
Italy's 2018 Finance Bill includes important provisions on the digital economy, cross-border taxation

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In brief

Italian Law no. 205 (the 2018 Financial Bill, or 'the Bill'), published in the Official Gazette on December 29, 2017, contains important tax provisions regarding the digital economy and international tax.

In detail

New tax on digital transactions effective January 1, 2019

The 2018 Financial Bill introduces a new business-to-business (B2B) tax on digital transactions (Web Tax). The Web Tax applies to services provided via electronic devices to Italian-resident corporations, government bodies, partnerships, sole proprietorships, and self-employed professionals, as well as to Italian permanent establishments (PEs) of non-Italian resident persons, subject to a few exceptions.

The Bill defines such services as "services provided by means of internet or any other electronic networks, the nature of which makes the provision of the service mainly automatic and characterized by a minimum human intervention and with no possibilities to be provided

without information technology support." The Ministry of Finance will release a specific ministerial decree by April 30, 2018. The decree will include additional detail regarding the Web Tax and will further define the services subject to it.

The Web Tax rate is 3%, applied to consideration paid for the service, net of VAT.

The Web Tax is due from both Italian and non-Italian resident service providers that, during a calendar year, carry out more than 3,000 transactions falling within the Web Tax's scope.

The service recipient withholds the Web Tax from the consideration payment and remits it to the tax authorities by the 16th day of the month following payment. The service recipient does not withhold

the Web Tax if the service provider attests in the invoice or similar document that the provider has not exceeded the 3,000 transaction threshold during the calendar year.

The tax will apply beginning January 1 of the year following the year in which the Minister of Finance publishes the specific ministerial decree in the Official Gazette (i.e., January 1, 2019).

Modified definition of permanent establishment

The 2018 Financial Bill expands and modifies the Italian domestic definition of PE, effective January 1, 2018.

Significant and continuous economic presence (a new 'nexus')

The Bill first introduces a new item to the 'positive list' — specifically, when a non-

resident enterprise has a “...significant and continuous economic presence in the territory of the State arranged in such a way that does not result in its physical consistency in such territory.”

This new nexus, based on the concept of significant economic presence, would create a PE in Italy (i.e., a taxable presence) even when there is no physical presence. However, there are no guidelines as to what economic presence precisely means. For example, there is no indication of what the thresholds are for an economic presence to be considered ‘significant and continuous,’ which transactions are covered (e.g., B2B, business-to-consumer (B2C), digital services, direct e-commerce), or how to attribute profits or losses to such PE.

It remains unclear if this new nexus should be considered an anti-abuse provision that also would apply if the non-resident enterprise can benefit from a tax treaty.

Taxpayers wishing to confirm their position for Italian tax purposes may want to consider applying for an advance ruling from the Italian tax authorities.

BEPS Action 7 amendments

The 2018 Financial Bill also:

- updates the PE ‘negative’ list to clarify that the overall activity of the fixed place of business must be of a preparatory or auxiliary character
- provides an anti-fragmentation rule in line with article 5.4.1. of the OECD Model Tax Convention (as amended to reflect BEPS Action 7), and
- expands the dependent agent definition to include the principal role leading to the conclusion of contracts and the new concept of

dependency (aligning it with updated article 5.5 of the OECD Model Tax Convention, as amended to reflect BEPS Action 7).

Taxpayers should evaluate if the changes to the PE Italian domestic definition can affect their position for Italian tax purposes, and if so, whether the applicable tax treaty, if any, would apply instead of the Italian domestic rules. In particular, taxpayers should consider the substance-over-form approach that the Italian Supreme Court generally applies.

On the matter of ‘undisclosed PEs’ for previous tax years, some non-resident entities may wish to consider ‘voluntarily disclosing’ their position to the Italian tax authorities. These are entities that belong to multinational groups with consolidated revenues greater than 1 billion Euro and supply goods and services in Italy for consideration greater than 50 million Euro. The disclosure program is based on the support provided by companies (or PEs) that already have been identified in Italy and belong to the same group. Consequently, if the Italian tax authorities determine the presence of a PE in Italy, the taxpayer can settle its position by paying reduced penalties of 1/6 of the minimum provided by law and avoiding any criminal punishment connected with an omitted income tax return.

In the medium term, taxpayers also should monitor the changes to Italian tax treaties that follow implementation of the Multilateral Instrument (MLI) and the expected OECD comprehensive and multilateral solution to the digital economy’s tax challenges.

Registration tax changes

The Bill amends section 20 of the Registration Tax Code, which addresses application of the

registration tax to the interpretation of deeds filed for registration. The new version of section 20 provides that the registration tax applies not only according to the intrinsic meaning and juridical content of the elements in the deed filed for registration, but also without considering any element not in the deed or any other deed that is connected to the deed filed for registration. The accompanying report clarifies that the objectives pursued by the parties are not relevant for applying the registration tax. Accordingly, the sale of 100% of a company’s shares cannot be recast as the sale of the underlying ongoing concern, even though the two transactions lead to the same ultimate objective.

The amendment aims to provide certainty when applying the registration tax in the context of share sales that may be part of a multi-step transaction and often are recharacterized as sales of the underlying assets for registration tax purposes based on their economic effect, as opposed to the juridical ones (see [PwC Insight dated August 8, 2017](#)). The accompanying report emphasizes that the general anti-avoidance rule still may apply to these transactions if they are devoid of any economic substance, create an undue tax advantage contrary to the tax system’s principles, and are not supported by valid non-tax reasons.

It remains unclear whether the provision will affect future transactions only or will also affect transactions occurring prior to entry into force of the Bill (i.e., before January 1, 2018).

Capital gains and dividends derived from ‘qualified shareholdings’

The 2018 Finance Bill harmonizes the tax treatment of income from capital and capital gain realized by Italian-resident individuals that do not hold

shares connected to a business activity, making irrelevant whether the shareholding is of a qualified or non-qualified nature.

Capital gains and dividends from 'qualified shareholdings' — i.e., either shareholdings representing more than 2% of the voting rights or 5% of the share capital for publicly traded companies, or shareholdings representing more than 20% of the voting rights or 25% of the share capital for non-publicly-traded companies — are now subject to a 26% substitutive tax, thus being subject to the same treatment as the non-qualified shareholdings.

The new rules apply to income from capital received from January 1, 2018, and to capital gains realized starting January 1, 2019. Former regimes still will apply to qualified dividends earned on or before December 31, 2017, whose distribution is declared between January 1, 2018, and December 31, 2022. Therefore, considering the of 24% CIT rate, qualified dividends earned

- through 2007 will be taxed at an effective tax rate of 9.6%
- from 2008 through 2016 will be taxed at an effective tax rate of 11.93%, and
- in 2017 will be taxed at an effective tax rate of 13.95%.

The change in law also applies to capital gains realized by non-Italian resident persons with no PE in Italy.

Accordingly, starting in 2019 capital gains realized by non-Italian resident persons and arising from qualified shareholdings will be subject to the 26% substitute tax unless tax treaty protection applies.

'Blacklist' dividends

Dividends received by Italian-resident corporations and paid by a company resident in a jurisdiction that has a

privileged tax regime under the 'blacklist' controlled foreign corporation (CFC) regulations are now 50% exempt as opposed to being 100% taxable. To obtain the 50% exemption, taxpayers must provide evidence that the company paying the dividend carries on an industrial or commercial activity in the market of the state or territory in which it is located. The indirect tax credit associated with the dividends is reduced proportionally.

If the dividends are paid out of retained earnings accrued in years in which the company was not considered to be resident or located in a tax haven under the CFC regulations applicable in those years, the 95% exclusion under the Italian dividend exemption regime applies. This provision applies to dividends received starting in 2015 for calendar-year taxpayers from earnings accrued in previous years.

Note: Non-blacklisted dividends are considered as paid first.

Taxpayers that received dividends in 2015 and 2016 should consider amending their tax returns to obtain refunds of the overpaid taxes.

Step-up regime for not resident controlled entities

The 2018 Financial Bill extends the possibility of electing to amortize goodwill, trademarks, and other intangibles recognized in an entity's consolidated financial statements and implicitly embedded in the value of qualifying shareholdings to situations in which the qualifying shareholding is in a non-Italian resident company without a PE in Italy.

The election is made through a 16% substitute tax payment. The 16% substitute tax is due by June 30 of the year following the one in which acquisition of the qualifying shareholding takes place. The step-up can be amortized over a five-year

period, with an initial deferral of two years. The benefits of the step-up are recaptured if the qualifying shareholdings or the intangibles whose value is implicitly embedded in those shareholdings are sold within four tax years following the substitute tax payment.

The extension applies starting from qualified shareholdings acquired in 2017. A specific ministerial decree will be issued within 180 days from entry into force of the Bill. The decree will provide the specifics of the new step-up election, with the stated objective being prevention of a double deduction of the intangibles that will receive the step-up in tax basis in the entity's consolidated financial statements.

Step-up of participation in Italian unlisted companies

The 2018 Financial Bill extends a one-time possibility for non-Italian resident entities or Italian-resident individuals to elect a step-up of participation in unlisted Italian companies held as of January 1, 2018. The election is made through an 8% substitute tax payment, and the value of the participation needs to be certified by sworn appraisal dated no later than June 30, 2018.

This provision could benefit entities that are tax resident in countries with no tax treaty in place with Italy or for which the applicable treaty does not provide an exemption for the capital gains on shares.

Interest deduction

The Bill no longer allows inclusion of dividends deriving from non-Italian resident subsidiaries in the definition of 30% EBITDA for interest limitation purposes.

The changes are aligned partially to Italian domestic law regarding the interest deduction under ATAD 1 (Article 4, par. 2 of EU Directive

2016/1164) and are effective starting from tax year 2017.

Extension of super-depreciation and hyper-depreciation

The Bill extends super-depreciation for investments in new tangible assets (excluding cars and other transport vehicles) through December 31, 2018. If the purchase order has been accepted by the seller and at least 20% of the purchase cost has been paid in 2018, the super-depreciation is extended to June 30, 2019. However, the 2018 Finance Bill also reduces the notional increase to CIT depreciation to 30%, bringing the taxable base to 130%.

The former 40% notional increase applies to investments made by June 30, 2018, if the purchase order has been accepted by the seller and at least 20% of the purchase cost was paid in 2017.

The 2018 Financial Bill also extends also the hyper-depreciation regime. In particular, it provides a 150% increase of the cost for investments in new tangible assets relevant for the company's technological and digital transformation (according to 4.0 Model) performed by December 31, 2018, or by December 31, 2019, if, by December 31, 2018, the relative order is accepted by the seller. Furthermore, at least 20% of the purchase price must have been paid in advance.

In addition, the Bill introduces a new provision that applies to both to the hyper-depreciation provided by the 2017 Financial Bill and to the hyper-depreciation extended by the 2018 Financial Bill. In particular, if a taxpayer sells an asset that qualifies

for hyper-depreciation, the relative benefit will not be lost if, during the same tax year, the taxpayer replaces the original asset with a new tangible asset with technological characteristics similar or superior to that provided by annex A to the Law 232/2016; and certifies the replacement of the asset, the characteristics of the new asset, and the interconnection requirement according to the rules provided by the art. 1, paragraph 11, Law 232/2016 (declaration of legal representative or sworn technical expertise/certificate of conformity).

If the acquisition cost of the new asset is lower than that of the replaced asset, the benefit continues, but based on the lower cost of the new investment.

Finally, the 40% increase of the acquisition cost of intangible assets is extended for the same period (2018), applicable to new intangible assets listed in annex B of Law 232/2016:

- (i) supply chain management systems aimed at drop shipping in e-commerce
- (ii) digital software and services for immersive, interactive, and participatory use, 3D reconstructions, and augmented reality, and
- (iii) software, platforms, and applications for the management and coordination of logistics with high integration characteristics of service activities (intra-fabric communication, factory field with telematics integration of on-field devices and mobile devices, telematics detection of

performance, and failure of on-field devices).

The takeaway

Major tax measures included in 2018 Financial Bill relate to:

- introduction of a domestic Web Tax on digital services levied at a 3% rate on the value of each transaction
- amendment of the domestic definition of PE based on the introduction of a new item in the 'positive list' and partial alignment to BEPS Action 7
- changes in rules on the interpretation of deeds for registration tax purposes
- changes to the tax regime of capital gains and dividends from substantial shareholdings
- changes to the tax regime of blacklisted dividends
- extensions of the step-up regime to Italian non-resident controlled entities
- one-off asset step up provision of participation in Italian unlisted companies
- extension of super-depreciation and hyper depreciation.

Multinationals should consider carefully the potential impact of the 2018 Financial Bill, analyze their position for Italian tax purposes and consider the opportunities recently introduced.

Let's talk

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