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EU Anti-Tax-Avoidance Directives

On 28 November 2018, the Italian Government approved Legislative Decree n. 142 for the implementation of EU Anti-Tax-Avoidance Directive no. 1164/2016 (ATAD1) as amended by Directive 2017/952 ("ATAD2"), published in the Italian Official Gazette.

The new legislation provides material changes relating to:

- interest limitation rules;
- controlled foreign company (CFC) rules;
- taxation of foreign dividends and capital gains;
- exit taxation rules; and
- hybrid mismatches.

The new rules will enter into force starting from FY 2019 for calendar-year companies. Provisions on hybrid mismatches will enter into force starting from 2020 and 2022.

Interest limitation rules

The Legislative Decree has replaced article 96 of the Italian consolidating act on income tax (TUIR) regarding interest expense

deduction rules. In particular, interest expenses can be deducted for an amount corresponding to the total of annual interest income plus any excess interest income from prior fiscal years, with any excess being deductible within the limit of 30% of the current FY EBITDA plus any 30% EBITDA carried forward from previous FYs. Qualifying EBITDA is no longer based on accounting figures as it should now be computed on the basis of corporate income tax relevant values.

CFC Rules

The Legislative Decree has modified the regime regarding controlled foreign companies ("CFC") pursuant to article 167 of TUIR regarding the conditions necessary for the application of the regime. In particular:

- **control requirement:** it is not only determined by the voting rights or influence over the subsidiary, but also takes into account the (direct or indirect) participation in the foreign subsidiary profits;
- **subjective requirement:** the application of the CFC regime has also been extended to the Italian permanent establishments of non-resident entities that control foreign entities that may be qualified as CFCs;
- **application of the CFC provision:** the CFC rules are revised to eliminate the difference between "white listed" and "black listed" controlled companies. A controlled company is a CFC if both following conditions are met: (i) the foreign entity's effective tax rate is lower than 50% of the effective tax rate that would have been applicable in Italy should the foreign entity be tax-resident in Italy; and (ii) the proceeds received by the foreign entity are originated for more than 1/3 from passive income sources (interest, dividend, royalties, capital gains) plus financial lease income, assurance, bank and other financial activities,

income from sale of goods and provision of low-value services to related parties.

- **Safe harbour:** the CFC does not apply if the resident controlling entity demonstrates, by filing a specific request for ruling, that the controlled foreign entity “carries out an effective economic activity, through the use of personnel, equipment, assets and premises”.

Dividends and capital gains related to non-resident holdings

The Legislative Decree has changed the rules on dividends arising from a low-tax jurisdiction, introducing article 47-bis in TUIR, which defines the criteria for the identification of Countries with privileged tax regimes.

Two different criteria apply depending on whether the Italian shareholder controls the non-resident entity. In particular, a foreign regime is deemed to be a low-tax regime if:

- controlled entities: the foreign entity’s effective tax rate is less than 50% of the Italian rate;
- non-controlled entities: the nominal foreign tax rate (as established by also taking into account special tax regimes) is lower than 50% of the nominal Italian tax rate.

The concept of “control” for these purposes is the same concept as extended by the Legislative decree in relation to the CFC rules.

Exit Taxation

According to article 166 of TUIR related to exit taxation rules, Italy exercises its power of taxation on unrealized capital gains, as well as untaxed reserves, when a taxpayer moves assets or its tax residence out of the tax jurisdiction of the State.

The Legislative Decree has introduced some changes to the exit tax rules, in particular:

- the introduction of “market value”: for the purposes of determining the taxable capital gain, the Legislative Decree has substituted the concept of “normal value” with “market value” as used in transfer pricing regulations;
- the decrease of the number of instalments: from 6 to 5 in case of instalment payment of the tax due on such capital gains and the elimination of the possibility of suspending the payment of the exit tax;
- the extension of the application of the exit tax to transfers of assets to permanent establishment entities, for which it has been exercised the option for the Branch Exemption.

Hybrid Mismatches

The Legislative Decree has introduced new rules aimed at contrasting “double deduction” and “deduction without inclusion” derived from conflicts in the qualification of certain arrangements or transactions between one or more tax jurisdictions.

The Legislative Decree addresses the following situations:

- hybrid mismatches leading to a double deduction (“Double Deduction”) or a deduction of a payment without a corresponding inclusion (“Deduction/Non-Inclusion”);
- reverse-hybrid mismatches, that include cases where there is a different tax treatment of an entity treated as tax transparent in Italy and as a separate “opaque” entity by the foreign jurisdiction where the shareholders are located;
- dual-resident entities mismatches, that include cases where the jurisdictions involved have different definitions of tax residence relating to the same entity

and essentially has introduced the following:

- in case the Italian entity is the recipient and the payment is deducted by the paying entity, deduction is not allowed;
- in case the Italian entity is the payer, the deduction is not allowed unless the tax inclusion of the payment in the other relevant jurisdiction is proved.
- The hybrid mismatch and tax residence mismatch rules will apply from 1 January 2020, while the reverse hybrid rules will apply from 1 January 2022.

2019 Italian Budget Law

On December 29, 2018 the Italian Parliament approved Law no. 145 of December 30, 2018 (the so called "2019 Italian Budget Law"), published in the Italian Official Gazette, which provides, inter alia, the following tax provisions on international tax law that may be of interest to multinationals with Italian operations.

Research & development tax credit

2019 Budget law has introduced several amendments to the tax credit regime for research and development activities.

Starting from fiscal year 2019, the new R&D tax credit regime provides two tax credit percentages: (i) generally, the tax credit amount has been reduced from 50% to 25%; (ii) while the tax credit amount at 50% applies only to qualifying R&D costs and in particular to a) expenses related to employees, directly hired in research and development activities, b) expenses related to contracts signed with universities and research organizations, as well as with independent innovative start-ups and Small and Medium Enterprises (SMEs) for the direct performance of R&D activities.

The maximum annual R&D tax credit has been reduced from Euro 20,000,000 to Euro 10,000,000.

Moreover, 2019 Budget Law has extended the scope of qualifying R&D expenditure, including the cost of material and supplies used for R&D activities; it also introduces the obligation, starting from FY 2019, to prepare a

technical report illustrating the R&D projects.

New Tax on Digital Services

2019 Budget Law has introduced a new version of the web tax (the so-called Italian Digital Services Tax).

This new tax is applied to entities (both individuals and enterprises, either resident or non-resident in Italy) carrying out commercial activities, who, during the fiscal year, individually or at group level jointly realize: (i) total revenues not lower than Euro 750,000,000; and (ii) revenues derived exclusively from digital services not lower than Euro 5,500,000.

The Italian Digital Services Tax should be paid quarterly and applies at a 3% rate on the relevant revenue deriving from the following digital services:

- advertising on a digital interface targeted to users of the same interface;
- digital multilateral interface aimed at allowing users to interact (also in order to facilitate the direct exchange of goods and services);
- Transmission of data collected from users and generated by the use of a digital interface.

It is expected that the government will issue an implementing decree for the Tax on Digital Services by 30 April 2019, and that these rules would be effective 60 days after publication (perhaps effective from 30 June 2019).

Step up regime for unlisted shares

2019 Budget Law gives the opportunity for resident individuals and non-resident entities, with no permanent establishment in Italy, to elect for an optional step-up of the tax cost of shares (both qualifying or non-qualifying) in unlisted entities, held as of 1 January 2019 through the payment of a substitute tax on the value of the participations, certified by a sworn appraisal prepared no later than 30 June 2019.

The substitute tax is applied at the following percentage:

- 11% in case of qualifying shares;
- 10% in case of non-qualifying shares

The substitute tax may be either paid in full by 30 June 2019 or through three annual instalments starting from 30 June 2019.

This regime could be convenient for non-residents (without a permanent establishment in Italy) who sell shares in unlisted Italian companies and cannot benefit from double tax treaty.

Venture Capital

The 2019 Italian Budget Law introduces new rules about Venture Capital Funds ("VFC"). In particular:

1. Tax benefit

As a general rule, the tax regime of investment funds, other than real-estate funds, established in Italy and of those based in Luxembourg, already authorized for placement in Italy, provides:

- the exemption from income tax of the VFC, pursuant to article 73,

- paragraph 5-quinquies of TUIR; and
- the taxation, in the hands of the investors of the fund, of the proceed distributed by the investment fund.

However, article 31 of Legislative Decree n. 98 of 7 July 2011, introduced a tax benefit for the fund's holders, providing the exclusion from taxation of proceeds distributed by VFC.

2. Definition of venture capital

2019 Italian Budget law introduced a new definition of venture capital. In particular, according to new rules, VFC is a CIU or a SICAF, resident in Italy for tax purposes or in a UE/EEA country, included in the list of Ministerial Decree dated 4 September 1996, that invests at least:

- 85% of the value of assets in Small and Medium size Enterprises (hereinafter "SMEs"), not listed on regulated markets in the following phases (i) financing);

- (iii) start-up of the activity (early-stage financing) or product experimentation (seed financing); (ii) establishment (start up development (expansion or scale up financing);
- remaining 15% in SMEs, as regulated and defined by article 1, paragraph 1, letter w-quater 1) of Legislative Decree 58 of February 24, 1998.

Compared to the previous regime, the business activity of the investor company must be carried the business activity by less than 7 years.

Flash News

Special tax regime for inbound

Legislative Decree n° 147/2015 introduced the special tax regime for inbound whose practical details are included into Circular letter n° 17 released by Tax Authorities on 23 May 2017. During 2018 and the first months of 2019, Tax Authorities released several Official Clarifications to appeals filed by individuals and companies, clarifying each peculiar situation and further detailing how individuals should apply the special tax regime.

For more information and details please [visit our website](#) or make reference to the Chapter on Employment income of the closely to-be-released *Manuale di Fiscalità Internazionale*, published by IPSOA.



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We will be pleased to discuss with you the particular application of the changes to your own circumstances. To this end please contact Alessandro Dragonetti or Gabriele Labombarda at their e-mail address below:
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