ITALY

ITALY

INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Recent tax law amendments include, among others:

- corporate income tax rate (IRES) has been set at 24% starting from 1 January 2017 onwards (with a 3.5% surcharge for banks and financial institutions)
- a patent box regime in line with the OECD approach
- new types of rulings, including (i) special rulings for companies with large investments to be realised in Italy (over Euro 30 million) or (ii) rulings in order to have certainty upon the existence of an Italian PE, the profits attributable to such PE and the correctness of the transfer pricing policy of multinational groups
- a revision of the CFC legislation and the abolition of rules on non-deductible costs charged by companies resident in black-listed countries
- a tax exemption regime for income deriving from qualified long-term (5 years) investments made by pension funds into (i) Italian companies or EU/EEA entities with a permanent establishment in Italy or (ii) Italian/EU/EEA investment funds which mainly invest in companies under (i)

In addition, the Italian Budget Law for 2018 (Law. No. 205 of 27 December 2017) provided for some material changes that may have an impact on multinational enterprises. In particular:

- Web tax
- definition of permanent establishment
- interest limitation rule
- VAT group regime
- recharacterization rule for registration tax purposes
- taxation of dividends and capital gains from substantial participations

Web tax – Starting from 2019 a new tax on digital services provided to Italian enterprises and Italian permanent establishments of foreign entities is introduced. Web tax will be levied at a 3% rate on the value of each transaction. It will apply to resident and non-resident digital service providers which in a calendar year carry on more than 3,000 transactions.

Definition of permanent establishment – The domestic definition of permanent establishment (PE) has been amended in line with the OECD's recommendations included in the 2015 Final Report on BEPS Action 7. In particular, the Budget Law: (1) qualifies as PE a significant and continuous economic presence in Italy which does not result in a physical presence; (2) introduces an anti-fragmentation rule; (3) in relation to the list of excluded activities, introduces the condition under which such activities must be of a preparatory or auxiliary nature; (4) extends the definition of agency PE.

Interest limitation rule – The interest limitation rule has been amended in line with Article 4 of the EU Anti-Tax Avoidance Directive (2016/1164). From FY 2017, dividends received from controlled foreign companies are no longer included in the calculation of the EBITDA for interest limitation purposes.

VAT group regime – Italian VAT group regime has been amended to implement the principles of the ECJ Case Skandia (C-7/13). As a consequence, supplies of goods and services carried on between a head office and its branch are relevant for VAT purposes if the head office or the branch are part of an Italian VAT group.

Recharacterization rule for registration tax purposes – According to the new rule, registration tax applies on the intrinsic nature and legal effects of each single deed subject to registration. In this respect, for example, tax authorities may no longer recharacterize a sale of shares (subject to EUR 200 registration tax) as a sale of a business going concern (subject to registration tax at proportional rates).

Taxation of dividends and capital gains from substantial participations – The new rules concerning the taxation of dividends and capital gains from substantial participations provide the following:

- Dividends and capital gains arising from substantial shareholdings (i.e. more than 20% of voting rights or 25% of the paid-in share capital in the company if the company is not listed, and respectively 2% and 5% if the company is listed) held by resident individuals and not connected to a business activity are now subject to a 26% final withholding or substitute tax (previously included in the general taxable base for the 58.14% of their amount and taxed at the ordinary progressive tax rate)
- Capital gains realized on substantial shareholdings held in Italian resident companies by non-resident persons (that do not hold the shares through an Italian PE) are now subject to a final 26% substitute tax (previously 58,14% of the capital gain was subject to the ordinary IRES rate of 24%) - unless a DTT prevents Italy from taxing the gain. As a general rule - unless a more favourable domestic or conventional regime applies - also before these changes non-resident persons were subject to a 26% withholding tax on dividends deriving from substantial shareholdings held in Italian resident companies

This new tax regime applies to dividends paid as of 1 January 2018 and to capital gains realized from January 1st, 2019.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

Italy signed the MLI during the formal signing ceremony on 7 June 2017 but has not ratified the MLI yet. It is worth mentioning that Italy made the reservation provided in Article 35(7)(a) of the MLI according to which the entry into effect of the MLI occurs 30 days after the notification that Italy has completed “its internal procedures for the entry into effect of the provisions of this Convention with respect to that specific Covered Tax Agreement”.

As far as Action Plans 6 is concerned, in the MLI Italy expresses its preference to apply PPT only.

In addition, some recommendations provided by the other BEPS Action Plans have already been introduced into Italian laws, e.g.:

- obligation of the country-by-country reporting for Italian multinationals (over Euro 750 million turnover), and Italian subsidiaries if the controlling company is not subject to the same rule in its country or there is not a treaty allowing exchange of information
- income paid by foreign companies may be taxable as a “dividend” (i.e. substantially exempt) only if it can be demonstrated that the same payment has not been deducted from the taxable income of the foreign company (rule against hybrid mismatches)
- a new anti-abuse rule (GAAR), which unifies the previous anti-avoidance tax law and the jurisprudential concept of the abuse of law, was introduced in August 2015 and is applicable to transactions after 1 October 2015 (and also prior to that date if the assessment is notified after that date). The new rule technically defines the concept of “abuse of law” according to the rules on aggressive planning and is in line also with the concepts described in the EU Parent –Subsidiary Directive. Transactions are deemed to lack economic substance when they involve facts, actions and agreements that cannot generate significant business consequences other than tax advantages. As indicators of lack of economic substance, the GAAR makes

reference to cases where there is an inconsistency between the qualification of the transactions and their legal basis as a whole and where the choice to use certain legal instruments is not consistent with the ordinary market practice. In the presence of proper business purposes (other than of a tax nature), including improving the organisational and managerial structure of the business, taxpayers should be free to pick and choose the transaction which triggers the lowest tax burden possible.

- on 21 February 2018, the Italian Ministry of Finance invited interested parties to provide comments on the discussion drafts related to the implementation of the Italian Transfer Pricing rules. In particular, three documents were released:

  a) a Draft Ministerial Decree providing guidelines for the application of the arm's length principle. It is worth mentioning that the Italian Transfer Pricing rule provided by Article 110(7) of the Italian Tax Code was recently amended by article 59 of the Law Decree n. 50/2017. The new provision basically rephrases the arm's length principle as is contained in article 9 of the OECD Model Tax Convention

  b) a Draft Revenue Agency Regulation implementing the request for unilateral downward Transfer Pricing adjustment (so-called corresponding adjustment). Indeed, according to the recently introduced article 31-quater of Presidential Decree 600/1973, in case of a foreign primary Transfer Pricing adjustment, the Italian Revenue Agency can recognize a downward adjustment not only in execution of a Mutual Agreement Procedure but also upon formal request by the taxpayer

  c) a Draft translation into Italian of the 2017 OECD Transfer Pricing Guidelines

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

A) Share deal

Such transactions concern the transfer of shares or quotas of a company which owns the business the purchaser is interested in. The transaction may concern an existing company or a new company in which the relevant business is first included through an extraordinary transaction (like a spin off or a demerger).

Tax advantages:

- The capital gain realised by the seller can be subject to a reduced income tax burden depending upon the type of seller; in particular it could be beneficial for domestic companies (when the conditions for the participation exemption regime are applicable) and for foreign companies (if a double tax treaty relief for capital gains is applicable)
- In a share deal the tax attributes carried forward (losses, interests paid exceeding limits, tax credits, etc.) stay with the company acquired and can be part of the deal, even if they are subject to certain limitation rules aimed to avoid the "trade" of attributes; please note that if the majority of the shares of a company are transferred and there is a change in the company's activity prior or after such transfer, the prior years' tax losses expire unless certain requisites are met
- A share deal is not subject to indirect taxes, unless the shares of an Italian joint stock company ("società per azioni") are sold, in which case a 0.2% tax (Tobin tax) has to be applied

Tax disadvantages:

- In a share deal all the contingent tax liabilities remain in the company whose shares are sold for the statute of limitations period, i.e. until 31 December of the fifth year following the filing of the tax return for 2016 onwards (for fiscal years until 2015 the reference is to the fourth year subject to a potential extension to eighth year in case of criminal proceedings) and therefore the buyer should in principle seek guaranties of the tax risks

- In a share deal, in principle there is no step up of the value of assets unless certain extraordinary transactions are carried out and/or a specific option is exercised which implies the payment of a substitute tax
- The deal may not include all the assets/liabilities of a company and therefore a preliminary carve out into a specific company may be needed which might have some tax costs. However, the contribution of a going business into a company in exchange for shares is a tax neutral transaction that does not change the tax values of the companies involved, and allows the seller in principle the possibility to apply the participation exemption regime on the subsequent sale of the new shares

B) Asset deal

Such transaction concerns the acquisition of assets or more frequently of a going business previously identified between the parties.

Tax advantages:

- In an asset deal the buyer acquires tax benefits, i.e. it implies a step-up for tax purposes in the depreciable basis of assets transferred corresponding to the purchase price paid allocated to each asset
- In an asset deal the tax attributes (tax losses or unused interest) remain with the selling company and are not transferred to the buyer, and this may represent an advantage for the seller in particular if the conservation of such tax attributes in a share deal is not possible due to the rules on "trade" in tax attributes
- In an asset deal the contingent tax liabilities relating to the assets or the going concern transferred remain as a general rule with the selling company. However, pursuant to Article 14 of Decree no. 472/1997, the buyer of a going concern is jointly and severally liable with the seller for the most recent tax liabilities in an amount not exceeding the value of the assets. A tax certificate stating the amount of tax liabilities attached to the going concern can be requested from the tax authorities and the buyer's liabilities are limited to the amount stated in the certificate. These liability rules do not apply if the asset deal occurs in a pre-bankruptcy regulated procedure

Tax disadvantages:

- In an asset deal the capital gain (loss) realised by the selling company is taxable (deductible) for corporate tax purposes at IRES ordinary rates (in the case of assets owned for more than three years, the gain may be deferred over at most five fiscal years) and is not subject to IRAP if the asset deal consists of a going concern
- When the asset deal is realised through the transfer of a going concern, no VAT is applied and the value of the going concern, net of liabilities, is subject to a registration tax and other ancillary taxes when real estate is present; the transfer taxes are paid usually by the buyer, but both parties are jointly and severally liable for the payment of registration tax (which is generally applied at a 3% rate, except for real estate assets which are mainly subject to 9%)

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

If the target company is subsequently merged with the acquiring company, the possible merger deficit (disavanso di fusione – i.e. the difference between the cost of cancelled shares and the book value of the net assets of the absorbed company) can be used to step up the value of the assets from an accounting point of view. Such step up is not relevant for tax purposes unless the company exercises one of the following options regarding, in full or in part, one or more assets:

a) the absorbing company is entitled to step up the tax value of the tangible and intangible assets received by paying a substitute tax at the rate of 12% on the portion of the step-up in value up to Euro 5 million, 14% on the portion of the step-up from Euro 5 million to Euro 10 million, and 16% on the portion of the step-up in value exceeding Euro 10 million. The option for the step-up can be elected in the tax return of the year in which the merger occurs or in that of the following tax year. The stepped-up tax values are effective starting from the fiscal year in which the option is exercised, subject to a recapture rule if the assets are disposed within the four fiscal years following the one in which the option is exercised

b) according to another specific provision, the step up may affect the tax value of intangible assets (goodwill, trademarks and other intangible assets) and is granted by paying a substitute tax of 16%. This specific regime allows the taxpayer to apply a depreciation period of 5 years for deducting goodwill and trademarks instead of the ordinary 18 years period. The substitute tax must be paid within the deadline for the payment of the IRES due for the fiscal year in which the merger occurs (i.e. the last day of the 6th month of the following fiscal year). The stepped-up tax values are effective starting from the fiscal year in which the substitute tax is paid, subject to a recapture rule if the assets are transferred within the fourth fiscal year following the one in which the option is exercised. The higher depreciation/amortization can be deducted starting from the fiscal year following the one in which the substitute tax is paid

c) in addition, if the absorbing company inherits a participation from the absorbed company and includes it in its consolidated financial statement (CFS), the step up may affect the values of goodwill, trademarks and other intangibles recognized in such CFS and implicitly embedded in the value of that participation. The step up at stake is notional and can be deducted by the absorbing company. This regime can be applied in the same periods and is subject to the same recapture rules already mentioned under (b) but the depreciation/amortization can be deducted starting from the second fiscal year following the one in which the substitute tax is paid

Moreover, given that the same step up regime, as described above under (c), is generally allowed where the qualified participation is acquired for consideration in a share deal, if the Italian acquiring company does not merge the target, but includes it in its consolidated financial statement, the step-up regime can be applied.

5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?

From an accounting viewpoint the goodwill acquired in a transfer of a going concern (asset deal) can be amortized over its useful life, or, if such life cannot be reliably estimated, over at most 10 years. For tax purposes, the goodwill must be amortized over no less than 18 financial years.

In cases where the goodwill has been subject to the optional regimes described in Section 4 and the taxpayer voluntarily pays the 16% substitute tax, the tax depreciation period of the goodwill can be reduced to no less than 5 fiscal years, irrespective of its accounting depreciation.

Please note also that trademarks are treated for tax purposes exactly like goodwill (both in ordinary and special regimes).

6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

According to Article 96 of the Italian tax code, net interest expense (i.e. interest expense less interest income) is deductible up to an amount equal to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) as shown in the profit and loss statement.

Interest expense exceeding the 30% EBITDA threshold is not deductible in the relevant fiscal year, but is carried forward to the following fiscal years (without any time limit) and may be deducted in a subsequent fiscal year if and to the extent 30% of EBITDA is higher than net interest expense in that fiscal year. If 30% of EBITDA exceeds net interest expense, such excess limitation can be carried forward to offset - in the future - excess interest.

In addition, excess interest expense generated by one company in a tax consolidation may be offset against the excess 30 percent of EBITDA of another company of the tax consolidation.

In a merger or a demerger, excess interest carried forward is subject to the same limitations as are imposed on the carrying-forward of tax losses (see Section 9.).

The above is applicable only for corporate income tax (IRES) while for regional income tax (IRAP) interest is fully nondeductible.

The described regime is not applicable to companies operating in the banking and finance industries, for which from 2017 interest is fully deductible for both income taxes (IRES and IRAP). For companies operating in the insurance industry, the Italian tax code allows a deduction of 96% of interest expense accrued both for IRES and IRAP.

7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN DEBT ON ACQUISITIONS?

Acquisitions of shares in an Italian target company are made through the merger of the acquiring new company (Newco) and the target (leveraged buyouts) so that the debt is pushed down into the surviving company and interest expense accrued on that debt is utilized to offset revenues generated by the target.

If, for whatever reason, a merger is not feasible, another option is to consolidate Newco and the target company in a domestic fiscal unity so that the target's tax position can be offset by Newco's tax position.

In the Circular Letter n. 6/E of 30 March 2016 the tax authorities have analyzed various tax issues regarding leverage buy-outs, confirming that:

- in principle such transactions (and the tax deduction for interest paid) cannot be challenged under the "abuse of law" doctrine, except in special cases of artificial structures, such as when the buyout structure is put in place by the same persons who were controlling the target company
- if the funds available for the acquisition of the target have been put at disposal of the Newco by the foreign entities of the group, this has to be considered as an intercompany service and subject to transfer pricing rules
- the tax authorities may recharacterize a shareholder loan as an equity injection according to OECD Guidelines if, on the basis of the specific facts and agreements, the economic substance of the transaction is such that it differs from a loan and is more/very similar to an equity contribution. As a consequence, interest paid on the recharacterized loan would not be deductible, but the loan would be relevant to the calculation of the deemed deduction provided by the ACE tax benefit as described in Section 8

The upstreaming of dividends may be another available strategy for pushing down debts, taking into account that only 5% of a dividend is taxable.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Italy's tax system provides a deduction (so called "ACE") from corporate income tax (IRES) of a deemed interest computed by applying a certain rate to the net equity increases arising after 2010 (equity contributions and undistributed profits less reductions of equity with respect to shareholders).

It is worth mentioning that, under a specific set of anti-abuse rules, the ACE base may be reduced in certain situations that entail the risk of "undue duplication" of the ACE benefits. Such situations are the following:

1. cash contributions between two members of the same group. The ACE base must be reduced at the level of the contributing company for an amount equal to the contribution made

2. acquisition of participations in controlled companies. The ACE base must be reduced at the level of the acquiring company for an amount equal to the price paid
3. acquisition of going concerns from group companies. The ACE base must be reduced at the level of the acquiring company for an amount equal to the price paid
4. increase of intercompany loans to group companies as compared to 2010. The ACE base must be reduced at the level of the lender for an amount equal to the loan granted. In this case, at the time of the loan repayment, the anti-abuse rule is neutralized

However, should such transaction not trigger an "undue duplication" of the ACE benefits, the anti-abuse rule may be made inapplicable by filing a specific request with the Italian tax authorities or flagging a specific box in the tax return.

The rate applied in computing ACE benefit was 1.6% for fiscal year 2017 and 1.5% from 2018 onwards.

Please note that an unused ACE deduction can be carried forward indefinitely or used to offset IRAP tax; unused ACE deduction can be also surrendered to the domestic fiscal unity.

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?

In principle tax losses can be carried forward without any time limit but can be used to offset only 80% of taxable income in any year.

Limitations on the carryforward of tax losses apply when the following conditions are both met:

- a majority of the voting shares in the loss company is transferred, and
- the main activity carried out by the company is changed from the one carried out in the fiscal years when losses were suffered. The change in the activity has to occur in the fiscal year in which the shares are transferred, during the previous two years, or the following two years

Nevertheless, even if the above conditions are met, a company can still carry forward losses if, during the two years before the transfer of shares, it did not reduce employees below 10 units, and it satisfies the "vitality test." "Vitality" is deemed to exist if the company's P&L for the fiscal year preceding the one during which the change of control occurs shows gross receipts (and other proceeds deriving from the main activity) and labour costs (and related social security contributions) in excess of the 40% of the average (same) receipts and costs of the two previous financial years.

In a merger (or demerger), tax losses carried forward by companies involved are available for the absorbing company (i.e., the surviving entity), on the condition that the "vitality test" (see above) is satisfied, and in an amount not exceeding the net equity computed without taking into account any contributions and payments to equity made during the prior 24 months.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

It should be carefully determined which is the applicable statute of limitations since for years through 2015 the period can be doubled if there has been any referral to a public prosecutor (irrespective of the outcome of the criminal proceeding).

If there are tax losses or excess interest to be carried forward, the impact of the rules which may limit the subsequent use of such tax attributes must be evaluated.

Transfer pricing issues must also be considered, since tax audits frequently raise such issues. It should be determined whether the company has proper TP documentation according to Italian TP rules in order to avoid the imposition of penalties in the event of tax assessments.

Finally, the situation of foreign subsidiaries must be monitored since tax authorities may deem in certain situations that such companies are tax resident in Italy and therefore subject to taxation.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

In a share deal, a financial transaction tax at a 0.20% rate applies to transfers of shares of joint stock companies ("società per azioni") having their legal seat in Italy, even if not carried out on financial markets. In addition, the transfer of shares is exempt from VAT and a fixed registration tax of Euro 200 is levied.

In an asset deal, indirect taxes depend upon the type of transaction:

- If a going concern is transferred, no VAT is applicable and a registration tax is applied on the market value of the assets transferred, including goodwill, net of liabilities transferred, as reported in the accounting books of the company. The applicable tax rate depends on the nature of assets transferred. Movable property, goodwill, patents and trademarks, inventory, etc., are taxed at the rate of 3%, while real estate assets are taxed mainly at the rate of 9%
- The transfer of an isolated asset (i.e., not a business as a going concern), by a VAT-taxable person will likely be subject to VAT

For financing acquisitions, any bank loan for a term of more than 18 months that is concluded in Italy is optionally subject to a 0.25% substitute tax (imposta sostitutiva) applied on the amount of the loan. This tax replaces other indirect taxes due on guaranties like mortgages, pledges, etc., related to the bank loan.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

In a share deal, the costs directly related to the participation acquired must be capitalized as an ancillary cost of the participation (and therefore are not tax deductible). If, instead, all or part of the costs are related to the financing received for the acquisition, it is possible to treat such costs as ancillary costs of the financing and deduct them over the term of the financing (subject to the same limitations as the interest paid).

In a leveraged buyout, the costs related to the acquisition (i.e. the management fees and the other fees charged by the Private Equity Fund to the target company) are deductible provided that they comply with the arm's length principle and reflect services actually performed for the benefit of the Italian target company. Therefore, in general the deduction is disallowed when such costs are, de facto, a portion of the costs that the manager should charge to the investors or the other members of the Private Equity Firm as related to services carried out for their benefit.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

In case of a share deal, the treatment of the VAT paid on acquisition costs depends upon the general principles of VAT, i.e. the VAT paid on such service costs must have a direct and immediate link with the output transactions.

According to Article 4 of Italian VAT Law, no VAT can be deducted if the acquiring company is a holding company operating without any direct structure designed to exercise financial activities or other activities of direction, coordination or management of the portfolio companies. If instead the holding company actively participates in the management of its portfolio companies, the link with the VAT output transaction may be found to exist, so that VAT paid may in principle be recovered.

According to the Circular Letter n. 6/2016 the same principles apply in a merger leveraged buy-out, where the VAT recovery is not allowed if the acquisition company is not involved in the management of the target.

In an asset deal, VAT paid on acquisition costs is in principle deductible from VAT due, unless the going concern carries on a VAT exempt activity.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

For foreign shareholders the taxation of profit repatriation and of capital gains on exit are relevant.

Outbound dividends are subject to a final WHT of 26%, except in the following cases:

- zero WHT where the EU Parent-Subsidiary Directive 435/90/CE is applicable
- a 1.375% (reduced to 1.20% for distribution of profits earned from 2017 onwards) WHT on dividends paid to EU companies or to companies of the European Economic Area providing exchange of information, if they are subject to ordinary income tax in their country
- a reduced rate (generally 5% or 10%) may be provided by the applicable tax treaty

Capital gains realized on the sale of substantial participations through 31 December 2018 are subject to IRES at a rate of 24% levied on 58.14% of the capital gain. Starting from 1 January 2019 a final substitute tax of 26% will apply on the whole amount of the capital gain.

On the other hand, capital gains realized on the sale of non-substantial participations are in principle subject to a final substitute tax of 26% on the whole amount of the capital gain. However, capital gains on the disposal of a non-substantial participation is not subject to tax in Italy if one of the following conditions is met:

- the sale concerns “non-qualified” participations held in an Italian listed company; or
- the sale concerns “non-qualified” participations held in an Italian company and the seller is a resident of a whitelisted country

In any case, the capital gain realised by a foreign company upon disposal of a participation in an Italian company is not taxable in Italy if an applicable tax treaty grants the exclusive right to tax the gain to the State of residence of the holding company.

Circular Letter n. 6/2016 clarified that the application of the above rules on dividends and capital gains should be carefully monitored if the foreign company does not have sufficient substance or is a conduit (as better described in Section 20).

Moreover, reduced treaty rates apply to the payment of dividends/interests/royalties by Italian companies to a foreign holding/finance company only if the foreign company is the beneficial owner of the payments.

15. CAN THE GROUP REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL MANNER THROUGH MERGERS OR A TAX GROUPING?

Italian law provides for a tax-neutral regime applicable to some qualifying corporate restructurings, such as mergers, de-mergers, contributions-in-kind and exchanges of shares. Under this tax-neutral regime, capital gains taxation is deferred and the acquiring entities receive a carryover basis in the assets acquired.

In transactions which allow the transfer of tax attributes (like mergers and de-mergers), particular attention has to be paid to the limitation rules (described in Section 9) which apply to tax losses and excess interest carried forward.

The main caveat in tax-neutral restructurings is the new rule regarding “abuse of law” (Article 10-bis of Law n. 212/2000) which is applicable to transactions lacking economic substance which realise undue tax benefits and consequently can be disallowed by the tax administration.

Taxpayers may request a ruling to determine whether a planned transaction may constitute abuse of law. No criminal charges would be imposed on the "abuse of law" behaviour.

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

In a share deal it must be taken into account that the favourable participation exemption regime for the selling company (see Section 20) does not apply to the transfer of shares in real estate companies (so these capital gains are subject to corporate income tax at the ordinary rate).

A real estate company is defined as a company whose assets have mainly consisted of real estate at any time during the last three fiscal years before the shares are sold. Properties used in a commercial activity are not deemed to be real estate assets for capital gain purposes.

In an asset deal, the sale of commercial real estate by a VAT taxpayer is VAT exempt or, at the option of the seller, is subject to ordinary VAT with the reverse charge system; in any event, a 3% cadastral tax and a 1% mortgage tax are due (reduced by half if a real estate fund is part of the transaction).

In case of a sale by a non-VAT taxpayer, the sale is subject to registration tax at a 9% rate in the case of a commercial building and 12% in the case of agricultural land (cadastral and mortgage tax are applied in a fixed amount of Euro 200 each).

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

The Italian tax consolidation regime provides for the determination of a single taxable basis, which is the sum of the taxable bases of the group entities, taken into consideration at their full amount, irrespective of the percentage of participation held by the consolidating company. As a consequence, taxable profits and losses realized by each company during the period of tax consolidation are offset. Conversely, tax losses suffered by each company before entering the domestic tax consolidation can be utilized only by the company that incurred them.

Other benefits of the regime are that (i) certain tax attributes (such as ACE and excess interest limitation) not used by the company creating them can be surrendered to the fiscal unity and (ii) the tax loss carryforward rules do not apply in mergers between consolidated entities.

If a company is owned by other companies with shareholdings ranging between 10% and 50%, a fiscal transparency regime can be elected so that the owned entity is not taxed for IRES purposes and its income /loss is transferred proportionally to the shareholders.

All the above regimes apply only for purposes of the corporate income tax (IRES), whereas local income tax (IRAP) remains applicable on a stand-alone basis.

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

The Italian Budget 2015 introduced an optional patent box regime, which grants a 50% exemption to income derived from the exploitation or the direct use of a qualifying IP both for corporate income tax (IRES) and local tax purposes (IRAP). In addition, the regime grants a 100% exemption on capital gains arising from the sale of qualifying IP under certain conditions.

The main aspects of the new patent box include the following.

- **Elective:** The Italian patent box regime is elective. The election is irrevocable and lasts for five years

- **Qualifying taxpayer:** Both resident entities and permanent establishments of non-resident entities may opt for the regime (in the case of a non-resident, only if it is are resident in a country that has a bilateral tax treaty with Italy and if the exchange of information between Italy and its country of residence is effective)
- **Qualifying IP:** The regime covers patents, know-how and other intellectual property subject to legal protection. The qualifying IP may be either self-developed or acquired. The regime applies if the taxpayer performs R&D activities to maintain/develop the qualifying IP. The taxpayer may perform R&D activities by itself or it may outsource them to third parties. Beginning in 2017, trademarks are excluded from the patent box regime
- **Income exemption:** The regime grants a 50% exemption of income derived from the exploitation or the direct use of qualifying IP, both for corporate income tax (IRES) and local tax purposes (IRAP). If the qualifying IP is directly used by the taxpayer, an advance ruling with the Italian tax authorities is required to determine the income allocable to the qualifying IP. "Directly used" means that the taxpayer uses the qualifying IP itself, without licensing it to other entities
- **Capital gain exemption:** Capital gains arising from the sale of qualifying IP will be totally exempted if at least 90% of the sale's consideration is reinvested, within the following two fiscal years, in the maintenance or development of other qualifying IP. The qualifying IP, as stated above, may be either self-developed or acquired
- **OECD "nexus approach":** The regime is in line with the OECD "nexus approach." The regime only applies to the amount of income derived from the qualifying IP, which is determined by applying the ratio of (1) R&D expenditures incurred by the taxpayer for maintaining/developing the IP, increased by part of the costs of the acquisition of the IP, if any, to (2) the total cost of producing that IP.

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

The transfer of the ownership of intangibles gives rise to a capital gain (loss) that is taxable (deductible) for income tax purposes. In addition, if the intangible is transferred to an affiliated company, the transfer should be at arm's length.

SELL-SIDE

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

Italian companies are entitled to a 95% participation exemption (i.e. only 5% of the capital gain on the disposal of shares in another company is subject to IRES at the rate of 24%) if the following requirements are met:

- **a)** the shareholding has been held at least since the first day of the 12th month prior to the disposal
- **b)** the shares were booked by the seller as a long-term investment (fixed financial asset) in the first balance sheet of its holding period (no minimum percentage is required)
- **c)** the owned company is not resident in a tax haven
- **d)** the owned company is carrying on a real business activity (e.g. other than real estate companies or intangible portfolio companies)

The requisites under c) and d) must be fulfilled throughout the three fiscal years prior to the sale.

If the requirements of the participation exemption are not satisfied, the capital gain is fully subject to IRES tax in the same year or, if the shares were booked as fixed financial assets in the last three financial years, over a period up to five years.

Capital gains are not subject to local income tax IRAP.

As described in Section 1, for individuals resident in Italy, beginning 1 January 2019, capital gains arising from substantial participations that are not connected to a business activity will be subject to a 26% substitute tax. Prior to that date, 58.14% of such gains are included in the general taxable base and taxed at the ordinary progressive tax rate). Capital gains on "non-qualified" participations are subject to a 26% substitute tax.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS ARE REINVESTED?

For companies, there is no specific fiscal advantage if the proceeds from the sale of shares are reinvested.

For individuals, non-profit entities and non-resident taxable persons Article 68(6-bis)(6-ter) provides exemption of the capital gains realized upon the disposal of both qualifying and non-qualifying participations in stock companies and partnerships, provided that:

- the owned entity has been set up for no more than seven years
- the shares sold were held for at least three years
- the capital gains realised are reinvested in another Italian resident company or partnership operating in the same business sector and incorporated within the previous three years. The new investment must be made through the subscription or acquisition of the capital of such companies and within two years from the disposal of the participations previously held

However, the amount of the exempt capital gain cannot, in any case, exceed five times the costs incurred by the issuing company during the five years preceding the disposal, for the purchase or the production of depreciable assets (intangible or tangible, excluding real estate properties) or for research and development activities.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

Although no specific substance requirements are provided by law, great attention is paid by the tax authorities to the real substance of foreign holding companies and in some cases to the application of the tax presumptions by which a foreign company may be deemed to be tax resident in Italy.

In Circular Letter n. 6/2016 the Italian tax authorities clarified that they may apply full domestic WHT on dividends or disallow the tax treaty exemption on capital gains if foreign intermediate holding companies have:

- a light organisational structure, do not perform a real activity and do not have any decisional autonomy from a substantial view point; or
- a conduit financial structure regarding the transaction, in which a substantial correspondence between what is cashed in and out of the company is arranged

Finally, please note that in certain cases foreign companies may be deemed to be tax resident in Italy. There is a rebuttable presumption according to which a foreign company is deemed to be tax resident in Italy if (i) the foreign company directly controls an Italian resident company and (ii) the foreign company is directly or indirectly controlled by Italian residents or its Board of Directors consists mainly of Italian resident individuals.

23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

The seller may need to carve out the business to be sold into a specific Newco and then sell the shares of such Newco.

This can be done through the contribution of an active business to a Newco in exchange for Newco's shares.

Although the transaction may evidence an accounting step up of the values of the assets contributed, the tax regime remains fully neutral since:

- for the receiving company the tax cost of the assets received is the same as for the contributing company
- for the contributing company the tax cost of the Newco shares received is equal to the original tax cost of the net assets contributed

The receiving company may optionally step up the assets for tax purposes by applying the substitute tax provided by the optional regimes described in Section 4.

The contributing company may subsequently benefit from the 95% participation exemption on a sale of the Newco shares to a third party even before the one-year minimum holding period has passed, if the going concern was held for that period. The contribution in kind followed by the sale of Newco shares is explicitly ruled by the law as a non-abusive practice for income tax purposes.

From an indirect tax point of view the contribution in kind in exchange for shares is subject to a fixed amount (Euro 200) for registration tax purposes (and for cadastral/mortgage tax purposes if building are involved). If the sale of the shares occurs immediately after the contribution, the tax authorities often try to recharacterize the transaction as a sale of a going business in order to apply proportional taxes. However, as described in Section 1, according to the new article 20 of the Registration tax code, Italian tax authorities should not recharacterize a sale of shares as a sale of a going concern.

With respect to mergers and de-mergers, please note that they are fully neutral both for income tax and for indirect taxes.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

With respect to stock grants offered to all or certain categories of employees, there is a limited exemption up to an annual value of Euro 2.065,83 and a holding period of three years. As regards stock option plans, there is an exemption from social contribution but the benefit for the employee remains fully subject to ordinary personal taxation.

Decree Law n. 50/2017, contains new rules on "carried interests" earned by employees or directors of companies or funds. Income derived from shares, quotas or other financial instruments will be taxed as dividends or capital gains and therefore will not be taxable as income from employment if the following conditions are met:

- the total investment of employees and directors should at least be 1% of the total investment of the fund or of the equity of the company
- the profits participation is subordinated to the repayment to other shareholders of the invested capital (plus a certain hurdle rate); the same applies in case of sale of the securities
- shares, quotas of financial instruments must be held for at least 5 years unless a change of control occurs

The above rules apply to companies or funds located in Italy or in other States or territories which allow adequate exchange of information.

The new rule is applied to "carried interests" received after 24 April 2017 even if accrued in previous years.

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