



International Tax

Italy Tax Alert

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Tax authorities clarify application of patent box regime

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The Italian tax authorities (ITA) issued guidance on 1 December 2015 that further clarifies the application of the patent box regime and its implementation rules and provides detailed instructions on how to elect into the regime, the procedure for obtaining a tax ruling, the treatment of losses connected to the use of qualifying intellectual property (IP) and the consequences of extraordinary transactions.

The patent box regime, introduced by the finance law 2015, grants a partial exemption from corporate income tax and the regional tax on productive activities for income deriving from qualifying intangible assets. For 2015, the exemption is equal to 30% of qualifying income, increasing to 40% in 2016 and 50% in 2017 (for prior coverage, see the [World Tax Advisor article dated 27 February 2015](#) and the [tax alert dated 24 October 2015](#)).

The patent box regime requires a taxpayer to obtain a tax ruling from the ITA where the relevant IP is used "directly"; a ruling is optional where the IP is based on an intercompany license. While the implementation rules that were published on 21 October 2015 provide details on the filing procedure for obtaining a ruling (such as the timing, format, potential ITA investigations and the consequences of failure to comply with the terms of the ruling), certain issues were not addressed. These issues are addressed in the new guidance.

Overview of new guidance

Election into the patent box: For tax years 2015 and 2016, a taxpayer may make an election to opt into the patent box regime by electronically submitting the relevant form and documentation to the ITA. As from tax year 2017, the election must be filed with the annual tax return. *Taxpayers that intend to benefit from the regime as from FY 2015 must submitting their elections by 31 December 2015.*

The election form requires general information on the persons that carry out the R&D activities giving rise to the IP. The simplified nature of the form is designed to give a taxpayer an opportunity to apply for the patent box regime, even if it has not been able to fully assess whether it has satisfied the relevant conditions. In other words, the computation of the qualifying income for 2015 may be finalized after the election form is submitted, and no negative consequences will arise if the taxpayer ultimately does not qualify for the patent box regime.

The election into the patent box regime may be exercised for certain categories of IP or on an asset-by-asset basis, but once an election is made, it is binding for five years (and it may be renewed).

Tax ruling procedure: Where a tax ruling is mandatory (or where the taxpayer opts to apply for a ruling), the request must be submitted to the advance pricing agreement and international tax controversy department of the ITA. (As mentioned above, the ruling request must be filed by 31 December 2015 to obtain benefits under the patent box for 2015, although the ITA can issue the ruling after this date.)

The tax ruling procedure consists of two steps:

- 1) *Submission of the application*, which will include general information, such as the identity of the taxpayer, the subject of the request, a description of the IP generating the qualifying income and the relevant R&D activities performed: The tax ruling request may relate to income deriving from the direct use of the IP, royalties arising from the indirect use of the IP or capital gains arising from an intercompany transfer of the IP (a ruling is optional in the latter two situations).
- 2) *Submission of additional documentation* within 120 days of the initial application: This documentation should contain an indication of whether individual IP assets are linked in such a way that they generate the same income, an analysis of the R&D activities performed, and the methods and criteria used for the computation of the income. The method used to calculate the income must be compliant with the OECD global transfer pricing standards, in particular, the standards in actions 8-10 of the final reports under the base erosion and profit shifting project.

Small and medium-sized enterprises will be able to submit less detailed information in the second stage of the ruling procedure.

The ITA can conduct a further investigation, which may include an exchange of information with the tax authorities in other jurisdictions, before it makes a decision on a ruling request.

Treatment of losses: If a taxpayer incurs losses from the relevant IP (i.e. its expenses exceed the relevant income derived from the IP), those losses may be deducted in full against regularly taxed income. However, the losses will be “recaptured” (using an asset-by-asset mechanism) by denying the benefit of the patent box rate to future income generated within the regime by the same IP, up to the amount of the losses. As a result, the benefit of the patent box regime for the specific IP that generated the losses will not be available until all of the losses actually have been recaptured in this manner.

Extraordinary transactions: In the case of extraordinary transactions (mergers, demergers and other corporate reorganizations), the transferee will assume the rights connected with the election made by the transferor. Where such a transaction results in the use of the IP becoming indirect (and, therefore, the ruling procedure being optional), no abuse of law will be deemed to exist, since no additional tax benefit would be generated by the transaction.

Comments

Italian companies that potentially are interested in the patent box regime should file the election (as well as a request for a tax ruling, if required) by 31 December to secure the benefit for 2015.

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