestic groups, i.e. a minimum tax rate of 15 percent in each jurisdiction where they operate (“Global Minimum Tax”). Essentially, the directive is closely aligned with the OECD’s model rules, except where it includes additional provisions to ensure its own alignment with the Treaties of the European Union (basically, by extending the rules to domestic groups and to all low-taxed constituent entities of a group based in a Member State).

The Decree is fully aligned with the directive, even though it includes certain clarifications provided by the OECD after the directive was approved. How the Decree should be applied and interpreted will be determined by secondary legislation, which will take account of the Commentary on the OECD rules, and the OECD’s past and future Administrative Guidance items.

The section of the Decree that implements the directive is Section II. This comprises 53 articles (articles 8-60), divided into nine chapters. Two separate documents accompany these new rules: the first lists definitions of the technical terms used in the Decree, while the second is a table of percentages for the payroll carve-out and tangible asset carve-out (“Substance-Based Income Exclusion – SBIE”).

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To which entities the Decree applies

The Decree applies to members of an MNE group or of a large-scale domestic group with combined revenues of EUR750 million or more in at least two of the four fiscal years immediately preceding the tested fiscal year (the same threshold used for CbCR). A group member (a “constituent entity” according to the OECD rules) falling within the scope of application of the rules is any entity that, through ownership or control, is included in the consolidated financial statements of the ultimate parent company (on a line by line basis) and/or any permanent establishment of a main entity that is part of a large MNE or domestic group. Because of their status or the special nature of their goals, the Decree specifically excludes certain categories that are not generally consolidated on a line by line basis (i.e. a governmental agency, international organisation, non-profit organisation, pension fund, investment fund that is an ultimate parent entity, and real estate investment vehicle that is an ultimate parent entity).

Top-up taxes

In Italy the top-up tax will be collected through three different taxes: a) a minimum domestic tax charged under the QDMTT (“Qualified Domestic Minimum Top-Up Tax – QDMTT”) to Italian constituent entities of a group (MNE or domestic) if the effective tax rate is lower than the minimum; b) a minimum top-up tax charged under the IIR (“Income Inclusion Rule – IIR”) to Italian parent entities (typically the ultimate parent entity) of MNE groups for their foreign low-taxed constituent entities; c) a top-up tax charged under the UTPR (“Undertaxed Profits Rule – UTPR”) to one or more Italian constituent entities when an equivalent minimum top-up tax has not been applied by parent entities for low-taxed constituent entities in other countries.

The top-up taxes should be applied in that order: QDMTT, IIR and UTPR.

Effective tax rate (“ETR”)

The Decree stipulates that the ETR must be computed for each fiscal year and for each jurisdiction (provided that there is net qualifying income in the jurisdiction). It is calculated by dividing the adjusted covered taxes (“Adjusted Covered Taxes”) by the net income or loss (“GloBE Income”) of all the entities located in the jurisdiction (“jurisdictional blending”). An exception is made in the case of members of a minority-owned subgroup (in which the ultimate parent entity has an ownership interest of 30 percent or less): the top-up tax must be computed, for the jurisdiction, as if the minority-owned subgroup were a separate MNE group or large-scale domestic group.

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.

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When the top-up tax applies

If, after combining the GloBE income (or loss) and the Adjusted Covered Taxes of all the constituent entities located in the same country, the ETR for the entire jurisdiction is lower than 15 percent, a top-up tax is due. This is calculated by first identifying (i) the percentage difference between the 15 percent minimum tax rate and the ETR (i.e. the “Top-up Tax Percentage”) and (ii) the excess profit for the jurisdiction (“Excess Profit”), which is the reported profit less a ‘routine profit’ equal to a fixed payroll carve-out plus a fixed tangible asset carve-out. The excess profit is then multiplied by the Top-up Tax Percentage to give the amount of top-up tax. The two carve-outs selected to reduce the net qualifying income are deemed to be less mobile and less likely to lead to tax-induced distortions than other possible indicators of substantive activities.

Simplified procedures

The reporting entity can opt for certain simplified reporting procedures. In particular, there is a de minimis exclusion (meaning that the top-up tax is presumed to be zero) for MNE groups or large-scale domestic groups that have, respectively, an average revenue of less than EUR10 million and an average qualifying income or loss of less than EUR1 million in a jurisdiction over a three-year period.

With regard to further simplified procedures, the Decree mentions qualifying international agreements, with which all Member States must comply. So far, the OECD has issued transitional CbCR safe harbor guidance (December 2022) , according to which the top-up tax is zero in the tested jurisdiction if, in that jurisdiction, the MNE group has only minimal operations, or has no excess profits after excluding routine profits, or has a simplified ETR at or above the minimum rate. Even the existence (and, as the case may be, payment) in the jurisdiction of a minimal equivalent domestic tax, satisfying certain requirements, may afford a safe harbour for the purpose of the OECD rules: a so-called Qualified Domestic Minimum Top-up Tax safe harbour (“QDMTT Safe Harbour”).

The Ministry of Economy and Finance has been delegated to issue decrees detailing and implementing the safe-harbour simplification procedures.

Filing obligations

The Decree indicates two types of returns: a top-up tax information return and an annual return.

The top-up tax information return is based on a standard OECD template (“Global Information Return”) and provides a tax administration with all the information it needs in order to assess the accuracy of the tax liability of the MNE constituent entities. It must be filed no later than 15 months after the last day of the reporting fiscal year. Each constituent entity in Italy must fulfil this filing obligation unless another local entity is designated to file the return on its behalf. A constituent entity will have no obligation to file a top-up tax information return if the ultimate parent company or its designated filing entity sends such a return to the competent tax authority in its own country and the competent authority of that country has a qualifying competent agreement in effect with Italy.

The penalty for not filing a top-up tax information return, or for filing it three months or more after the deadline, is EUR100,000. For the first three years, this penalty is halved.

The annual return is the actual tax return for the top-up tax due by way of the QDMTT minimum domestic tax, IIR minimum top-up tax or UTPR top-up tax. Like the top-up tax information return, the annual return must be filed no later than 15 months after the last day of the reporting fiscal year (18 months for the first year).

Any top-up tax must be paid in two instalments: 90 percent by 30 November of the subsequent year and the remaining 10 percent no later than one month after the filing deadline for the annual return.

The penalty for failing to file the return is that established by income tax rules. However, no penalties will apply in the first three years, except in cases involving criminal intent or gross negligence.

When do the new rules take effect?

The new rules in Italy kick in from the fiscal year subsequent to that in progress on 31 December 2023. However, those on the application of the UTPR top-up tax will only kick in from the fiscal year subsequent to that in progress on 31 December 2024.

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IAS 12 amendments

In 2023, amendments to IAS 12 Income Taxes were approved. These have introduced a temporary exception to the accounting for deferred taxes arising from implementation of the Pillar Two rules, as well as targeted disclosure requirements for affected companies. In particular, in fiscal years in which the Pillar Two rules are actually in force, the changes require entities to indicate current tax expense (income) arising from the Pillar Two rules separately. Instead, when the Pillar Two rules have been enacted or substantially enacted but are not yet actually in force, the entity must disclose known or reasonably estimable information to help users of the financial statements better understand the entity's exposure to Pillar Two income taxes arising from those rules.

What next?

MNE groups and large-scale domestic groups need to swiftly assess the impact of these new rules on their tax exposure and their compliance obligations. Adaptation of their accounting and tax reporting systems to these new and complex rules will require considerable effort and it is essential to start the process in good time.

Document prepared by Lucia Barone

Contacts

KPMG in Italy, Tax & Legal

Tax & Legal Professional Practice Team
E: it-fm-tpp@kpmg.it

kpmg.com/it

kpmg.com/it/socialmedia

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