

# *European Tax Newsalert*

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**ITALY**  
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## *Urgent measures for Italian financial stabilization*

On July 17, 2011, the Italian parliament enacted Law Decree n. 98/2011 (the "Decree"), concerning urgent measures for Italian financial stabilization.

The Decree introduced a number of changes to existing tax law, the main features of which are summarized in this newsalert.

### **Carryforward of tax losses**

Before the Decree was enacted, there was a distinction between:

- (i) Tax losses incurred in the first three fiscal years following a company's incorporation ("Start-up Losses"). These losses could be carried forward indefinitely provided they were generated by a new business activity; and
- (ii) Other tax losses ("Ordinary Losses"). These losses could be brought forward and used only within the subsequent five fiscal years.

The Decree repeals the time limitation provided for Ordinary Losses, and these losses are now eligible for carryforward.



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However, unlike Start-up Losses, Ordinary Losses can now only be used to offset 80% of the taxable income of any given fiscal year. Accordingly, in the absence of Start-up Losses, a corporation will be required to pay IRES (i.e., the Italian Federal Tax, levied at 27.5%) on at least 20% of its taxable income (resulting in an effective rate of 5.5%), even if it has sufficient Ordinary Losses to offset its taxable income.

Based on the wording of the law, the new rules should apply to losses incurred during the current fiscal year and subsequent fiscal years. For losses generated in prior fiscal years, the old rules should continue to apply.

Companies should consider how these changes may impact the financial statements, particularly with regards to how carried forward tax losses may affect the recognition of deferred tax assets.

## Cost base uplifts and substitutive tax

Mergers, demergers and contributions of "going concerns" in exchange for shares (i.e., typically tax neutral transactions), might uplift the accounting carrying values of fixed assets and intangibles.

Italian tax laws allow for the alignment of the tax cost base of these assets to the uplifted accounting carrying value by paying a "substitutive tax". The substitutive tax can:

- Be applied at a blended rate under a "bracket" computation (i.e., 12% up to five million Euros, 14% from 5 to 10 million Euros, 16% for amounts greater than 10 million Euros); the tax can be paid in three annual instalments of 30%, 40% and 30%, or
- For intangibles only, the tax can be paid in one instalment at a 16% rate. In this case, the corporation may amortize goodwill and trademarks over 10 fiscal years, instead of the normal 18 year amortization period.

The Decree extends the one-off payment option (at the 16% substitutive tax rate) to goodwill, trademarks, and other intangibles implicitly embedded in the higher value of qualifying shareholdings. To qualify, the shareholdings must be acquired through: a tax neutral transaction, the purchase of a "going concern", or the acquisition of a target entity's equity interests.

The stepped-up basis equals the higher value of the participation that, in the consolidated financial statements, is allocated to goodwill, trademarks or other intangibles.

The substitutive tax payment does not affect the participation's tax basis. Instead, the payment's only impact is to allow the tax amortization of the higher value allocated to the intangibles in the consolidated financial statements.

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Qualifying shareholdings are those that satisfy the conditions for inclusion in the consolidated statutory financial statements.

This new provision applies to transactions completed prior to the 2011 fiscal year, provided the substitutive tax is paid by November, 2011. The effect of the tax step-up, however, has been deferred until the fiscal year commencing 2013. It is not clear whether the new provision applies to transactions occurring during, or after, 2011.

Details for this new option should be issued shortly by the Italian tax authorities.

## Beneficial ownership requirement

The Decree introduced a new 5% withholding tax for certain interest payments to European corporations ("EU Entities") that, although meeting all the other requirements to benefit from the withholding tax exemption under the EU Interest & Royalties Directive, cannot be considered the beneficial owner of the interest income received.

The new 5% withholding tax replaces the ordinary 12.5% withholding rate.

For the new withholding tax to apply, companies must meet the following conditions:

1. The EU Entities must issue a bond that is traded in a European Union ("EU") or Economic European Area ("EEA") regulated qualified market;
2. The interest income received by the EU Entities must be utilized to finance the interest payments to the bond-holders; and
3. The bond must be guaranteed by the Italian company paying the interest - or by another qualified group company - and a 0.25% registration tax must be paid on the guarantee.

This new provision applies to qualified interest payments effective July 6, 2011. For existing loans outstanding at July 6, all qualifying interest payments made prior to the entry into force of the Decree where no withholding tax has been being levied can be regularized by paying a 6% withholding tax (together with interest for delayed payment) by November 30, 2011.

## Increased IRAP (local tax) rate for financial institutions

The Decree increases the IRAP rate for financial institutions and insurance companies from 3.9% to 4.65% and 5.9%, respectively. The new rates are effective beginning with the 2011 fiscal year.

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