Italy reduces local corporate tax, increases withholding tax on financial income

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In brief

The new Italian government announced several tax measures on April 24, 2014 in Law Decree no. 66 (the Decree). The Decree's following provisions could affect US multinational companies (US MNCs) doing business in Italy. These provisions:

- reduce the local corporate tax (IRAP) from 3.9% to 3.5% for most companies
- increase the financial income withholding tax from 20% to 26%
- make the asset step-up substitution tax payable in one installment
- introduce an individual income tax credit for employees earning less than €26,000.

The Italian Parliament has 60 days from the publication in the announcement to convert the Decree into law. ***Note:*** The provisions of the Decree may be amended during this period**.**

In detail

IRAP reduction

For tax years starting on or after January 1, 2014, IRAP will decrease for most companies from 3.9% to 3.5%.

For financial institutions and insurance companies, IRAP will decrease from 4.65% and 5.9% to 4.2% and 5.3%, respectively. For entities that get concessions for public services from the government, IRAP will decrease from 4.2% to 3.8%, with a few exceptions.

Because of the IRAP reduction, special rules will apply to advance payments of taxes under the forecast method.

Withholding tax increase

Beginning July 1, 2014, withholding and similar taxes on certain dividends, interest, and capital gains will increase from 20% to 26%.

The new 26% rate generally will apply to:

- loan interest due on or after July 1, 2014;
- capital gains from disposals of non-qualified share-holdings realized on or after July 1, 2014. A capital gain is realized once the deed of transfer is executed, regardless of the consideration payment (Circular 165/E/1998);
- dividends received on or after July 1, 2014; and
- interest on bonds accrued on or after July 1, 2014.

The following tables show how the most common categories of financial income will be taxed beginning July 1, 2014:

Dividends

Dividends received by European Union (EU) parents qualifying for the EU Parent/Subsidiary directive	Dividends received by Swiss parents qualifying for the EU/Switzerland agreement	Dividends received by EU and EEA shareholders qualifying for the Italian domestic reduced rate	Dividends received by others currently subject to 20% tax
Nil	Nil	1.375%	26% (i) (ii)

(i) A refund of up to 11/26 of the Italian tax may be available if the recipient is not Italian resident, to the extent tax is paid in the recipient's country of residence.

(ii) A reduced rate might be available under an applicable treaty.

Interest

Interest on loans from EU lenders qualifying for the EU Interest/Royalties Directive	Interest on loans from Swiss lenders qualifying for the EU/Switzerland agreement	Interest on government bonds and other bonds issued by other public bodies	Interest on qualifying publicly traded bonds or bonds issued by 'Large Issuers'	Interest on Italian bank deposits received by non-Italian-resident persons	Interest on loans from EU lenders qualifying for the EU Interest/Royalties Directive, when the beneficial owner uses the loan proceeds to pay interest to bondholders	Other interest on loans currently subject to 20% tax
Nil	Nil	12.5%(i) (ii)	26%(i) (ii)	Nil	5%	26%(ii)

(i) An exemption might be sought by 'white listed' recipients (i.e., a recipient that is resident in a country with an adequate exchange of information regime).

(ii) A reduced rate/exemption might available under an applicable treaty.

Capital gains

Capital gains from the disposal of qualified (i.e., substantial) shareholdings (i)	Capital gains from the disposal of non-qualified shareholdings	Capital gains from the disposal of non-qualified shareholdings that are publicly traded on recognized stock exchanges	Capital gains from the disposal of government bonds or bonds issued by other public bodies
13.67% (ii)	26%(ii)(iii)	Nil	12.5%(ii)(iii)

(i) A qualified shareholding is defined as a shareholding of more than 2% of voting rights or 5% of equity for publicly traded companies, and 20% of voting rights or 25% of equity for other companies. The test is performed on a 12-month rolling basis.

(ii) An exemption might be sought under applicable treaty.

(iii) An exemption might be sought by white listed recipients

Change to due date of the asset step-up substitution tax

The 'substitution tax' that must be paid to elect a step-up in an asset's value is now due in one installment on the due date for paying the taxpayer's 2013 corporate income tax liability. Under the original version of the 2014 budget law, the substitution tax could be paid in three equal installments.

Under the election, Italian-resident companies, Italian partnerships, and Italian permanent establishments of non-resident companies that do not use international accounting standards may elect to step-up — for both accounting and tax purposes — the value of certain assets, intangibles, and equity investments in controlled or connected companies by paying a substitution tax. Note: Only the value of assets reported on the financial statements of the period that includes December 31, 2012, can be stepped up.

The substitution tax is set at 16% for depreciable or amortizable assets and intangibles, and 12% for non-depreciable assets.

Tax amortization of the step-up is available starting with the third tax year after the one in which the step-up takes place (i.e., the 2016 tax year for calendar-year taxpayers). A claw-back rule applies when assets or intangibles are sold by the end of the fourth tax year following the step-up.

A step-up in value requires the formation of an accounting net equity reserve. This reserve is considered to be in 'suspense' for tax purposes, meaning that it creates taxable income for the entity if it is later distributed. Taxpayers can eliminate this tax by paying an additional 10% substitution tax. This tax is subject to the same timing rules and other considerations as the main substitution tax discussed above.

Individual income tax credit

The Decree introduces a tax credit against income taxes for an individual with a salary of less than €26,000 during the 2014 fiscal year. The tax credit is €640 for workers with an annual gross salary of less than €24,000. The tax credit is reduced for employees earning between €24,000 and €26,000.

The takeaway

US MNCs should carefully consider the changes in withholding tax rates to properly address the impact on their operations and investments in Italy. Furthermore, the increase in withholding taxes puts more pressure on ensuring that the European platforms set up to invest into Italy have sufficient substance to qualify for the withholding tax exemptions under the EU directives.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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