

BASE ASPECTS OF THE ITALIAN CORPORATE TAX ENVIRONMENT

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Italian legal environment for business at a glance

- ▶ Italy is a parliamentary democracy, member of the European Union (EU) and of the OECD.
- ▶ Civil Law country (Civil Code, also regulating companies)
- ▶ Public Business Register (corporate details and annual financial statements)
- ▶ Annual Statutory accounts approved and filed within 4 months (extension to 6 months allowed if certain conditions are met)
- ▶ Accounting principles: ITA Gaap (OIC) and IFRS

Italian Corporate tax environment at a glance

- Corporate income taxes on business income: Ires: 24%; Irap: 3,9%/6,97%

However, it is possible to progressively reduce the Ires tax rate based on the reinvestment of profits.

In fact, a portion of taxable income equal to the amount of net profit destined to reserve (or equal to the net equity increase from 2018, whichever is lower) can be subjected to a progressively lower Ires rate.

In particular, for IRES purposes the eligible portion of taxable income can be subjected to the following lower rates:

22,5% for 2019;

21,5% for 2020;

21% for 2021;

20,5% for 2022;

20% starting from 2023, when fully operational.

Italian Corporate tax environment at a glance

- Optional income tax consolidation (Ires)
- Participation exemption regime (Ires): 95% exemptions on dividend and capital gain from sale of participations (also applicable to holding companies)
- Ires losses can be carried forward without any time limits
- Fiscal year: calendar year or any other closing date
- 3 degrees of Tax Courts

Italian Corporate tax environment at a glance

- ▶ - Vat: ordinary rate is 22% although 10% and 4% may apply to some types of transactions. Exports and intra-EU transactions are zero-rated.
- ▶ - Non-EU resident companies may apply for VAT registration in Italy. In this case, a local Vat representative and compliance to Vat obligations are required.
- Vat consolidation/Vat group
- National e-invoicing system
- Electronic tax payments system

Italian Corporate tax environment at a glance

- Withholding tax system (regarding various types of income flows)
- Cash flow impact from W/T in case of domestic transactions
- P/L impact from W/T in case of non-Italian beneficiary (except use of DTT and/or foreign tax credit)
- Domestic withholding taxes applicable to outbound flows of income to a non-EU beneficiary (in the absence of DTT):
 - (i) dividend: 26% (up to 11/26 of W/T is refundable, based on taxes paid on dividend by the beneficiary)
 - (ii) interest: 26% (NB: interest on cash pool is excluded from W/T)
 - (iii) royalties: 22,5%

Italian Corporate tax environment at a glance

- EU Directives, e.g.:
 - parent/subsidiary Directive (exemption from W/T on dividend)
 - Interest & Royalties (exemption from relative W/T)
 - VAT
- World wide taxation principle: resident companies are taxed on worldwide income, non-resident companies are taxed only on Italian sourced-income
- Wide range of Double Tax Treaties in force (currently around 100)
(Italy/Kenya DTT: signed but not yet entered into force)
- Country-by-Country reporting obligations
- Consistency with OECD principles and guidelines (TP/PE)

Italian Corporate tax environment at a glance

- ▶ *Transfer pricing regulations*
- ▶ Italy's domestic regulations on transfer pricing are substantially in line with OECD guidelines.
- ▶ Transfer pricing documentation (so-called "Country file") can be prepared in order to avoid penalties ("penalty protection" optional regime) in case of tax assessment by tax authorities on transfer pricing matters. The availability of the Country file must be declared in advance to tax authorities in the annual Ires return.

USUAL VEHICLES USED FOR MAKING BUSINESS IN ITALY

- S.P.A. (joint stock Company)
S.R.L. (limited Liability Company)
BRANCH (secondary office of non-Italian legal entity)

| | S.P.A. | S.R.L. | Branch |
|-----------------------------|--|--|--------------|
| Minimun Share capital | € 50.000 | € 10.000 | Not required |
| Board of Statutory Auditors | 3 effective + 2 alternate members required | min.1 member required when exceeding 1 of alternative thresholds (*) | Not required |
| Financial Audit | required | required when exceeding 1 of alternative thresholds (*) | Not required |

- ▶ (*) Alternative thresholds (for 2 consecutive years):
 - ▶ Total assets: euro 2 million
 - ▶ Sales: euro 2 million
 - ▶ Average number of employees: 10
- ▶ Usual time required for setting-up either a legal entity or a branch: a few days (once all legal papers are ready)
- ▶ Involvement of a notary public required

Main tax incentives to corporate investments

- ▶ Increased tax depreciation
- ▶ R&D Tax credit
- ▶ Patent box regime

Increased tax depreciation

- ▶ (i) Super-depreciation
- ▶ This incentive allows Ires deduction of:
 - ▶ 130% (i.e. increase of 30%) of acquisition cost of new tangible fixed assets, with a cap of EURO 2.5 million (in aggregate), made until 31 December 2019 (*).
 - ▶ The investment in new tangible fixed assets can also be completed by June 30, 2020, provided that by December 31, 2019 the relevant order is accepted by the seller and down payments for at least 20% of the acquisition cost are made.
 - ▶ 140% (i.e. increase of 40%) of the acquisition cost of certain intangible fixed assets for the use of the technological equipment purchased, benefiting from the hyper-depreciation (see below). The intangible asset does not need to be specifically linked to the tangible fixed asset benefiting from the hyper-depreciation.
- ▶ (*) the above investment deadlines could however be prolonged by the Government.

Increased tax depreciation

- ▶ (ii) Hyper-depreciation (alternative to Super-depreciation)
- ▶ Also this incentive allows Ires deduction of more than 100% of acquisition cost of certain new digital fixed assets, i.e. allows Ires deduction as follows:
 - ▶ 270% for investments up to 2.5 million euro;
 - ▶ 200% for investments from 2.5 million euro to 10 million euro;
 - ▶ 150% for investments from 10 million up to 20 million euro.
- ▶ The investment in new digital fixed assets has to be made in 2019, or by December 31, 2020 provided that by December 31, 2019 the relevant order is accepted by the seller and down payments for at least 20% of the acquisition cost are made (these investment deadlines could however be prolonged by the Government).
- ▶ One of the key requirements to benefit from hyper-depreciation is that the purchased fixed asset is interconnected with the company's production management system or supply network.

R&D Tax credit

- ▶ All Italian companies or companies resident abroad having a permanent organization in Italy that carry out Research and Development activities (either on their own or in outsourcing) can benefit from an R&D tax credit.
- ▶ R&D expenses related to fundamental research, industrial research and experimental development are all eligible.
- ▶ The tax credit is equal to 50% or 25% of the incremental expenses in Research and Development, with an annual cap of € 10 million / year per beneficiary.
- ▶ Expenses are defined as incremental as are eligible those in excess of the average of R&D expenses incurred in 2012-2014 or, if the company was set up after those years, compared to the average of the previous 3 years or compared to the date of incorporation.

R&D Tax credit

- ▶ The eligible R&D expenses (by nature) and related tax credit are the following:
 - labor cost relative to employees, even for a fixed term, employed directly in R&D: 50%
 - free lance costs directly involved in R&D: 25%
 - amortization of laboratory instruments and equipment:25%
 - expenses for research contracts stipulated with universities, research institutes and similar bodies, innovative start-ups and innovative SMEs (except companies of the same group): 50%
 - expenses for research contracts with other companies (except companies of the same group): 25%
 - technical and private industrial skills materials, supplies, other similar products directly used in R&D: 25%

R&D Tax credit

Audited accounting documentation and a technical report are required.

The R&D tax credit can be used, even in the event of losses, to offset a wide range of taxes and contributions, after indicating the R&D expenses incurred in the tax return.

The R&D tax credit is currently applicable for expenses in Research and Development incurred up to 2020.

The R&D tax credit can be combined with, super-depreciation, hyper-depreciation and patent Box regime.

Patent box regime

Italian legal entities (as well as branches of foreign companies resident in countries covered by DTT) may apply for an optional intellectual property patent box regime.

This regime provides for a 50% income tax exemption (for both Ires and Irap purposes) of income deriving from indirect (i.e. licensing) or direct exploitation of qualifying IP (excluding trademarks).

The election for the regime is irrevocable for 5 years and could be made with reference to single IP assets.

Qualifying IP:

- ▶ -Copyright-protected software
- ▶ -Industrial patents
- ▶ -Drawings and templates
- ▶ -Secret formula processes and information relating to experiences acquired in commercial or scientific industrial fields that are legally protectable (know-how)

Patent box regime

The "Nexus approach"

- ▶ In compliance with the OECD principle of "Nexus approach", in order to benefit from this incentive it is required to:
 - ▶ -own the right to the economic exploitation of the intangible asset, and to
 - ▶ -carry out research and development activities.
- ▶ In other words, there must be a "link" between research and development activities, intangible assets and the eligible income referable to them.

Patent box regime

For the purposes of Irpef/Irap computation, a decreasing adjustment of taxable base has to be made, for which computation it is required to:

- ▶ 1. identify the amount of income deriving from the direct or indirect use of the intangible asset
- ▶ 2. calculate the "nexus ratio", given by the ratio between:
 - research and development costs incurred to maintain (or increase) the value of the eligible IP
 - total costs incurred for the acquisition/creation and maintenance of the intangible asset
- ▶ 3. multiply the nexus ratio with total income deriving from the direct or indirect use of the intangible asset, the result of which is the portion of income eligible to 50% exemption

Patent box regime

- ▶ 1. Identification of notional income (“economic contribution”) deriving from the direct use of the intangible asset

In determining the methods and criteria for “abstracting” (from the total business income) the notional income deriving from the direct use of the single intangible asset, it is required that reference should be made to the relevant international standards developed by the OECD, with particular reference to the guidelines on transfer pricing.

In particular, this notional income (or loss) is the result of the “virtual P/L” referable to the intangible asset, which takes into account:

- ▶ -as notional revenues, the “implied royalty” on the intangible asset incorporated in the sale price of the product or service sold and,
- ▶ -as costs, all the direct and indirect costs relating to the activities connected with the creation, development, maintenance and / or improvement of the intangible asset.

Patent box regime

In consistency with OECD TP Guidelines, the transfer pricing method to be applied in evaluations involving the transfer or use of intangible assets is the Comparable Uncontrolled Price (CUP) method (and sometimes the Profit Split Method).

In essence, for the computation of notional revenue reference should be made to the revenues that would be potentially achievable if the intangibles were used on the market, under the same conditions of use, by independent third parties.

Patent box regime

- ▶ 2. Identification of income deriving from the indirect use of the intangible asset
- ▶ Income deriving from licensing of the intangible asset is determined by the relative license fees, less direct and indirect costs

Patent box regime

- ▶ In order to agree on the income deriving from the intangible assets, a ruling procedure with the Italian Tax Agency is normally required.
- ▶ However, taxpayers may alternatively determine the eligible income by indicating relative computation criteria in appropriate documentation. In such a case, the income tax base decreasing adjustments will have to be split into three annual equal instalments (i.e. in the IRES and IRAP returns for the tax period in which the PB option is exercised and in the two subsequent tax periods).
- ▶ As long as the economic exploitation of the intangible asset may generate a tax loss, it is possible to defer the positive effects of the regime until the same asset will be productive of income