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TAX

NEWSLETTER / 1 AUGUST-15 SEPTEMBER 2018

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LEGISLATION

1.1
Conversion into law, with amendments, of decree law No. 87 of 12 July 2018, containing urgent provisions for the dignity of workers and companies – Law No. 96 of 9 August 2018, published in Italian Official Journal No. 186 of 11 August 2018

Decree Law No. 87/2018 containing "*Urgent provisions for the dignity of workers and enterprises*" was published in Italian Official Journal No. 161 of 13 July 2018. The Decree was converted into law No. 96 of 9 August 2018, published in Italian Official Journal No. 186 of 11 August 2018.

The changes introduced by Decree Law No. 87/2018 were dealt with in our 1-15 July 2018 Tax Newsletter to which reference should be made.

We provide below our comments on the main provisions.

Restrictions to the delocalization of companies who received State aid (article 5)

Without prejudice to the terms of the applicable international treaties, Italian and foreign companies doing business in Italy which received State aid to carry out productive investments, lose the entitlement to such aid if they delocalize all or part of their business to non-EU member states (with the exception of States that are members of the European Economic Area), in the five years subsequent to the conclusion of the qualifying investment.

Recovery of the hyperdepreciation benefit in the event of sale or delocalization of the qualifying assets (article 7)

Hyperdepreciation applies if qualifying assets are used in production facilities within the Italian territory. If during the period in which hyperdepreciation applies the qualifying assets are sold or transferred to productive facilities abroad, whether or not belonging to the same company, the hyperdepreciation deducted is disallowed and recovered. The provision applies to investments made as of 14 July 2018.

R&D credit and costs for the purchase or license of intangible assets from third parties (article 8)

The tax credit for R&D investment does not apply to the purchase or license of intangibles from transactions with group companies.

Split payment rules (article 12)

The Split payment rules (article 17-*ter* of the VAT Decree) no longer apply to services rendered to professionals whose fees are subject to withholding tax as final liability or on account, pursuant to article 25 of Presidential Decree No. 600 of 29 September 1973.

Netting off of tax liabilities with tax credits owed to enterprises and professionals by Public Authorities (article 12-*bis*)

The conversion law has extended the possibility for professionals and enterprises to offset outstanding tax liabilities with any tax credits owed to them by the Public Authorities. The relevant liabilities are those notified to the collection agents by 31 December 2017.

1.2
Draft legislative decree implementing Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market as amended by Council Directive (EU) 2017/952 as regards hybrid mismatches with third countries, was submitted to the President of the Chamber of Deputies on 13 August 2018 (Government act subject to parliamentary opinion)

The Government issued the draft legislative decree implementing law No. 163 of 25 October 2017 (European Delegation Bill) transposing Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD 1) as amended by Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD 2) was submitted to the President of the Chamber of Deputies on 13 August 2018.

The draft decree is divided into six Chapters corresponding to the four areas of the ATAD 1 Directive, as follows: Chapter I (Provisions on the deductibility of interest), Chapter II (Exit taxation rules), Chapter III (Controlled foreign company rules), Chapter IV (Rules to tackle hybrid mismatches), Chapter V (Definitions and coordinating provisions), Chapter VI (Transitional and final rules). Chapter III was divided into two Sections: Section I (Controlled foreign company rules) and Section II (Dividend and capital gains rules).

The new rules shall be effective as follows:

- Chapters I, II and III (Section I) shall apply as of the fiscal year subsequent to that in progress at 31 December 2018;
- Chapter III, Section II, shall apply as of the fiscal year subsequent to that in progress at 31 December 2018, and to the profits distributed and capital gains realized in the same fiscal year;
- Chapter IV shall apply as of the fiscal year subsequent to that in progress at 31 December 2019 or the fiscal year subsequent to that in progress at 31 December 2021;
- Chapter V shall apply as of the fiscal year subsequent to that in progress at 31 December 2018.

We set out below the main changes introduced by the new rules.

Provisions on the deductibility of interest

The following amendments have been made to article 96(1) of the Italian Income Tax Code:

- the deductibility limit applies also to capitalized interest expense and similar financial costs;
- interest expense can be offset not only with the interest income for the period but also with the excess interest income carried over from prior fiscal years;
- upon certain conditions, interest income on loans taken out to fund a long-term public infrastructure project may fall outside the deductibility limits.

The excess interest income over and above the sum of interest income for the period and the excess interest income carried over from prior fiscal years is deductible up to 30% of the gross operating income for the period and 30% of the gross operating income from prior years. The main change concerning the gross operating income is that it will not be possible to carry it over indefinitely.

Instead of gross accounting operating income, as was the case under the prior rules, gross tax operating income will be used, taking into account the tax bases of the items composing it. Therefore, where both accounting and tax bases are adopted, the relevant amounts will be the latter.

The new wording of article 96 also provides that the excess interest income (i.e., the difference between the interest income accrued in the year and the sum of interest expense accrued in the year and interest expense carried over from prior years) can be carried over to future fiscal year, without time limit. Instead, the excess gross operating income can be carried over for a maximum of 5 fiscal years.

If a company is a member of a domestic tax group, for the purpose of determining the group's aggregate income the excess interest expense generated by one of the group members may be offset not only with the excess gross operating income generated by other group members but also with the excess interest income generated by the same members.

Exit taxation rules

The Draft Decree replaced article 166 of the Italian Income Tax Code and, accordingly, also article 166-*bis* containing rules on the tax recognition of entry values. The new rules differ in that they introduced the notion of arm's length value measurement of the items transferred (replacing the notion of "*valore normale*"), reduced from 6 to 5 the maximum number of tax instalment payments and eliminated the possibility to take advantage of the suspension of tax payments. Furthermore, the scope of application of the rules has been extended (to cover additional cases, expressly provided by article 5 of the Directive) and exit taxation applies also to the transfer of assets to permanent establishments in respect of which the head office elected for the branch exemption referred to in article 168-*ter* of the Italian Income Tax Code.

Controlled foreign company (CFC) rules

CFC rules apply if the effective tax rate in the country where the controlled company is established is less than half the rate the CFC would have been liable to had it been resident in Italy. Therefore, in order to identify the low-tax jurisdiction, reference is to be made to the effective, rather than the nominal, tax rate. Accordingly, a comparison has to be made between the foreign effective tax rate and the domestic virtual

tax rate. Furthermore, the legislation applies to passive income; specifically, the further condition in order to qualify for the rules is that passive income (e.g., interest or any other income generated from financial assets, dividend and income from the sale of shareholdings, finance lease income) accounts for more than one third of the CFC's income.

The CFC rules apply if the controlled company concurrently meets both conditions.

The CFC rules do not apply if the non-resident entity actually carries out a business using staff, equipment, assets and premises. The taxpayer may also file a tax ruling request pursuant to article 11(1)(b) of law No. 212 of 27 July 2000 to check application of the safe harbor rules.

In order to determine the CFC's income to be attributed to the resident company on a flow-through basis, the rules for the determination of the income liable to IRES (corporation tax) for resident companies apply, with the exception of the following:

- convenience companies rules;
- rules for companies constantly in a loss position;
- industry studies;
- Aid to economic growth (ACE);
- Payment of capital gains tax by instalments.

The CFC income attributed to the Italian taxpayer on a flow-through basis is subject to separate taxation at the controlling entity's average rate and in any case at a rate not lower than the standard IRES rate.

New procedures have been introduced; in the event of an inspection, the Revenue Agency must allow taxpayers a period of 90 days to produce evidence that CFC rules do not apply before issuing a notice of deficiency; furthermore, there is an obligation to report in the Income Tax Return the shareholdings subject to the CFC rules, if no ruling request was filed or if a negative response to a tax ruling request was obtained.

Dividend and capital gains rules

One of the key changes is the one concerning the notion of control, which also becomes relevant for the purposes of the taxation of dividends and capital gains from companies resident in low-tax Countries. There is control if an enterprise, company or entity is directly or indirectly controlled, including through a fiduciary company or any third party, as stated in article 2359 of the Italian civil code, or if a company directly or indirectly, through one or more controlled companies, owns a share in the profits exceeding 50%.

The new article 47-*bis* of the Italian Income Tax Code introduced a new condition for the identification of low-tax countries, making reference to the effective or nominal tax rate depending on whether the shareholding is a controlling or non-controlling stake, consistently with the notion applicable under CFC rules. Article 47-*bis* distinguishes between controlling shareholdings (in which case a low-tax jurisdiction is identified based on the comparison between the foreign effective tax rate and 50% of the Italian effective tax rate) and non-controlling shareholding (in which case a low-tax jurisdiction is identified based on the comparison between the nominal foreign tax rate and 50% of the Italian nominal tax rate, having regard to the impact of any special regime on nominal rates).

There are two safe harbor rules for the non-application of the rules on low-tax jurisdictions: the foreign controlled company carries out a real economic activity in the country of establishment – using staff, equipment, assets and premises – or ownership of the shareholding in the foreign company by the resident entity does not result in the income being subject to taxation in low-tax jurisdictions.

Another significant change introduced by the rules is that the capital gains exemption PEX regime (which used to be applicable to listed companies resident in black-listed countries only in respect of non-qualifying shareholdings) has been made equivalent to the dividend exemption PEX regime (already applicable to listed companies resident in black-listed companies in respect of both qualifying and non-qualifying shareholdings).

Furthermore, with regard to capital gains taxation, a fixed 5-year monitoring period has been established for sales outside the group (unless the actual ownership period is shorter): if the country where the subsidiary is established is regarded as a low-tax jurisdiction in one or more years during the relevant

5-year period, the capital gain will not be exempt unless it can be proved that the relevant safe harbor rule applies in those years.

Rules to tackle hybrid mismatches

The new law introduced provisions against hybrid mismatches, referred to in Directive (EU) 2016/1164 as amended by Directive (EU) 2017/952 of 29 May 2017, in line with the 2015 OECD Report named *Neutralising the Effects of Hybrid Mismatch Arrangements* and the 2017 OECD Report named *Neutralising the Effects of Branch Mismatch Arrangements.*

The newly introduced anti-hybrid provisions aim at combating the effects of double deduction or deduction without inclusion from conflict in the characterization of financial instruments, payments, entities, permanent establishments or from the allocation of payments. These measures apply to all taxpayers subject to corporate income tax in Italy, including individuals and Italian PEs of non-resident entities.

The mismatch relevant for the purposes of anti-hybrid rules (which the rule intends to combat) consists of one of the following tax effects:

- a "*double deduction*", i.e., a deduction of the same cost in the country in which incurred (or allegedly incurred) – i.e. the payer's jurisdiction – and in the investor's jurisdiction; or,
- a "*deduction without inclusion*", i.e., the deduction of a cost in the country in which incurred (or allegedly incurred) – i.e. the payer's jurisdiction – without the corresponding inclusion of the related income in the beneficiary's jurisdiction.

In the first case (i.e. "*double deduction*") the deduction made by one of the two parties concerned is disallowed.

The rules concern cross-border hybrid mismatches, since domestic hybrid mismatches may be combated with the prohibition of abuse of law. Furthermore, the benefits provided by article 1 of Decree Law No 201/2011, converted with amendments into Law 214/2011 as amended (aid to economic growth – ACE benefit), do not generate hybrid mismatches.

Article 9 of the Decree concerns reverse hybrid mismatches, whereas article 10 deals with tax residency mismatches.

Financial holding companies

The new article 162-*bis* of the Italian Income Tax Code provides a single definition of financial intermediary for IRES and IRAP. The new definition also affects the identification of persons who carry out on an exclusive or prevailing basis the acquisition of shareholdings in companies carrying out a banking or financial activity (financial holding companies) or in other companies.

Paragraphs 2 and 3 establish the conditions for determining whether the acquisition of shareholdings in financial intermediaries is a prevailing activity compared to the acquisition of shareholdings in other entities. Specifically, this is so when, based on the financial statements approved for the latest fiscal year, the aggregate amount of the shareholdings in such financial intermediaries and other arrangement between them – including any commitments to pay funds and guarantees issued – exceeds 50% of the company's assets (including any commitments to pay funds and guarantees issued).

Instead, the acquisition of shareholdings in entities other than financial intermediaries is considered to be carried out on a prevailing basis when, based on the financial statements approved for the latest fiscal year, the aggregate amount of the shareholdings in such entities and other arrangement between them exceeds 50% of the company's assets.

GUIDANCE

2.1

Tax matters of interest to the *amateur* sports clubs and associations referred to in article 90 of law No 289 of law 27 December 2002, arisen during the technical Round Table between the Italian Revenue Agency and the Italian National Olympic Committee – Ministerial Circular No. 18/E of 1 August 2018

In Circular No. 18/E/2018, the Tax Authorities provided clarification on doubts regarding the tax reliefs for amateur sports clubs arisen during a technical round table with the Italian National Olympic Committee, focusing *inter alia* on the following issues:

- tax characterization of not-for-profit amateur sports clubs and associations;
- beneficial tax regime pursuant to law No. 398 of 16 December 1991;
- stamp duty exemption.

As regards especially the beneficial tax regime pursuant to law No. 398 of 16 December 1991, the Circular provided clarification on the IRES and VAT regimes.

As for IRES, it pointed out that in order to determine the taxable income of not-for-profit *amateur* sports clubs and associations, it is necessary to consider that they are regarded as IRES taxable persons pursuant to article 73(1)(a) of the Italian Income Tax Code, whose income (from any source) constitutes business income[1].

As for VAT, pursuant to article 9(1) of Presidential Decree No. 544 of 30 December 1999, not-for-profit *amateur* sports clubs and associations which have opted for the beneficial regime under Law 398/1991 apply the provisions of article 74(6) of the Italian VAT code (special regime for entertainment activities) "*in respect of all proceeds generated from commercial activities related to their core activities*". Consequently, for these entities the special VAT regime for entertainment activities applies also in respect of proceeds generated in respect of activities not subject to the entertainment tax.

1 The amateurs sports club pursuant to article 90 of Law No. 289/2002 must apply the 3% profitability rate on all income and proceeds included in the aggregate income pursuant to article 81 of the Italian Income Tax Code, with the exception of capital gains.

2.2

VAT regime of investment research services – Ministerial Resolution no. 61/E of 8 August 2018

In their Resolution No. 61/E/2018, the Tax Authorities dealt with the VAT regime of the investment research service[2]. First, it reported the definition of investment research service and subsequently clarified that, pursuant to article 13 of the Delegated Directive 2017/593/EU, this service should not be regarded as an inducement if it is received by an individual asset manager in return for either of the following:

- direct payments by the investment firm out of its own resources;
- payments from a special-purpose payment account and "*funded by a specific research charge to the client provided that the investment firm sets and regularly assesses a research budget, is held responsible for the research payment account and regularly assesses the quality of the research purchased*".

The Revenue Agency specified that the research service provided to individual *portfolio* managers does not fall within the scope of any of the exemptions provided by article 10(1) of the VAT law and cannot be regarded as a "*mediation, intermediation and agency service*", in connection with the securities transactions referred to under points (4) and (9) of the same article.

Furthermore, the investment research service provided by traders to individual *portfolio* managers (which is separately remunerated in accordance with the new conditions established by article 13 of the Delegated Directive 2017/593/EU) no longer qualifies for the exemptions provided by article 10(1) nos. (4) and (9) of the VAT law: therefore, this service is subject to VAT at the standard rate.

The Resolution also clarified that if the investment research service is separately remunerated from the trading activity it may qualify for the exemption provided that it can be included among the management

2 Pursuant to article 36 of Commission Delegated Regulation (EU) 2017/565 *"investment research shall be research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public, and in relation to which the following conditions are met: (a) the research or information is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation; (b) if the recommendation in question were made by an investment firm to a client, it would not constitute the provision of investment advice for the purposes of Directive 2014/65/EU*".

of investment funds pursuant to article 10(1)(1) of the Italian VAT law according to the definition adopted by the European Court of Justice in decision dated 4 May 2006 in case C-169/04 (Abbey National plc v. Commissioners of Customs & Excise)[3].

Based on clarification provided by the ECJ, the investment research service provided to collective asset managers can be considered to be one of the VAT-exempt outsourced services falling within the scope of the management of funds, provided that such service has the characteristics specified by EU judges.

2.3
Super- and hyper-depreciation – Further clarification on the investments in self-supporting warehouses – Article 1(93) of Law no. 208/2015 – Ministerial resolution no. 62/E

By Ministerial Resolution no. 62, the Revenue Agency replied to certain tax ruling requests related to the beneficial treatment of self-supporting warehouses. In particular, it clarified the criteria to separate real estate from personal assets which are not relevant for the purposes of the attribution of the land registry income.

Self-supporting warehouses are big structures used for the storage of goods of different types; moreover, they have shelving systems connected with automated handling equipment which is included in the construction system of the entire building. The shelving systems of self-supporting warehouses are the elements to be included in the land registry income estimate.

As clarified in the Resolution[4], if all requirements prescribed by the law are met, solely the elements of the self-supporting warehouses not included in the land registry income qualify for super/hyper-depreciation.

3 The ECJ stated that (in principle) the application of the VAT exemption is not precluded even if the management of investment funds is broken down into a number of separate services provided by a third party (i.e., outsourced). However, as specified in the Resolution, , to be regarded as exempt transactions, services performed by a third-party manager must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of the exempt service, i.e. the management of the fund (point 70 of ECJ decision dated 4 May 2006 on Case C-169/04).

4 Taking into consideration the clarification provided in Ministerial Circular no. 4/E/2017, par. 9, on the super-depreciation of photovoltaic and wind-powered installations.

2.4

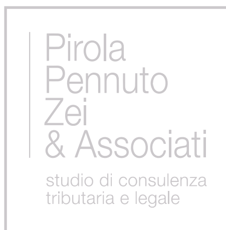
Tax ruling request for interpretations of unclear tax rules – Contribution by a nonresident entity of a business division belonging to its Italian permanent establishment to a resident entity. Ministerial Resolution no. 63/E dated 9 August 2018

The Resolution has provided clarification on the tax treatment of a contribution by a nonresident (French) entity of a business division belonging to its permanent establishment in Italy to a resident entity. In practice, the contribution will occur as follows:

- the receiving company (wholly owned by the non-resident entity) will increase its share capital by an amount corresponding to the net book value of the business division contributed;
- the shareholding, equal to the value of the above share capital increase, will directly be allocated to the transferring Italian permanent establishment.

In the Revenue Agency's opinion, the contribution at issue[5] is subject to the tax neutrality regime, prescribed by articles 178(1) c) and 179(2) of Italian Income Tax Code (according to article 179(2), the tax neutrality regime prescribed by article 176 of Italian Income Tax code solely applies to the balance sheet items of the permanent establishment actually allocated to the receiving company). The tax neutrality regime is conditional on the circumstance that, as a result of the contribution, the shareholding in the receiving company will be carried to the accounts of the transferring permanent establishment from which the assets contributed derive; basically, the shareholdings in the receiving company, issued after the contribution, must be directly attributed to the Italian permanent establishment. This solution is consistent with the application of the principle established by the OECD according to which a permanent establishment is a "*functionally separate entity*" from its parent company (see the Commentary to article 7 of the OECD Model Convention against double taxation, updated in July 2016, the OECD Report on the Attribution of profits to permanent establishments of July 2010, article 152(2) of Italian Income Tax Code – introduced by article 7(1) b) of Legislative Decree no. 147/2015 and Ministerial Resolution no. 44/E/2006).

5 Whereas no. 14 of European Directive no. 2005/19/EC has clarified that the transfer of assets of a permanent establishment (i.e. a business or business division – in view of the definition of "*transfer of assets*" provided in article 2c) of Directive no. 90/434/EEC, and confirmed in Directive no. 2009/133/EC) located in the Member State of the receiving company entails the transfer of assets from a company of a Member State to a company of another Member State, which is accordingly covered by the Directive.



In the Resolution it has been specified that the recognition of the shareholding resulting from the contribution in the balance sheet of the Italian permanent establishment is subject to the general condition that a "*functional connection*" exists between the shareholding and the permanent establishment's assets, in compliance with article 152 of the Italian Income Tax Code (as amended by article 7 of Legislative Decree no. 147/2015). If the shareholding received in exchange for the contribution is attributed to the transferring permanent establishment and subsequently transferred to its parent company, or is directly attributed to the parent company, or if the above mentioned "*functional connection*" does not exist at the time of the contribution or ceases to exist thereafter, any capital gains earned (or capital loss suffered) by the transferring permanent establishment will be considered partly exempt (or not deductible) only if the shareholding meets the requirements specified in article 87 of Italian Income Tax Code.

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TAX NEWSLETTER | 1 AUGUST - 15 SEPTEMBER 2018

LEGISLATION, MINISTERIAL GUIDANCE AND CASE LAW AT 15 SEPTEMBER 2018.
THIS NEWSLETTER IS INTENDED AS A SUMMARY OF KEY TAX DEVELOPMENTS AND HIGHLIGHTS MATTERS OF GENERAL INTEREST, AND THEREFORE SHOULD NOT BE USED AS A BASIS FOR DECISION-MAKING.
FOR FURTHER DETAILS AND INFORMATION, PLEASE CONTACT YOUR RELATED PARTNER OR SEND AN EMAIL TO UFFICIOSTUDI@STUDIOPIROLA.COM