



Agenzia nazionale per l'attrazione
degli investimenti e lo sviluppo d'impresa SpA

Italy's Tax System

Invitalia is the Italian national agency for inward investments and economic development. Its mission is to promote the country's competitiveness – in particular in the Southern Regions – and support growth in strategic sectors.

Its main objectives are:

- Supporting inward investments*
- Boosting innovation and growth*
- Improving the economic opportunities in the Regions.*

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Italy's Tax System

Italy's Tax System Reform

Italy's corporate taxation system recently underwent a major reform, with subsequent additional amendments.

The main features of the new tax system are:

- Reduction of corporate income tax rate (IRES) to 27.50%
- Partial exemption (95%) of capital gains on the sale of equity investments in companies registered either in Italy or abroad (so-called "Participation Exemption")
- Abolition of tax credit system for dividends and introduction of partial tax exemption (95%) of dividends from equity investments in companies registered either in Italy or abroad
- Introduction of a ceiling on the interest expense deductibility equal to 30% of the gross operating income of industrial or commercial companies
- Introduction of a ceiling on interest expense deductibility for financial companies (96%)
- Introduction of a group taxation mechanism under which Italian and foreign companies belonging to the same group may compute a single taxable income for the parent company resident in Italy
- Tax exemption of capital gains reinvested in start-ups.

Taxes and Withholdings

Direct Taxes

Individual Income Tax (IRPEF)

Individual Income Tax (IRPEF) is governed by Italy's Income Tax Consolidated Text (Testo Unico delle Imposte sui Redditi – TUIR). Individuals resident in Italy for tax purposes are subject to IRPEF on income earned either in Italy and abroad.

Individuals not resident in Italy for tax purposes are subject to IRPEF only on income earned in Italy. Taxable income is taxed at progressive rates currently ranging between 23% and 43%.

Corporate Income Tax (IRES)

Corporate Income Tax (IRES) is also governed by TUIR. Companies resident in Italy for - IRES tax purposes are subject to IRES for income earned in Italy and abroad. Companies not resident in Italy for tax purposes are subject to IRES only for income earned in Italy. Taxable income is taxed at a 27.50% rate.

The Regional Business Tax (IRAP)

The Regional Business Tax (IRAP) is a local tax levied on the value of production generated in each tax period in Italian Regions by subjects engaged in business activities.

Non-resident companies are subject to IRAP only on the value of production generated by permanent establishments in Italian territory.

Indirect Taxes

Value Added Tax (VAT)

Italian rules governing Value Added Tax (VAT - IVA) comply with the relevant Community directives. In principle, the system is designed so as to ensure such tax is only paid by final consumers, as businesses can generally deduct VAT paid at intermediate stages of production. VAT is generally levied on each sale of goods and/or services carried out in Italian territory. The ordinary VAT rate is 20%.

Registration fees and other property transfer duties

Registration fees are levied on specific written instruments made in Italy or written instruments made abroad whereby they regard the transfer of real property or enterprises located in Italian territory. The tax base and applicable rate vary in relation to the type of instrument and the parties involved.

Property transfers are also subject to other duties (namely: imposta ipotecaria and imposta catastale), due in respect of the formalities associated with the registration and/or transfers in public real estate/cadastral registers.

Registration fees and other property transfer duties are either fixed (€168.00) or proportional to the value of the asset being transferred – i.e. 3% - 15% rates for registration fees depending on the instruments or assets involved; 2% for imposta ipotecaria, and 1% for imposta catastaria.

Municipal Property Tax - ICI

Municipal Property Tax is annually due from owners and holders (resident in Italy or abroad) of real rights in immovable property located in Italian territory, with the exception of households' primary residence. The tax base is equal to the value in the relevant property registers, stemming from the imputed property income multiplied by a given coefficient. The rate is set by each municipality within a range varying between 0.04% and 0.07%.

Inheritance Tax

Inheritance Tax is applied to transfers of assets or rights as a result of death (with the exception of transfer of Italian government securities, receivables from the Italian State, or units in investment funds in the amount of any Italian government securities held). Inheritance Tax is levied on the value of the individual shares assigned to each heir at a rate varying between 4% and 8%.

Donor's Tax

Donor's Tax is applied to transfers of assets or rights as a result of donations or other gratuitous transfers, and to establishment of restrictions on intended use.

Donor's Tax is levied on the value of individual shares assigned to each beneficiary at a rate varying between 4% and 8%.

In the case of immovable property, the imposta ipotecaria (2%) and the imposta catastale (1%) are due in addition to inheritance or donor's tax, without prejudice to the benefits applicable to primary residences.

Transfers of enterprises or controlling stakes in enterprises to descendants or spouses are exempt from inheritance or donor's tax. The beneficiary is required to continue the business activity or retain control for five years from the transfer date.

Withholding Taxes

The three main withholding taxes are levied on dividends, interest and royalties.

Withholding Taxes on Dividends

Dividends distributed by Italian or non resident companies received by individuals outside the scope of a business activity are subject to a 12.5% withholding tax in settlement of whereby they concern non-qualifying holdings.

Qualifying holdings consist of shares (other than savings shares) and any other investment in the capital or equity of a company to which are attached voting rights in the ordinary Shareholders' Meeting exceeding 2% or 20%, if the securities are traded on a regulated market, or 5% or 25% in other cases.

Dividends received by individuals outside the scope of a business activity regarding a qualifying holding in Italian companies are not subject to withholding tax, whereas those regarding foreign companies are subject to a 12.50% withholding tax on account for the taxable portion of profit – i.e. 49.72% of the total (with a consequent filing requirement and deduction of any credit for taxes paid abroad), net of any withholding tax applied in the foreign country. In applying the withholding, account is taken of double taxation agreements which could provide for the reduction or elimination of the tax.

Whereby dividends are distributed by a foreign company resident in a State under a privileged tax regime (tax havens), they shall be subject to taxation in full, unless the taxpayer receives a positive response to an opinion request (interpello) from the Revenue Agency.

Dividends received by parties other than individuals not resident in Italy are generally subject to a 27% withholding tax in settlement (the rate is reduced to 12.5% for dividends paid to holders of savings shares). However, whereby non-resident parties are companies or entities subject to corporate income tax in the countries entered in the so-called white list, the rate is equal to 1.375%.

Withholding Tax on Interest

In principle, interest on current accounts and deposit accounts with banks, as well as bonds and similar securities, received by persons resident in Italy for tax purposes is subject to a withholding tax of either 27% or 12.5%, generally applied on account (gross interest is included in taxable income and the withholding is deducted from the gross tax). However, whereby the interest is received by residents outside the scope of a business activity, the withholding tax is applied in settlement and interest is not part of the overall taxable income.

Interest on current and deposit accounts, as well as bonds and similar securities, received by non-residents is not subject to any withholding tax, with the exception of persons resident in tax havens, for whom a 12.50% withholding tax applies.

In general, interest on loans is subject to a 12.5% withholding tax on account if received by persons resident in Italy for tax purposes other than persons engaged in the business activity. If

interest is received by persons not resident in Italy for tax purposes, the withholding tax is applied in settlement.

The withholding tax rises to 27% whereby the recipient is resident in a tax haven as identified in ad-hoc ministerial decree.

The withholding tax may be applied at a lower rate if so provided for in any double taxation agreement between Italy and the recipient's residence State.

In compliance with the EU Interest and Royalties Directive, withholding tax is not due on interest paid by companies resident in Italy for tax purposes or by permanent establishments in Italy of companies resident in the European Union to (i) resident companies, or (ii) permanent establishments of companies resident in other Member States of the European Union. In accordance with the Directive, the benefit is applicable if requirements concerning minimum holdings are fully met.

Withholding Tax on Royalties

Royalties generated in Italy and received by subjects not resident in Italy for tax purposes are subject to a 30% withholding tax in settlement.

In specific cases, the taxable amount is reduced by 25% of total royalties. The withholding may be applied at a lower rate if so provided for in any double taxation agreement¹ between Italy and the recipient's residence State.

In line with the EU Interest and Royalties Directive provisions, withholding tax is not due on royalties paid by companies resident in Italy for tax purposes or by permanent establishments in Italy of companies resident in the European Union to (i) companies resident for tax purposes, or (ii) permanent establishments of companies resident in other Members States of the European Union. In accordance with the Directive, the benefit is applicable if requirements concerning minimum holdings are fully met.

Taxation on Corporations Resident in Italy

Corporate Income Tax - IRES (Imposta sul Reddito delle Società)

Entities subject to corporate income tax, rate and tax period

¹ ibidem

Corporate Income Tax (IRES) applies both to corporations either resident or not resident in Italy.

Companies resident in Italy for tax purposes are subject to IRES both for income earned in Italy and income earned abroad.

Companies not resident in Italy for tax purposes are subject to IRES only for income earned in Italy.

For tax purposes, the following forms of corporation are considered resident in Italy:

- Società per Azioni (S.p.A.)
- Società a responsabilità limitata (S.r.l.)
- Società in accomandita per azioni (S.a.p.a.).

Also considered Italian residents are foreign companies and entities having their administrative headquarters or their main activities in Italian territory for most of the tax period. In specific circumstances, the administrative headquarters of foreign companies and entities is presumed to be located in Italy in any case.

Partnerships (società in nome collettivo, società in accomandita semplice) are not subject to IRES. The income produced by such entities is usually taxed pursuant to the rules envisaged for Individual Income Tax (IRPEF), with the income being directly attributed to partners on the basis of their percentage holding in the entity.

However, partners may elect to tax such income separately at the same rate envisaged for IRES (27.50%). The option may be exercised on the condition that such income is not distributed (pursuant to ad-hoc ministerial decree establishing the relevant implementation provisions).

For tax purposes, the tax period coincides with the financial year, as established in the Articles of Association or By-Laws. If not otherwise specified, the tax period coincides with the calendar year. The IRES rate is equal to 27.50%.

Trusts

Trusts whose registered office is in Italy and foreign trusts whose administrative headquarters and/or primary business are in Italy, are also subject to IRES.

The headquarters of foreign-registered trusts are presumed to be located in Italy if the trust is established in a country on the black list and:

- At least one of the trustors and at least one of the beneficiaries are resident in Italy for tax purposes; or
- An Italian resident makes a contribution to the trust involving transfer of ownership of immovable property or establishment of restrictions on the intended use of such property.

Taxable income

Taxable income is determined pursuant to TUIR provisions. Generally speaking, all income received by corporations resident in Italy for tax purposes is considered as corporate income (redditi d'impresa), regardless of its nature, and is taxed in accordance with the rules governing its specific category.

Taxable income is composed of net income produced (anywhere) over the tax period, as reported in the income statement, adjusted up or down in accordance with TUIR provisions.

Taxable income does not include exempt income and/or income subject to withholding tax in settlement.

Without prejudice to a number of specific exceptions, the positive and negative components of income are considered on an accruals basis for tax purposes (one exception concerns dividends, included in taxable income on a cash basis). In order to determine taxable income for IRES purposes, it is necessary to distinguish between positive and negative components of income.

Positive components of income

- Revenues

Revenues include proceeds from: a) sale of goods and services whose production or exchange is the business focus; b) sale of raw and ancillary materials and semi-finished goods; c) sale of shares, bonds and similar securities not classified as non-current financial assets.
- Capital gains

Capital gains include the positive income components generated by the sale of company assets other than revenue-generating assets (typically, capital gains are generated by the sale of non-current assets).

Capital gains are included in taxable income for the tax period in which they are performed or, whereby the assets have been held for at least three years, in equal instalments through five years beginning in the year they are performed.

Such rules also apply to capital gains generated by equity investments (other than those qualifying for participation exemption) recognised under noncurrent financial assets in the last three financial years.

Participation Exemption

Partial exemption of capital gains on the disposal of equity investments

95% of capital gains realised by companies resident in Italy for tax purposes on the disposal of equity investments in corporations/partnerships resident in Italy or abroad are IRES-exempt.

Equity investments eligible for such treatment are those classified as non-current financial assets, engaged in commercial activities, held continuously for at least twelve months and resident for tax purposes in a country or territory other than a tax haven (white list countries).

Capital losses, write-downs and expenses related to the disposal of equity investments qualifying for the participation exemption are not deductible.

Exemption of capital gains on the disposal of equity investments reinvested in start-ups

Capital gains earned by resident individuals and non-residents of any nature on the disposal of equity investments in partnerships and corporations established no more than seven years earlier and held for at least three years do not form part of taxable income whereby they are reinvested in companies engaged in the same business within two years of their performance.

Partial exemption of dividends

Dividends received from corporations resident for tax purposes in Italy or a State or territory other than a tax haven are excluded from taxable income for IRES purposes in the amount of 95%.

Negative components of income

In general, negative components of income (costs and expenses) can be deducted from taxable income as long as they:

- Are related to the business, i.e. contribute to producing taxable income
- Are acknowledged in the income statement.

Costs and expenses generally related to the production of exempt income and taxable income can be deducted in an amount corresponding to the ratio of taxable revenues to total revenues.

Interest – Deductibility ceiling

Industrial and commercial companies can fully deduct interest expense and similar charges (not capitalised in the cost of assets) in an amount equal to interest income and similar revenues. The excess may be deducted up to a ceiling of 30% of Gross Operating Profit – GOP (Risultato Operativo Lordo - ROL). GOP (ROL) is equal to the difference between item A (Production Value) and item B (Production Costs) in the income statement, increased by depreciation and amortisation of property, plant and equipment, and intangible assets and lease payments.

Interest expense that cannot be deducted (due to limit exceeding) can be carried forward to subsequent tax periods if and to the extent in which the amount of interest expense and similar charges for such periods is less than 30% of GOP (ROL).

As from 1 January 2010, the GOP (ROL) portion not used in a given tax period as it exceeds interest expense may be carried forward to increase GOP (ROL) in subsequent years.

Specific rules apply in the case of companies participating in the consolidated taxation mechanism.

A 96% ceiling on interest expense deductibility was also introduced for financial companies.

Tax losses, withholding taxes and tax credits

Tax losses

Tax losses arising in a given tax period can be deducted from taxable income in subsequent periods up to a maximum of five years. Tax losses may not be deducted from taxable income generated in previous tax periods.

Tax losses arising in the first three tax periods following the company establishment date may be deducted from total income in subsequent tax periods with no time limit, as long as losses concern a new business.

Withholding taxes

Income received by corporations resident in Italy for tax purposes are subject to withholding tax in a limited number of situations (e.g. interest on current and deposit accounts, interest on specific bonds and similar securities).

Dividends and royalties are not subject to withholding tax.

Withholdings on income received by companies resident for tax purposes in Italy are generally made on account, and thus represent an advance payment of IRES. Income subject to withholding tax is included in the recipient's taxable income, and withholdings are subsequently deducted from gross IRES.

Credits for taxes paid abroad

If taxable income includes income earned abroad, corporations resident in Italy for tax purposes are entitled to deduct any tax effectively paid on such income abroad from their gross IRES liability.

Tax credit for paid taxes is equal to the lesser of:

- Tax paid abroad
- Portion of Italian tax related to the income earned abroad (on the basis of the foreign income ratio to overall gross income).

A number of double taxation agreements introduced by Italy grant specified tax credit to individuals resident in Italy for tax purposes, even whereby the tax levied in their origin State is less than the credit, or no taxes are levied at all.

Taxation on a consolidated basis

Companies resident in Italy for tax purposes belonging to the same group may elect to adopt the consolidated taxation mechanism.

Under such mechanism, the subsidiaries' income is attributed to the parent company.

Exercising the consolidated taxation option therefore involves calculating a single taxable income for the entire group, represented by the algebraic sum of the companies' net profit or loss included within the consolidation scope.

Regardless of the size of the stake held by the parent company, the consolidation process considers the entire net income of subsidiaries.

The taxation mechanism enables offsetting the taxable income of some group companies against the tax losses generated by other group companies.

The option of electing consolidated taxation is subject to compliance with a number of conditions, namely:

- The parent company shall be resident in Italy for tax purposes or, if resident abroad, shall be resident in a country with which Italy holds a double taxation agreement. In addition, its holdings in the companies included in the consolidation scope shall be attributable to a permanent establishment in Italy
- Subsidiaries shall be resident in Italy for tax purposes, subject to the ordinary IRES system and not benefiting from any tax rate reduction
- Consolidated companies shall be controlled by their respective parent company. To such end, as from the start of each tax period the parent company shall directly or indirectly hold a majority of voting rights in the ordinary Shareholders' Meetings of the subsidiary, and be directly or indirectly entitled to more than 50% of the subsidiary profits
- The parent company and its subsidiaries shall follow the same financial year (i.e. the same tax period) and shall exercise the option for consolidated taxation jointly.

The option election has duration of three years and may not be revoked.

The consolidated taxation mechanism does not have to be adopted by all subsidiaries.

Group taxable income is determined by the parent company as the algebraic sum of the taxable income of each consolidated company.

Non-deductible interest expense and similar charges attributable to a participant in the consolidated taxation mechanism (i.e. expense exceeding 30% of GOP - ROL) can be used to reduce group taxable income if and to the extent other participants in the consolidated taxation mechanism have not entirely used the available GOP (ROL) for deduction. The rule also applies for any excess carried forward, with the exception of excess generated prior to participation in the consolidated taxation mechanism. To such end, under specific conditions, the GOP (ROL) attributable to the group's foreign companies may also be computed whereby the latter would satisfy the requirements for participation in the consolidated taxation mechanism if resident in Italy.

Taxation on a pass-through basis

Under the rules governing taxation on a pass-through basis (i.e. transparency regime), shareholders of corporations resident in Italy for tax purposes can elect to include the income of the companies in which they own a stake in their own taxable income(s).

More specifically, under the pass-through taxation mechanism, the corporation taxable income is directly attributed to each shareholder in proportion to its holding in the company. The option

of electing pass-through taxation may only be exercised if a number of specific conditions have been met, including:

- Shareholders shall be corporations resident in Italy or resident abroad if the latter are not subject to withholding tax at source on dividends
- The percentage holding in profits and voting rights in the Shareholders' Meeting held by each shareholder shall be no less than 10% and no greater than 50%
- The option shall be jointly elected by the company and all its shareholders.

The option election has a three-year duration and may not be revoked.

Regional Business Tax - IRAP (Imposta Regionale sulle Attività Produttive)

The Regional Business Tax (IRAP) is a local tax levied on the value of production generated in each tax period in Italian Regions by, among others, corporations resident in Italy for tax purposes.

The Reform required the Government to gradually eliminate IRAP by first enabling the gradual deduction of labour costs and other currently non-deductible costs from taxable income as calculated for IRAP purposes.

Taxable income and tax rate

Taxable income for IRAP purposes is equal to the net value of production generated in each Italian Region and calculated as the difference between the macro-categories A and B (with the exception of a number of items) of the income statement as drawn up on the basis of Italian National Accounting Standards (for entities drawing up their financial statements in accordance with International Accounting Standards - IAS, the corresponding items are considered).

For industrial and commercial enterprises:

- Positive components include all income, with the exception of: a) capital gains generated by the disposal of companies and equity investments); b) specified extraordinary income components; c) financial income (dividends, interest)
- Negative components include all costs and expenses, with the exception of: a) labour costs (with some exceptions); b) interest and finance charges; c) specified capital losses and negative components of extraordinary income. IRAP is not deductible from taxable income as calculated for IRES purposes. Industrial and commercial companies are subject to an

ordinary IRAP rate of 3.9%. Regions may however change the rate by up to one percentage point for some specific sectors. Whereby the rate is changed by Regions, it is adjusted on the basis of a 0.9176 coefficient.

The production value is considered to be produced in a given Region if the company has a fixed office located in the given Region for at least three months of the tax period. The net value of production is allocated among the Regions in which the company's business is conducted on the basis of labour costs attributable to each Region.

A number of deductions from IRAP taxable income are envisaged for

- New hiring
- Research and development personnel
- Employees hired upon permanent contracts

in order to reduce the so-called "tax wedge", i.e. the difference between the overall cost incurred by the enterprise for employees and the net compensation received by such employees.

Taxation on Non-Resident Corporations with Permanent Establishment in Italy

Corporate Income Tax (IRES)

The income earned by companies not resident in Italy for tax purposes through a permanent establishment in the Country is considered as Italian source income and is therefore subject to IRES. Except for a number of specific exceptions, the definition of permanent establishment as per TUIR equals the definition provided by the OECD Model Double Taxation Convention.

In general, comprehensive income produced by non-resident companies through permanent establishment in Italy shall be calculated on the basis of a specific income statement for the permanent establishment operations, pursuant to the same rules governing the accounts of companies resident in Italy for tax purposes.

However, for permanent establishments in Italy of non-resident companies, a number of components of income generated in Italy and directly received by the foreign company (i.e. without permanent establishment participation) are nevertheless included in the taxable income of the permanent establishment (so-called "force of attraction" of the permanent establishment).

More specifically, the “force of attraction” operates for:

- Capital gains and losses of assets associated with commercial activities conducted in Italian territory
- Profits distributed by corporations and entities resident in Italy for tax purposes
- Capital gains on the disposal of assets located in Italy and equity investments in companies resident in Italy for tax purposes.

Generally speaking, the force of attraction of the permanent establishment does not operate whereby the foreign company is resident, for tax purposes, in a Country with which Italy holds a double taxation treaty or agreement. In this case, the income attributable to the permanent establishment is solely limited to the corporate income actually produced by that given establishment.

Regional Business Tax (IRAP)

Non-resident companies are subject to IRAP only on the value of production generated by permanent establishments located in Italian territory. The value of production is calculated in accordance with the same rules applied to resident companies.

Branch Tax

Italian tax legislation does not establish any additional tax on the repatriation of income earned by non-resident companies through permanent establishments in Italy.

International Agreements/Treaties and Community Directives

Italy has established agreements/treaties with the following countries to avoid double taxation:

Double Taxation Agreements and Treaties			
Albania	Ethiopia	Malta	United States
Algeria	Philippines	Morocco	South Africa
Argentina	Finland	Mauritius	Sweden
Australia	France	Mexico	Switzerland
Austria	Georgia	Mozambique	Tanzania
Bangladesh	Ghana	Norway	Thailand
Belgium	Germany	New Zealand	Trinidad and Tobago
Brazil	Japan	Oman	Tunisia
Bulgaria	Greece	Netherlands	Turkey

Canada	India	Pakistan	Ukraine
Czechoslovakia*	Indonesia	Poland	Uganda
China**	Ireland	Portugal	Hungary
Cyprus	Israel	United Kingdom	Soviet Union ****
South Korea	Yugoslavia***	Romania	Uzbekistan
Ivory Coast	Kazakhstan	Russia	Venezuela
Denmark	Kuwait	Senegal	Vietnam
Ecuador	Lithuania	Syria	Zambia
Egypt	Luxembourg	Singapore	
United Arab Emirates	Macedonia	Spain	
Estonia	Malaysia	Sri Lanka	

* The agreement between Italy and Czechoslovakia applies to the Czech Republic and the Slovak Republic.

** The agreement between Italy and China does not apply to Hong Kong or Macao.

*** The agreements between Italy and Yugoslavia apply to Serbia and Montenegro, Croatia, Slovenia and Bosnia Herzegovina.

**** The agreement between Italy and the Soviet Union applies to the following countries: Belarus, Moldova, Armenia, Azerbaijan, Kyrgyzstan, Tajikistan and Turkmenistan.

Such agreements/treaties generally establish more favourable tax treatment for subjects not resident in Italy than would normally apply under domestic legislation.

Most of the above agreements/treaties are based on the OECD Model Double Taxation Convention.

The EU Parent-Subsidiary Directive

Italy has transposed the provisions of the EU "Parent-Subsidiary Directive", intended to prevent double taxation of the profits produced by companies resident in a given EU Member State for tax purposes (subsidiary companies) and distributed to companies resident in another EU Member State for tax purposes (parent companies).

Under the new rules governing dividend taxation, dividends received by parent companies resident in Italy for tax purposes are IRES-exempt in the amount of 95%, regardless of the percentage holding in the subsidiary and period for which the investment is held.

Under specific circumstances, dividends received by a parent company resident in another EU Member State are exempt from withholding tax or are entitled to reimbursement of any withholding applied.

The parent company is eligible for exemption, whereby it inter alia holds a direct shareholding in a subsidiary resident in Italy for tax purposes equal at least to 10% for dividend distributions.

Withholding exemption is granted whereby the minimum shareholding in the Italian subsidiary has been held without interruption for at least one year as of the dividend payment date. Alternatively, the parent company may request reimbursement of the paid withholding tax once the minimum holding period has elapsed.

The EU Merger Directive

Italy has transposed the provisions of the EU Directive on a common system of taxation on mergers, divisions, transfer of assets and exchanges of shares among companies resident for tax purposes in different EU Member States.

In line with the Directive provisions, Italy's tax law governs the conditions under which the tax neutrality envisaged for such restructuring operations shall apply.

The EU Interest and Royalties Directive

The Directive abolishes withholding tax at source on payments of certain forms of interest and royalties between associated companies resident in different Member States of the European Union. The Directive establishes an exemption from all withholding taxes on interest and royalty payments in the source EU Member State, with taxation only in the Member State in which the beneficial owner of the payments is resident.

The Italian Government implemented the Directive via Legislative Decree 143 of 30 May 2005 (entered into force on 26 July 2005).

Entitlement to the exemption from withholding tax on payments made to companies resident in EU Member States is subject to the following conditions:

- The companies receiving the payments are final beneficiaries, not mere intermediaries
- The company making (receiving) the payment has a direct minimum holding of at least 25% of the voting rights in the company receiving (making) the payment, or a third company has a direct minimum holding of at least 25% of the voting rights in both the company making the payment and the company receiving it
- The shareholdings to which the voting rights indicated in the previous point are attached have been held without interruption for at least one year.

Satisfaction of the conditions and qualifications necessary to be eligible for the exemption shall be established by way of supporting documentation at the time the payment is made.

The implementing decree also introduces a 30% withholding tax on compensation paid to non-residents for use or grant for use of industrial, commercial or scientific equipment located in Italian territory.

Transfer Pricing

Transfer pricing refers to the set of rules that, for tax purposes, govern the determination of prices in international transactions between companies belonging to the same group.

Italian tax legislation establishes that the components of income generated by transactions with foreign companies belonging to the same group shall be measured at their so-called "normal value", i.e. on the basis of the average price of the same or similar goods and services in a free market at the same commercialisation stage.

In 1980, Italy's financial and tax authorities issued a circular illustrating methodologies and criteria for correct determination of transfer prices. In general, such criteria are compliant with the instructions issued by the OECD.

Taxpayers may ask tax authorities in advance to assess the appropriateness of the methodologies they have adopted.

The "International Ruling" procedure is completed with the signing of an agreement with the tax authorities, binding for a maximum of three years.

Foreign Subsidiaries and Associates

Italian law establishes provisions applicable to certain foreign subsidiaries and associates, namely Controlled Foreign Companies (CFCs²). Such rules are intended to prevent the allocation of taxable income to companies resident for tax purposes in Countries with privileged tax regimes (tax havens), identified on the basis of an ad-hoc ministerial decree.

More in detail, under specific conditions (e.g. percentage of holdings in the foreign company benefiting from the privileged tax regime), the income generated by the CFC, regardless of actual receipt, is attributed to the Italian shareholders in proportion to their shareholding size. In other words, regardless of the actual distribution of profits, the income generated by the CFC is included in the taxable income of the controlling party resident in Italy and, as such, is subject to Italian taxation.

CFC rules do not apply whereby:

- The CFC actually engages in industrial or commercial activities in the State in which it is located
- The shareholding does not give rise to a transfer of income to States where such income would enjoy a privileged tax regime.

In order to claim exemption from CFC rules, the parent company resident in Italy for tax purposes shall submit a prior request to Italy's Revenue Agency.

² Foreign Controlled Company (CFC) regulation, pursuant to Article 127-bis of TUIR.

Taxpayer Requirements

Income tax returns

Each year, taxpayers shall declare their taxable income by submitting a tax return to the relevant tax authorities.

Corporations resident in Italy for tax purposes shall submit their tax returns electronically by the end of the seventh month following the final month of their tax period.

Individuals resident in Italy for tax purposes shall submit their tax returns by 31 July, if electronically. Alternatively, individuals shall submit their returns in hardcopy (paper form) through an authorised intermediary (bank or post office) by 30 June.

IRAP returns

Taxpayers subject to the Regional Business Tax (IRAP) shall submit separate corporate income tax returns compliantly with the same procedure followed for personal income tax returns.

Payment deadlines

In general, payment of IRES and IRAP for each tax period is broken down into two advance payments and one final balance payment.

More specifically, for a given tax period:

- The first advance payment is due by the sixteenth day of the sixth month following the first month of the tax period
- The second advance payment is due by the final day of the eleventh month following the first month of the tax period
- The balance is due by the sixteenth day of the sixth month following the first month of the tax period.

In general, the same rules for payment of IRPEF and IRAP also apply to individuals resident in Italy for tax purposes.

Audits and Disputes

Audits

Tax authorities conduct both formal and substantive audits of income tax returns.

Formal audits are designed to correct material errors and calculation mistakes made by taxpayers. The outcome of the check is notified to taxpayers, with a specification of the reasons for the adjustment to the amounts declared, which also enable the taxpayer to correct the data reported or settle the discrepancy quickly.

Substantive audits are intended to adjust taxable income or the VAT turnover reported by the taxpayer.

In such audits, the tax authorities may carry out inspections at the taxpayer's premises.

Following such checks, whereby omissions or violations are found, the competent tax authorities will issue an assessment.

Deadlines for assessments

For the purposes of assessments related to income tax and VAT, the deadline is 31 December of the fourth year following the year in which the tax return was submitted.

If no tax return was submitted, the deadline is extended until 31 December of the fifth year following the year in which the return should have been submitted.

The above deadlines are doubled (31 December of the eighth year following the year in which the tax return was submitted or 31 December of the tenth year following the year in which the return should have been submitted) whereby the taxpayer has committed a violation for which the authorities are required to file a complaint accusing the taxpayer of one of the offences envisaged in Legislative Decree 74/2000.

Disputes

Notices of assessments and/or penalties issued by tax authorities can be appealed to bodies responsible for adjudicating tax disputes.

Appeals against notices of assessments and/or penalties shall be lodged with the Provincial Tax Commission within 60 days from notification. Rulings of the Provincial Tax Commission may be appealed both by tax authorities and taxpayers to the Regional Tax Commission. The rulings of

the latter may be appealed to the Court of Cassation (Corte di Cassazione – Italy's Supreme Court of Appeal) by tax authorities and taxpayers only for legality questions.

Opinion requests

Taxpayers can request an opinion from tax authorities concerning interpretative uncertainties in the application of tax regulations to specific cases.

Taxpayers may also request a special type of opinion (pre-filing opinion) to govern international issues concerning transfer prices, royalties and dividends.

The response to the request is valid for three years and, assuming no change in the factual or legal circumstances, is binding on tax authorities.

Taxation on Individuals

Natural persons resident in Italy are subject to Individual Income Tax (IRPEF) on income produced in Italy and abroad.

Non-residents are only subject to IRPEF on their Italian income.

The tax period coincides with the calendar year.

Tax residence

Residents are individuals who, for more than half of the tax period:

- Are entered in the Register of Italian residents; or
- Have their domicile or residence in Italian territory.

Pursuant to the Italian Civil Code, “residence” is the place in which individuals have their habitual abode, while “domicile” is the place in which their affairs are primarily conducted (the centre of their vital interests).

Unless otherwise demonstrated, residents also include Italian citizens removed from the Register of Italian residents who have emigrated to a State or territory with a privileged tax regime, as per ad-hoc ministerial decree.

Income and taxable income - categories

IRPEF is applied to individuals with income falling within one of the following categories:

- Real property income
- Investment income (e.g. dividends, interest)
- Compensation of employees (e.g. salaries)
- Income from self-employment (e.g. professional fees)
- Corporate income
- Other income (e.g. capital gains on the sale of shares or similar securities).

Each of the above categories has different rules for determining taxable income.

Both exempt income and income subject to withholding tax in settlement (e.g. interest on bonds, dividends) are excluded from the calculation of taxable income.

Specific income components are taxed separately (except whereby the taxpayer elects to include such income in ordinary income, if envisaged as an option). These include severance pay, capital gains on the disposal of enterprises owned for more than five years, income from withdrawal from a partnership, and so forth. Separate taxation takes account of the fact that certain forms of income are formed over a number of years. Therefore, instead of the ordinary marginal IRPEF rate, income is taxed at the same rate that would apply to half of total income in the two previous years.

Compensation of employees earned from an activity performed abroad is taxed as per ad-hoc ministerial decree, regardless of the compensation actually received.

Tax rates

The following tax rates (by income bracket) apply:

Taxable income	Rate
Up to €15,000	23%
€15,001 - €28,000	27%
€28,001 - €55,000	38%
€55,001 - €75,000	41%
Over €75,000	43%

The gross tax is determined by applying IRPEF rates to global income, i.e. to the sum of all the incomes in the above categories, net of specific deductible expenses (medical expenses, alimony payments, and pension and welfare/social security contributions).

The net tax liability is determined by subtracting from the gross tax:

- Exemptions for employees (the amount declines as income increases)
- Standard deductions for specific categories of income (compensation of employees and similar income, income from self-employment, and corporate income for persons qualifying for simplified accounting)
- Other deductions (e.g. primary residence and medical expenses).

The tax to be paid is calculated by subtracting any tax credit and withholding tax on account from the net tax.

The global income calculated for tax purposes, net of deductible expenses, is also subject to a regional IRPEF surtax, ranging between 0.9% and 1.4%, and a municipal IRPEF surtax – the rate is set by the State with a consequent reduction of IRPEF rates (to date, no rate has been established). Individual municipalities may adjust the base rate up to a maximum of 1.2%.

International Accounting Standards (IAS)

Article 25 of Law 306 of 31 October 2003 concerning the exercise of the options provided for by Regulation (EC) 1606 of 2002 granted the Italian Government enabling authority to extend the adoption of international accounting standards to the separate financial statements of listed companies in Italy, as well as to the separate and consolidated financial statements of other companies whose securities are not listed on regulated markets in the European Union. The Decree also provided for the option of adoption of international accounting standards by commercial companies.

In implementation of the enabling authority, the Government issued Legislative Decree 38 of 28 February 2005. In addition to regulating the accounting aspects, the Decree also introduced legislative amendments governing the tax effects of the transition to/adoption of international accounting policies. The amendments were designed to ensure neutrality of transition/adoption, notably to prevent the transition to/adoption of the IAS from creating a benefit or disadvantage in respect of companies that draw up their accounts on the basis of the accounting standards ordinarily applicable to commercial companies.

However, with the 2008 Finance Act, the principle of tax neutrality has given way to differential treatment depending on the tax involved.

In particular, entities adopting IAS are required:

- For income tax purposes, to apply the qualification, recognition and classification criteria envisaged in international accounting standards (IAS)
- For IRAP purposes, to calculate taxable income on the basis of the items corresponding to those adopted by persons applying Italian national accounting standards.
- In addition, the 2008 Finance Act introduced numerous specific tax rules for IAS adopters. For instance:
 - The value changes (increases or decreases) acknowledged in application of IAS in respect of shares, bonds and similar financial instruments held for trading (not recognised under non-current assets) are now material for the purposes of direct taxation. Dividends from shares, units and similar instruments held for trading are fully taxable for the beneficiary. Conversely, no changes were made as to the immateriality for tax purposes of changes in values recognised for shares, units and similar instruments held as non-current assets (i.e. "not held for trading")
 - Rules governing dividend washing¹⁹ do not apply to IAS adopters, subject to specific rules under which the tax cost of shares, units or instruments comparable to shares meeting the requirements of the participation exemption application (with the exception of the holding period) is reduced by an amount equal to the tax-exempt share of dividends received during the holding period.

The implementing and coordination provisions governing such changes will be established via ad-hoc ministerial decree.