ITALIAN TAX SYSTEM

Excerpted from the Invitalia’s report, “Italy’s Tax System”
Taxes and Withholdings – Direct Taxes

**Individual Income Tax (IRPEF):** people residing 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):** 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.

**Regional Business Tax (IRAP):** 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.

Irap current rate is 3.90%.
Taxes and Withholdings – Indirect Taxes

**Value Added Tax (VAT):** VAT is generally levied on each sale of goods and/or services carried out in Italian territory. The ordinary VAT rate is 22%.

**Registration tax:** Registration tax is levied on specific legal instruments made in Italy (for example, the transfer of a real property) or, in some case, made abroad. The tax base and applicable rate vary in relation to the type of instrument and the party involved.
Taxes and Withholdings – WHT Taxes (1)

DIVIDENDS

Dividends received by individuals outside the scope of a business activity are subject to a 20% WHT tax in settlement of whereby they concern non-qualifying holdings (i.e. not more than 20% of the voting rights).

Dividends received by individuals outside the scope of a business activity regarding a qualifying holding in Italian companies are not subject to WHT tax, but they are subject to IRPEF in the portion of 49.72% of the total.

If dividends are distributed by a foreign company resident in a State under a privileged tax regime (tax havens), they shall be subject to a taxation in full.

Dividends received by parties other than individuals non resident in Italy are generally subject to a 20% WHT tax in settlement. 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%. EU Directives and double taxation treaties may also apply.
INTEREST

Interest on current accounts and deposit accounts with banks, as well as bonds and similar securities, received by people resident in Italy for tax purposes is subject to a WHT tax of 20%, generally applied on account. However, whereby the interest is received by residents outside the scope of a business activity, the WHT 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 WHT tax, with the exception of persons resident in tax havens, for whom a 20% WHT tax applies.

In general, interest on loans is subject to a 20% WHT 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 people not resident in Italy for tax purposes, the WHT tax is applied in settlement.

In compliance with the EU Interest and Royalties Directive, WHT 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 EU to (i) resident companies, or (ii) permanent establishments of companies resident in other Member States of EU. The benefit is applicable if requirements concerning minimum holdings are fully met.
Companies resident in Italy for tax purposes are subject to IRES both for income earned in Italy and income earned abroad.

Companies non 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.).

Foreign companies and entities having their administrative headquarters or their main activities in Italian territory for most of the tax period are also considered Italian residents.

Partnerships (s.n.c.; s.a.s.) are not subject to IRES. The income produced by such entities is usually taxed pursuant to the rules envisaged for 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.
Taxable 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:** C.G. 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).

C.G. 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 C.G. generated by equity investments – other than those qualifying for participation exemption – recognised under non-current financial assets in the last three financial years).
Participation Exemption (PEX)

**Partial exemption of C. G. on the disposal of equity investments**: 95% of C.G. 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 tax haven.

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

**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%.
**Taxable Income – 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 expenses and similar charges in an amount equal to interest income and similar revenues. The excess may be deducted up to ceiling of 30% of Gross Operating Profit – GOP.

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

The GOP portion not used in a given tax period as it exceeds interest expense may be carried forward to increase GOP in subsequent years.
Tax losses, WHT 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 80% of the taxable income of each period. 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.

**WHT taxes:** income received by corporations resident in Italy for tax purposes are subject to WHT 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 WHT 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 WHT 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 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: a) tax paid abroad; b) portion of Italian tax related to the income earned abroad (on the basis of the foreign income ratio to overall gross income).
Corporate Income Tax (IRES)

The income earned by companies not resident in Italy for tax purposes through a permanent establishment is considered as Italian source income and is therefore subject to IRES. Except for a number of specific exceptions, the domestic definition of permanent establishment 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 (socalled “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.
Italy has established agreements/treaties with the following countries to avoid double taxation:

### Double Taxation Agreements and Treaties

<table>
<thead>
<tr>
<th>Albania</th>
<th>Ethiopia</th>
<th>Malta</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>Philippines</td>
<td>Morocco</td>
<td>South Africa</td>
</tr>
<tr>
<td>Argentina</td>
<td>Finland</td>
<td>Mauritius</td>
<td>Sweden</td>
</tr>
<tr>
<td>Australia</td>
<td>France</td>
<td>Mexico</td>
<td>Switzerland</td>
</tr>
<tr>
<td>Austria</td>
<td>Georgia</td>
<td>Mozambique</td>
<td>Tanzania</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Ghana</td>
<td>Norway</td>
<td>Thailand</td>
</tr>
<tr>
<td>Belgium</td>
<td>Germany</td>
<td>New Zealand</td>
<td>Trinidad and Tobago</td>
</tr>
<tr>
<td>Brazil</td>
<td>Japan</td>
<td>Oman</td>
<td>Tunisia</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Greece</td>
<td>Netherlands</td>
<td>Turkey</td>
</tr>
<tr>
<td>Canada</td>
<td>India</td>
<td>Netherlands</td>
<td>Turkmenistan</td>
</tr>
<tr>
<td>Czechoslovakia**</td>
<td>Indonesia</td>
<td>Malaysia</td>
<td>Sri Lanka</td>
</tr>
<tr>
<td>China**</td>
<td>Ireland</td>
<td>Pakistan</td>
<td>Ukraine</td>
</tr>
<tr>
<td>Cyprus</td>
<td>Israel</td>
<td>Poland</td>
<td>Uganda</td>
</tr>
<tr>
<td>South Korea</td>
<td>Yugoslavia***</td>
<td>Portugal</td>
<td>Hungary</td>
</tr>
<tr>
<td>Ivory Coast</td>
<td>Kazakhstan</td>
<td>United Kingdom</td>
<td>Soviet Union****</td>
</tr>
<tr>
<td>Denmark</td>
<td>Kuwait</td>
<td>Romania</td>
<td>Uzbekistan</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Lithuania</td>
<td>Russia</td>
<td>Venezuela</td>
</tr>
<tr>
<td>Egypt</td>
<td>Luxembourg</td>
<td>Senegal</td>
<td>Vietnam</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>Latvia</td>
<td>Syria</td>
<td>Zambia</td>
</tr>
<tr>
<td>Estonia</td>
<td>Island</td>
<td>Singapore</td>
<td></td>
</tr>
</tbody>
</table>

* 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 and Bosnia Herzegovina. **** The agreement between Italy and the Soviet Union applies to the following countries: Moldova, 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.