



Italy tax alert

Budget law for 2017 passed

Italy's budget law for 2017, published in the official gazette on 22 December 2016, makes a number of significant changes to the country's tax rules, including changes to the notional interest deduction (NID), the extension of the extra 40% depreciation for certain tangible assets, the introduction of extra 150% depreciation for high-tech assets, several opportunities for Italian companies to obtain beneficial treatment and an extension of the research and development (R&D) tax credit. Unless otherwise noted, the changes described below are effective as from 1 January 2017.

Additionally, as provided by the budget law for 2016, the corporate income tax is reduced to 24% (from 27.5%) as from 1 January 2017.

Notional interest deduction (NID)

The new rate for the NID—the corporate income tax deduction computed as a percentage of the annual increase in a company's equity (from new cash contributions and retained earnings)—is 2.3% for 2017 (reduced from 4.75%) and 2.7% for 2018 and thereafter.

Under a new limitation introduced by the budget law, the NID may be reduced based on the increase of investments in securities and financial instruments other than participations, as compared to the amount shown in the financial statements for 2010.

Similar limitations to those that apply to the carryforward of net operating losses (and excess interest) in the case of a change of control or merger/demerger also will apply to the excess NID (i.e. the NID that exceeds the tax base for the year and generally can be carried forward):

- In the case of a change of control, no carryforward will be allowed if, in the year of the change of control or in the two preceding or following periods, the business activity of the company is modified; and
- In the case of a merger/demerger, a carryforward will be allowed up to the amount of the net equity value shown in the last approved financial statements or (if lower) in the interim balance sheet, reduced by any capital increases in the prior 24 months, as long as the revenue and labor costs recorded in the fiscal year preceding the merger/demerger are at least equal to 40% of the average of the two previous fiscal years.

Additional depreciation for certain assets (“super depreciation”)

The budget law extends the extra 40% depreciation deduction (i.e. total tax depreciation of up to 140% of the cost) for tangible assets whose depreciation rate for tax purposes exceeds 6.5%. The measure now will be applicable to new assets that are purchased (or leased under a finance lease agreement) by 31 December 2017 (however, real estate assets, pipelines, “rolling stock,” airplanes and—as from 2017—company cars are excluded from the benefit). Assets that are purchased by 30 June 2018 may benefit from the additional depreciation, provided the relevant purchase order is made and at least 20% of the purchase price actually is paid by 31 December 2017.

The extra 40% depreciation deduction also will be extended to apply to new intangible assets (i.e. software, systems, platforms, etc.) related to the technological transformation mentioned below (the “Industry 4.0” plan).

Extra depreciation for certain high-technology assets (“hyper depreciation”)

The budget law introduces an extra 150% depreciation deduction (i.e. total tax depreciation of up to 250% of the cost) for new assets acquired for the technological transformation of enterprises, under an initiative known as the Industry 4.0 plan (relating to plant, equipment and machinery whose operations are digitally controlled and/or operated by smart sensors and drives interconnected with a factory’s computer systems (the law contains a list of qualifying assets)).

This measure is applicable to assets purchased from 1 January 2017 to 31 December 2017 (or 30 June 2018, provided the relevant purchase order is made and at least 20% of the purchase price actually is paid by 31 December 2017).

Book and tax step-ups for assets owned by Italian companies

A new window is opened for Italian companies to “step up” the business assets in their 2016 financial statements for book and tax purposes. The step-up election is available for tangible and intangible assets (except for immovable property held by real estate companies), as well as for qualifying shareholdings, provided such assets were included in the 2015 financial statements.

Companies may choose the categories of assets to be stepped up through the payment of a substitute tax (16% for amortizable/depreciable assets and 12% for

nonamortizable/nondepreciable assets). The substitute tax payment will result in a higher tax basis, allowing:

- Depreciation/amortization at a 27.9% rate, starting from the third year following the year of the step-up (i.e. from 1 January 2019 for calendar-year companies); and
- Lower taxable gains in the case of a disposal of the assets, starting from the fourth year following the year of the step-up (i.e. from 1 January 2020 for calendar-year companies).

The equity reserve created as a consequence of the step-up may be freely distributed, provided a 10% substitute tax is paid.

Italian companies reporting under International Financial Reporting Standards (IFRS) are not eligible to make the election for the step-up.

Step-up of tax basis of Italian participations for nonresident companies

The budget law also opens a new window for nonresident entities to elect to step up the tax basis of participations in unlisted Italian companies held as of 1 January 2017, through the payment of an 8% substitute tax.

The substitute tax is calculated on the value of the participation as of 1 January 2017, which must be certified by a sworn appraisal to be completed by 30 June 2017. The substitute tax may be paid in full by 30 June 2017 or paid in three annual installments starting from the same date (in this case, 3% annual interest is due on the second and third installments).

This provision may be of interest to foreign entities that potentially could realize a capital gain on the disposal of such participations that would be subject to tax in Italy (e.g. if no exemption under an applicable tax treaty would apply).

Tax-simplified transfers of real estate and registered movable property to shareholders

A new window is opened for Italian companies and partnerships to benefit from a tax-simplified method of transferring certain assets (real estate and registered movable property) to their shareholders/partners, in the case of an attribution or disposal or by transformation into a simple partnership by 30 September 2017.

The tax regime will be available for both "dormant" and "nondormant" companies; an 8% substitute tax (10.5% in the case of dormant companies) will be applied to the difference between the cost recognized for tax purposes and the fair market value of the assets.

Any deferred tax reserve eliminated as a result of the relevant transactions will be subject to a 13% substitute tax.

Registration tax, if due on the specific transaction, will be applied at 50% of the normal rates, while mortgage and cadastral taxes will be applied on a lump-sum basis.

R&D tax credit extended/increased

The R&D tax credit is extended through 31 December 2020 and is increased to 50% (previously, it was 25% or 50% depending on the

type of cost) of the annual R&D incremental expenditure (of any type) exceeding the average spending of fiscal years 2012, 2013 and 2014. The annual cap also will be increased to EUR 20 million per year (from EUR 5 million).

As from 1 January 2017, the benefit also may apply to resident companies (and Italian permanent establishments of nonresident companies) that carry out R&D activities through contracts with entities that are resident for tax purposes in EU/European Economic Area (EEA) countries or in other countries and territories that allow an adequate exchange of information with Italy.

“Sabatini-ter”

The budget law extends the “Sabatini-ter,” a provision aimed at facilitating the purchase (or lease) of capital goods by small and medium-sized entities (SMEs) by covering part (i.e. reducing the amount the SMEs must pay) of the interest on bank loans (or leases) between EUR 20,000 and EUR 2 million through 31 December 2018. A specific and more generous measure will apply to the purchase of new assets connected with the Industry 4.0 plan (as described above).

Tax deductions for investments in innovative start-ups and SMEs

The tax deductions introduced in 2012 for individuals or companies investing in innovative start-ups and SMEs (personal income tax deduction of 19% for investments up to EUR 500,000 and corporate income tax deduction of 20% for investments up to EUR 1.8 million) are converted from temporary to permanent incentives and increased to a 30% deduction for both individuals and companies. The investment limit for individuals is increased to EUR 1 million. The benefit is subject to authorization by the European Commission.

Transfer of tax losses of start-up companies

Italian start-up companies will be able to transfer tax losses incurred in the first three fiscal years of activity to their holding company, if the transferee is a company listed on an EU/EEA regulated market or is controlled (directly or indirectly) by a company listed on a EU/EEA regulated market. The transfer will be allowed if the following requirements are met:

- The companies (both the transferor and the transferee must be Italian resident companies that are not part of a tax consolidation) have the same fiscal year;
- At the end of the fiscal year, a minimum 20% participation requirement is met (in terms of both voting rights and distribution rights); and
- The transfer is made before the deadline for filing the annual tax return.

The remuneration paid to the start-up company will not be taxable. The transferee will be able to fully offset its own taxable income with the tax losses received, and the excess may be carried forward. Similar rules to those provided for the transfer of corporate tax credits will be applied.

Substitute tax for individuals transferring tax residence to Italy

The budget law introduces an optional substitute tax on foreign-source income earned by individuals (that were not tax resident in Italy for nine out of the 10 prior years) who transfer their tax residence to Italy. The substitute tax will be equal to EUR 100,000 per year (EUR 25,000 for each additional family member moving to Italy), regardless of the actual amount of the foreign income for the year. Capital gains realized on the sale of qualified participations (i.e. participations exceeding 20% of the voting rights or 25% of the capital or profit rights) during the first five years will not be covered by the substitute tax. The election will have to be authorized by the Italian tax authorities through an advance tax ruling, and will be valid for up to 15 years but may be revoked by the taxpayer at any time.

VAT grouping rules

The budget law introduces, as from 1 January 2018, the option for Italian companies to elect for a European VAT group. If the election is made, all companies included in the group will be treated as a single VAT taxable person, with the following effects:

- Transactions carried out between the companies in the group will not be subject to VAT; and
- Transactions carried out between a group member and a third party will be treated as being made by the group as an entity.

There will need to be financial, economic and organizational links for a company in Italy to make an election for a VAT group:

- There will need to be common control through a direct or indirect participation granting 50% or more of voting rights (financial link);
- All members will have to have the same core business and economic activities or the activities will need to be complementary, ancillary and auxiliary activities with respect to the other group members (economic link); and
- There will have to be coordination between the boards of directors of the entities (organizational link).

If the election is made, all entities meeting the above requirements must be included in the group (all-in/all-out).

Contacts

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