TAX LAW MATERIALS

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A. INTRODUCTION TO TAX LAW

"Taxes are the price we pay for civilization" (O.W. Holmes). Taxes are the main instrument through which Governments raise the funds that are necessary to support public activities. Through taxes the Governments apportion public expenses among subjects who bear a reasonable economic allegiance with the territory of the State, due to a subjective (residence, citizenship) or objective (place where the taxable event takes place) link. The power to tax is therefore an essential feature of sovereignty. In time, this power has been restricted in different ways.

1. Rule of Law

The first limitation is a procedural one (it relates to the procedure to be followed to introduce and regulate taxes): **the rule of law**. Taxes can be imposed, administered and enforced only under the authority of a law, *i.e.* under the authority of an act of the Parliament, or of an act of the Government with which the Parliament concurs, in advance (through delegation) or subsequently (through ratification). As the Parliament is the place where the representatives of the citizens sit, the rule of law reflects the principle of "**no taxation without representation**". In the Italian Constitution it is laid down in Art. 23.

It is generally accepted that the rule of law does not require that all aspects of a tax be regulated by law. In order to comply with the rule of law, it is sufficient for the tax to have a basis in the law, meaning that it is sufficient for the law to identify (or to allow to identify) **the essential elements of the tax**, such as the taxpayers, the taxable event, the tax base and the tax rate.

2. Ability to pay

The second limitation has a substantive nature (it relates to the content of the tax provisions): **the ability to pay**. This principle represents the criterion to be followed by the Parliament in the apportionment of public expenses among taxpayers. According to it, the taxpayer's fiscal position should not reflect the benefits which he/she obtains from such expenses (benefit principle). It should reflect his/her economic capacity to contribute to them. In the Italian Constitution the principle is laid down in Art. 53.

It is widely recognized that the ability to pay principle applies **the principle of equality** to the field of taxation: for the purposes of taxation two persons are equal, and should therefore be treated equally, if they show the same ability to pay. The ability to pay is:

- the prerequisite of taxation, being that if no ability to pay exists no taxation is allowed;
- the parameter of taxation, being that the level of taxation depends on the level of ability to pay;
- and the limit of taxation, being that taxes cannot exceed the ability to pay.

Although ability to pay implies economic capacity, the two concepts do not overlap. In particular, the economic capacity related to the basic personal and familiar needs of the taxpayer (**life minimum**) does not show a capacity to contribute to public expenditure. Furthermore, in some cases, the same economic capacity may result in different ability to pay. For example, it is generally accepted that income from capital, being of a permanent nature and not depending on the actual efforts of the taxpayer and his/her ability to maintain them, shows a higher ability to pay than income from work.

Income represents one of the most important measures for such capacity. However, there are also other relevant parameters, such as **consumption**, which can be used to assess the taxpayer liability.

The taxpayer's ability to pay should be real, not theoretical. **Provisions which establish legal presumptions** regarding the existence of the taxable event are needed in order to allow the tax administration to effectively fight tax evasion and avoidance. Nevertheless, when these provisions bar the taxpayer from giving evidence of the contrary (of the fact that the presumed event did not actually take place), they clearly violate the principle of ability to pay. Indeed, even if the presumption that they establish is reasonable, in this latter case, the application of these provisions may result in the collection of taxes in the absence of the relevant taxable events.

Retroactive legislation, *i.e.* legislation which attaches consequences to events occurred before its enactment, is generally not prohibited in the field of tax law. However, when a law characterizes as taxable an event which took place long before its enactment, the economic capacity displayed by such an event may very well be lost by the time the law is

enacted. Therefore, the economic capacity may very well be absent at the moment the taxpayer is requested to contribute. In this case it may be held that the law, insofar it is applicable retroactively, violates the principle of ability to pay.

Linked to the principle of ability to pay is the **principle of progressivity**, which requires an increase of the tax rate as the tax base grows. This principle is based on the assumption that the sacrifice endured by the taxpayer decreases as his/her economic capacity grows. The purpose of the principle is therefore to reduce, mainly through the application of graduated rates, the differences existing among taxpayers in the degree of such sacrifice. Progressivity does not have to be a feature of every tax. It is a typical character of individual income taxes.

3. International restraints

The power to tax also faces a growing number of restraints having their source in international law. Indeed, States must comply with obligations incurred upon entering into international treaties with other States.

All States have a large net of **bilateral conventions for the prevention of international double taxation**. These conventions limit the power to tax of the contracting States in several ways. For example, they may prevent them from taxing some income items, or place a ceiling to the amount of tax they can levy on them.

For EU member States, strong restraints derive directly or indirectly from the **EU Treaty**. In particular, the power to tax of member States is limited by:

- the four fundamental freedoms (free movement of workers, freedom to provide services, freedom of establishment, free movement of capital);
- the prohibition of State aids;
- EU regulations and EU directives, which, among other things, play a fundamental role in the field of VAT.

4. Structure of Italian tax system

The concept of ability to pay presupposes a full and comprehensive recognition of income. Certain tax systems are structured on "**Global Income Tax**" model many others on a "**Schedular Model**". A Global

Income Tax is based on the imposition of a single tax on all income, regardless of its source and nature. In the latter case all income and expenses are considered together in order to determine the relevant **taxable base** of the **taxpayer**. In a Schedular Model the taxable income is determined separately for each category of income and different tax rates may be applied in respect to the same categories. Most of the tax systems may be regarded as being "composite", whereby a Schedular Model is combined with the application of a single tax rate structure[1]. On the other hand, the global system of many countries have become partially schedularised by the use of withholding taxes on certain types of income (*e.g.* dividends and interest) and lower tax rates on capital income.

The Italian tax system is based on a Schedular Model with some Global characterization whereby the general individual tax rate structure is shaped on a "**Progressive System**" with some exception for investment and real estate income.
The income tax is imposed on a periodic basis. The tax period is established by the legislation (generally 12 months). Business taxpayers may be allowed to use different period in particular circumstances (*e.g.* following the accounting period).

The periodic imposition of the income tax requires a separate calculation of the taxable income of a taxpayer for each tax period. To this end, it is necessary to define specific rules of allocation, which identify the tax period in which a certain item of income, or an expense, must be included. Income or expenses may be allocated for on a cash or an accrual basis

Under the "**cash method**", income is derived in the tax period in which it is actually received by, made available to, or, in the case of benefit, provided to the taxpayer.

Under the "**accrual method**", income is derived in the tax period in which the right to receive the income arises, and expenses are accounted for in the tax period in which the obligation to pay arises. The accrual method usually requires a proper accounting system which is able to calculate the correct amount of income and expenses which are attributable to a given tax period. Therefore, it is generally applied to <u>business taxpayers</u>.

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[1] For a more detailed analysis on Global tax system vs Schedular, see Victor Thuronyi, Tax Lax Design and Drafting, Volume 2 page 495, 1998, International Monetary fund.

5. Residence and Source

A country usually imposes income taxes because of the nexus between the country and the person earning the income. Such nexus is defined as "**Residence**". Any person subject to the residence jurisdiction of a country generally is taxable on its "**worldwide income**", without reference to the source of the income and regardless whether such income has been realised in the residence country or abroad.

Income may also be taxable under the tax laws of a country because of a link between that country and the activities which generated the income ("**Source**" jurisdiction).

The Italian Tax Code (Presidential Decree no. 917 of 22 December 1986 – "**ITC**") provides for two main types of income tax, applicable to both resident and non-resident taxpayers:

- the individual income tax ("**IIT**" or *Imposta sui redditi delle persone fisiche* "**IRPEF**"), applicable to individuals, and
- the corporate income tax ("**CIT**" or *Imposta sui redditi delle Società* "**IRES**"), which applies to companies and other identified legal entities (*e.g.* trusts).

6. Tax residence of Individuals

Under Italian law, an individual is resident in Italy for income tax purposes if one of the following conditions is met for the greater part of the tax period:

a) to be registered in the Civil Registry of an Italian Municipality;

b) to be domiciled in Italy, according to Italian Civil Code;

c) to be resident in Italy, according to Italian Civil Code.

Please note that, as with regard to the "tax period", reference has to be made to the calendar year. As a consequence, the conditions above have to be verified on a 183-days basis, to be calculated from the 1st January to the 31st December of the same calendar, regardless whether the timing has been fulfilled on a continuous basis.

The conditions above are alternative and not concurrent (*i.e.* the existence of any one of them is sufficient to determine the status of resident for fiscal purposes). The registration under point (a) is a mere formality,

whilst as far as the concepts of "domicile" and “residence” reference is made to the provisions of the Italian Civil Code, accordingly:

- an individual's domicile is the place where the individual has established the principal centre of his business and interests;
- an individual's residence is the place where the individual has his habitual abode.

Registration in Civil Registry of an Italian Municipality

Registration in the Civil Register is a pure formal requirement which, *per se*, determines the tax resident status of an individual. It is therefore of relevance that, any Italian citizen, who want to transfer his residence abroad, shall file an appropriate form with the relevant Italian Municipality of residence and enrolled in the so-called AIRE (*Anagrafe Italiani Residenti all'Estero*).

The filing of the above mentioned form will determine the cancellation of the individual from the Civil Registry of the relevant Italian Municipality as from the date of filing.

Concept of domicile and residence under Italian tax law

According to the Italian tax law, as interpreted by practice and jurisprudence, an individual who is cancelled from the Civil Registry of an Italian Municipality may be deemed to have his domicile or residence in Italy if the Italian Tax Authorities are able to demonstrate that the principal centre of his business and interests or habitual abode are in Italy.

More precisely, an individual may be deemed to have his domicile or residence in Italy, when, for the greater part of the tax period, even though not continuously (*i.e.* for more than 183, or 184, days during the calendar year):

a) as with regard to the domicile, he:

   – carries on his business in Italy;

   – receives a significant portion of his incomes from Italian businesses;

   – owns Italian bank accounts frequently used or on which significant amounts are credited;

   – his family is established in Italy;

- his children attend an Italian school;

b) as with reference to the residence, he:

   - incurs significant and frequent utility costs (*e.g.* electricity, heating, telephone, etc.) in relation to a property located in Italy;
   - holds real estate properties in Italy where he stays as often as possible (excluding for vacation purposes);
   - it results by the statement of his bank account that a significant number of expenses are related to frequent payments executed at Italian retail shops, restaurants and/or supermarkets.

It stems from the above that, in determining the residence status of an individual, emphasis is added to the business (*e.g.* employment relationship) and personal (*e.g.* location of the family) circumstances relevant for the definition of an individual's domicile and residence.

7. Tax residence of Corporations

Pursuant to the Italian Income Tax Law any entity (*e.g.* a company or a partnership) is deemed to be resident in Italy if, for the greater part of the tax period, either its legal seat (*sede legale*) or its main business purpose (*oggetto principale*) or its place of effective management (*sede dell'amministrazione*) is in Italy.

Although the concept of place of effective management is not defined in the Italian law, it is generally identified with the place where the key management and commercial decisions that are necessary for the entity's activity, as a whole, are in substance made.

The tax authorities consider various elements in order to ascertaining whether the place of effective management of a foreign entity is in Italy, such as, by way of example:

a) where the meetings of its board of directors or equivalent body are usually held;

b) where the chief executive officer and other senior executives usually carry on their activities; and

c) where the senior day-to-day management of the entity is carried on. The lack of substance is one of the main elements on which Italian tax authorities base their challenges on the residence status

as well as the treaty and EU Directives entitlement of foreign entities.

Further guidance are provided in respect companies which may be regarded as a "mere artificial scheme" aimed at achieving an undue tax saving. To this regard, relevance is given to both the activity actually carried out and the physical structure of the foreign entity.
As far as “holding companies” are concerned, tax administration acknowledges that they represent a peculiar case, since their activity does not usually entail a "relevant physical presence" and the latter circumstance, on the one hand, cannot automatically lead to consider all of them as "mere artificial scheme", but, on the other hand, requires a specific careful analysis. The assessment should be carried out on the basis of the following main distinction:

a) a company which merely holds a participation without influencing the investment strategy of its subsidiary. In this case, the holding company plays a passive role whereby dividends received from the subsidiary are usually channelled to its shareholder;

b) an investment company which carries on a management and coordination activity over its investments. In the latter case, it actually carries out an entrepreneurial activity through investment decisions which ultimately may regard also its subsidiaries, whereby dividend proceeds are not necessarily channelled to its shareholder, but often re-invested in the same subsidiary or in other financial opportunities.

A holding company, which falls within the description under point b) above, should not be considered a "mere artificial scheme". The key factor is the management and coordination activity which features holding companies that can be regarded as engaged in a true business activity. As a matter of example (expanded under Annex 1) the holding company should be managed as it follows:

- the board of directors should actually take strategic and operating decisions on regular basis in its country of residence;
- such activity should not be limited to the approval of annual reports of participated companies. On the contrary, the holding company should periodically verify its investments, monitoring economics of the subsidiaries;

- representatives of the holding company should participate to the subsidiaries' shareholders meetings playing an active role in the decision making process.

Expenses incurred by the foreign entity should be coherent with the management activity described above. Accordingly, financial statements of the holding company should show an adequate amount of expenses borne by the company (*e.g.* leasing costs for office spaces, telecommunications costs, expenses related to the consolidation of subsidiaries' financial statements, remuneration of the directors).
Finally, it is important that the management activity actually performed by the foreign entity is evidenced in the company's documentation.

B. INDIVIDUAL INCOME TAX

Individuals are generally subject to personal income tax on all income they realize.

Under Italian tax law, the IIT is levied on personal income, whether in money or kind, falling under one of the following categories:

1. Business income
2. Income from professional services
3. Income from employment
4. Income from real estate properties
5. Income from capital
6. Other income

Earnings not falling within one of the six categories do not qualify as taxable income, although they may be subject to other forms of taxation, such as inheritance and gift tax.

Each category of income constitutes an autonomous microsystem and is governed by specific rules that provide for the qualification, the actual determination of the tax base and the taxation.

The overall taxable base is calculated by adding the income of each category, unless any item of income is subject to a final withholding or a substitute tax.

Italian tax law does not allow the deduction of expenses related to income derived from capital or employment. Only business income, income from independent work (even though not habitually engaged in) and certain items of miscellaneous income are computed net of deductible expenses.

However, certain tax deductions from total income are permitted in respect of expenses not directly deductible in computing income under the separate categories, provided that those deductions are documented at the time of filing the tax return for the relevant calendar year.

Tax is payable based on the calendar year. The attribution of income to a period is governed by the rules applicable to the category of income to which it belongs. In general terms, business income is attributed to the

tax year of accrual, while income of other categories is attributed to the tax year of collection.

Once calculated the taxable base, the final tax burden shall be determined by applying the relevant tax rates. To this regard, usually ITT is levied on a progressive basis.

A **progressive tax** is a tax that takes a larger percentage from high-income earners than it does from low-income individuals. The progressivity depends upon the number of brackets and how quickly the related tax rates increase.

A **tax bracket** refers to a range of incomes that are subject to a given tax rate. The following table summarizes brackets and tax rates under Italian tax law:

- 23% on that part of income not exceeding € 15.000;
- 27% on that part of income between € 15.001 and € 28.000;
- 38% on that part of income between € 28.001 and € 55.000;
- 41% on that part of income between € 55.001 and € 75.000; and
- 43% on that part of income exceeding € 75.000.

Progressive tax systems have the ability to collect more taxes than flat taxes or regressive taxes, as tax rates are indexed to increase as income climbs. Progressive taxes allow the people with the greatest amount of resources to fund a greater portion of the services all people and businesses rely on.

Unlike progressive tax systems, a **flat tax system** does not impose different tax rates on people with different income levels. Instead, flat taxation imposes the same percentage tax on everyone regardless of income.

Flat tax rates are generally applied on corporate taxable income and on certain items of income which are subject to withholding tax or any substitutive tax at source such as, for example, income from capital (*e.g.* on interest and dividends)

1. Employment Income

The definition of employment income under Italian tax law is very broad, and includes any and all compensation, in cash or in kind, received during a year in connection with an employment relationship. As a consequence, benefits in kind are included in the individual's taxable base in the amount corresponding to the difference between the fair market value and the consideration paid to acquire such benefit in kind.

However, it should be noted that not all the goods/services attributed/rendered to employees by an employer at favorable conditions (*i.e.* if compared to fair market conditions) shall be relevant for tax purposes, as they may not represent additional income made available to the employees (*e.g.* mandatory security devices for construction workers, uniforms granted under gratuitous loan, etc.).

For what regards the determination of the taxable base of the benefit in kind granted to employees, Italian tax law establishes that reference shall be made to the "normal value" of the goods/services attributed/rendered. The normal value is defined as the price normally applied for similar goods or services, at a similar commercial stage (*e.g.* wholesale, retail), taking into consideration, if available, pricing lists, tariffs and normal discounts.

As an exception to the general principle described above, in case the employer attributes to its employees its own internally manufactured products, the normal value of such benefit in kind shall be determined according to their wholesale price.

The following are not included in income and thus are not considered benefits in kind:

- social security contributions paid by the employer and employee to entities or funds whose sole purpose is social welfare or benefit in accordance with the provisions of law;
- health care contributions paid by the employer and employee to approved health care and welfare funds;
- supply of provisions in canteens or equivalent services and the provision of transportation services, even if contracted out to third parties;
- supply of collective transportation services to all employees or categories of employees, even if contracted out to third parties;

- the value of services provided by the employer for the benefit of all employees or categories of employees for education, recreation and religious purposes including payments made by the employer as a contribution to expenses for nursery schools and scholarships for members of the employee's family.

As an exception to the general principle described above, in case the employer attributes to its employees its own internally manufactured products, the normal value of such benefit in kind shall be determined according to their wholesale price.

Further, the following types of income, amongst others, shall be treated as employment income:

- income derived from the offices of director, member of the board of the statutory auditors of companies;
- compensation received by workers who are members of cooperatives;
- scholarships or other allowances, prizes or grants for purposes of study or professional training, whoever pays them;
- non-gratuitous life annuities and fixed term annuities; and
- other regular allowances, whatever they may be called, which are paid without the actual use of capital or services.

No deductions for expenses are allowed from employment income.

As a general rule, all reimbursements by the employer are taxable for the employee, with the exception of the refund of travelling expenses, subject to certain limits and conditions.

The taxable base is calculated on a cash basis. As an exception to such general principle, income derived by employees from an activity permanently performed abroad is taxable on the basis of salaries determined annually by a decree of the Ministries of Labour and Social Security in cooperation with the Ministry of Economy and Finance, instead of the salary actually received. This applies only if the activity performed abroad is the exclusive object of the employment, and the employee stays abroad for more than 183 days in a 12 months period.

2. Professional Income

Professional income, which falls under the category income from self-employment (*redditi di lavoro autonomo*), is income derived from exercising an art or profession, *i.e.* engaging in activities of self-employment in a habitual way which does not necessarily have to be exclusive.

Income derived from exercising an art or profession is calculated as the difference between the amount of fees, whether in cash or in kind, received during the tax period (corresponding to the calendar year), including profit shares, and the amount of expenses incurred in exercising that art or profession during the same period.

Hotel accommodation, travel, transport and food expenses, directly paid by the client of the professional for the benefit of the professional, do not qualify as benefits in kind for that professional.

The following negative item of income may also be deductible for the purposes of determining the taxable base:

a) depreciation of immovable property used for the conduct of the relevant activity, with certain limitations;

b) annual depreciation of movable assets used in the art or profession. The maximum amount of annual depreciation is established for pools of assets of a similar kind by a decree of the Minister of Finance;

c) lease payments for assets acquired through financial lease contracts;

d) 50% of the expenses relating to the purchase of personal property used both for the taxpayer's art or profession and his personal or family use;

e) entertainment and promotional expenses, with a limit of 1% of the gross amount of fees received in the tax year.

The limitation on the deductibility of the expenses listed under letter d) and e) above are aimed at, on the one side, avoiding the reduction of the taxable base with expenses which, by nature, may have a personal (other than professional wise) utilization and, on the other side, simplify the

determination of that amount of costs that pertain to the personal benefit and that to the professional one.

Professional income is calculated on a cash basis.

3. Income from Real Estate Property

Property taxes in the form of income taxes levied on land and buildings are generally considered to be more efficient than other taxes with a less adverse impact on the allocation of resources, primarily because their tax base is less mobile.

In Italy real estate property is subject to income taxes or value.

If the property is rented out, the rental fee contributes to the formation of the tax base which is applied to the personal income tax levied on individuals.

The property owner who decides to rent it can choose between two different tax systems:

1. the progressive income tax rate. In such a case, the taxable base is the higher between the imputed "**cadastral income**"[2] and the actual income, net of directly attributable expenses up to 5% of the gross income (*i.e.* the actual net income cannot be lower than 95% of the gross income). If the property which is rented out is of a recognized cultural or historical interest, the taxable base is the higher between the imputed cadastral income and the actual income, net of directly attributable expenses up to 35% of the gross income (*i.e.* the actual net income cannot be lower than 65% of the gross income); or

2. income from property rented for use as dwelling may be subject to a 21% substitute tax (*cedolare secca*). A reduced rate of 10% applies for residential properties located in special areas with a shortage of housing or which are densely populated. The substitute tax is an optional regime, which may be chosen by the lessor instead of ordinary taxation under individual income tax at progressive rates. The taxable base for the substitute tax is the annual rent, as determined by the parties to the rental contract. The substitute tax absorbs individual income tax, registration tax and stamp duty.

[2] The **cadastral value** is an estimate of what the "normal" (*i.e.*, average for similar properties in the same general location) rental value of the subject property would be as of 1988–89. It is based on location and building type, but very little else; there is, for instance, no information on type of construction, building condition, or even age of building.

If the property is not rented or leased, the taxable base shall be determined on the basis of the cadastral income and subject to Imposta Municipale ("**IMU**"). The taxable base for IMU is the imputed income, as entered into the cadastral value on 1 January of the relevant year, plus a 5% addition to the imputed income, multiplied by a coefficient ranging from 55 to 160, depending on the cadastral classification of the property. The ordinary IMU tax rate is 0.76%

While taxes on property in Italy are not low, they are not out of line with other advanced economies. The introduction of the IMU at the start of 2012 fundamentally reformed, and increased, property taxation. In replacing the previous Imposta Comunale sugli Immobili ("**ICI**"), it scaled up cadastral values by adjusting them with ad hoc factors.

As part of the IMU reform, an ad hoc increase in property values was implemented through the application of multiplicative factors to the tax base.

If immovable property qualifies as a principal dwelling of the taxpayer, it is generally not subject to IMU. In the case that its cadastral classification is among those for high value properties, it is subject to a reduced rate of 0.4%.

Immovable property held abroad

An Italian resident owner or person having an interest (*e.g.* property, usufruct, etc.) in immovable property, *e.g.* land, buildings and apartments, located abroad is subject to tax in Italy (*imposta sul valore degli immobili situati all'estero*, **IVIE**). The taxable base is the value as declared in the purchase agreement or the fair market value set in the country in which the property is located.

The tax rate is 0.76%. In respect of immovable property located in an EEA country, the reference value for IVIE is the value used in the relevant foreign country as the taxable base for the purposes of any property or transfer taxes. In the absence of these parameters, the cost of the property declared in the transfer documentation continues to form the taxable base for IVIE.

However, the taxpayer may opt, at his convenience, to determine the taxable base by multiplying the imputed income calculated under foreign

tax laws by the same coefficients established for IMU purposes. Foreign real estate taxes are credited against the Italian taxes.

4. Income from Capital

Income from capital is generally identified as any income or proceeds derived from the employment of capital, which has to be intended as assets, including for example money, shares, bonds and any financial instruments.

Hence, income from capital does not typically derive from the direct production of work and it may also be defined as passive income. On the contrary, when the income is derived by an organized trading, professional or business activity with the objective of generating profits over the same assets listed above, then it will likely fall within the definition of business income or other professional activity.

Income from capital is calculated on a gross basis, *i.e.* without any deduction for expenses or costs related thereto. The taxable base is determined on a cash basis, with some very limited exceptions.

Income from capital may include, *inter alia*:

- **Interest:** *i.e.* the compensation earned by a creditor for the use of his or her money during the period of the loan (debt obligation).

- **Dividends:** *i.e.* income from shares, "jouissance" shares or "jouisance" rights and other rights, not being debt-claims, participating in corporate profits.

4.1. Interest

Under Italian tax law, interest derived from loans, deposits and current accounts, including the difference between the amount received at maturity and that loaned or placed on deposit, and interest and other revenue derived from bonds and similar securities, including the difference between the amount received or the market value of the assets received at maturity and the issue price, are subject to different tax regimes depending upon the type and origin. See Table A below for details.

Interest on loans is presumed to have been received at the due date and at the rate agreed in writing, unless proved otherwise. If the due date is not established in writing, interest accrued is presumed to have been received in each tax year.

4.2. Dividends

As far as taxation of dividends is concerned, a distinction must be made between qualified and non-qualified participations.

An investment in a company is considered a "**qualified participation**" if it represents more than 2% of the voting rights or 5% of the capital, in the case of participations in listed companies; and more than 20% of the voting rights or 25% of the capital, in the case of other participations. In such a case any dividends qualifying as income from capital shall be subject to progressive tax rates only on an amount equal to 58.14% of the same dividends.

An investment in a company is considered a "**non-qualified participation**" if it represents no more than 2% of the voting rights or 5% of the capital, in the case of participations in listed companies; no more than 20% of the voting rights or 25% of the capital, in the case of other participations. **In such a case any dividends qualifying as income from capital shall be subject to substitutive tax equal to 26%.**

Based on the provisions of the Italian Tax Bill for fiscal year 2018, dividends paid out of profits realized from fiscal year 2018 and dividends paid out of profits realized until fiscal year 2017 and whose distribution is resolved after 1 January 2023, from both "qualified" and "non-qualified" participations, would be subject to a substitute tax of 26%.

Interest on bonds.	**Corporate bonds** issued by listed and private companies and banks.	26% substitute tax.
	Italian Governmental bonds and assimilated instruments.	12.5% final withholding tax.
Interest on financings.		Full taxation at progressive rates.
Interest on bank accounts.		26% final withholding tax.
Dividends	**Qualified participation**	41.86% tax exempt; the remaining 58.14% shall be included in

		the individual income tax base and subject to tax at progressive rates.
	Non qualified participation.	26% final withholding tax.
	From "tax haven" resident companies.	Full taxation at progressive rates[3].
	Tax Bill 2018 regime	26% final withholding tax, regardless of the type of participation.

Financial assets held abroad

As a general rule, Italian tax resident individuals are subject to tax monitoring obligations. The tax monitoring obligations are fulfilled disclosing the assets, investments and financial activities held abroad, on a yearly basis, by mean of filling-in a specific section ("*Quadro RW*") of the yearly income tax return ("*Modello Redditi*").

The Italian taxpayers are not required to fulfil the tax monitoring obligations in respect to the investments and financial activities held abroad in case the same assets are managed with the intervention of Italian tax resident financial intermediaries, subject to the condition that the latter intermediaries apply all the relevant withholding taxes / substitutive taxes on the taxable income (if any) arising therefrom.

Moreover, Italian tax resident individuals are also subject to a tax on the value of the financial assets held abroad Italy ("*Imposta sul valore delle attività finanziarie all'estero*", "**IVAFE**"). As from 2014, IVAFE is applied at a rate equal to 0.2%, on on a taxable base equal to the fair market value of the financial assets and, in the absence, to their nominal or reimbursement value.

Where the foreign financial assets are managed with the intervention of Italian financial intermediaries, which apply all the relevant withholding

[3] Unless the investors obtain, from the Italian Tax Authorities, a ruling which confirms that through the offshore company they have not achieved the localization of income in a "tax haven" territories.

taxes / substitutive taxes on the taxable income (if any) arising therefrom, Italian stamp duty would be applicable (instead of IVAFE) at 0,2% rate, on the same taxable base applicable for IVAFE purposes.

5. Business Income

Both individuals and legal persons engage in business activities. If business income is not defined in tax law, reference is made to the commercial law provisions. Generally, an entrepreneurial activity is a commercial or industrial activity of an independent nature undertaken for profits.

Under Italian law, the statutory definition of the conduct of a commercial enterprise makes reference to the civil law definition of commercial activities, thus including, *inter alia*:

- activities to produce goods or to render services;
- intermediary activities regarding the transfer of property;
- activities connected with transportation by land, sea or air;
- banking or insurance activities; and
- activities auxiliary to those mentioned above.

Two basic models are used to determine the taxable income arising from business activities:

- **The receipts-and-outgoings system**: under which the determination of taxable business income is based on the calculation of all recognised income amounts derived by the taxpayer in the tax period and all deductible expenses incurred by the taxpayer in the same tax period.

- **The balance-sheet system**: whereby the starting point is the commercial income arising from financial accounting, to which adjustments are added to take into account differences between tax rules and financial accounting rules.

Italian tax legislation regulates in detail the computation of business income and the criteria for evaluation of the assets and liabilities forming the working capital of the enterprise.

In general, taxable business income is that resulting from business activities in accordance with the commercial profit and loss accounts (balance-sheet system), taking into account adjustments required by specific tax rules.

Business income is generally calculated on an **accrual basis**:

- Revenues are derived when the right to receive the income arises.
- Expenses are incurred when the obligation to pay arises.

For corporations, the accrual method is also the basis of financial accounting where specific regulations are provided.

In determining business income, in general, revenues include both gains from ongoing commercial activities and gains on the disposal of business assets. The concept of business assets should include not only assets physically used in, or held by the business, but also investment assets related to a business activity. This is achieved through a broad definition of **business assets** that includes all assets used, ready for use, or held for the purpose of a business.

The inclusion in business income of gains arising on the disposal of business assets needs to be coordinated with any special regime applying to specific types of assets, such as:

- **Inventories,** which give rise to revenues. Under Italian tax law, inventory (stock-in-trade) is, in principle, valued at the lower of cost price or market value. Both the LIFO and FIFO systems are permitted. In the first tax year, inventory is valued by attributing to each unit its value in relation to the total cost of goods (of the same category and type) produced or purchased in the same tax year. In subsequent years, if the inventory increases with respect to the prior tax year, the greater quantities are indicated as separate items according to the tax year of their acquisition. If in a tax year the average unit value exceeds the market value in the last quarter of the tax year, the minimum valuation may be ascertained by multiplying the total quantity of goods by their market value.

- **Depreciable and amortisable assets,** which give rise to capital gains or losses. Such assets generally have a useful life which is longer than one tax period. Their cost is therefore split among tax periods in which the assets contribute to the income production (**depreciation/amortisation plan**).

  A depreciation/amortisation plan must consider:

  - the cost of the asset;
  - the period of useful life;
  - the residual value at the end of the "useful period".

Under Italian tax law, only the straight-line depreciation method is permitted, in accordance with a table of percentages established by a Decree of the Minister of Finance. The depreciation allowance is reduced by half for the year of acquisition.

The depreciation rates differ per industry and it is determined for pool of assets of a similar typology. By way of example, the depreciation rates for the manufacturing industry are:

- Industrial buildings: 3% to 7%
- Light buildings, sheds, etc.: 10%
- General plant and machinery: 10% to 12.5%
- Specific machinery: 12.5% to 22.5%
- Ordinary office furniture and machines: 12%
- Electronic office machines: 18%
- Motor vehicles: 20%

- **Other assets** (*e.g.* participation in companies), which may produce capital gains or losses and are not subject to the depreciation/amortisation process such as participation in companies and partnerships. To this regard, the tax law usually provide special tax regime in order to reduce the economic double taxation (see below paragraph on participation exemption regime and on the integration between shareholders and companies).

Tax rules related to business assets shall define:

- **Timing rules** for the realization of gain or losses. To this regard, an item of income may be considered realised when the taxpayer ceases to own the business assets (*i.e.* when the asset is disposed of in a very broad sense). Accordingly, it is crucial to identify the concept of disposal which includes not only the sale but also, by way of example, the loss of a business asset for damage, the exchange of assets, the contribution in kind and any utilisation other than for business purposes (*e.g.* personal use).

- **Cost base** of an asset, which is equal to the consideration given for the acquisition of an asset, plus any ancillary cost incurred in the acquisition of the asset (*e.g.* legal and registration fee, transfer taxes, etc.). Such base should also include any capital expenditure incurred over the same assets.

- **Determination** of gain or loss. Generally, the consideration is equal to the cash price received. In case of consideration in kind, than the relevant amount for determining the taxable gain or loss shall be calculated on the basis of the arm's length principle (*i.e.* the fair market value, which is the price that unrelated parties would have agreed upon, given the same circumstances of the transaction at hand).

In the calculation of the relevant taxable base for business purposes, expenses and other negative items of income shall be deductible if and to the extent that **they relate to activities or assets which produce revenue** or other receipts which are included in the taxable income. Such general principle defines the so-called "**concept of inherence**". Accordingly, any cost or expense shall be deductible from the taxable income all those costs that **are functional to the business activity**, even if they are not strictly related to a specific revenue.

The Italian tax laws provide for specific limitations in respect to certain type of expenses, such as:

- personal expenses;
- capital expenses;
- policy-motivated restrictions (*e.g.* no tax deduction for fines, penalties, bribes etc.);
- interest expenses (see para C.5 below);
- expenses that have elements of both business and personal consumption (*e.g.* entertainment, meal and refreshment).

6. Other income

Other Income is *de facto* a residual category of income that under Italian tax law includes, *inter alia*, the following item of income, provided they are not realised in exercising a professional or business activity or in relation to an employment relationship:

- winnings in lotteries, prize contests, games and betting organized for the public;
- income from land not determinable through the cadastral value, including land rented out for non-agricultural use;
- income from land or buildings located abroad;
- income from the economic use of intellectual property, inventions, patents, industrial processes, formulas and know-how earned by persons other than the author or the inventor;
- income derived from the sale of going concerns received as a consequence of an inheritance or gift;
- deemed income due to the use by the entrepreneur, shareholder or his relatives of assets formally held in a business capacity; such a deemed income is calculated as the difference between the market value of the use of such assets reduced by any amount paid by the entrepreneur, shareholder or his relatives to the enterprise or company;
- income derived from business activities not habitually engaged in;
- income derived from independent work not habitually engaged in;
- gains realized on the transfer for consideration of buildings held for less than 5 years;
- capital gains on shares and other participations.

C. CORPORATE INCOME TAX

1. Introduction

Resident and non-resident companies are subject to corporate income tax. The CIT rate is 24%. Banks and other financial intermediaries, except for asset management companies and brokerage companies are subject to a surtax equal to 3.5%.

Resident companies are taxed on their worldwide income whilst non-resident entities are subject to corporate income tax only on Italian sourced income.

All income derived by companies that carry on business activities is considered business income and is subject to corporate income tax.

The taxable base is the worldwide income shown on the profit and loss account prepared for the relevant fiscal year according to company law rules and adjusted according to the tax law provisions concerning business income (see paragraph B. 5. above).

The taxable period for corporate income tax purposes is the company's fiscal year as determined by law or the articles of association. If the fiscal year is not so determined, or if it is longer than 2 years, the taxable period is the calendar year.

As per general rule applicable to the determination of "business income", companies may deduct costs and expenses only if they are incurred for the production of income. This rule does not apply to certain deductible items, such as interest subject to a special rule (see below), certain taxes, social security contributions and costs incurred for the general benefit of employees (*e.g.* recreational facilities).

The deduction of business expenses is allowed on an accrual basis, with some exceptions (*e.g.* directors' fees) and some limitations (*e.g.* maintenance expenses).

In addition, costs and other expenses are deductible in the fiscal year in which they are certain or ascertainable. Accordingly, expenses lacking such requisites are temporarily non-deductible and increase the taxpayers' effective tax rate of the fiscal year in which they accrued (so called timing

differences). A corresponding decrease of the taxable base would be recognized in the fiscal year in which both the criteria are met.

2. Employees' remuneration

Compensation, in cash or in kind, paid to employees is deductible by the company even if the remuneration does not constitute taxable income for the employee (*e.g.* small gifts).

Certain benefits in kind are deductible only in part or not deductible at all. For example, expenses incurred by the company for the general benefit of employees for educational, recreational, sanitary or religious purposes are fully deductible if these benefits are provided under a collective labour agreement.

3. Directors' fees

Directors' fees, including those paid in the form of participation to profits, are fully deductible on a cash basis.

4. Maintenance expenses

Maintenance expenses can either be capitalized or deducted. In the latter case, the deduction is allowed only up to 5% of the aggregate cost of the fixed tangible assets at the beginning of the fiscal year (fixed tangible assets purchased during the year are not taken into account for calculating the 5% limit).

Maintenance expenses that exceed the threshold can be deducted in equal instalments in the following 5 fiscal years.

Expenses arising from periodical maintenance services contractually agreed are not subject to the limitations above.

5. Deduction of interest expenses for income tax purposes

Net interest expenses (*i.e.* passive interest minus active interest) up to 30% of the company's EBITDA. Any amount of non-deductible interest, as well as any part of the 30% EBITDA not used to grant the interest deduction, shall be carried forward in the subsequent fiscal years.

Companies belonging to the same group may maximize the deductibility of net interest expenses by opting for the application of the tax consolidation regime.

6. Tax losses

Taxpayers subject to corporate income tax realize a tax loss if, in a fiscal year, the allowable deductions exceed the income.

Taxpayers subject to corporate income tax may use their tax losses to offset the taxable income of subsequent fiscal years up to 80% of the taxable income of any given fiscal year. Such 80% limitation does not apply to tax losses incurred in the first 3 fiscal years of business activity, which may be set off in full.

Any amount of tax losses not utilized shall be carried forward indefinitely in the subsequent fiscal years.

7. Capital gains

Fixed assets

Capital gains or losses from the disposal of fixed assets are equal to the difference between (i) the sale price, reduced by the costs directly attributable to the sale, and (ii) the acquisition cost of the asset, net of tax deductible depreciation accrued.

A taxpayer may choose to (i) include realized capital gains in the taxable income of the fiscal year when they are realized or (ii) spread them in equal instalments over that year and the following years, up to the fourth year. The option under (ii) is only available in the case of disposal of assets held for at least 3 years.

Participations

The taxable base shall be determined as the positive difference (if any) between (i) the sale price and (ii) the tax value of the participation in the hands of the seller (*i.e.* initial purchase price plus ancillary acquisition costs).

The capital gain upon the transfer of participations shall be either (i) fully included in the taxable income or (ii) taxable for an amount equal to 5% of the capital gain if the following requirements for the participation exemption regime are fulfilled:

a) the participation has been held continuously from the first day of the 12th month prior to the disposal;
b) the participation has been accounted for amongst the fixed financial assets in the first financial statements of the holding period;
c) the participated company is resident in a white-listed country since the beginning of the third tax period preceding the tax period of disposal;
d) the participated company performs a real business activity since the beginning of the third tax period preceding the tax period of disposal.

Losses on the disposal of participations that qualify for the participation exemption are not deductible

8. Transfer pricing

Transactions between companies belonging to the same group may fall outside the entrepreneurial logic underlying the same transactions incurred between two independent parties (mainly profit driven). In order to avoid the armful practice of "shifting profits" from one jurisdiction to another just for benefiting of a lower tax rate, the Italian tax system provide for specific rules to be applied on transactions with associated companies.

More in particular, the ITC provides that price paid in respect of an intragroup transaction shall be consistent with the arm's length principle, according to which the price and the conditions of an intra-group transaction shall not differ from those that would have agreed between independent parties under arm's length conditions and in comparable circumstances

Italy has since 1980 officially applied the OECD Transfer Pricing Guidelines with reference to the determination of income derived from operations with non-resident corporations that directly or indirectly control the enterprise, are controlled by the enterprise or are controlled by the same corporation that controls the enterprise.

The Italian tax administration can be considered among those strictly applying the existing transfer pricing rules, based on the arm's length principle, which effectively and efficiently allocate the income of MNEs among taxing jurisdictions

On May 2018, the Ministry of Economy and Finance issued an implementing Ministerial Decree (the "**DM**") setting forth the general guidance for the correct application of the arm's length principle. The implementing DM reflects the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017)("**OECD TP Guidelines**") and overrides the previous circular letters on transfer pricing which dated back to 1980.

Under the DM, "**associated enterprises**" are the resident enterprise and the non-resident companies where one of them participates, directly or indirectly, in the management, control or capital of the other or where the same person participates, directly or indirectly, in the management, control or capital of both enterprises.

When making reference to enterprises under common control, the term "participation in the management, control or capital" includes the participation by more than 50% in the capital, voting rights or profits of another enterprise or the dominant influence on the management of another enterprise based on ownership or contractual bounds.

Economic double taxation caused by transfer pricing adjustments can be mitigated under Italy's income tax treaties that follow the OECD Model or that contain other similar, appropriately worded provisions. Within the European Union, cases of economic double taxation caused by a transfer pricing adjustment can also be dealt with under the Arbitration Convention (Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 90/436/EEC).

The same rule shall apply if the result thereof is a decrease in the taxable income of the resident enterprise only inasmuch as it is necessary for the observance of agreements reached with the competent authorities of foreign States pursuant to the special mutual agreement procedures provided for in income tax treaty.

Once established that a transaction falls within the scope of the Italian transfer pricing rules it must be verified if such transaction has been carried out on the basis of the arm's length principle as introduced above.

Amongst different methodologies, the administrative practice put emphasis on the application of traditional transaction methods which are identified by the followings:

A. "**the price comparison method**";

B. "**the resale price method**"; and

C. "**the cost plus method**".

The main factors to be considered for determining the comparability of transactions are the following:

- characteristics of goods/services;
- functions performed by the parties (so called "**functional analysis**");
- risks assumed by the parties;
- characteristics of the relevant market.

As a general rule the functions carried out by the respective parties will determine, to some extent, the allocation of risks between the parties and therefore the conditions (i.e. the remuneration) each party would reasonably expect in an independent transaction.

The price comparison method

According to such methodology, the arm's length value is determined by comparing the price applied to the transaction under examination with either the one that would be applied in comparable transactions between independent entities or – to be preferred – the one that would be applied by the associated entity towards an independent entity.

Where the transaction under examination, by reason of its characteristic, does not permit the use of the comparable price method (e.g. in lack of comparables), other methods such as the resale price method or the cost plus method can be adopted.

The resale price method

Such a method could be useful in those cases in which one of the associated entity acts as a reseller without adding actual value to the purchased goods.

According to the "resale price method" the arm's length value is equal to the price at which the goods which have been purchased by an associated seller are resold to an independent entity decreased by a gross margin.

The gross margin may be calculated considering either the margin realized by the purchaser/reseller in comparable sales to independent third parties of similar goods previously acquired from independent third entities or considering the profit margin obtained by independent third parties by the comparable resale of similar goods.

In other words, the starting point of the resale price method is the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise.

This price (the resale price) is then reduced by an appropriate gross margin representing the amount covering the selling and other operating expenses of the reseller and, in the light of the functions performed (taking into account assets used and risks assumed) granting an appropriate profit.

What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as the normal value for the original transfer of property between the associated enterprises.

The cost plus method

Such a method shall be particularly suitable when the goods are transformed or are included in a more complex product that changes their identity, preventing the distinction between the value of the final goods and the value of its components or where the controlled transaction is the provision of services.

Through the cost plus method, the transfer price is calculated by increasing the production costs incurred by the associate supplier (or service provider) by a gross margin.

The gross margin may be calculated either:

- *i)* by comparing the gross margin of the transaction under examination with that obtained by the same enterprise in doing business with third parties on the same market and with the same functions; or
- *ii)* by comparing the gross margin obtained by independent third parties with similar transactions with the same functions.

The administrative practive specifies that the production costs – which are the starting point for the application of the method at hand - must be determined according to the so-called "full production cost" which comprises direct costs (*e.g.* raw materials, labor) and indirect costs (*e.g.*

industrial, marketing, general, management, research and development costs, financial charges) sustained for the manufacturing of goods or the performing of services.
The production costs are then increased by an appropriate gross margin representing the amount covering the production costs themselves and, in the light of the functions performed (taking into account assets used and risks assumed) granting an appropriate profit.

The result of the addition of such margin to the full production cost can be regarded as the normal value for the activity performed by an associated entity to another associated entity.

9. Italian tax consolidation regime

Under Italian tax law, an Italian resident company and one or more of its Italian resident subsidiaries may elect to apply for the domestic tax consolidation regime.

A non-resident company may also apply for the domestic tax consolidation, as consolidating entity. In particular, the non-resident company must:

a) be resident in a Country that has a tax treaty in force with Italy that allows an adequate exchange of information; and

b) carry on a business activity in Italy through a permanent establishment, regardless whether this permanent establishment has, among its assets, the shares in the Italian subsidiary or not.

The rules governing the determination of the consolidated taxable base can be summarized as it follows:

a) the consolidating company determines the consolidated taxable base as the algebraic sum of 100% of the taxable income/loss of each participating company, regardless of whether the participation actually amounts to 100%;

b) tax losses incurred by the consolidated companies after the exercise of the option may be consolidated with the income of other group companies (and carried forward at consolidated level, if the consolidated taxable base is negative), while tax losses incurred before the exercise of the election may be offset only against the income of the company that incurred the losses;

c) interest expenses which have not been deducted by an entity of the tax group and occurred after the exercise of the option can be used to offset the consolidated taxable income, provided that other entities within the tax group have EBITDA carry forward;

d) the payments (if any) made between the companies of the tax consolidation as consideration for the transfer of tax attributes (e.g. tax losses, interest expenses carried forward) to the tax group are not relevant for the computation of the taxable base.

The election for the domestic tax consolidation may not be revoked for a period of 3 fiscal years and is deemed to be renewed at the end of the 3-year period, unless expressly revoked. The consolidating company will be liable for the filing of the consolidated tax return and for the IRES payments, if due.

10. Controlled Foreign Company Legislation ("CFC")

The profits realized by a non-resident company are deemed to be the profits of a resident person, or a permanent establishment of a non-resident person in Italy, if:

- the resident person or the domestic permanent establishment controls, directly or indirectly, also through trustee companies or interposed third persons, the non-resident company; and

- the non-resident company meets the two following conditions:
  - the actual foreign income taxes are lower than 50% of the Italian corporate income taxes that would apply to the company if this were resident in Italy; and
  - more than one third of the company's revenues are "**passive**", *i.e.* derive from:
    - *(i)* interest or any other income generated by financial assets;
    - *(ii)* royalties or any other income generated from intellectual property;
    - *(iii)* dividends and income from the disposal of shares;
    - *(iv)* income from financial leasing;
    - *(v)* income from insurance, banking and other financial activities;

(vi) income from invoicing companies that earn sales income from goods purchased from and sold to related enterprises, and add no or little economic value; and

(vii) income from invoicing companies that earn services income from services purchased from and sold to related enterprises, and add no or little economic value.

Under the CFC rules, all income (profits) of the CFC (and not just certain classes of "passive" income) must be allocated to the resident shareholder in proportion to its interest in the CFC's profits, even if there is no distribution of dividends or other form of repatriation of profits.

The income is imputed to the shareholder on the last day of the CFC's fiscal year. The resident shareholder must treat the income allocated under the CFC rules as business income and compute it accordingly, with certain exceptions.

The income is then taxed separately from the other income of the resident shareholder and is subject to a tax rate equal to the average tax rate applied on the shareholder's aggregate income.

However, this average rate may not be lower than the ordinary IRES rate. Income taxes (*e.g.* corporate income tax) paid by the CFC, whether in the foreign jurisdiction in which it is resident or elsewhere, may be credited against the Italian corporate income tax.

If, in a later year, the CFC distributes dividends to the resident shareholder, these dividends are not included in the shareholder's income and, therefore, are not taxed in Italy up to the amount that has already been taxed under the Italian CFC rules (previously taxed income "**PTI**").

Therefore, Italy does not tax the shareholder twice. Moreover, foreign taxes (*e.g.* withholding tax) levied on the part of the profits that are PTI for the resident shareholder (and, thus, not included again in its taxable income) can also be credited against the taxes due in Italy on the CFC income up to the amount exceeding the foreign taxes already credited under the CFC regime.

The resident shareholder may apply for an advanced tax ruling claiming the non-application of the CFC rules. To this end, the resident taxpayer must give evidence that the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises.

D. ITALIAN SOURCE OF INCOME OF NON-RESIDENT TAXPAYER

1. The general rule on source of income

Non-resident taxpayers may be subject to tax in Italy only on the income which is deemed to be sourced in the Italian territory.

In accordance with the "schedular system" of taxation, the ITC lists the circumstances under which an item of income shall be sourced in Italy, such as, *inter alia*:

- income and gains from **real estate assets** situated in Italy;
- **income from capital** (most notably, dividends and interest) paid by the government, by resident persons or by Italian permanent establishments of non-resident persons, except for interest and other proceeds accruing on bank deposits, bank accounts or postal savings deposits;
- **business income** derived through a permanent establishment in Italy;
- **other income** derived from property situated in Italy or activities carried out in Italy;
- **capital gains** on the transfer of participations in Italian companies, except for capital gains on participations that represent no more than either 2% of the voting rights or 5% of the stated capital of a listed company;
- **royalties** paid by the government, by resident persons or by Italian permanent establishments of non-resident persons; and
- income derived by non-resident enterprises as consideration for the **performance of professional services** or artistic activities in Italy.

Italian income is computed according to the rules applicable to each single category of income. The method of levying the tax also follows this rule. Therefore, interest, dividends, royalties and service fees, for example, are generally taxed by way of a final withholding tax on the gross amount (see section "F Collection" below).

Income and gains from real estate assets situated in Italy and miscellaneous income derived from property situated in Italy or from a

business in Italy must instead be reported in the corporate income tax return and be subject to accordingly.

2. The concept of Permanent Establishment ("PE")

Pursuant to the ITC, business income earned by a non-resident but attributable to activities conducted in Italy by a PE is subject to taxation in Italy.

If a non-resident entrepreneur has PE in Italy, it is subject to the same provisions as resident companies.

The ITC defines the term "permanent establishment" as a **fixed place of business** through which the business of the non-resident enterprise is wholly or partly carried on in Italy.

Accordingly, in order for a permanent establishment to be deemed to exist in Italy, there must be:

(i) a place of business;
(i) which is permanent from a geographical as well as a temporal perspective;
(ii) which is at the disposal of the enterprise; and
(iii) through which its business is carried on.
(iv)

The tax authorities clarified that the mere possession of immovable property in Italy does not per se determine the existence of a permanent establishment therein since, in order for a permanent establishment to exist, it is necessary for it to qualify as a functionally and organizationally independent structure able to function on its own.

The domestic definition of PE contains a list of examples, which are considered to constitute a permanent establishment. These are, *inter alia*:

- a place of management;
- a branch;
- an office;
- a factory;
- a significant and continuous economic presence in the Italian territory in a way that it does not give rise to a physical presence in Italy.

The latter example is example has been introduced in 2018, aiming at tackling hidden permanent establishments of multinational enterprises

carrying on their business mainly through digital means, without a physical connection with the Italian territory.

The Italian tax provision extends the concept of permanent establishment to a building site, construction, assembly or installation project or supervisory activities connected therewith, provided such site, project or activities continue for a period of more than 3 months.

The following activities, *inter alia*, do not constitute a permanent establishment, provided that they are not of an auxiliary or preparatory character:

- the use of an installation solely for the purpose of storage, display or delivery of goods belonging to the enterprise;
- the maintenance of a stock of goods belonging to the enterprise solely for the purpose of storage, display or delivery;
- the maintenance of a stock of goods belonging to the enterprise solely for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or of collecting information for the enterprise;
- the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity.

Under the Italian Supreme Court jurisprudence, it is an accepted principle that in order for a place of business to be considered as a PE, the following conditions must be met:

- the existence of an organised structure is to be instrumental to the activity carried out, on an habitual basis, by the general enterprise;
- this organised centre must have a certain degree of permanency (fixed place) regardless its dimension and any prevalence of human or technical factor.

On the other hand, it is not sufficient for a PE to exist that a non-resident company has a participation (even if 100%) in a resident company. A PE might be deemed to exist only in case the non-resident company controls the Italian company management and uses it as its own organisation

Where a non-resident enterprise does not have a "fixed place of business" as defined above, a PE may still exist in case a resident or non-resident person that is acting in Italy on behalf of a non-resident enterprise constitutes a **dependent agent PE** of said non-resident.

In order to qualify as a "dependent agent PE", such person must habitually concludes contracts or acts for the purposes of the conclusion of contracts that are concluded by the enterprise without material modifications and these contracts are in the name of the enterprise or for

the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.

3. The allocation of profits to a PE

The ITC explicitly states that the permanent establishment is treated as if it is a distinct and separate enterprise, engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, the risks assumed and the assets held. The "free capital" of the permanent establishment (*fondo di dotazione*) is determined based on the OECD principles, taking into account the functions performed, the risks assumed and the assets held.

The permanent establishment must keep a separate P&L in order to determine the income that is taxable in Italy.

The existence of a permanent establishment of a non-resident taxpayer in Italy has several effects on the tax treatment of the non-resident. In particular:

Taxable income of non-resident companies operating in Italy through a permanent establishment is subject:

- to IRES at a rate of 24%. Banks and other financial intermediaries (except for asset management companies) are subject to a surcharge equal to 3.5%;
- Local Tax at a rate of 3.9% generally applies provided the non-resident company maintains a permanent establishment in Italy for at least 3 months.

The existence of a permanent establishment affects the withholding tax applicable on payments attributable to it and it obliges the non-resident to act as a withholding agent on payments borne by the PE

Dividends paid to non-residents are subject to taxation if distributed by Italian resident companies. It is worth noting that if dividends are received through a PE in Italy, they are taxed as if received by an Italian resident company.

E. CORPORATE SHAREHOLDERS TAXATION

The term "double taxation" is used in many different contexts (*e.g.* international or domestic).
In general:

- **economic double taxation** occurs when the same item of income is taxed twice in the hands of different taxable person; whilst
- **juridical double taxation** occurs when the same item of income is taxed twice in the hands of the same taxable person.

Juridical double taxation is usually the consequence of the application of a withholding tax on certain payments, such as dividends, interest and royalties considerations.

Economic double taxation is the direct consequence of taxation of business income produced through a legal entity and then distributed to the shareholders.

Countries have different approaches to economic double taxation:

- **Classic system** (double taxation).
- **Exemption**; and
- **Imputation system** (avoidance/mitigation of double taxation at a shareholder level).

1. Classic system

Both taxes at the level of corporation and taxes at the level of the shareholder are levied without any reference one to the other.

Example:	
Taxable profits	100
CIT (30%)	(30)
Net profit	70
Dividend received	70
Tax at shareholder's (50%)	(35)
Net income	35
Total tax	65
Effective tax rate	65%

2. Imputation system

The shareholder can offset, from his tax liability, an amount equal to the taxes paid by the corporation.

Example:

Taxable profits	**100**
CIT (30%)	**(30**)
Net profit	70
Dividend received	70
Credit (gross up)	30
Taxable income	**100**
Tax at shareholder's level (50%)	(50)
Credit to offset	**30**
Total tax	20
Effective tax rate	50%

3. Exemption system

The shareholder deduct from his taxable base, an amount equal to the dividends received.

Example:

Taxable profits	**100**
CIT (30%)	**(30**)
Net profit	70
Dividend received	70
Taxable income	--
Tax at shareholder's level (50%)	--
Total tax	30
Effective tax rate	30%

Italy applies a classical system of taxation of corporate profits. No clear definition of dividends is given. Reference is made to the distribution of profits by companies and other entities that are subject to corporate income tax. Furthermore, specific provisions exist under which distributions of reserves other than those arising from profits are not regarded as dividends.

The classical system is however “mitigated by the application of a partial exemption regime or by the substitutive tax as described at paragraph above.

E. VAT

Article 93 of the EC Treaty establishes the harmonization of indirect taxes insofar as is necessary for the establishment and the functioning of the internal market. This is the basis for the advanced integration of turnover taxes within Europe. Turnover taxes have been harmonized to a large extent.

Value Added Tax (**VAT**) was introduced and subsequently amended with the European Directives, amongst others:

- Directive 67/227/EEC and 67/228/EEC **(First and Second Directive)**
- Directive 77/388/EC **(Sixth Directive)**
- Directive 2006/112/EC
- Directive 2008/8/EC and 2008/9/EC **(EU VAT Package)**

Italian implementing provisions are set forth by Presidential Decree No.633/1972.

Intracommunity transactions are dealt with Legislative Decree No.331/1993.

The VAT is:

- a **general tax** that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services;
- a **consumption tax** because it is borne ultimately by the final consumer. It is not a charge on businesses;
- charged as a percentage of the taxable base and the actual tax burden is visible at each stage in the production and distribution chain;
- collected **fractionally**, via a system of partial payments whereby taxable persons (*i.e.* VAT-registered businesses) deduct from the VAT they have collected the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is **neutral** regardless of how many transactions are involved. In this way, as the final price of the product is equal to the sum of the values added at each preceding stage, the final VAT paid is made up of the sum of the VAT paid at each stage;

- paid to the revenue authorities by the seller of the goods, who is the "taxable person", but it is actually paid by the buyer to the seller as part of the price. It is thus an **indirect tax**.

VAT shall be applicable in given Member States provided that subjective, objective and territoriality requirements are all verified.

- **Subjective requirement:** definition of taxable person (WHO?)
- **Objective requirement:** Supply of goods, services, Import, Intracommunity transaction (WHAT?)
- **Territoriality:** WHERE it takes place?

Once, a given transaction falls within the VAT scope, it will be necessary to determine the actual burden.

1. **Timing:** (WHEN?)
2. **Calculation of the Taxable Base:** HOW MUCH?
3. **Special Regimes:** Exemption

General definition

VAT taxable transaction: any supply of goods or service carried out for a consideration in the course of a business or an independent professional activity within the Italian territory. Are also considered taxable transactions:

- imports; and
- intra-Community acquisitions.

Taxable Person

A taxable person is any person who independently carries out in any place any economic activities, whatever the purpose or the result of that activity. The economic activities covered are all those of producers, traders and persons supplying services.

Some activities are automatically deemed to fall within the definition of "business activity" for VAT purposes. This presumption applies to all supplies of goods and services made by companies (including foreign companies) and similar entities.

To be taxable for VAT purposes, a person must supply goods or services in the course or furtherance of business, or artistic or professional enterprise. This generally means on a regular, or habitual, basis. Accordingly, an isolated transaction or occasional supply shall not qualify a person as a VAT taxable person.

The Supply of Goods

The supply of goods is the transfer of the right to dispose of tangible property as its owner for a consideration.

The term supply of goods includes the transfer of the right of usufruct and other real estate rights, also including easement rights. Real estate rights are subject to VAT because their establishment or transfer entails a restriction of the ownership right and, therefore, they are a partial supply of such right.

It is worth noting that the transfer of intangible property (*e.g.* patent rights, licenses and trademarks) are, conversely, deemed to be the supply of services.

Certain transactions are also deemed to be supplies of goods, such as, for example:

- the sale of goods in which the seller retains title of ownership under a special contractual scheme;
- the private use of goods; and
- the allocation of goods by a company to its shareholders.

Certain transactions which would ordinarily qualify as supplies of goods are specifically considered by statute to be outside the scope of VAT. This is the case, for example, of:

- the supply of currency (domestic and foreign) and credits;
- the supply of an entire business or of independent branches of a business and the contribution thereto;
- the supply of land which may not be used for building projects (unless the buildings are intended for operational purposes, including farmhouses);
- the supply of low-value trade samples, marked as such.

The Supply of Services

All transactions carried out in exchange for consideration which are not supplies of goods, are supplies of services (EU Directive definition).

Services usually consist of the obligation to perform or refrain from performing acts or the granting of permission to perform acts (Italian definition).

The following transactions qualify as supply of services:

- the transfer of goods pursuant to a rent or lease contract;
- the financing transaction;

- the provision of food and drink; and
- the transfer of contracts of any kind and for whatever purpose.

VAT shall be applicable also to the private or non-business use of services supplied by a taxable person.

With respect to **composite transactions** under the same consideration (*i.e.* a combination of supplies of different goods, services or a combination of supplies of both goods and services), the following principle should be considered:

- where it is possible to allocate the consideration to each supply, they must be treated according to its own VAT regime;
- if one supply is dominant, the VAT regime of the dominant supply must be applied to the mixed transaction (absorption).

Importation

Importation is a VAT taxable event. The import of goods means the entry into Italy of:

- goods of non-EU origin;
- goods from a territory which forms part of the customs territory of the European Union but is not treated as a part of EU territory for VAT purposes; or
- goods placed under customs arrangements, arrangements for temporary import with total exemption from import duties or external transit arrangements if the goods cease to be covered by these arrangements in Italy.

To be noted that, unlike the supply of goods and services, importation of goods shall be relevant for Italian VAT purposes regardless whether the person importing the goods is a VAT taxable person or not.

Territoriality

Goods and services supplied outside the relevant State are not subject to VAT in the same State.

The supply of goods shall be considered as carried out in Italy under the following circumstances:

- when they relate to immovable properties located on the Italian

territory;

- when they relate to any other goods which are on the Italian territory and have not been transported outside the same territory.

If goods are located outside Italy at the time of their supply, then the place of supply is outside the territory of Italy. As a consequence, the supply is not subject to VAT in Italy, even if the transaction is concluded between two taxable persons established in Italy

With respect to the rules for the **place of taxation of services**, a distinction is made between services supplied to taxable persons ("business- to-business" or "**B2B services**") and services supplied to final consumers ("business-to-consumer" or "**B2C services**").

As a general rule, services shall be deemed to be carried out in Italy when:

- the services are provided to taxable persons **established** in Italy; and
- the services are provided to final consumers by taxable persons **established** in Italy.

The place of supply with respect to services provided to final consumers (B2C services) is in Italy, if the services are supplied by a taxable person established in Italy (taxation in **the place of the supplier**).

The place of supply concerning services carried out in favor of other taxable persons (B2B services) is in Italy if the recipient of the services is established in Italy (taxation in **the place of the principal**).

Service Provider	**Client Business (B2B) ITA**	**Client Consumer (B2C) ITA**
ITA	Italian VAT	Italian VAT
EU (non ITA)	Italian VAT	No VAT in Italy
Extra EU	Italian VAT	No VAT in Italy
Service Provider	**Client Business (B2B) EU**	**Client Consumer (B2C) EU**

ITA	No VAT in Italy	Italian VAT
Service Provider	**Client Business (B2B) Extra UE**	**Client Consumer (B2C) Extra UE**
ITA	No VAT in Italy	Italian VAT

It is therefore relevant to determine the place of establishment of the taxable person (*i.e.* where the company is resident or have a permanent establishment).

Certain types of services are deemed to take place in the place of performance. For example, **services connected with an immovable property** are deemed to be supplied where the immovable property is located.

The place of importation of goods is deemed to be in the Member State where the goods enter into the EU territory.

Timing

Whilst the VAT relevance of a certain transaction depends upon the analysis of the subjective, objective and territoriality requirements, the actual tax burden and related administrative VAT formalities will depend upon the exact point in time at which the transaction is deemed to take place.

Determining the time of supply is important because it affects:

- the time at which liability for VAT arises;
- the place of supply;
- the applicable rate;
- the time limits for issuing assessments; and
- the deduction of input tax.

The VAT law contains detailed provisions for determining the time of supply in respect of different types of transactions.

Accordingly, the **supply of goods** shall be regarded as effected:

- on signature of the contract in the case of real property; and
- at the time of delivery or shipment in the case of movable goods.

However, transfers whose transferal or constitutive effects are produced subsequently shall be considered effected at the time when these effects are produced.

By way of exception to the above general principle, the transaction shall be considered effected:

- for periodic or continual supply of goods in performance of contracts of purveyance, at the time of payment;
- for assignment to the personal consumption of the entrepreneur and his family and for other purposes extraneous to the operating of an enterprise at the time of removal of the goods;
- for transfers of goods relating to contracts of consignment on sale or return, at the time of resale to third parties or, for goods not returned, on expiration of the term agreed between the parties and at all events when one year has elapsed from delivery or shipment.

Performances of services shall be considered as effected at the time of their payment.

If before the full payment is made, an invoice has been issued or their amount paid fully or partly, the transaction shall be considered as realized up to the amount invoiced or paid, on the date of the invoice or payment.

The taxable amount

The taxable base is generally identified with the **consideration in cash** paid under the relevant transaction. Should such consideration be in kind, the taxable base shall be valued in accordance with the **normal value**.

The normal value of goods and services shall mean the price or sum paid on average for goods or services of the same or similar kind on the free market at the same stage of the commercial process at the time and in the place where the operation was effected or at the nearest time and place. In determining the normal value, reference shall be made, insofar as possible, to price lists or to tariffs of the business that supplied the goods or services or, failing that, to the market reports and price lists of the nearest chamber of commerce, to professional tariffs and to stock exchange lists.

Please note that the exchange of goods, for VAT purposes, shall entail two different transactions, each of them to be valued at normal value of the goods or services received in exchange.

Normal value shall be applicable also in respect to self-supply of goods

or services (*e.g.* utilization for personal purposes).

The tax rates

The following rates of Italian VAT are applicable:

- standard rate of **22%**;
- reduced rate of **10%** (*e.g.* tea and mate spices; meat; fish; natural honey; chocolate, house refurbishing works…);
- super-reduced rate of **4% and 5%** (*e.g.* flour and meal of wheat; fresh milk vegetables and edible greens; newspapers, and daily news bulletins; wheelchairs and similar vehicles for invalids food; supplies of passenger urban transport services via sea, lake, river and lagoon…).

Exempt transactions

Unlike the EU VAT Directive which provides for one single definition of exempt transaction, the Italian VAT provisions make a distinction between the so-called zero-rated transaction (*operazioni non imponibili*) and exempt transaction (*operazioni esenti*).

The above distinction is of relevance since the **zero-rated transactions have no impact on the deductibility of the input vat by the seller/service provider** as described in the following paragraph, whilst the **exempt transactions limit the deductibility of the input VA**T.

The typical zero-rated transaction is the exportation of goods outside the European Union. In such a case, the transportation of the goods may be carried out either by the seller or by the purchaser. However, where the purchaser wishes to benefit from the zero-rated provisions must provide evidence to the seller that the goods have been delivered outside the European Union within the 90 days following the remittance of the goods. Otherwise the seller shall be obliged to charge VAT.

Sample of exempt transactions are listed below:

- credit transactions and financing, including discounting of credits, of bills or of banking checks, of surety bonds or other forms of guarantees, deferment of payments, as well as the administration of common investment funds and similar administrations;
- transactions of insurance, reinsurance and of annuities;
- transactions concerning shares of stock and bonds or other

certificates not representative of merchandise, as well as of partnership shares;

- transactions concerning collection of taxes, including those which are relative to the payments of taxes;
- medical diagnostic, care and reclassification services furnished to the person in the exercise of the health professions;
- hospitalization services and care given by hospitals or clinics, as well as by approved establishments of care and societies of mutual aid having juridical personality, including furnishing medications, health aid and supplies, as well as care services rendered by thermal establishments;
- educational services of children and young people, as well as didactic performances of all kinds, whether concerning occupational training, re-training, re-qualification and occupational re-conversion rendered by the institutes or by the schools recognized for that purpose by the public administrations.

Deduction of VAT

VAT is levied at all stages of production, distribution, and the supply of goods as well as the supply of services. In order to avoid an accumulation of VAT in case of more than just one taxable person, within the supply chain, the taxable person may deduct VAT charged by his supplier to him from his VAT liability (input VAT deduction). Due to the VAT deduction on all supplies received, the taxable person will end up with a VAT liability on the value added by him

The input VAT on the acquisition and import of goods and services is recoverable at the time when the VAT is due and the corresponding right of deduction may be exercised at the latest, with the VAT return in the second year subsequent to the year in which the right arises

If the amount of input VAT exceeds the amount of output VAT due for any month or quarter, the taxable person must normally carry the "excess" forward. It is then set against the VAT payable in future tax periods. Certain taxable persons may request a refund of the "excess" input VAT.

VAT is not deductible on the acquisition, lease, repair, etc. of buildings, or part of them, for dwelling purposes, except for businesses that build or sell those goods.

VAT may not be recovered on entertainment expenses.

VAT in respect of mixed transactions is normally recovered on the **pro rata basis**. This states that, if a taxable person makes exempt supplies in a VAT year, he must reduce the amount of VAT claimed for that year, by a percentage. This percentage is calculated by dividing the supplies on which the VAT is recoverable by the sum of this amount and the **exempt supplies** in the same year. The result is rounded up or down to the nearest whole number.

By way of example, if a taxable person carries out only zero-rated transaction or, more in general, fully taxable transactions, it will have full right to deduct input VAT, whilst where a taxable person carries out only exempt transactions, it will have no right to deduct input VAT. Should the taxable person carry out both exempt and fully taxable transactions (including zero-rated transactions) the deductibility of the input VAT shall be determined on the basis of the above pro-rata calculation.

Taxable persons who carry on more than one business activity, within the same legal entity, may elect to account for VAT separately on each activity, as if it were a separate business.

Each separated part of the business must keep independent VAT records. Goods and services are directly attributed to each separated part of the business. The pro rata is then applied, based on the taxable and exempt supplies made in each. VAT must be accounted for on any goods and services supplied by one separated part of the business to any other part, if it is partially exempt

Intracommunity Transactions

The following is a general definition of an **intra-Community acquisition** of goods: the acquisition of the ownership (or other right of enjoyment) in movable property supplied for a consideration, by a taxable person registered for VAT purposes in another Member State, where the goods have been dispatched or transported to the territory of the Member State by the supplier, or the acquirer, or by a third party acting on their behalf.

The transfer of goods owned by a taxable person between Member States shall also be regarded as a deemed intra-Community transaction. Accordingly, when a taxable person transfers goods from his undertaking in Italy to a branch of the same business in another Member State, he makes an intra-Community supply in Italy. This is followed by an intra-Community acquisition in the other Member State acquisition

Generally, the transfer of goods from a business in Italy to another

Member State is a zero-rated **intra-Community supply**. Indeed, such transaction shall be relevant in the Member State of destination as intracommunity acquisition.

F. TAX COLLECTION AND ASSESSMENT

1. Collections

Italy has adopted a system where taxpayers assess themselves (self-assessment approach). This system put on the shoulders of taxpayers the duty to determine, declare and pay the correct amount of tax and, on the other hand, made the tax authorities intervene only in cases of divergence between taxes declared and taxes assessed.

Withholding tax is used as a tool for advance collection of tax on employment income, self-employment income and business income, which are included in the aggregate yearly taxable income of the taxpayers and are ordinarily taxed.

Conversely, withholding tax is a final tax for a variety of income from investment and certain investment income (*e.g.* interest on Italian government bonds) is subject to substitutive taxation, a mechanism of taxation similar to a final withholding tax.

In general terms, withholding taxes are not levied on income from land and buildings and apply only to some types of miscellaneous income.

In compliance with the Italian constitutional ability-to-pay principle (*cfr.* paragraph A.2 above), the person obliged to pay taxes is the person who earns the income (*i.e.* the taxpayer).

The withholding tax mechanism breaks such a traditional scheme by introducing a private third party – the withholding tax agent – in the relationship between the taxpayer and the Italian Revenue. Indeed, in certain situations specifically provided by the law, the withholding agent replaces the taxpayer in his/her duty to pay taxes through the levying of a tax withheld on the amount payable to the taxpayer.

Withholding tax may represent a final or an advance payment of IRPEF or IRES. To simplify, it can be stated that, if the withholding tax is a final withholding tax (so-called "*ritenuta a titolo di imposta*"), then the income to which it relates is excluded from the tax base of the payee. Conversely, an advance withholding tax ("*ritenuta a titolo di acconto*") is only an advance payment made by the payor that does not relieve the payee from including the gross withheld amount of the income in his/her overall income tax base.

The application of a final withholding tax by the withholding tax agent excludes the payee from any substantial and/or reporting duty connected to the income withheld which, on the contrary, is transferred to the withholding tax agent.

Indeed, the amount withheld will not concur with the overall taxable income of the taxpayer and neither the income withheld nor the withholding tax levied shall be indicated in the annual income tax return of the same taxpayer. Final withholding taxes are often referred to as substitutive taxes when the withholding tax regime fully replaces the ordinary taxation regime for income tax; this is the case for many types of investment income or transactions.

2. Withholding tax on Employment Income

The employer withholds the relevant individual income tax by applying the relevant progressive rates determined on the basis of the overall employment income due to the employee throughout the calendar year.

In case the employee does not realize any income (subject to progressive tax rate) other than the employment income subject to the withholding tax, then he will not be required to file the ordinary tax return and the withholding tax shall be considered as final payment.

Conversely, should the employee have any other source of income (which is subject to progressive taxation), he will be required to file the tax return in order to declare such other income and, eventually, to adjust the marginal tax rate at which the employment income has been already subject to tax by the employee.

3. Withholding tax on Income from Professional Services

Considerations paid in respect to self-employment activities by, *inter alia*, corporations, individual entrepreneurs, or other professionals are subject to a 20% withholding tax. In such a case, the withholding levy is a mere advance payment. Hence, all tax obligations connected with the income realised remain with the payee.

Accordingly, the entire income will concur with the determination of the overall tax base of the payee, who will be able to deduct the amount of the advance withholding taxes withheld in the fiscal year from the annual tax liability.

Upon filing his annual tax return, the taxpayer shall have to pay the net amount of taxes due (*i.e.* amount of tax liability net of any withholding tax applied on the same income).

The excess of withholding tax (if any) on the amount of tax liability may:

(i) be compensated with other typology of tax liabilities (*e.g.* VAT);
(ii) be carry forward in the next taxable period or, at discretion of the taxpayer;
(iii) be applied for reimbursement.

As far as the obligations of the withholding tax agent are concerned, the amount of taxes levied at source shall be remitted by the 16th day of the month following that of payment.

In addition, the withholding tax agent has provide the taxpayer with an annual certification of the entire amount of taxes withheld in the course of the relevant year.

4. Withholding tax on Income paid to Corporations

Italian tax law provisions governing the application of withholding taxes on payments received by corporations are not uniform and vary depending on the qualification of the sum paid.

Dividends and royalties paid by resident companies to other resident companies are not subject to withholding tax.

In principle, interest income derived by resident companies is subject to a 26% withholding tax as an advance payment of the IRES due by these companies on such income.

However, no withholding tax is levied on interest paid to resident companies on:

- loans;
- bonds issued by the government and other public entities;
- bonds, bond-like securities and commercial papers issued in Italy by banks and companies whose shares are listed on regulated markets or multilateral trading facilities established in EU or in a white list EEA State; and
- bonds, bond-like securities and commercial papers issued by non-listed companies if they are either:
    - traded on a regulated market or multilateral trading facility in a white list EEA Member State; or
    - only held by one or more qualified investors.

5. Statute of limitations

The Italian tax system is a voluntary income tax system based on self-assessment. Accordingly, both individuals and companies are generally required to disclose, on a yearly basis, their income in a tax return and file it to the Italian Tax Authorities, who will check the correctness of the information indicated therein.

While individuals who do not engage in entrepreneurial activities are required to file only their income tax return, companies are generally subject to broader tax filing obligations, which include:

a) corporate income tax return;

b) local operating profit tax ("**IRAP**") tax return;

c) VAT tax return;

d) withholding ("**WHT**") tax return (where they act as WHT agent on certain kind of income, such as employment income).

The yearly deadlines provided under Italian tax law are summarized in the following table:

Tax return filing deadlines			
FY	**Corporate / Individual / IRAP tax return**	**WHT tax return**	**VAT tax return**
2013	30/09/2014	31/07/2014	30/09/2014
2014	30/09/2015	31/07/2015	30/09/2015
2015	30/09/2016	31/07/2016	30/09/2016
2016	31/10/2017	31/10/2017	28/02/2017
2017	31/10/2018	31/10/2018	30/04/2018
2018	31/10/2019	31/10/2019	30/04/2019

According to Italian tax provisions in force until FY 2015, the Italian Tax Authorities may issue an assessment notice within 31 December of the fourth subsequent year from the date of filing the relevant tax (*e.g.* IRES, IRAP, WHT and VAT) return. Such statute of limitations is extended for

one-year period with regard to taxpayers, which did not file a relevant tax return.

The statute of limitations is doubled in case the Italian Tax Authorities allege tax infringements, which would constitute a tax criminal offence.

According to relevant provisions of law, a criminal tax offence might be alleged when:

- in the event of unfaithful tax return, tax assessed is higher than €150.000 and assessed item is higher than 10% of the overall taxable items shown in the tax return (or higher than €3 million);
- in the event of omitted tax return, tax assessed is higher than €50.000.

However, it should be noted that such provision will no longer apply with regard to FY 2016 onwards.

Please note that the statute of limitations for tax assessment has been broadened by mean of Article 1, paragraphs 130 and 131 of Law No. 208 of 28 December 2015.

According to the amendments introduced by such provisions, the Italian Tax Authorities may issue a notice of assessment within 31 December of the fifth subsequent year from the date of filing of the relevant tax return.

In the event no tax return had been filed, the statute of limitation deadline will be on 31 December of the seventh year following the one when the tax return should have been filed.

Moreover, it has been clarified that the amended statute of limitation shall be applicable starting from FY 2016, thus meaning that all infringements relating to previous FYs shall still be subject to the previous statute of limitation.

In the table below there is an illustrative example of the Statute of Limitation mechanism in relation to FYs, which may still subject to assessment.

Statute of limitations		
FY	**Ordinary**	**Ordinary – criminal tax offence**
2012	31/12/2017	31/12/2021
2013	31/12/2018	31/12/2022
2014	31/12/2019	31/12/2023
2015	31/12/2020	31/12/2024
2016	31/12/2022	n.a.
2017	31/12/2023	n.a.
2018	31/12/2024	n.a.

Please note that Budget Law for FY 2014 has clarified that, in case of amendment of a tax return, the ordinary statute of limitation elapses starting from the date of amendment, for the item amended only.

As with regard to the statute of limitations for indirect taxes purposes:

- municipal property taxes (ICI and IMU) have the same statute of limitations of direct taxes, as outlined above;
- other indirect taxes such as Registration tax and mortgage and cadastral taxes (where applicable) can be assessed by the Italian Tax Authorities within the following deadlines:
  - in case of omitted filing of the deed for registration purposes, the statute of limitations lasts for five years from the date upon which the parties should have filed the deed for registration;
  - in case the deed has been filed with the Italian Tax Authorities for registration purposes, the statute of limitations lasts for three years from the registration date.

Special limitations to the ordinary Statute of Limitation apply in case of purchase of a going concern. In particular, under Italian Tax Law, the buyer has a joint secondary liability with the seller for tax violations committed by the seller, if any, or communicated by the Italian Tax Authorities in the year in which the business was transferred as well as in the two preceding years.

6. Settlement procedure

Italian tax law provides for different types of tax audits: (*i*) formal or (*ii*) substantial.

Formal tax audits are carried out electronically on virtually all tax returns. The purpose of such audits is to check whether formal mistakes have been committed (*e.g.* check of actual payment of the taxes claimed within the tax return, correct carry forward of tax losses or tax credits, etc.).

Substantial audits of tax returns are instead carried out on a sample basis, according to the criteria established for each year by a DM of the Ministry of Economy and Finance.

Italian Tax Authorities have wide powers to obtain any relevant information from the taxpayer. The powers include the right to summon him, ask for additional information and documents, visit his premises and make whatever examinations they deem necessary to determine that the tax return complies with tax law.

In addition, the tax police ("*Guardia di Finanza*") may assist the tax administration in its investigations.

As opposite to formal tax audits, substantial tax audits do not imply the obligation in the hands of the taxpayer to pay the amount challenged, but rather report a list of alleged infringements, which may be used by the Italian Tax Authority in order to make a tax assessment.

The Italian tax system highly incentivizes taxpayers to settle the claims of the Italian Tax Authorities, before entering into a tax litigation process and even before a tax inspection is started.

First of all, taxpayers may spontaneously amend their tax returns, in order to correct errors, within the ordinary statute of limitation. Under such circumstances, if any higher tax liability arises, taxpayers may settle it according to a self-liquidation procedure ("*ravvedimento operoso*").

In a nutshell, under such procedure, taxpayer are allowed to "settle" the amount of prospective challenges by paying the related taxes and interest accrued, benefitting from a substantial reduction of penalties.

Such procedure is available also in case of alleged infringements discovered in case of tax inspections, where a tax assessment has not been already obtained. Under such circumstances, taxpayers may freely decide upon what infringement needs to be settled (*i.e.* there is no obligation to settle all the claims made in the tax audit).

Where a tax assessment is received, taxpayers have 60 days to appeal such assessment before the Tax Court of First Instance. Nevertheless, they

may still apply to certain procedures in order to reduce their tax liabilities, without entering into a litigation process.

In particular, in a scenario of acceptance ("*acquiescenza*") of the alleged tax claims, additional taxes (and related interest) shall be paid in full by the taxpayer, whereas penalties are reduced.

As an alternative, the taxpayer may ask the Italian Tax Authority to discuss further the content of the tax assessment, in order to reach an agreement on the findings illustrated in the tax assessment ("*accertamento con adesione*").

The parties have maximum 90 days to reach an agreement. While discussions are ongoing, the terms for appealing the tax assessment are suspended. In case an agreement is reached, reduced penalties would apply on the amount of higher taxes agreed upon.

7. Litigation process

Taxpayers willing to challenge the requests made by the Italian Tax Authority in a tax assessment shall file an appeal before the competent Tax Court, within 60 days from its notification.

Under Italian tax law, tax disputes are dealt with by specialized judges in the Tax courts of First and Second instance.

The two levels of courts are composed of both ordinary judges and judges practicing legal professions (mainly lawyers and qualified accountants) and other professions (*e.g.* law professors).

Since 2012, judicial actions relating to disputes not exceeding EUR 20,000 (EUR 50,000 from FY 2018 onwards) in value are submitted to an administrative complaint and mediation attempt procedure of the Italian Tax Authorities, which is a preliminary requirement to be included in the appeal before activating the jurisdiction of the Tax Court of First Istance.

The decision of the Tax Court of Second Instance may be appealed before the Italian Supreme Court, which will only resolve on the correct application of law principles during the tax litigation (*i.e.* the Italian Supreme Court is not allowed to assess the particular circumstances and factual merits of a case).

The collection of the amounts claimed within the tax assessment is made in instalments, depending on the phase of the litigation.

The table below summarizes the main terms applicable.

Collection during tax litigation		
Phase of the litigation	**Outcome**	**Amount due**
Appeal of the tax assessment	Taxes assessed and interest accrued	1/3 of taxes and interest
	Penalties	None
Decision of Tax Court of First Instance	Against the taxpayer	2/3 of the overall tax liability
	Partially against the taxpayer	Amount determined by the judge (anyway not higher than 2/3 of the overall tax liability)
Decision of Tax Court of Second Instance	Against the taxpayer	Amount left of the overall tax liability
Decision of Italian Supreme Court	Against the taxpayer	Amount left of the overall tax liability