Italy: Final legislation includes new NID rules and reduced penalties for PEs

The law decree published by the Italian government on 24 April 2017 was converted into law on 21 June 2017, with some modifications (for prior coverage, see World Tax Advisor, 12 May 2017). The final law contains a number of tax measures that are designed to help reduce Italy’s budget deficit, and makes the following changes to the law decree that was published in April:


- The amendments to the notional interest deduction (NID) regime that would have calculated the NID based on the equity increases and retained earnings of the prior five years are not adopted;
- The notional interest rates for 2017 and later years are reduced from those that would have applied under the 2017 budget law; and
- A provision that reduces penalties for foreign companies that settle tax liabilities of previously undisclosed Italian permanent establishments (PEs) is newly introduced.

Under Italian law, the April decree was required to be converted into law by the parliament within 60 days of being published: the final law was published in the official gazette on 23 June 2017, with the changes applicable as from 24 June 2017. The provisions included in the April law decree that were converted into law without modification are effective as from 25 April 2017.

Notional interest deduction

The NID regime grants Italian companies (and branches of foreign companies) a tax deduction that generally is calculated by applying a “notional interest rate” to the increase in qualifying net equity (with certain adjustments) for the period ending on or after the 2010 fiscal year.

The April 2017 law decree had included an amendment that would have calculated the NID based on the applicable equity increases and retained earnings of the prior five years, rather than those received/accrued from fiscal year 2010. This amendment was not included in the final law.

The final law sets the notional interest rate at 1.6% for 2017 and 1.5% thereafter (instead of 2.3% for 2017 and 2.7% for 2018 as provided in the 2017 budget and in the April law decree). The 1.6% notional interest rate for 2017 applies retroactively as from the beginning of the fiscal year that includes 24 June 2017 and, in determining advance payments, companies must recalculate their prior year’s corporate tax by applying the 1.6% rate.

Reduced penalties for PEs

The final law introduces a provision that allows foreign multinationals access to Italy’s “cooperative compliance regime” to determine the existence of previously undisclosed Italian PEs, and to settle, with reduced penalties, the PEs’ overdue tax liabilities. This provision applies only to multinational groups with total consolidated annual revenue exceeding EUR 1 billion and annual revenue derived from sales carried out in Italy exceeding EUR 50 million. The settlement procedure is not available if the group has been notified by the Italian tax authorities (ITA) or otherwise made aware that it is or will be under audit concerning the potential existence of a PE in Italy.

The settlement procedure reduces the administrative penalties that otherwise would be due on the PE’s tax underpayment by 50% and waives any applicable criminal penalties.

Foreign entities that take advantage of the new provision and settle the tax liabilities of their previously undisclosed Italian PEs also will be allowed to join the cooperative compliance program going forward, with the following benefits:

- The avoidance of tax audits and controversies by having the ITA evaluate the proper tax treatment of facts and transactions before the company files the corporate tax return;
- The reduction of otherwise applicable administrative penalties by 50% in cases where the taxpayer has not reached an agreement with the ITA at the conclusion of the advance evaluation process.
• An expedited 45-day deadline for the ITA to respond to advance ruling applications (the deadline ordinarily is 90 days); and
• The elimination of the taxpayer guarantees that normally would be required for refunds of tax credits.

Other provisions

The final legislation adopts with no further changes (but with effect from 25 April 2017) the measures included in the April law decree that:

• Exclude trademarks from the types of IP that can benefit from Italy’s patent box regime under transitional rules (which brings the regime in line with the OECD’s recommendations under action 5 of the BEPS project);
• Eliminate the definition of the arm’s length standard in the Italian tax code as it applies to intercompany cross-border transactions and introduce a new definition that is in line with that in the OECD model treaty;
• Provide that downward adjustments in the Italian tax return (to avoid double taxation as a result of a transfer pricing adjustment by a foreign tax authority) may be made through (i) joint audits carried out in the context of international cooperation activities whose outcomes are shared by the participating countries, and (ii) a specific request by the Italian taxpayer with the Italian competent authority for a correlative (i.e. compensating) adjustment in Italy (but only where the foreign country allows an appropriate exchange of information with Italy); and
• Treat income from “carried interests” as capital income or capital gain (rather than employment income) for tax purposes under certain conditions.

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