CLEARY GOTTLIEB

ALERT MEMORANDUM

Italy: Highlights on the 2020 Budget Law and Related Tax Legislation

January 6, 2020

At the end of December 2019, the Italian Parliament passed two pieces of legislation, the Budget Law for 2020 and a related tax law decree[1], which introduce, among other things, a new tax on digital services, as well as a number of other tax measures material to corporations and individuals, becoming effective either as of January 1, 2020 or during 2020.

This memorandum briefly illustrates some of the main tax measures included in such legislation.

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1) The New Web Tax

The 2020 Budget Law introduces a new 3% tax on digital services (the "Web Tax")[2] applicable on Italian-sourced gross revenues resulting from the supply of (i) advertising services through digital media, (ii) digital platforms allowing users to interact and possibly facilitate the direct supply of goods and services, and (iii) users' data generated via digital media. Such revenues are generally deemed to be Italian-sourced if supplied to customers using a digital device on the Italian territory[3].

The Web Tax will only apply to companies that, on a stand-alone basis or at group level, generated revenues of at least Euro 750 million, of which at least Euro 5.5 million from Italian-sourced qualifying digital services, in the preceding tax period .

The Web Tax is effective as of January 1, 2020, but it could be repealed or amended if an agreement on the taxation of digital economy were reached at the international level.

[1] The 2020 Budget Law has been approved with Law No. 160 of December 27, 2019, while the related tax law decree was approved with Law Decree No. 124 of October 26, 2019, converted into law with Law No. 157 of December 19, 2019 (the "Tax Decree").

[2] The Italian 2019 Budget Law (Law No. 145 of December 30, 2018) already provided for a tax on digital services, to be implemented via a Ministerial Decree that, however, was never adopted. Therefore, that tax never came into force.

[3] More specifically, revenues generated from the supply of data is deemed to be Italian-sourced if the data were collected in relation to customers using a digital media on the Italian territory.

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2) Deferral of Certain Tax Allowances for Financial Institutions and Insurance Companies

The 2020 Budget Law increases the tax liability of financial institutions and insurance companies by deferring certain corporate income tax ("IRES") and local quasi-income tax ("IRAP") allowances on write-downs and losses relating to receivables.

In particular, while financial institutions and insurance companies are currently entitled to fully deduct write-downs and losses relating to receivables in the tax period in which they are accounted for, write-downs and losses accrued up to 2015 are allowed to be deducted in variable installments during the 2016-2025 period[4]. More specifically, for 2019, under such rules, financial institutions and insurance companies were entitled to deduct an amount corresponding to 12% of the pre-2016 write-downs and losses. The 2020 Budget Law has now deferred the 2019 12% instalment allowance to the 2022-2025 tax periods, in four equal instalments[5].

Moreover, in 2018, financial institutions and insurance companies were granted an IRES and IRAP allowance for losses on receivables booked as a result of the first-time adoption of the new IFRS No. 9. Such allowance was available on a straight-line basis over a ten-year period. The 2020 Budget Law has postponed to 2028 the deductibility of the 2019 annual instalment.

While not novel (the 2018 instalment had been postponed to 2026 with the 2019 Budget Law), these cash-in measures result in last-minute additional levies that will likely affect the yearly tax charges and budgets of financial institutions and insurance companies.

3) The Re-instatement of the Allowance for Corporate Equity Rules

The Allowance for Corporate Equity ("ACE") rules, in force through 2018, have been retroactively reinstated, as of the 2019 tax period. Equity increases occurred in 2019 will benefit from ACE upon filing of the year-end tax return.

ACE allows for an IRES deduction of a notional 1.3% yield applicable on any corporate net equity increase compared to the net equity accounted for in the 2010 financial statements. The material net equity increase is equal to the difference between any equity increasing items (such as retained earnings, equity contributions and receivables' waivers resulting in a capital increase) and items resulting in the reduction of the company's net equity (as, for instance, in case of a share buy-back program) in the relevant period.

Any ACE amount exceeding the taxable income for a relevant tax period can be carried forward to future tax periods, transferred to the fiscal unit (if the company is part of a tax consolidation group), or possibly converted into a tax credit to be offset in five equal instalments against any IRAP due.

Since its introduction in 2011, ACE has significantly contributed to reducing the debt-to-equity ratio of Italian businesses and promoting equity investments.

After being repealed with the 2019 Budget Law, ACE was replaced with a measure entailing a taxation of retained earnings at a reduced rate. Such measure, which should have been applied as of 2019, was more complex than the ACE mechanism and promised not to meet its results, which prompted its repeal and the CAE reinstatement.

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[4] The rules regulating the deductibility of such write-downs and losses were particularly stringent up to 2014 (*e.g.*, write-downs were deductible for an amount not exceeding 0.30% of the overall receivables, whereas any amount exceeding the 0.30% threshold could be carried forward and deducted in equal installments in the following 18 years). Article 16 of Law Decree No. 83 of June 27, 2015, converted into law with Law No. 132 of August 6, 2015, allowed, as of 2015, the full deductibility of write-downs and losses in the year in which they were accounted for, with the exception of write-downs and losses accounted for in 2015, which were allowed to be deducted for only 75%. The remaining 25%, as well as the amount of write-downs and losses realized up to 2014 (and not yet deducted), were allowed to be deducted in instalments (ranging from 5% to 12% of the overall amount) over the next ten years, up to the 2025 tax period.

[5] Pursuant to the ordinary rule, financial institutions and insurance companies will remain entitled to deduct any "new" write-downs and losses on receivables accounted for in 2019.

4) The Non-Listed Equity Tax Step-up Regime Extended through 2020

Individuals, certain partnerships, non-commercial and non-resident entities (to the extent the participation is not held through a permanent establishment in Italy) can benefit from the extension of a beneficial regime available in 2019 and in prior years, enabling to step up the tax basis in any equity interest not traded on regulated markets held on January 1, 2020.

Eligible taxpayers need to (i) obtain an expert appraisal, to be sworn-in no later than June 30, 2020, certifying the equity's market value as at January 1, 2020, and (ii) pay a 11% substitute tax on such appraised value. The tax can be paid either entirely by no later than June 30, 2020, or in three equal annual installments, due on June 2020, 2021 and 2022 (the second and third installment being subject to a 3% interest charge).

Since capital gains are taxed at a flat rate of 26%, such a step-up option may result to be particularly advantageous to those eligible shareholders who are contemplating divestments in the short to medium term.

5) Wealth Taxes on Foreign Assets Held by Resident Trusts and Partnerships

As of 2020, the wealth taxes on financial instruments (such as shares, bonds, life insurance policies, bank accounts) held abroad ("IVAFE") and on foreign real estate ("IVIE") are applicable also to non-commercial entities (including trusts and foundations) and certain Italian tax resident partnerships.

IVAFE and IVIE, previously applicable to individuals only, are levied, respectively at a:

- 0.2% rate on: (i) financial instruments' fair market value; or (ii) in case the fair market value cannot be determined, on their face or redemption value; or (iii) if the face or redemption value cannot be determined, on their purchase cost;
- 0.76% rate on: (i) for real estate properties situated in the E.U. or E.E.A. Member States, their cadastral value or, absent such cadastral value, their purchase price or, absent a purchase price, their market value; or (ii) for real estate properties situated in other countries, their purchase price or, absent a purchase price, their market value.

A tax credit is granted for any foreign wealth tax levied abroad on such financial assets and real estate, in an amount not exceeding the IVAFE or IVIE due.

6) Criminal Tax Liabilities Harshened

The Tax Decree has significantly harshened the criminal liabilities applicable in connection with certain tax offences, as set forth in Legislative Decree No. 74 of March 10, 2000.

For instance, for the crime of filing an unfaithful tax return[6], the Tax Decree has (i) increased the applicable prison sentence from a range of 1 to 3 years to a range of 2 to 4 years and 6 months, and (ii) reduced the materiality thresholds to Euro 100,000 (from Euro 150,000) of omitted taxes and to Euro 2 million (from of Euro 3 million) of tax items not reported in the tax return[7].

Moreover, the Tax Decree has provided that some tax crimes (*e.g.* the filing of a fraudulent tax return, or the concealment or elimination of the mandatory accounting books) would now give rise to corporate liability pursuant to Legislative Decree No. 231 of June 8, 2001[8], pursuant to which corporations would be

[6] See Art. 4 of Legislative Decree No. 74 of March 10, 2000.
[7] The Tax Decree has also increased the applicable prison sentence applicable to (a) omitting to file a due tax return, from a range of 18 months to 4 years to a range of 2 to 5 years; and (b) concealing or eliminating the mandatory accounting books, from a range of 18 months to 6 years to a range of 3 to 7 years.
[8] Pursuant to Decree No. 231/2001, if certain crimes are committed in the interests of a company or to its advantage by individuals acting as its legal representatives, directors, formally or *de facto* executives or employees, the individual is criminally liable for his/her actions, and the company may be held liable for benefiting from such criminal conduct. If a crime is committed in Italy, any legal entity incorporated in Italy employing the alleged suspect(s) may be prosecuted and held administratively liable before criminal courts in Italy. Moreover, Italian court precedents have held that foreign companies employing the suspect(s) may be held liable if the crime is committed in Italy. If a company is held liable, applicable sanctions range from financial penalties and

subject to monetary and disqualification penalties, as well as the possible seizure of the crimes' profits.

These new measures are applicable to crimes committed as of December 24, 2019.

7) Tax Breaks for Workers Moving to Italy Applicable as of April 2019

As illustrated in our alert memo of May 8, 2019 (https://www.clearygottlieb.com/news-and-insights/publication-listing/italy-enhances-tax-breaks-for-certain-individuals-moving-to-italy), Law Decree No. 34 of April 30, 2019, significantly simplified and improved the existing tax breaks contemplated for certain individuals moving to, and becoming tax residents of, Italy as of 2020.

The new rules apply to workers, whether employees or self-employed, and regardless of their citizenship, who transfer their tax residence to Italy and (i) have not been resident in Italy in the 2 preceding tax years, (ii) maintain an Italian tax residence for at least 2 tax years, and (iii) will work mostly in Italy (i.e. for more than 183 days in each tax period). Entrepreneurs meeting these conditions, and starting a new business in Italy, are also eligible.

Such individuals can enjoy a 70% (previously, 50%) exemption from the Italian personal income tax (currently levied at graduated rates of up to 43%, plus local surcharges of up to 4.23%) of any employment, self-employment or business income earned during the five-year period including the year of the transfer and the following four. The exemption increases to 90% if the individual moves to certain southern regions.

Moreover, the tax break is extended for an additional 5-year period if (x) the individual has at least one minor or dependent child, or (y) he/she (or his/her partner or children) purchases a house in Italy in the year of the transfer or the preceding year, provided that in such additional 5-year period the exemption is reduced to 50% (but if the eligible individual has at least 3 minor or dependent children, it is increased to 90%).

Following the approval of the Tax Decree, these new rules apply to individuals who transferred their tax residence in Italy as of April 30, 2019, while individuals who transferred their tax residence before such date would not be able to benefit from such enhanced tax breaks.

8) Foreign Trust Income

The Tax Decree establishes that income paid to Italian tax resident beneficiaries (individuals and non-commercial entities) by opaque trusts (*i.e.* trusts the beneficiaries of which are not identified and, as such, are not looked through for tax purposes), set up in a low tax jurisdiction, is subject to tax in the hands of the Italian resident beneficiaries[9]. For purposes of this rule, a country is deemed to be a low tax jurisdiction if the trust income is subject to a tax rate lower than 50% of the Italian applicable tax rate (which is currently equal to 24%)[10].

All distributions made by such trusts are deemed to be income, unless evidence is provided that the amount distributed is in fact a capital distribution, in that case not subject to tax.

As a result, based on these rules, (i) income distributions made by foreign opaque trusts not established in a low tax jurisdiction should not be subject to tax in the hands of their Italian resident beneficiaries; (ii) income from opaque trusts established in a low tax jurisdiction should be taxed in Italy only when such income is cashed by the Italian resident beneficiary; (iii) distributions of capital should not be subject to income tax.

Conceivably, the tax administration will issue guidelines on point.

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confiscation of the proceeds of the crime to disqualifying measures (such as being banned from economic dealings with public authorities). Companies may shield themselves from corporate responsibility if, prior to the commission of the crime, they adopted and effectively implemented an organizational model suitable to prevent crimes of the same kind as that committed.

[9] Foreign opaque trusts are only subject to tax in Italy on Italian-source income.

[10] *See* Art. 47-*bis* of Presidential Decree No. 917 of December 22, 1986.