Italy: Budget Law 2018 - New IRES and IRAP measures for enterprises

Tax Alert

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The Budget Law 2018(1) was published in Official Gazette no. 302 of 29 December 2017 and has been in force since 1 January 2018. However, many provisions have specific effective dates.

Listed below are the most important measures introduced by article 1 of the Budget Law 2018, in the area of direct tax.

1. Extension of the extra depreciation/amortization of certain tangible/intangible assets
2. Extension of the step-up regime to equity interests held in foreign companies
3. IRES rate and deduction of interest expenses for SIM investment companies
4. Postponed deadline for electronic submission of tax returns (Redditi, IRAP, 770) and the CU
5. Reduction in the interest expense deduction
6. Extension of the step-up regime for the cost of land and unlisted shares
7. New taxation of dividends and capital gains on qualifying shares
8. Amendments to the taxation of dividends arising from a tax haven
9. Amended definition of permanent establishment
10. New web tax on digital services
11. Full deduction, for IRAP purposes, of the cost of seasonal workers

1. Extension of the extra depreciation/amortization of certain tangible/intangible assets (paragraphs 29-36)

'Super' depreciation

The Budget Law 2018 extends the 'super' depreciation regime introduced by the Budget Law 2016, thus allowing higher depreciation of investments made in certain new tangible assets in 2018 or - provided that, by the end of 2018, the order has been accepted by the seller and at least 20 percent of the purchase cost has been paid in advance - in the first six months of 2019 (up to 30 June).

(1) Law no. 205 of 27 December 2017.

There are certain differences with respect to the original ‘super’ depreciation regime: the new measure sets a lower increase in the depreciable cost (30 percent instead of 40 percent) and does not apply to vehicles and other means of transportation.

‘Hyper’ depreciation

The Budget Law 2018 also extends the ‘hyper’ depreciation regime (introduced by the Budget Law 2017[2]) to investments made in 2018 and - under the same conditions mentioned above - until 31 December 2019. This rule allows a 150 percent increase in the purchase cost of certain tangible assets used in the technological and digital development of enterprises (promoted by the Italian Government under the ‘Industry 4.0 plan’).

‘Hyper’ depreciation will also continue to be granted - under certain conditions - if the taxpayer replaces tangible assets with other new assets having similar or superior technological features.

Extra amortization of intangible assets for ‘hyper’ depreciation taxpayers

Also extended to investments made in 2018 and - under the same conditions mentioned above - until 31 December 2019 is the 40 percent increase in the cost of certain intangible assets (e.g. software), introduced by the Budget Law 2017. This rule applies to taxpayers who benefit from ‘hyper’ depreciation in 2018. The Budget Law 2018 also extends this benefit to other intangible assets, such as supply chain systems for e-commerce drop-shipping, and 3D reconstruction software and platforms.

Limits and documentary evidence

For all types of extra depreciation/amortization, the Budget Law 2018 sets the same limits and documentary evidence requirements as previous budget laws.

2. Extension of the step-up regime to equity interests held in foreign companies (paragraphs 81-83)

The Budget Law 2018 extends the step-up regime (introduced by article 15[10-*bis*] and [10-*ter*] of Law Decree no. 185 of 2008) to transactions involving equity interests in *non-resident* controlled companies. This rule allows the carrying amounts of controlling equity interests - booked by a beneficiary in a merger, demerger or contribution of a going concern, or acquired in a purchase of shares or a going concern - to be stepped up by paying a 16 percent substitute tax, provided that the new higher carrying amounts relate to goodwill, trademarks and other intangibles.

The new rule applies to equity interests acquired since the fiscal year preceding that in progress on 1 January 2018 - i.e. since fiscal year 2017, for calendar year taxpayers - and to the higher carrying amounts recognized at the end of that previous year. The Italian Revenue Agency will issue a Statement of Practice, indicating the implementing measures.

(2) See our Tax Focus of 9 December 2016.

3. IRES rate and deduction of interest expenses for SIM investment companies (paragraphs 84-86)

Starting from fiscal year 2017, for calendar-year taxpayers, the Budget Law 2018 excludes investment companies (SIMs) from the application of the 3.5 IRES surcharge introduced by the Budget Law 2016 for companies in the banking and financial sector. Consequently, SIMs will be subject to the standard IRES rate (currently 24 percent). Correspondingly, for IRES and IRAP purposes the deduction of interest expenses accrued by SIMs is reduced to 96 percent.

4. Postponed deadline for electronic submission of tax returns (Redditi, IRAP, 770) and the CU (paragraphs 932-933)

The Budget Law 2018 postpones to 31 October the deadline for electronic submission to the Italian Revenue Agency of the following tax returns, for calendar-year corporate taxpayers.

- Income tax return (*Modello Redditi*) - previously to be submitted by 30 September of the year following that in which the income accrued.
- Regional tax return (*Modello IRAP*) - previously to be submitted by 30 September of the year following that in which the income accrued.
- Withholding tax agent return (*Modello 770*) - previously to be submitted by 31 July of the year following that of payment of the income.

Moreover, the Budget Law 2018 postpones to 31 October the deadline for electronic submission of any *Certificazione Unica* (‘CU’)[3] which contains only exempt income or does not contain information needed for the tax return to be filled in directly by the Revenue Agency on behalf of the taxpayer. Previously, the deadline was 7 March of the year following that of payment of the income.

5. Reduction in the interest expense deduction (paragraphs 994-995)

The Budget Law 2018 changes the calculation process for the tax deduction of interest expenses (the earnings stripping rule). With effect from fiscal year 2017, for calendar-year taxpayers, dividends received from foreign controlled subsidiaries will no longer be included in EBITDA, for the purposes of deducting interest expenses. The report accompanying the Budget Law 2018 clarifies that this amendment complies with Directive 2016/1164/EU (‘ATAD 1’).

6. Extension of the step-up regime for the cost of land and unlisted shares (paragraphs 997-998)

The Budget Law 2018 extends the deadline for the optional step-up of the tax cost of land and (qualifying or non-qualifying) shares in unlisted entities, held on 1 January 2018 by resident individuals and by non-resident entities without a permanent establishment in Italy[4].

(3) The CU is a statement of income subject to withholding tax paid in the year, that the payer (i.e. the WHT agent) must submit to the Italian Revenue Agency and the payee.

(4) See our Tax Alert of 22 November 2017. The step-up regime was originally introduced by the Budget Law 2002.

The step-up is subject to payment of an 8 percent substitute tax on the cost, to be appraised by 30 June 2018. This tax must be paid by 30 June 2018 or in three equal annual installments.

This optional regime allows a tax saving if the asset is sold, as the higher cost reduces any taxable capital gain. However, the step-up is irrelevant for the purpose of deducting capital losses, i.e. if the sale price is lower than the stepped-up cost, any capital loss will not be deductible.

This regime could be advantageous for non-residents, without a permanent establishment in Italy, who sell shares in unlisted Italian companies and cannot benefit from double tax treaty relief. To understand whether they would benefit from this new rule, such taxpayers should compare: (i) the tax on capital gains from the sale of shares in unlisted Italian companies, i.e. 13.95 percent for gains realized in 2018 from the sale of qualifying shares (see par. 7 below), with (ii) the 8 percent substitute tax on the cost emerging from the appraisal made by 30 June 2018 (generally this will be the fair market value of the shares, leading to a low or zero capital gain).

7. New taxation of dividends and capital gains on 'qualifying' shares (paragraphs 999-1006)

The Budget Law 2018 harmonizes the taxation of capital income (i.e. dividends and similar proceeds) and capital gains realized from qualifying[5] and non-qualifying shares by (i) resident individuals outside a business context and (ii) with respect to capital gains only, non-residents (individuals and entities).

Dividends

Dividends from qualifying shares, received by resident individuals (not acting in the course of business) from 1 January 2018, will be subject to a final 26 percent withholding tax. However, dividends accrued up to 31 December 2017, whose distribution is approved by 31 December 2022, will still be subject to the old rules (i.e. 49.72 or 58.14 percent of the dividends will be included in the individual's taxable income for IRPEF purposes).

Capital gains

Capital gains realized as of 1 January 2019 by non-residents from the sale of qualifying shares in Italian companies will be subject to a 26 percent substitute tax, like those realized on the sale of non-qualifying shares in unlisted[6] resident companies.

Capital gains realized in 2018 will still be taxed under the old rules, i.e. the 26 percent substitute tax will continue to apply only to the transfer of non-qualifying unlisted shares (unless the seller is resident in a country that allows an adequate exchange of information with Italy[7]) while the transfer of qualifying listed or unlisted shares will be subject to IRES of 13.95 percent[8].

If a double tax treaty applies, capital gains are usually taxable only in the seller's country of residence and therefore the new provision may affect non-residents who are resident in a country that has no double tax treaty with Italy or whose double tax treaty deviates from the OECD standard.

8. Amendments to the taxation of dividends arising from a tax haven (paragraphs 1007-1009)

Dividends paid, directly or indirectly, by companies located in a tax haven, as defined for the purposes of the controlled foreign companies (CFC) rule[9], are generally 100 per cent taxable in the hands of the resident (corporate) shareholder at the full corporate income tax rate, unless a safe-harbor rule applies (i.e. the 'subject-to-tax test').

The Budget Law 2018 provides that 50 percent of such dividends will be excluded from the taxable income of the resident shareholder, if it can prove that as its core business, the foreign company paying the dividends actually trades on the market of the state or territory in which it is located (first CFC safe-harbor rule or 'business test').

In such cases, the resident shareholder (or its intermediate controlled companies) may benefit from a foreign tax credit for income taxes paid on profits accrued by the company resident in the tax haven over the period that the shares are held.

However, the Budget Law 2018 also provides that, in order to ascertain whether dividends have arisen in a tax haven, the shareholder must refer to the rules in force in the year when the profits accrue.

- Dividends received since the fiscal year following that in progress on 31 December 2014, 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)[10], are not deemed to have arisen in a tax haven.
- Dividends accrued in a year following that in progress on 31 December 2014, and in which the foreign company was not deemed to be resident in a tax haven, will not be treated as having arisen from a tax haven, even if paid in a year when the foreign company is deemed to be resident in a tax haven.

In any case, the law stipulates that profits distributed by a non-resident are presumed to be formed first by those that are not from countries or territories considered to be tax havens.

(5) 'Qualifying' shares are those that represent more than 20 percent of the voting rights or 25 percent of the stated capital of a resident unlisted company or more than two percent of the voting rights or five percent of the stated capital of a resident listed company.

(6) Capital gains on the transfer of non-qualifying shares in resident listed companies are outside the scope of IRES - see our Tax Alert of 19 July 2017.

(7) In this case, a specific exemption may apply.

(8) In other words, 58.14 percent taxable gain*24 percent IRES rate.

(9) Since 2016, these are states or territories, other than EU Member States or States in the EEA (i.e. Norway, Iceland and Liechtenstein), whose tax regimes (ordinary or special) grant a nominal level of taxation that is less than half the level of the nominal corporate tax rate in Italy (currently less than 13.95 percent).

(10) In other words, the foreign company was not included in the list contained in the decree of 21 November 2001 which, until fiscal year 2016, identified tax havens.

9 Amended definition of permanent establishment (paragraph 1010)

The Budget Law 2018 extends the domestic definition of permanent establishment (PE) contained in article 162 of the Italian Income Tax Code, in order to make it fully compliant with that proposed by the OECD in the BEPS Action 7 Final Report. More specifically, the amendment:

— extends the agency PE definition to include a person that 'operates for the conclusion of contracts by the foreign enterprise with no material modifications' and narrows the definition of 'independent' agent;

— makes the 'negative' list conditional on the taxpayer proving the preparatory or auxiliary nature of the activities;

— includes the 'anti-fragmentation rule'.

Moreover, the amendment introduces an additional definition of a fixed-place PE: 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'.

These changes to the domestic PE definition will need to be coordinated with the position on the Multilateral Convention, signed on 7 June 2017, where Italy, for instance, reserved the right not to widen the agency PE definition.

10. New web tax on digital services (paragraphs 1011-1016)

The Budget Law 2018 introduces a new 3 percent tax on the consideration (net of VAT) paid by taxpayers resident in Italy (and permanent establishments in Italy of non-resident enterprises), other than private individuals, for digital services supplied electronically, i.e. services which are delivered over the Internet or an electronic network and the nature of which means that their supply is essentially automated, involves minimal human intervention, and is impossible to ensure without information technology[(11)]. A forthcoming ministerial decree will define such services in more detail and introduce implementing measures[(12)].

(11) This definition resembles the definition of electronically supplied services for VAT purposes contained in article 7 of Council Implementing Regulation (EU) No 282 of 2011.

(12) According to a Report issued by Parliament, e-commerce transactions should be excluded.

The tax will apply to services supplied by resident or non-resident taxpayers that carry out more than 3,000 digital transactions in a calendar year. The tax will be levied by the recipient of the services at the payment date and must be paid by the 16th of the following month.

The new 3 percent tax should apply as of fiscal year 2019.

11. Full deduction, for IRAP purposes, of the cost of seasonal workers (paragraph 116)

For fiscal year 2018, resident corporations (including insurance and finance companies) can deduct 100 percent of the cost of seasonal workers employed for at least 120 days in a two-year period. Deduction is allowed from the start of the second contract signed with the same employer within two years of termination of the first contract. For 2018 only, this rule essentially increases, from 70 percent to 100 percent, the benefit already allowed by the Budget Law 2016.

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