20 November 2020

Global Tax Alert

Italy publishes draft 2021 Budget Law

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Executive summary

On 20 November 2020, the Italian Government issued an updated version of the draft of the budget law for the year 2021 (Draft). The Italian Budget Law is currently under discussion within the Italian Parliament and expected to be approved by the end of December 2020. Future Alerts will cover any relevant changes and additions to such Draft that may occur until the date of final approval by the Italian Parliament.

The most relevant tax measures contained in the Draft relate to:

i. Reduced taxation of dividends for non-commercial entities

ii. Extension of the tax deduction regime for qualifying works to financial year (FY) 2021

iii. Tax benefits for selected business aggregations

iv. Withholding tax exemption on dividends and capital gains for European Union (EU)/European Economic Area (EEA) investment funds

v. Extension of Advance Pricing Agreements (APAs) rollback

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Detailed discussion

Reduced taxation of dividends for non-commercial entities (Article 10)

The Draft proposes that starting from FY 2021, dividends will be excluded in the measure of 50% from the Italian corporate income tax (CIT) taxable base of non-commercial entities or Italian permanent establishments of foreign non-commercial entities (currently fully taxed on such dividends).

To qualify for this favorable tax regime, the non-commercial entities shall jointly meet the following requirements:

i. They shall exclusively or principally carry out one or more qualifying non-profit activities of general interest for civic, solidarity and social purposes – e.g., family and related values, crime prevention and public safety, scientific and technological research.

ii. They shall use the related tax savings to finance the mentioned general interest activities, allocating it in a non-distributable and indivisible reserve.

However, such favorable tax regime would be denied with regards to dividends arising from low-tax jurisdictions under Italian tax law.

Extension to FY 2021 of the tax deduction regime for qualifying works (Article 12)

The Draft proposes the extension, to FY 2021, for benefitting from the tax deduction connected with expenses incurred for qualifying works including: (i) energy requalification works; (ii) building renovation works; (iii) purchase of furniture; (iv) purchase of large low-energy consumption appliances aimed at furnishing the renovated building; and (v) the recovery or restoration of the external facade of existing buildings.

Such amendments are in line with the provisions recently enacted by Italy with the "Relaunch Decree,"[1] which introduced the possibility to convert, during 2020 and 2021, the tax deduction connected with expenses incurred for qualifying works (including some of those mentioned above) into either:

(a) A transferable tax credit

(b) A discount of the relevant cost applied by the service provider (in such case, the transferable tax credit is granted to the service provider)

Tax benefits for selected business aggregations (Article 39)

Specific tax benefits would be provided for selected business aggregations via mergers, de-mergers and business contribution implemented in 2021.

The receiving entities involved in the aggregation can opt for the conversion into a tax credit of the deferred tax assets (DTAs) related to the tax losses carried forward and excess Italian notional interest deduction (ACE).

The threshold of the convertible DTAs is generally 2% of the sum of the assets of the entities involved (but excluding the entity with more assets).

For such purposes it is not required that the convertible DTAs are recorded in the financial statements.

The companies involved in the relevant business aggregation should, among others:

i. Be active for at least two years

ii. Not be part of the same group nor be linked by a shareholding relationship greater than 20% or (indirectly) controlled by the same person as per Article 2359(1)(1) of the Italian Civil Code, at the date of the relevant business aggregation and in the two previous years. However, this condition is not required where the control of the involved entities is achieved during 2021 and the aggregation occurs within one year from the acquisition of the control.

The Tax Credit generated upon conversion of the DTAs can be: (i) offset against every kind of tax liabilities and social contributions; (ii) sold; or (iii) requested for refund from the Italian tax authorities.

The DTAs conversion becomes effective upon the payment of a tax-deductible fee, equal to 25% of the total amount of the converted DTAs.

Withholding tax exemption on dividends and capital gains for EU/EEA investment funds (Article 110)

The Draft introduces an exemption from the Italian withholding tax on dividends and capital gains for selected EU/EEA investment funds.

Investment funds established in EU or EEA countries allowing the exchange of information, either compliant with the UCITS IV Directive or not UCITS compliant but having a manager subject to regulatory supervision in the foreign country of establishment under the AIFM Directive, are exempt from:

i. The 26% withholding tax on Italian source dividends

ii. The 26% substitute tax on capital gains arising from the disposal of Italian shares, either listed or not, representing a substantial participation

If approved, the new measure will expand the dividend and capital gain exemptions currently provided for Italian funds to EU/EEA funds, thus avoiding the risk of possible infringement procedures by the European Commission pursuant to the EU non-discrimination principles.

If the Draft is approved in the current version, the new exemptions for EU/EEA funds should be applicable to dividends paid and capital gains realized from 1 January 2021 onward.

Extension of APAs rollback (Article 196)

In line with the international best practice, the Draft proposes an extension of the rollback of APAs available to international enterprises for managing in advance selected tax risks.

The rollback of all the unilateral, bilateral and multilateral APAs will be conformed, extending the respective APA to the fiscal year still open to assessment by the Italian tax authorities under the relevant statute of limitations.

The rollback mechanism applies through the amendment of past tax returns and the payment settlement of any additional income tax due in the light of the APA. No administrative penalty can be imposed in this respect.

The rollback does not apply where: (i) issues covered by the APA are addressed by investigations or tax assessments served for such FYs; (ii) the foreign competent authorities does not agree to extend bilateral or multilateral APAs; or (iii) the circumstances during the past FYs are different from those considered in the APA.

Moreover, for filing an APA ruling request before the Italian tax authorities the enterprise shall pay a fee equal to:

(i) €10k where the overall turnover of the group is lower than €100m

(ii) €30k where the overall turnover of the group is higher than €100m and lower than €750m

(iii) €50k where the overall turnover of the group is higher than €750m

Endnote

1. See EY Global Tax Alert, *Italy enacts "Relaunch Decree" to further manage COVID-19*, dated 21 May 2020.

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EYG no. 008082-20Gbl

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