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LABOUR

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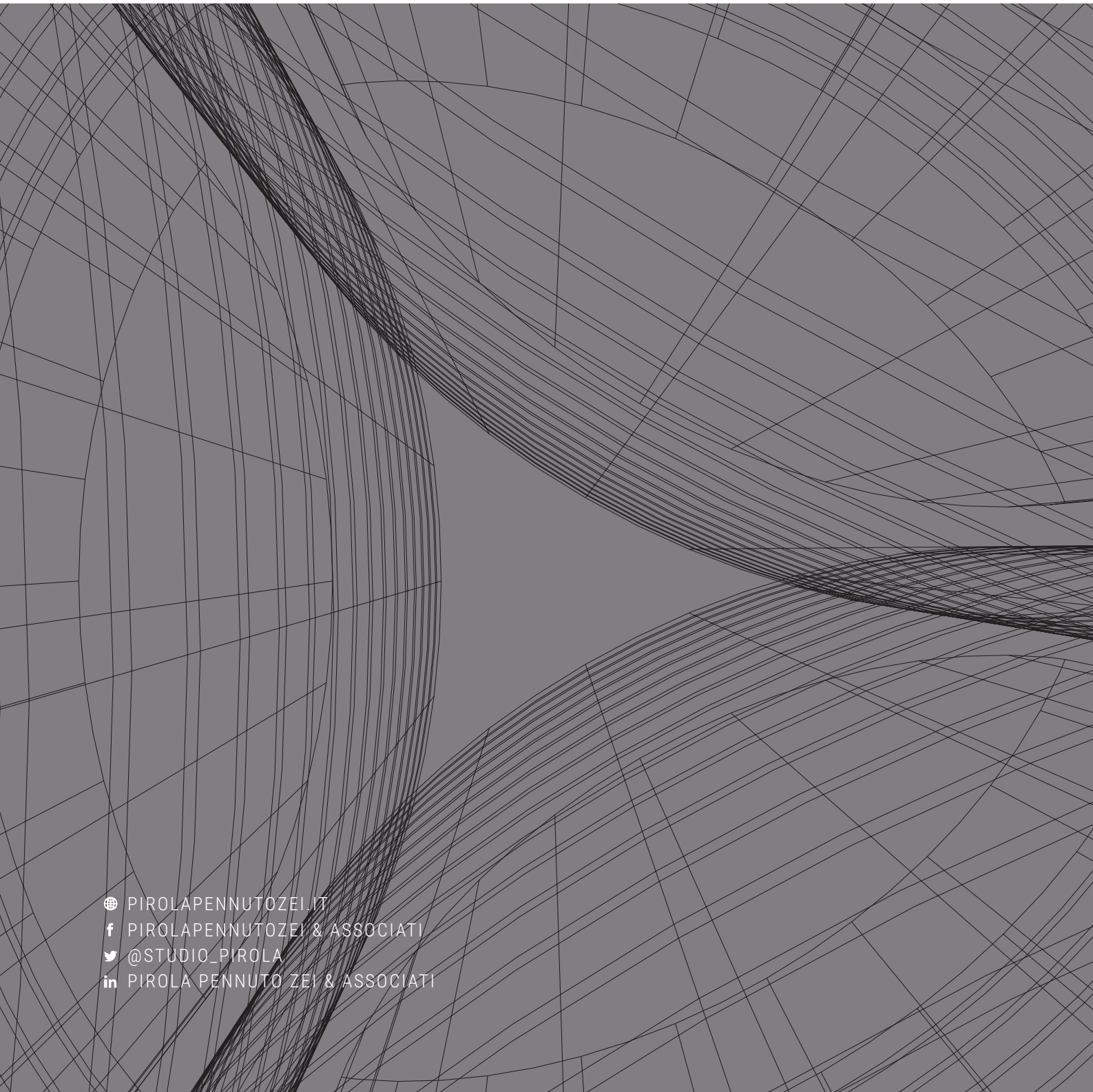

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GUIDANCE

1.1
Productivity bonuses, reduced social security contributions and corporate welfare – Clarification by the Italian Revenue Agency

By circular No. 5/E of 29 March 2018, prepared jointly with the labor ministry, the Revenue Agency provided significant clarification on the beneficial tax treatment of variable-amount performance bonuses, paid to workers in connection with increased productivity, profitability, quality, efficiency and innovation, introduced by the 2016 Italian Budget Act ("*Stability Law*") and recently amended by the 2017 Italian Budget Act and by Decree Law 50/2017. The clarification was required as a result of the changes made in 2017 and introduced by the 2018 Budget Act, which extended the possibility to use performance bonuses, with particular regard to the replacement of such bonuses with welfare instruments.

Qualifying bonus

The 2016 Italian Budget Act provided that a 10% substitute tax, in lieu of Italian personal income tax (IRPEF) and relevant regional and municipal surcharges, had to be levied on gross productivity bonuses up to Euro 2,000 (subsequently increased to Euro 3,000). The qualifying bonus for companies which have implemented a model whereby employees are directly involved in the organization, was initially set at Euro 2,500 and subsequently raised to Euro 4,000.

Income threshold

The beneficial treatment applies for private employees who in the year prior to that of payment of the bonus – even if accrued before 2017 or paid pursuant to agreements already in place at that date – earned income from employment liable to personal income tax at gradual bands of income in an amount not exceeding Euro 80,000 p.a. (not including income subject to separate taxation).

Direct involvement of employees

The circular clarified the actual meaning of "*direct involvement*" of employees, specifying the measures to be put in place by the employer to implement it.

The specially-appointed committee for the direct involvement of employees ("*comitati paritetici nazionali*")

or the employer can work out an "*Innovation Plan*" to be incorporated into a bargaining agreement between companies and the trade unions, with the following contents:

a) description of the situation existing within the company before the introduction of the employee direct involvement plans;

b) description of the measures which the employer is planning to take in this connection;

c) description of the expected results;

d) identification of the trade unions' role in the project.

For example, among the solutions provided by the Innovation Plan with a view to the direct involvement of employees, the tax authorities proposed two models: participation of employees in Innovation ("*SOP*" - *Schema Organizzativo di innovazione Partecipata*) or participation of employees in management ("*PGP*" - *Programma di Gestione Partecipata*), which can be implemented by:

- the creation of project groups for the improvement of individual production areas or production stages;
- workers' specialist training;
- implementation of systems for the recognition of employees' suggestions and contributions;
- communication campaigns within the company (workshops, interactive seminars…);
- introduction of forms of work-life balance through specific work management programs (e.g., part-time jobs in line with business hours, teams in charge of the self-management of working shifts, remote working);
- teamwork planning and assignment of production targets.

Alternatively, the employer may implement different solutions which directly and actively involve employees in business performance innovation processes and the processes for life and work improvement.

Reduced social security contributions in the event of direct involvement of workers

Article 55(1) of Decree Law No. 50/2017 provides for a 20% reduction of the employer contribution (and exemption from the employee contribution) for invalidity, old-age and death benefits (IVS - *Invalidità, Vecchiaia e Superstiti*) on up to Euro 800 of the performance bonus per annum. Should the employee change employer during the year, Euro 800 will constitute the maximum annual qualifying amount for all employers.

The contribution incentive applies to premiums and amounts paid by the employer pursuant to bargaining agreements entered into between companies and the trade unions - or amended or supplemented to reflect employees' direct participation programs - as of 24 April 2017.

Therefore, companies which entered into similar agreements before 24 April 2017 will only be eligible for

the tax relief on a maximum performance bonus of Euro 3,000, whereas those who did so later will qualify for both the tax and social security incentives.

Productivity bonuses paid by more than one employer – maximum qualifying amount

The Revenue Agency specified that the stated maximum qualifying amount is to be determined on a yearly basis per employee, regardless of whether bonuses were paid by more than one employer. Therefore, the employee will be responsible for informing the new employer of any bonuses received from other employers. If employees fail to provide the necessary information enabling employers to calculate tax at the correct substitute tax rate, they will be required to determine the actual amount of tax in their income tax return.

The role of trade unions

The payment of the performance bonus must be regulated by agreements entered into between companies and internal trade unions associations and must provide for the possibility to replace the bonus with welfare instruments. In the latter case, the employer will issue a special-purpose policy regulating the welfare instruments made available to employees.

If the company has no internal trade unions associations, the employer may apply the territorial collective bargaining agreement for the relevant business segment and levy the 10% substitute tax on the performance bonus paid thereunder.

If no territorial collective bargaining agreement for the relevant business segment has been entered into, the employer may adopt the territorial agreement he will consider to be most suitable for its purposes, provided that workers are informed in advance of his decision.

Performance appraisal to determine eligibility for the bonus

According to the Revenue Agency clarification, the increase in productivity, profitability, quality, efficiency and innovation must be assessed at company level based on the results obtained on the date established by the company paying the bonus. But what happens if the premium is paid pursuant to a territorial bargaining agreement? The Revenue Agency states that the only basis for determining eligibility for the bonus is the paying company's performance, not the results attained within the relevant territory by all entities doing business there. Therefore, even though the relevant business segment performed well in the territory, the employer will not qualify for the tax incentive if his employees did not derive an actual benefit therefrom.

Similar considerations apply where the company's bargaining agreement conditions the payment of the bonus to the attainment of a group's performance target; in order for the employer to qualify for the tax incentive, the performance increase must concern the company itself, and not the group the company is a member of.
Nevertheless, in the Revenue Agency's opinion, where a single employer can be identified at the entire group level, the company may qualify for the tax incentive regardless of whether or not it directly realized the increase, provided that it is resident in or carries out business in Italy.

Payment of differentiated performance bonuses to workers

Revenue Agency Circular No. 28/E of 2016 stated that the "*structure of the productivity bonus was to be kept separated from the results identified by the company for eligibility*". Since at first this had raised interpretation doubts, at the beginning companies tended to structure bonus plans with care especially when establishing differentiated parameters for different employees, individual performance and the possibility to correlate bonuses to such performance being sensitive issues for companies. In 2017, Lombardy's Revenue Office (*Direzione Regionale della Lombardia*), replying to a tax ruling request, stated that a welfare plan may provide for benefits related to the attainment of both company and individual objectives. The tax authorities' ruling specified that the granting of diversified benefits based on individual performance – which inevitably gives rise to disparity between employees – is not an issue for the purpose of the eligibility for the tax incentive. In the new circular, the Revenue Agency has confirmed its stance, specifying that "*the fact that differentiated bonuses are paid based on the employees' individual performance is not in contrast with the condition required by the law for the application of substitute tax …*", provided that the company realized an increase as identified in the trade union agreement. In this regard, it was confirmed that the "*tax incentive applies even though only one from among the productivity, profitability, quality, efficiency and innovation targets identified by the parties has increased over a fair period of time agreed between the parties*". Therefore, if the trade union agreement conditions the payment of the bonus to more than one target, the attainment of only one of them, measurable by appropriate indicators, is sufficient basis for eligibility. Although not expressly specified in the circular, any individual targets must be objective and measurable; in the spirit of the rule, bonuses paid solely on the basis of the employer's subjective evaluation should not qualify for the tax incentive where such evaluation cannot be demonstrated in accordance with pre-established targets.

Terms of application of the tax incentive – Payment of advances

Instructions have been provided with regard to the application of the tax incentive in the cases where it is not possible to determine eligibility for the incentive by the date on which tax balancing payments are made or if advances on the bonuses are paid.

In addition to the thresholds of income (€80,000) and bonuses (€3,000/4,000), the condition to apply the substitute is the achievement by the company of a measurable increase which cannot always be determined by the date of the tax balancing operations. According to the Revenue Agency, if an advance on the bonus has been paid and the ordinary tax rate applied, once the increase has been assessed a new statement of earnings (*certificazione unica*) must be issued, whereby the employer will certify that the condition for the application of the tax incentive is met. The employee will then recover the tax overpayment in his/her Tax return (Form 730 or *Unico*). The issue of a new *certificazione* after the ordinary deadline will not entail any fine. The Revenue Agency allows the application of the tax benefit on advances, provided that at the time of payment the required increase has been assessed. If several payments on account are made, it will be necessary to add up the result of the last quarter with that of the previous quarters, provided that the tax incentive is applicable only if the aggregate result was an increase.

Conversion of the performance bonus into welfare services

The 2016 Stability Law introduced the beneficial tax treatment of performance bonuses on a permanent basis and significantly innovated so-called "*company welfare*" giving employees the possibility to wholly or partly convert the tax incentive into welfare services, with full social security and tax exemption. The replacement was initially allowed for the amounts specified in paragraphs 2 and 3 of article 51 of the Italian Income Tax Code, but starting from 2017 it is now allowed also for the benefits specified in article 51(4) of the Italian Income Tax Code, i.e. (a) business cars, (b) loans, (c) property leased or granted to employees on gratuitous bailment, (d) trips for railway companies' employees.

The Revenue Agency's note was required in order to understand the correct portion to be taxed as a consequence of the replacement, as there were doubts as to whether the taxable base should be determined on a "*fair market value*" or "*agreed value*" basis, as required by the Italian Income Tax code.

According to the instructions provided by the Revenue Agency, the use of a business car, the granting of loans or the provision of lodging, in lieu of the payment of the performance bonus and up to the amount of the qualifying bonus (€ 3,000 or 4,000), are subject to ordinary taxation on an "*agreed value*" in

accordance with article 51(4) of the Italian Income Tax Code. The portion of bonus exceeding such value would be subject to substitute tax. See the following examples, provided by the Revenue Agency:

a) Business cars (or motor-vehicles) (for both business and private use):

This benefit is included in the employee's income solely with regard to the value of the vehicle determined on a lump-sum basis – according to Italian Automobile Club (ACI) rate tables – instead of the fair market value attributable to the use of the vehicle. For instance:

- o Qualifying performance bonus: € 3,000;
- o Taxable value of the car benefit (car for both business and private use), based on ACI rate tables: €1,855.50 (€0.4190 x km 15,000*30%);
- o Taxable base of the car benefit, including following the conversion of the performance bonus: €1,855.50, subject to ordinary taxation;
- o Taxable base subject to substitute tax or, at the employee's choice, to ordinary taxation or, at the employee's choice, replaced by other benefits: €1,114.50 (€ 3000- € 1.885,50).

b) Loans:

This benefit is included in the employee's income at the rate of 50% of the difference between the interest calculated at the official discount rate in force at 31 December of each year and the interest payable by the employee, including when the employer pays the loan interest in lieu of the bonus. For instance:

- o Qualifying performance bonus: € 3,000;
- o Interest due by the employee pursuant to the loan agreement: € 4,000;
- o Interest calculated at the official discount rate: € 2,000;
- o Interest payable by the employee following the conversion of the bonus: € 1,000 (€ 4,000 - € 3,000);
- o Taxable base of the benefit: € 500 (€ 2,000 - € 1,000 = € 1,000 * 50%);
- o Taxable base subject to substitute tax or, at the employee's choice, to ordinary taxation or replaced by other benefits: € 2,500 (€ 3000 - € 500).

c) Property leased or granted on gratuitous bailment:

This benefit is included in the employee's income as the difference between the land registry income of the property, plus the utilities costs borne by the employer, and the amount of bonus accrued by the employee. For instance:

- o Qualifying performance bonus: € 3,000;
- o Land registry income after deduction of the amount paid by the employee: €2,000;

o Taxable base of the benefit, following conversion of the performance bonus: € 2,000;
o Taxable base subject to withholding tax or, at the employee's choice, to ordinary tax or to be replaced by other benefits: €1,000 (€3,000 - €2,000).

d) Free-of-charge trips for railway companies' employees:
This benefit is included in employment income solely with regard to the lump-sum value of the train trip after deduction of the amount paid to the employee.

o Qualifying performance bonus: € 1.000;
o Lump-sum value of the trip: € 187.20 (€ 0,072* km. 2.600);
o Taxable base of the benefit, following conversion of the performance bonus: €187.20;
o Taxable base subject to withholding tax or, at the employee's choice, to ordinary tax or replaced by other benefits: €812.80 (€1,000 - €187.20).

Further cases of conversion of performance bonuses:
The Revenue Agency has clarified that performance bonuses can be converted into contributions to pension schemes, health and welfare schemes and shares, as explained in the 2017 Budget law:

a)Complementary pension schemes:
The contributions allocated to pension schemes are deductible from income up to an annual amount of Euro 5,164.57. Starting from 1 January 2017, if the employee has decided to convert the bonus into contributions to complementary pension schemes, such contributions are not included in the employee's income even if they exceed the general € 5,164.57 cap.
Accordingly, if the contributions to complementary pension schemes are paid in lieu of the performance bonus, they are not included in the employee's income up to €8,164.57 (general €5,167.57 cap + €3,000 maximum amount of the non-taxable bonus), or €9,164.57 if employees are directly and actively involved in the company's organization. Moreover, the contributions exceeding the cap must be notified every year to the pension fund as "*non-deducted contributions*" and "although not taxed, they will not be included among taxable pension scheme benefits".

b)Contributions to health and welfare benefit schemes:
Contributions paid to health and welfare benefit schemes are not included in employment income up to Euro 3,615.20 per annum.

Starting from 1 January 2017, if the employee decides to convert the bonus into contributions to such schemes, the contributions are not included in the employee's income even if they exceed the Euro 3,615.20 cap.
Accordingly, the contributions paid to health and welfare benefit schemes in lieu of the performance bonus are not included in the employee's income up to the amount of Euro 6,615.20 (general €3,615.20 cap + maximum amount of non-taxable bonus of €3,000) or €7,615.20 where the employees are directly and actively involved in the company's organization.
The Revenue Agency specified that such schemes operate on a "*mutual benefit*" basis and this is the reason why the relevant contributions are deductible. If there is a strict correlation between the amount of the contribution made by the employee and the benefit paid by the scheme, there would be doubts as to the satisfaction of the "*mutual benefit*" principle and therefore the advantage of tax deductibility would not apply.

c) Award of shares:
To date Italian Income Tax Code prescribes that when shares are awarded to all employees the value of such shares is not included in the employee's income up to €2,065.83 in the tax period. The tax benefit does not apply if the shares are not held at least three years. The 2017 Budget law allows the tax-exempt conversion of the performance bonus into shares even though the three-year minimum holding period has not been completed. The Revenue Agency has specified that the derogation prescribed by the 2017 Budget law refers not only to the value of the shares not included in the employee's income, but also to the three-year holding period. Accordingly, in the event of replacement of the bonus with shares, no employment income will arise in the following cases:

- shares are allocated to certain categories of employees, and not to all of them;
- the value of the shares exceeds the Euro 2,065.83 cap but is not hither than Euro 6,065.83 or 7,065.83 where employees are directly and actively involved in the company's organization;
- the shares are transferred before the end of the three-year holding period, including as a result of the repurchase by the issuing company or the employer.

Sums paid or reimbursed for the purchase of public transport passes – 2018 Budget law
The 2018 Budget law has introduced a regulation prescribing that sums paid or reimbursed or expenses directly incurred by the employer, either voluntarily or as required by contractual terms or company rules, for the purchase of local, regional and interregional public transport passes for the benefit of all employees

or certain categories of employees are not included in employment income. Public transport passes may be given to either employees or their dependent relatives as specified in article 12 of Italian Income Tax code. In particular, dependent relatives are the spouse, children and other persons specified in article 433 of the Civil Code. The employer must keep the documentation demonstrating that the sums received have been utilized for the intended purposes. It is immaterial whether the sums received wholly or partly cover the cost of the public transport pass. According to Revenue Agency circular no. 19/E/2008, qualifying public transport passes "*are passes allowing the owner to make an unlimited number of journeys, for periods of several days, on a certain route or on the entire network, over a given period of time*" and therefore do not include tickets for the occasional use of public transport services.

Substitute benefits – time of receipt

The Revenue Agency has clarified the doubts in respect of the time when the benefit is received, in case of services provided by way of "*vouchers"* and "*welfare credit*" since the time when the service is actually received by the employee is different from the time the "*voucher*" is delivered or the "*welfare credit*" arises. In such cases, based on the cash basis principle applicable for tax purposes, "*the benefit is considered received by the employee, and is relevant for income tax purposes, when it is made available to the employee, regardless of the fact that the service is received at a later time*".

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LABOUR NEWSLETTER | MARCH 2018

LEGISLATION, MINISTERIAL GUIDANCE AND CASE LAW AT 31 MARCH 2018.
THIS NEWSLETTER IS INTENDED AS A SUMMARY OF KEY DEVELOPMENTS AND HIGHLIGHTS MATTERS OF GENERAL INTEREST, AND THEREFORE SHOULD NOT BE USED AS A BASIS FOR DECISION-MAKING.
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