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LEGAL INFORMATION NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest.

We would welcome any comment you might have.

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**THE ITALIAN TAXATION SYSTEM:  
OVERVIEW OF THE MAIN  
DOMESTIC AND EU STATUTORY  
REGULATIONS ON CORPORATE  
TAXES**

Act No. 244/07

Act No. 633/72

Act No. 917/86

EU Directive No. 435/90

EU Directive No. 434/90

EU Directive No. 434/03

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**INTRODUCTION** – The Italian Tax System is of schedular character. It is mainly codified in a general statutory tax regulation (*Testo Unico per le imposte sui redditi*), which is updated each year by the annual Finance Act.

The main features of this tax regulation are that:

- Italian resident corporations and individuals are subject to Italian tax on world wide incomes;
- Non-resident corporations and individuals are subject to tax on Italian-source incomes only;
- Progressive rates apply for individuals: the higher the income, the higher the rate of tax payable.

Taxes in Italy are generally divided in two types:

- Direct taxes such as the income tax on corporations and individuals (IRE);

- Other taxes (indirect taxes) such as tax on goods, services, imports (VAT), Regional production tax (IRAP), municipal property tax on buildings and agricultural lands (ICI), etc.

In Italy the tax system is administered by *Agenzia delle Entrate*, the national tax Authority. Its local tax offices provide information to all citizens, whether they are Italian resident tax-payers or not.

**CORPORATE INCOME TAX (IRES)** – Corporate income tax (IRES) is regulated by the Unified Text on direct Taxes (“*Testo Unico Imposte Dirette*”).<sup>1</sup>

As said Italian resident corporations are subject to IRES on their worldwide income., while non-Italian resident corporations are subject to IRES only on Italian source income.

As of January 1, 2004, the imputation system previously in force has been abolished and replaced with the so called 'partial exemption' method, under which corporate profits are subject to income tax at the level of the company and partially exempted at the level of the shareholders.

In addition, other significant measures have been introduced, e.g. reductions in corporate income tax, the participation exemption regime and the domestic tax consolidation regime.

**TAXABLE PERSONS, TAX RATES AND TAXABLE PERIOD** - Corporate Income Tax (IRES) applies to resident and non-resident corporations.

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<sup>1</sup> Act No. 917/86.

Resident corporations are subject to IRES on their worldwide income, so-called 'unlimited taxation'.

Non-resident entities are subject to IRES only on income considered sourced in Italy, 'limited taxation'.

Resident corporations include Corporations (“*Società per azioni - Spa*”), Limited liability companies (“*Società a responsabilità limitata - Srl*”), and Partnerships limited by shares (“*Società in accomandita per azioni - Sapa*”).

Resident corporations also include companies formed under foreign jurisdictions which, for most of the taxable period, have their statutory office, place of effective management, or main object of their business in Italy.

Resident partnerships not limited by shares, are not subject to IRES. Such partnerships, namely “*società in nome collettivo - Snc*”, or “*società in accomandita semplice - Sas*”, are considered transparent entities.

For tax purposes, their income is attributed to the partners and subject to tax accordingly.

For IRES purposes, the taxable period coincides with the company's financial year, as provided by the law or by the articles of association.

Otherwise, the taxable period coincides with the calendar year.

IRES is levied at a flat rate of 27,5%.<sup>2</sup>

**REGIONAL TAX ON BUSINESS ACTIVITIES (IRAP)** - Regional tax on business activities, “*Imposta regionale sulle attività produttive – IRAP*”, is a local tax applied on the value of the production generated in each taxable period by persons carrying out business activities in a given Italian region.

Non-Italian resident corporations are subject to IRAP only on the production generated through Italian permanent establishments.

Rates may vary, though they range around 3.9%.

## **INDIRECT TAXES – VALUE ADDED TAX (VAT)**

The Italian value-added tax (VAT) system conforms fully to European Union VAT rules.

In principle, the system ensures that VAT is borne by the ultimate consumer only and that, at the upper level, input VAT is deducted by the suppliers of goods and of services.

VAT is charged on any supply or service deemed to be made or rendered within the Italian territory.

The ordinary VAT rate is set at 20%.<sup>3</sup>

**TRANSFER TAX** – Transfer tax (“*Imposta di registro*”), is due on specific contracts if formed in Italy, and contracts including those formed abroad, regarding the transfers or leases of business concerns or immovable properties situated within the Italian territory.

The taxable base and rates depend on the nature of the contracts and on the status of the parties.

When transferring immovable properties, cadastral and mortgage taxes also apply.

These are due for formal transcription in the public registers. The tax base matches that of the transfer tax, with tax rates set respectively at 1% and 2%.

Transfer tax, cadastral and mortgage taxes are imposed as a lump sum of €129.11 on transfers of immovable properties subject to VAT. Alternatively, transfer tax rates may vary from 4% up to 15% depending on the type of real property.

**MUNICIPAL TAX ON REAL ESTATE** – Any owner, resident or non-resident, of real properties located within Italian territory must pay annually the municipal tax on immovable property, “*Imposta comunale sugli Immobili - ICI*”.

The taxable base equals the sum of the estimated value for the type and class of immovable property, as determined by the

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<sup>2</sup> Act No. 917/86.

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<sup>3</sup> Act No. 633/72.

Cadastral Office, e.g., the cadastral income, and a given multiplier.

The municipality where the immovable property is located sets the tax rate at not less than 0.04%, and no more than 0.07%.

**INHERITANCE AND GIFT TAX** – On December 24, 2007 new rules were enacted to regulate inheritance and gift taxes.<sup>4</sup>

The inheritance and gift tax is imposed on the value of the share of each beneficiary. The rates vary depending on the relationship between the deceased and the beneficiary, as well as the non-taxable threshold amount.

Inheritances of spouses and direct descendants or ascendants are subject to inheritance tax at a rate of 4% on the amount exceeding €1,000,000 per beneficiary.

Transfers to brothers or sisters are taxed at 6% on the amount exceeding €100,000 per beneficiary.

Transfers to relatives up to the fourth degree or relatives-in-law up to the third degree are taxed at 6% on the entire amount of their inheritance.

Any other transfer is taxed at 8% on the entire amount.

**WITHHOLDING TAXES** – There are three main withholding taxes applicable at source on certain payments: dividend withholding tax, withholding tax on interest, and withholding tax on royalties.

[A] *Dividend withholding tax* – In principles, dividends paid to Italian resident individuals from non-substantial participations in Italian corporations are subject to a 12.5% final withholding tax.

Dividends from substantial participations in Italian corporations are not subject to withholding tax.

Dividends paid to Italian resident corporations, or to Italian permanent establishment of non-resident corporations, are not subject to withholding tax.

Dividends paid to non-resident corporations without, or not through, an Italian permanent establishment, from substantial and non-substantial participations in Italian corporations are subject to a 27% final withholding tax.

The withholding tax rate is reduced to 12.5% for dividends from saving shares.

Reduced rates are possible under any tax treaties, Italy has concluded with the recipients' country of residence.

The withholding tax is not due, in line with the EU Parent-Subsidiary Directive, for dividends paid by Italian resident corporations to its EU parent company. The benefit is subject to the parent's current ownership dating back at least one year, of no less than 25% of the Italian subsidiary's share capital.

[B] *Withholding tax on interest* – In principle, interest from bank accounts and deposits, certain bonds, and similar securities are subject to withholding tax at rates of 27% or 12.5%.

These taxes, if any, on interest received by Italian residents generally consist of an advanced payment of income tax due by the recipients.

As such, gross interest must be included in the recipient's tax base and the withholding tax deducted from the aggregate taxable income.

If non-Italian residents receive interest from bank accounts and deposits through an Italian permanent establishment, no withholding tax is due.

Interest and other profits from certain bonds issued by the state, by banks and by Italian-listed corporations are subject to a 12.5% substitute tax.

If Italian resident corporations receive interest from such bonds no substitute tax is due.

If residents in countries listed in the so-called 'White List', e.g. those with adequate exchanges of information with the Italian tax authorities, receive interest from such bonds, not through an Italian permanent establishment, no substitute tax is due.

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<sup>4</sup> Act No. 244/07.

In principle, interest from loans received by residents other than business entities is subject to a 12.5% advance withholding tax.

If non-residents receive interest from loans, not through an Italian permanent establishment, the withholding tax is a final payment of tax.

The withholding tax rate is set at 27% for recipients resident in countries listed in the so-called 'Black List', e.g., countries granting privileged tax regimes.

The withholding tax rate may be reduced under any tax treaties Italy has concluded with various foreign Countries.

In line with the provisions of the EU Directive on Interest and Royalties, the withholding tax on interest payments is not levied if these payments are made by Italian resident companies or by Italian permanent establishments of EU resident companies to affiliated (i) companies resident, for tax purposes, in another EU Member State or to (ii) permanent establishments of companies resident, for tax purposes, in another EU Member State.

In line with the above-mentioned Directive, the benefit is applicable if certain shareholding requirements are satisfied.

[C] *Withholding tax on royalties* – Royalties paid to Italian resident corporations, or to Italian permanent establishments of non-resident corporations, are not subject to withholding tax.

In principle, royalty payments to non-Italian residents are subject to a 30% final withholding tax.

Under certain conditions, the tax base may receive a 25% flat deduction.

The withholding tax rate, if due, can be reduced under any tax treaties Italy has concluded with various foreign Countries.

In line with the provisions of the EU Directive on Interest and Royalties, the withholding tax on royalty payments is not levied if these payments are made by Italian resident companies or by Italian permanent establishments of EU resident companies to (i) companies resident, for tax purposes, in another EU Member State or to (ii)

permanent establishments of companies resident, for tax purposes, in another EU Member State.

In line with the above-mentioned Directive the benefit is applicable if certain shareholding requirements are satisfied.

**TAX TREATIES** – In order to avoid double taxation, Italy has concluded tax treaties with the following Countries:

Albania	Georgia	Mexico	Sweden
Algeria	Germany	Morocco	Switzerland
Argentina	Greece	Mozambique	Tanzania
Australia	Hungary	New Zealand	Thailand
Austria	India	Norway	The Netherlands
Bangladesh	Indonesia	Oman	Trinidad & Tobago
Belgium	Ireland	Pakistan	Tunisia
Brazil	Israel	Philippines	Turkey
Bulgaria	Ivory Coast	Poland	Ukraine
Canada	Japan	Portugal	United Arab Emirates
China	Jugoslavia	Romania	United Kingdom
Cyprus	Kazakhstan	Russia	U.S.A.
Czechoslovakia	Kuwait	Senegal	Uzbekistan
Denmark	Lithuania	Singapore	Venezuela
Ecuador	Luxembourg	South Africa	Vietnam
Egypt	Macedonia	South Korea	Zambia
Estonia	Malaysia	Soviet Union	
Finland	Malta	Spain	
France	Mauritius	Sri Lanka	

The treaties generally provide more favourable tax treatment of Italian non-residents than the treatment provided under local Italian law.

Most of these treaties are based on the OECD Model Convention.

**EU PARENT-SUBSIDIARY DIRECTIVE**

- Italy has fully implemented the EU Parent-Subsidiary Directive for the abolition of double taxation on corporate profits generated by an EU subsidiary, and distributed to an EU parent resident in another EU Member State.<sup>5</sup>

According to the rules on taxation of dividends, dividends received by Italian parent corporations are 95% exempt from IRES regardless of the size of the underlying shareholding, and of the relevant holding period.

Dividends paid by Italian subsidiaries are exempt from withholding tax provided that the EU parent corporations hold, for an interruptive period of one year, a direct shareholding of at least 25% in the Italian subsidiaries.

Italy has not yet implemented the Directive 123/2003 regarding, amongst the other, the reduction of the relevant threshold to 20%.

**EU MERGER DIRECTIVE** – Italy has fully implemented the EU Merger Directive regarding the tax ramifications arising from mergers, divisions, transfers of assets and exchange of shares between EU-resident corporations.<sup>6</sup>

In line with the EU Merger Directive, Italian tax law specifies the conditions under which income, profits and capital gains from the above indicated business reorganizations - occurring between Italian and other EU-resident corporations - are deferrable.

**EU DIRECTIVE ON INTEREST AND ROYALTY PAYMENTS**

– The EU Directive on Interest and Royalty Payments authorize provides for the abolishment of withholding tax on payments of certain interest and royalties between corporations resident in different EU Member States.<sup>7</sup>

The benefit of the exemption from withholding tax on payments made in favour

of EU beneficiaries is subject, amongst the others, to the following conditions:

[A] The recipient is the beneficial owner of the interest and royalties payments.

To this end, the recipient is regarded as the beneficial owner only if it receives the payment for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person

[B] The interest and royalties payments are made:

[1] By a company which directly holds at least 25 per cent of the voting rights in the ordinary shareholders meeting (“Voting Rights”) of the company which receives the payment

[2] To a company which directly holds at least 25 per cent of the Voting Rights in the company which makes the payments

[3] To a company whose Voting Rights are directly held for a percentage not less than 25 per cent by a third company which also directly holds said minimum percentage in the company which makes the payments and in the company which receives the payments.

[C] The minimum 25 per cent stake at point (ii) above is held without interruptions for at least 12 months.

For the purposes of the exemption, the beneficial owner of the payments shall have to attest its residence through a certificate issued by the Tax Authorities of its State of residency.

The implementing Decree provides that the exemption is applicable on interest accrued or royalties payable as from January 1, 2004.

In addition, the Legislative Decree introduces a withholding tax of 30% on payments made to non-Italian residents deriving from licences of industrial, commercial and scientific equipments.

*Article contributed by Riccardo G. Cajola*

<sup>5</sup> EU Directive No. 435/90.

<sup>6</sup> EU Directive No. 434/90.

<sup>7</sup> EU Directive No. 434/03. See also the implementing Legislative Decree No. 143/05.