International Tax

Italy Tax Alert

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Major changes made to international tax rules

Contacts

Stefano Schiavello
stschiavello@deloitte.com

Luca Bosco
lubosco@sts.deloitte.it

Italy's government issued a decree on 14 September 2015 ("Growth and Internationalization Decree") that makes a number of changes to tax rules relevant to foreign investors and Italian companies with cross-border operations. These include changes to the measures governing tax rulings, tax havens, the migration of a company's residence, permanent establishments (PEs) and the tax consolidation regime. The decree was published in the official gazette on 22 September, and will enter in force as from 7 October 2015. Most of the new rules will apply as from 2015 for calendar-year taxpayers (and as from the beginning of the year that includes 7 October 2015 for fiscal-year taxpayers), unless otherwise noted below.

The new rules are aimed at making the Italian tax system more attractive and competitive for both foreign investors and Italian companies, by harmonizing domestic rules on cross-border transactions with recent decisions of the Court of Justice of the European Union (CJEU) and international best practices (such as recommendations of the OECD), as well as eliminating distortions and reducing administrative burdens on Italian companies.

The tax changes most relevant for cross-border investment are the following:

Enhancing the use of tax rulings

The decree modifies the existing advance ruling regime and introduces a new form of ruling.

International tax rulings allow companies with cross-border activities in Italy the opportunity to conclude agreements with the Italian tax authorities on certain issues. The scope of these issues has been broadened under the new rules, and now will include the following:

- Transfer pricing;
- Fair market determination of the tax values attributed to a company's assets, in the case of a migration of a company's tax residence (legal seat/registered office) into or out of Italy (which is an expansion under the new rules);
- Allocation of profits/losses to Italian or foreign PEs (which is an expansion under the new rules);

- Preliminary assessment of the existence of an Italian PE of a foreign company; and
- Tax treatment of payments of dividends, interest and royalties.

Under the new rules, it will be possible to conclude retroactive advance pricing agreements (applicable as from the tax year of the initial filing), which is not permitted under the current rules. The new rules will apply from the date provided by an implementation decree, to be issued within 90 days from the entry into force of the decree.

A new form of tax ruling, the "investment tax ruling," will allow companies to request an advance opinion (that will be binding on the Italian tax authorities) on the overall direct and indirect tax treatment of new investments of at least EUR 30 million that will have a "significant and long-term impact on employment" (as provided in the decree) in Italy. An investment tax ruling also may include a preliminary assessment on the applicability of anti-abuse rules in the specific case. The new rules will apply from the date of publication of an implementation decree, which is expected to address certain other issues (e.g. the time period for requesting a ruling) and is to be issued within 70 days from the entry into force of the decree.

Tax treatment of transactions with tax haven jurisdictions

The decree includes rules that revise the anti-avoidance provisions that apply to transactions between Italian companies and entities located in tax havens ("black-list countries"):

- The "white list" of countries that allow an adequate exchange of information, introduced in 2007 but never implemented, is replaced by the black list for purposes of various anti-avoidance rules, including the rules described below.
- The controlled foreign company (CFC) rules are amended to exclude foreign companies in which an Italian entity does not hold a majority participation (i.e. it holds less than 50% of the share capital) from the scope of the CFC rules, and to eliminate the need for a mandatory advance tax ruling (which now will be optional) to obtain an exemption from the CFC rules. Under the new rules, Italian companies also will be able to demonstrate the inapplicability of the CFC rules during a tax audit.
- Dividends distributed by entities located in black-list countries will be subject to full taxation only where the Italian dividend recipient owns a direct interest in the black-list entity or a controlling interest in a white-list entity that receives dividends from a black-list entity (i.e. the scope of the current rule that permits full taxation of, e.g. dividends originating from a black-list entity and received through a noncontrolling interest in a white-list subsidiary will be narrowed).
- In the case of fully taxable dividends from black-list countries, a foreign tax credit will be available for the underlying taxes paid by the black-list subsidiary if the Italian shareholder receiving the dividend (or realizing the capital gain) is able to demonstrate that the foreign controlled entity is carrying on an actual commercial/industrial activity in the black-list country.
- Arm's length costs arising from transactions with entities in black-list jurisdictions will be deductible without the taxpayer having to demonstrate that the black-list company has business substance. The deductibility of costs exceeding the arm's length amount will be allowed only if the

taxpayer can demonstrate that it has an actual economic interest for entering into the transaction and that the transaction actually took place.

Migration of the residence of a company

Under Italy’s exit tax deferral regime, Italian companies that transfer their residence to EU/European Economic Area (EEA) member states can pay the exit tax in installments or benefit from a deferral from capital gains tax on gains that are deemed to be realized upon the transfer.

The exit tax deferral regime, which currently applies only for the direct transfer of a company’s legal seat/registered office to another EU/EEA member state, will be extended to include indirect transfers deriving from mergers, demergers and contributions of a “going concern” within the EU/EEA. The decree confirms (through an official interpretation of the original rules, with retroactive effect from 24 January 2012 (the date the exit tax deferral rules entered into force)) that exit tax deferral also is available for the transfer of a going concern owned by an Italian PE of a foreign entity.

The decree includes new rules for the direct transfer of a foreign company’s legal seat/registered office into Italy. The new rules provide that, regardless of the applicability of exit taxation in the other country, the tax asset basis in Italy will be equal to the arm’s length value (however, different rules apply to entities migrating from black-list countries).

Taxation of PEs

The decree contains rules that will align Italy’s domestic law on the determination of income derived by an Italian PE of a nonresident company with OECD principles. Specifically, new rules will formally implement the OECD “functionally separate entity” approach into Italy’s domestic law for purposes of the corporate income tax and the regional tax on productive activities. Under the new rules, Italian PEs of foreign companies will have to prepare separate financial statements. The Italian tax authorities will issue specific rules for the quantification of the amount of the “endowment fund” for Italian PEs (the equivalent of share capital for a branch).

A new, optional branch exemption regime is introduced for the taxable income of foreign branches of Italian companies. The branch exemption regime, based on similar regimes adopted in other EU member states (such as the Netherlands and the UK) will be an elective alternative to the worldwide taxation principle (tax credit imputation system). Once exercised, the option will be irrevocable and will have to be applied to all foreign PEs of the company (“all in-all out”). For existing foreign branches, the election will have to be exercised by the end of 2017. A specific method of computation is provided for the recapture of net operating losses incurred in the five years before the election. Under the new rules, an Italian company will be able to request a tax ruling on the existence of a foreign PE.

These provisions will apply as from 1 January 2016 for calendar-year taxpayers (and from the year following the year that includes 7 October 2015 for fiscal-year taxpayers).

Tax consolidation regime

The tax consolidation rules are amended to comply with recent decisions of the CJEU relating to tax consolidation rules in EU member states (for prior coverage, see the tax alert dated 12 June 2014). Specifically, the amended rules will allow horizontal consolidation between Italian sister companies with a common parent company established in an EU/EEA member state, even in the absence of an Italian PE of the foreign parent company. Italian PEs of EU/EEA-resident companies also may be included in the tax consolidation.