Italy:
Notional interest deduction implementation rules amended

A decree issued by Italy’s Ministry of Economy on 3 August 2017 and published on 11 August 2017 amends the implementation rules for the notional interest deduction (NID). The decree replaces the original implementation decree issued on 14 March 2012 (for prior coverage, see World Tax Advisor, 18 May 2012). It generally is applicable from the tax year starting after the date the decree was published in the official gazette (i.e. tax year 2018 for calendar year companies), except for the reduction of the NID rate, which is effective from 2017.

URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120518_2.html

The decree contains specific rules for the computation of the NID basis by companies that use Italian GAAP for financial reporting purposes. However, it also makes other changes to the NID implementation rules, including a reduction of the NID rate and a broadening of the anti-abuse provisions to prevent the double or multiple use of qualifying equity.

Overview of NID

The NID is a corporate income tax deduction computed as a percentage of the annual increase in a company’s net equity from new cash contributions and retained earnings. Introduced in 2011, the NID is designed to encourage businesses to strengthen their capital structures and to level the tax treatment of companies that are funded with equity 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 periods ending after calendar year 2010.

Changes to NID implementation rules

In addition to the specific rules for the computation of the NID basis by companies that use the revised Italian GAAP for financial reporting purposes, the decree modifies the implementation rules, as follows:

- The NID rate is reduced to 1.6% for 2017 (for calendar year taxpayers) and 1.5% for 2018 and thereafter.
- Retained earnings derived from profits originating from a contribution of an active trade or business no longer are included in the NID base, regardless of which financial reporting standards (Italian GAAP, IAS/IFRS) the company uses.
- To prevent double or multiple use of the NID benefit within groups, specific anti-avoidance rules address various types of intercompany transactions. A new definition of “group” applies for these purposes, which includes all group entities, including nonresident entities and individuals. The following transactions are within the scope of the anti-abuse rules:
  - Cash contributions to group companies (the NID base of the contributing company is permanently reduced by the amount of the cash contribution);
  - Acquisitions of participations or business going concerns from other group entities (the NID base of the purchasing company is permanently reduced by the amount of the purchase price); and
  - Intragroup financing (the NID base of the financing company is reduced temporarily by the increase in the loan receivables at the end of the year).

A specific anti-avoidance rule targets cash contributions received directly or indirectly from jurisdictions that do not allow the exchange of tax information with Italy (a “black-list” jurisdiction), even if the contributing entity does not belong to the group. Such contributions may not generate equity that qualifies for the NID. (A look-through approach is used to determine whether an ultimate shareholder (even one with a minority interest) is resident in a black-list jurisdiction, with certain exceptions).

A taxpayer can avoid the application of the anti-abuse rules if it is able to demonstrate that there is no double or multiple use of the NID in the specific case. The taxpayer can request a tax ruling (for cash contributions received...
from black-list jurisdictions, the taxpayer also must prove that all ultimate shareholders are not resident in black-list jurisdictions), or alternatively, it can disclose the existence of the intercompany transaction potentially subject to the anti-abuse provision in the tax return.

Comments

Since transactions implemented in prior years that potentially are captured by the new rules are not grandfathered, the NID computation of Italian subsidiaries should be carefully reviewed.

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