Italy:
New law decree includes measures on the NID, patent box and transfer pricing

A law decree published by the Italian government on 24 April 2017 contains a number of tax rules that are designed to help reduce the budget deficit. The decree entered into force on 25 April 2017, although it still must be converted into law by the parliament within 60 days to be final. The changes that are most relevant for foreign investors are the following:

- Amendment to the basis of computation of the notional interest deduction (NID);
- Exclusion of trademarks from the scope of the patent box regime;
- Introduction of a new downward adjustment mechanism for transfer pricing purposes; and
- Change in the tax treatment of carried interests.

Notional interest deduction

Introduced in 2011, the NID is designed to encourage businesses to strengthen their capital structures and to equate the tax treatment of companies that are funded with equity more closely to that of companies that are funded with debt. To this end, the NID grants Italian companies (and branches of foreign companies) a tax deduction that corresponds to a notional yield return on qualifying equity increases. The NID is computed on the amount of qualifying equity, and is determined by applying the notional yield to the increase in the qualifying book net equity as recorded in the financial statements (net of distributions and other adjustments to avoid duplications of basis from intercompany transactions) for the period ending on or after calendar year 2010. If any notional interest exceeds the net taxable income of the relevant year, the excess is carried forward and may be used to offset the net taxable income of a subsequent tax period. The NID rate is set periodically by the Minister of Finance (the rate is 2.3% for fiscal year 2017, increasing to 2.7% for fiscal year 2018).

The 2017 budget law added another limit to the NID base, i.e. the NID may be reduced based on the increase in investments in securities and financial assets (other than participations), as compared to the amount shown in the financial statements for 2010 (for prior coverage, see Italy tax alert, 23 December 2016).


The law decree adds another limitation to the computation of the NID base. The computation will be based on the equity increases and retained earnings of the prior five years, rather than those received/accrued from fiscal year 2010 as provided in the original legislation. As a result, when a taxpayer is computing its NID for 2017, it will need to take into account the relevant net equity increases during the period 2013-2017.

The new rule applies from the beginning of the taxpayer’s 2017 fiscal year and must be taken into account for 2017 advance payments by recalculating the corporate tax due for 2016 (i.e. in determining the 2017 advance payment, the 2016 corporate tax must be recalculated by applying the new timing limitation rule).

Patent box

The patent box regime, introduced by the 2015 budget law, is designed to encourage the development of intellectual property (IP) in Italy. The patent box grants a partial exemption from corporate income tax (50% as from 2017) and the local tax on productive activities on income derived from certain intangible assets. Income derived from the following types of IP is eligible for the patent box regime:

- Industrial patents that have been granted or that are in the process of being granted;
- Software protected by copyright;
- Trademarks (including collective brands) that have been registered or that are in the process of being registered;
- Models and designs capable of being legally protected; and
- Business and technical-industrial know-how.

Once a taxpayer opts into the patent box regime, the election is irrevocable for a five-year period, which may be renewed.
To bring the patent box regime in line with the OECD’s recommendations in action 5 of the BEPS project, the law decree excludes trademarks from the types of IP that can benefit from the regime (know-how, however, will continue to benefit). The exclusion applies as follows:

- For taxpayers with a calendar fiscal year, to requests to apply the patent box submitted after 31 December 2016; and
- For taxpayers with a fiscal year other than the calendar year that make a request to apply the patent box after 31 December 2016, with effect from the third fiscal year following the fiscal year that includes 31 December 2014.

Taxpayers that exercised their option to benefit from the regime in tax years in progress on 31 December 2015 or on 31 December 2016 still can benefit from the patent box with respect to trademarks until 30 June 2021.

Transfer pricing

The decree eliminates the definition of the arm’s length standard (ALS) in the Italian tax code as it applies to intercompany cross-border transactions, and introduces a new definition that is in line with that in the OECD model treaty. Under the new definition, income arising from intercompany transactions carried out with nonresident related entities will be determined according to the conditions and prices that would have been applied between unrelated parties, operating in free competition and in comparable circumstances.

Although the change is somewhat academic since both businesses and the tax authorities use the OECD definition of the ALS in practice, it still may be relevant in certain cases where reference to arm’s length “pricing” rather than to arm’s length “conditions” could result in different conclusions as to whether a transaction complies with the standard (an issue that recently has been addressed by the Italian Supreme Court).

The decree also introduces additional procedures that will allow Italian companies to avoid economic double taxation resulting from transfer pricing adjustments made by foreign tax authorities under the arm’s length principle. In particular, if a decrease in Italian taxable income is necessary to avoid double taxation, a downward adjustment in the Italian tax return now will be possible not only by means of the mutual agreement procedure provided under the EU arbitration convention and the relevant tax treaty, but also through:

- Joint audits carried out in the context of international cooperation activities whose outcomes are shared by the participating countries; and
- A specific request by the Italian taxpayer with the Italian competent authority for a correlative (i.e. compensating) adjustment in Italy. This option, which would allow the taxpayer to recover the higher tax paid in Italy, may be used only where transfer pricing adjustments are made by the tax authorities of a country that allows an appropriate exchange of information with Italy.

Italy’s Ministry of Finance and the head of the tax authorities are expected to issue detailed guidelines on the application of the new definition of the ALS and the implementation of the new correlative adjustment procedure.

Carried interests

The law decree also contains provisions addressing the tax treatment of carried interests. The decree provides that income from a direct or an indirect participation (if related to certain shares or other financial instruments granting economic rights) in companies, entities or undertakings for collective investment derived by (i) their employees or directors, or (ii) the employees or directors of other entities that (directly or indirectly) control, are controlled by or are in charge of the management of the entities, will be treated as capital income or capital gains (rather than employment income) if the following conditions are fulfilled:

- The actual cash investment made by the employees and directors is at least 1% of the entire investment made in the undertaking for collective investment or in the net equity of the company or other entity;
- The income is attributed only after all the shareholders or unit holders have earned an amount equal to the equity invested in the company, increased by the minimum surplus provided in the company’s bylaws; and
- The investment is held for at least five years, or if less than five years, the disposal was due to a change in control or a change of management of the company.
This new rule allows a significant reduction in the level of taxation for employees and directors on the capital income attributable to the carried interest (from a marginal tax rate of up to 45% to a fixed 26% rate) and the exclusion of the income from social security contributions. The rule applies to companies, entities and undertakings for collective investments resident in Italy and in any other countries that allow an appropriate information exchange with Italy, on income realized as from 25 April 2017.

— Luca Bosco (Turin)  
Partner  
Deloitte Italy  
lubosco@sts.deloitte.it

Stefano Schiavello (New York)  
Partner/Client Service Executive  
Deloitte Tax LLP  
stschiavello@deloitte.com

Aldo Castoldi (Milan)  
Partner  
Deloitte Italy  
acastoldi@sts.deloitte.it

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

© 2017. For information, contact Deloitte Touche Tohmatsu Limited.