taxanalysts
Respectfully disagreeable since 1970.

tax notes international

Volume 41, Number 11 ■ March 20, 2006

Finance Law Amends Corporate Tax Provisions

by Federico Raffaelli, Carolo Romano, and Guido Zavadini

Reprinted from *Tax Notes Int'l*, March 20, 2006, p. 957

Reprinted from *Tax Notes Int'l*, March 20, 2006, p. 957

taxanalysts tax notes international

Finance Law Amends Corporate Tax Provisions

by Federico Raffaelli, Carolo Romano, and Guido Zavadini

Italy's corporate tax system has been modified by the 2006 Finance Law (published in the official gazette on January 13) and other recent provisions. The most important changes are discussed below.

Foreign Securities and Financial Instruments

The conditions necessary to consider foreign securities and participations as equivalent to domestic shares for purposes of the capital gain exemption and the 95 percent dividends exemption have changed, effective January 1, 2006.

Securities and financial instruments issued by nonresident companies and participations in the stock capital or the equity of those companies are considered equivalent to domestic shares if a taxpayer's remuneration is fully derived from its participation in the profits of a nonresident company and if that profit distribution is totally nondeductible from the taxable income of the nonresident company, as determined in its state of residence.

The nonresident company must certify that the profit distribution is totally nondeductible in its state of residence or must prove that through other objective means (for example, the tax return of the company or the existence of specific and unequivocal provisions of law in its state of residence).

Under the new capital gain exemption provisions:

- capital gains derived from the disposal of shares and other participations realized by companies up to October 3, 2005, are 100 percent tax-exempt;
- capital gains derived from the disposal of shares and other participations realized by companies between October 4, 2005, and December 2, 2005, are 95 percent tax-exempt;
- capital gains derived from the disposal of shares and other participations realized by companies between December 3, 2005, and December 31, 2006, are 91 percent tax-exempt; and
- capital gains derived from the disposal of shares and other participations realized by companies as of January 1, 2007, will be 84 percent tax-exempt.

Furthermore, the required holding period has been extended from 12 months to 18 months for capital gains realized as of October 4, 2005.

Capital losses derived from the sale of shares that qualified for the capital gain exemption will continue to be fully nondeductible if the relevant shareholding has been continuously held from the first day of the 12th month before the disposal.

Dividend Washing

A specific new antiavoidance rule designed to counter dividend washing transactions has been introduced. In a typical dividend washing transaction, one taxpayer disposes of its shares, benefiting from the capital gain exemption, and the new shareholder receives dividends, benefiting from the dividends exemption; afterward, the same shares, which now have been deprived of the dividends, are sold, with the benefit of a capital loss deduction.

Capital losses realized as of January 1, 2006, arising from the disposal of participations (shares, quotas, or other financial instruments assimilated to shares) that do not qualify for the participation exemption regime are partially nondeductible. The nondeductible amount is equal to the nontaxable portion (95 percent) of the dividends (including dividend prepayments) received during the 36 months before the disposal.

The rule applies to participations (shares, quotas, or other financial instruments converted into shares) acquired during the preceding 36 months.

Just before the introduction of the new antiavoidance rule, the Italian Supreme Court addressed dividend washing transactions by holding that purchase and sale contracts concluded under that type of transaction are null and void for civil law purposes if they are exclusively motivated by tax reasons (decision no. 20398 of October 21, 2005). That much-debated judgment reversed the previous positions taken by Italian courts on the matter.

Domestic Tax Group Regime

There also have been two recent developments concerning the possibility for nonresident companies to enter into the domestic tax group regime.

First, a nonresident company may be the controlling entity of a domestic tax group regime if it is resident in a country with which Italy has a tax treaty in force and if it carries on a business activity in Italy through a permanent establishment, as defined under domestic law, and the participations in each controlled company are included in the PE's assets. It is no longer required that the participations in each controlled company are effectively connected to the PE; rather, it is sufficient that they are registered in the PE's books.

Second, Italy's Ministry of Finance (in Resolution 123/E of August 12, 2005) has clarified that a Dutch BV (limited liability company) that is controlled by an Italian resident company may have access to the domestic tax group regime — as a controlled company — by transferring its fiscal residence to Italy (and if other relevant conditions are met). According to the Finance Ministry, a Dutch BV may be considered analogous to the genus of the Italian *società di capitali* (which includes stock companies (Spa), companies with liability limited by shares (Sapa), and limited liability companies (Srl)). The similarity is confirmed by the list of companies that may benefit from the EC parent-subsidiary and merger directives.

Fixed Assets

Companies and individual entrepreneurs are entitled to revaluate their fixed assets for income tax (IRES/IRE) and regional tax (IRAP) purposes.

The main features of the revaluation can be summarized as follows:

- the revaluation is optional;
- it covers fixed assets included in the 2004 balance sheet;
- it must be made on the 2005 balance sheet;
- it requires the payment of an "in lieu" tax of 12 percent for depreciable assets (commercial buildings, equipment, and so on) and of 6 percent for nondepreciable assets (for example, participations);
- the in lieu tax, to be computed on the amount of the revaluation, must be paid in June 2006;
- the revaluated value of the assets will be recognized for tax purposes starting from the 2008 tax period; and
- specific rules have been established for the revaluation of building areas (including, for example, a 19 percent in lieu tax rate and a different timetable for payments).

As a result of the revaluation, the company must book a special reserve in its net equity or increase its stock capital. In the event of a capital reduction or a distribution to the shareholders of the special reserve, ordinary taxation will occur in the hands of the distributing company, unless a 7 percent in lieu tax is paid. The payment of the 7 percent in lieu tax is optional and must be effected in three installments ending on June 2006 (10 percent), June 2007 (45 percent), and June 2008 (45 percent).

Revaluation of Some Participations

Nonresident subjects (for example, individuals and companies without a PE in Italy) and residents not carrying on business activities (individuals, noncommercial entities, and so on) are entitled to revaluate, for capital gain tax purposes, the acquisition cost of participations in nonlisted companies, building areas, and agricultural lands owned on January 1, 2005.

The revaluated cost must be assessed on the basis of a sworn appraisal made by eligible experts by June 30, 2006. The appraised value is subject to an in lieu tax at the rate of 4 percent for qualified participations, building areas, and agricultural lands. The in lieu tax rate is reduced to 2 percent for nonqualified participations. The in lieu tax must be paid by June 30, 2006, or in three equal installments ending on June 30, 2006, June 30, 2007, and June 30, 2008. ◆

♦ *Federico Raffaelli, Carlo Romano, and Guido Zavadini, CMS Adonnino Ascoli & Cavasola Scamoni, Rome*