

EUROPEAN HOLDING COMPANIES - ITALY

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Corporate Tax Rate

An Italian resident holding company is subject to the normal corporate income tax (“I.R.E.S.”) at the rate of 27.5% according to the Italian Income Tax Code - Presidential Decree No. 917/1986 (“I.T.C.”).

Holding companies are also subject to the Regional Tax on Productive Activities (“I.R.A.P.”) at a rate 4.65%.

Dividends received by a holding company

Dividends are generally 95% exempt from the taxable base.

Dividends are fully taxed if deriving from a subsidiary resident in a black listed country or in the case of shares “held for trading” by IFRS/IAS adopters.

Dividends paid by a holding company

Dividends paid to Italian resident companies, partnerships or individuals holding the shares in the context of a business activity, are not subject to any withholding tax.

If the recipient of the dividends is an Italian resident individual who does not hold the shares in the context of a business activity and the shares represent a participation in the capital of the holding company that does not exceed 20%, the dividends are subject to a final withholding tax of 20%.

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Dividends paid to non-Italian resident companies or individuals that do not have a permanent establishment in Italy are subject to a 20% final withholding tax.

Dividends paid to an EU Member State resident may benefit from a reduced 1.375% withholding tax rate.

Parent-subsidiary Directive

The Parent Subsidiary Directive has been implemented in Italy by art. 27-bis, Presidential Decree No. 600/1973.

Dividends distributed by an Italian company to an EU resident company are exempt from withholding tax if the parent company:

- is resident in an EU Member State and is not deemed to be resident in a non-EU country under an applicable tax treaty;
- has one of the corporate legal forms listed in the Annex to the Directive;
- is subject to one of the corporate income taxes listed in the Annex to the Directive without the possibility to opt for a more favourable, or for an exemption, regime;
- holds at least 20% of the voting rights in the shareholders meeting of the Italian company for a continuous period of 12 months.

In addition, in order to benefit from the exemption, the subsidiary must acquire and hold a certificate issued by a foreign tax authority attesting the compliance with the first three conditions. The last condition is corroborated by a declaration.

A specific anti-avoidance provision is also provided: in situations where the Parent company is directly or indirectly controlled by non-EU entities, the withholding tax exemption only applies if the company demonstrates that the participation is not held for the exclusive or main purpose of benefiting from the exemption regime.

Capital Gains - Participation Exemption

Under art. 87 of the ITC any capital gain derived by an Italian-resident company from the disposal of shares is 95% tax-exempt if the following requirements are met:

1. The participation is held as of the first day of the 12th month period prior to the disposal;

2. The participation is registered as a fixed financial asset in the financial statements for the fiscal year of the acquisition of the same participation;
3. The subsidiary carries on a commercial activity;
4. The subsidiary is not resident in a black listed country for CFC purposes.

As far as requirement no. 1 is concerned, where shares purchased at different times, in order to verify the participation eligible for the regime, a last-in-first-out (LIFO) criterion applies.

Regarding requirement no. 3, art. 87 provides that it does not apply to companies listed on a regulated market or to sales made in the context of public offerings. Moreover, the requirement must be already exist at the time of the disposal for at least 3 fiscal periods. In addition, according to art. 87, real estate companies cannot comply with the requirement.

According to art. 86 of the ITC, expenses connected to participations eligible for the participation exemption regime are deductible only for an amount equal to 5%.

Capital Losses

Under article 101(1) of the ITC, capital losses realized through the disposal of participations (whether in Italian-resident or non-Italian resident companies) can be deducted from the taxable base.

According to article 109(3-*bis* and 3-*ter*) of the ITC, capital losses deriving from the disposal of participations qualified for the participation exemption regime cannot be deducted from the taxable base for an amount equal to the portion of the dividends distributed in the 36 months prior to the disposal that have been 95% exempt.

The above limitation does not apply to companies that adopt IAS/IFRS.

Interest and Royalties Directive

Art. 26-*quater* Presidential Decree No 600/1973 implemented the Interest and Royalties Directive.

According to this provision, payments of interest or royalties made by an Italian company to an EU resident company are exempt from withholding tax if the following requirements are met:

- The recipient is an associated company of the payer;
- The recipient is a company having one of the corporate legal forms listed in the Annex to the Directive;
- The recipient is fully taxed in the State of residence;
- The recipient is the beneficial owner of the interests or the royalties;

In order for the first requirement to be met, art. 26-*quater* provides that two companies can be deemed to be associated when the first one holds at least 25% of the voting rights in the shareholders meeting of the second one or when a third company holds more than 25% of the voting rights in the shareholders meetings of both companies. A minimum of one year holding period is required.

Interest deduction

Interest is fully deductible from the taxable base within the limit of the amount of interest accrued in the tax year.

Any interest paid in excess is deductible only for an amount equal to 30% of the difference between the “value of production” and the “costs of production” within the same year.

The amount of interest in excess of this 30% threshold can be carried forward to subsequent tax years indefinitely.

Tax Losses Carry-Forward

The tax losses carry-forward regime has been recently modified.

Under the previous version of article 84 of the ITC, tax losses reported in one year could be carried forward and could fully offset the taxable basis of the following fiscal years, up to the fifth year.

The new regime provides that tax losses can be carried forward and utilized to offset the profits of subsequent periods indefinitely, but within the limit of 80% of the taxable profits of each subsequent period.

The new rule does not affect the right for companies to fully carry forward tax losses realized in the first three tax periods after the commencement of the business without any limitations.

Aid to Economic Growth (Ace)

A provision aimed at countering the endemic low capitalization of Italian companies has been recently introduced.

The new provision provides for the exclusion from the taxable income of a notional return on equity increases. The relevant equity increases are those that lead to an increase in the company's net assets in the relevant fiscal year realized by contribution in cash or by the non-distribution of the yearly profits.

For the first three years (2011-2013), the notional return is fixed at 3%. From 2014 the Ministry of Finance will establish the return on a yearly basis considering the average financial returns of State bonds plus a premium risk.

Non-Operating Companies

The non-operating company regime is aimed at countering tax avoidance through the use of the legal form of stock companies holding assets.

A company is deemed to be non-operating if the total amount of the proceeds and the inventory's increase is lower than the minimum revenues determined by applying specific parameters ("operating test"): the sum of (i) 2% of the value of shares or other interests in companies; (ii) 6% of the value of the real property reported in the financial statements as long term investments (reduced to 5% for real estate assets classified under cadastral category A10 or to 4% for residential properties acquired or revalued in the course of the year or in the two previous years); (iii) 15% of the value of other assets reported in the financial statements as long term investments. Specific exemptions may apply under certain circumstances.

If a company qualifies as non-operating based on the above parameters, such a company has to recognise a certain deemed minimum income. Moreover, the excess of VAT tax credit (if any) shown in the VAT return would not be refundable or available for offsets against other taxes or transferable to third parties.

Starting from the 2012 taxable year, the corporate income tax rate for companies considered as non-operating is increased by 10.5%. As a consequence, the total tax rate for those companies is 38%.

Moreover, a company may be considered as non-operating - even if it passed the operating test - when it makes tax losses in three fiscal years in a row or when,

over a three-year period, it makes tax losses for two fiscal years and declares a taxable income lower than the minimum income required in another fiscal year. Companies falling under either of the above circumstances will be considered as non-operating in the following fiscal year.

Controlled Foreign Company

Italian CFC legislation is contained in articles 167 and 168 of the ITC. According to the rules, profits realized by an entity resident in a territory considered a tax haven are deemed to be the profits of the Italian resident entity (individual, company or another entity subject to corporate income tax) if the resident entity, directly or indirectly, controls the foreign entity.

For the purposes of the CFC rule, the “control” is that set forth by art. 2359 of the Italian Civil Code according to which the control of a company exists when:

- another company, directly or indirectly, holds the majority of votes in the shareholder’s meeting;
- another company, directly or indirectly, holds enough votes to exercise a decisive influence in the shareholder’s meeting;
- another company exercises relevant influence due to special contractual relationships.

The income of the CFC is taxed in the hands of the Italian entity by applying the ordinary Italian provisions and is taxed separately at the Italian entity’s average tax rate. However, this rate cannot be lower than 27%.

From 2010, the CFC regime also applies to entities resident of white listed countries when:

- the foreign company is subject to an effective taxation that is more than 50% lower than the tax burden that would have been levied if the company was resident of Italy and;
- more than 50% of the annual revenues of the foreign company derive from passive income.

The regime does not apply if the Italian company is able to prove that the foreign company does not constitute a pure artificial arrangement.

The Italian resident company may avoid the application of the CFC rules, by applying to the Italian Revenue Agency for a specific advanced ruling. In this case the applicant must prove alternatively that:

- the foreign company carries on a legitimate industrial or commercial activity in the territory of residence; or
- the participation in the foreign entity does not have the consequence of localizing the income in black listed counties.

Domestic Tax Consolidation

For fiscal purposes a group of companies is constituted by a parent company and by its subsidiaries when the parent (see Art. 117-129 ITC):

- holds, directly or indirectly, more than 50% of the capital of the subsidiary; and
- is entitled to more than 50% of the subsidiary's profits.

The “control” must exist at the beginning of each fiscal year of the consolidation and cannot be revoked for three years.

In addition, the parent company must be an Italian resident or a foreign company which carries on a business activity in Italy through a permanent establishment.

The tax consolidation consists in the determination, in the hands of the parent company, of a single taxable income which includes the sum of the taxable income of each group member.

Worldwide Tax Consolidation

The ITC (Art. 130-142) also provides the possibility of a worldwide tax consolidation when an Italian resident company controls one or more foreign companies.

Tax Transparency Regime

The transparency regime (see Art. 115-116 ITC) is available to Italian resident companies where the shareholders hold at least 10% but not more than 50% of the voting rights.

The profits of the transparent company are imputed to the shareholders in proportion of their right to participate to the profits.