

Implementation of the Italian penalty protection regime for hybrid mismatches

December 20, 2024

In brief

What happened?

The Italian Ministry of Economy and Finance, on December 6, approved the Decree implementing the penalty protection regime for hybrid mismatch arrangements based on anti-hybrid documentation as set forth by Decree no. 209 published in December 2023.

Why is it relevant?

Proper preparation of the anti-hybrid documentation is critically important for Italian taxpayers within multinational groups, as the penalty-protection regime:

- protects them against administrative penalties;
- ensures that they have ready-to-exhibit and adequate supporting documentation against the application of anti-hybrid rules (AHR) in case of a tax audit;
- provides benefits during due diligence;
- demonstrates proper management of internal tax risks and is connected to the cooperative compliance regime.

Relevant hybrid cases are not always a result of aggressive tax planning strategies but, instead, can be created by unintended behaviors. Consequently, proper documentation allows taxpayers to control the tax and penalty risks connected to previous fiscal years not duly mapped.

Actions to consider

Impacted taxpayers should consider developing an effective, efficient, and practical approach to anti-hybrid documentation. User-friendly technology should be able to help with this approach.

In detail

The AHR in a nutshell

Anti-hybrid rules are complex both from a technical and compliance perspective as they involve cross-border scenarios that, even if they have specific and identifiable law requirements (namely a deduction/not-inclusion 'D/Ni' or double deduction 'DD' effect attributable to a hybrid element like a different tax characterization of an item of income, and a certain subjective scope) can be difficult to detect, quantify, and comply with in practice.

In sum, the AHR seek to deny for tax purposes the deductibility of negative items of income (otherwise deductible in determining the taxable base) or, alternatively, to force the inclusion of positive items of income (otherwise not included or recognized in the taxable base) to the extent that:

- there is a cross-border mismatch (a D/Ni or DD);
- such mismatch occurs among related parties (including entities acting together) or parties to a structured arrangement (scope); and
- the mismatch is attributable to the different tax qualification of a financial instrument or item of income due under that instrument, hybrid transfers and substitute payments, hybrid entities (direct or reverse), and permanent establishments (including incoherent profit attribution).

Additionally, Italian AHR includes an 'imported mismatch' provision that denies tax deductions for negative items of income made by the Italian entity if they are directly or indirectly offset with an offshore hybrid mismatch elsewhere in the group (or under a structured arrangement).

Scope

The option to prepare the anti-hybrid documentation and benefit from the penalty protection regime is available to all Italian tax-resident entities and permanent establishment (PEs) of foreign entities. While each Italian taxpayer can prepare their own anti-hybrid documentation, they also may appoint another Italian group entity to prepare the documentation on their behalf, with a separate section required for each entity. This approach is particularly efficient for multinational groups with multiple entities or PEs in Italy.

For Italian entities under the cooperative compliance regime, preparing anti-hybrid documentation is a requirement under the transparency pillar required by the Italian Tax Authorities (ITA).

Fiscal years in scope

The anti-hybrid documentation can be prepared for all fiscal years in which anti-hybrid rules applied in Italy, starting from the fiscal year following the one in progress as of December 31, 2019.

However, the mapping also should include transactions related to items of income generated before the enactment of the AHR, specifically during the tax period following the one in progress as of December 28, 2018. This extension covers depreciation, amortization, and write-downs related to tangible or intangible assets acquired during this period. It also covers tax losses and interest expenses and similar financial charges accrued during this tax period. Items of income incurred previously are considered grandfathered.

Timing

For calendar-year taxpayers the Decree specifies the following deadlines for preparing anti-hybrid documentation:

- for fiscal years ending on December 31, 2020-2022, the deadline is June 2025 (six months from the approval of the Decree);
- for fiscal years ending on December 31, 2023-2024, the deadline is October 31, 2025 (the deadline for filing the fiscal-year 2024 tax return);
- from 2025 onwards, the relevant documentation must be filed by the deadline for filing the tax return for the respective tax period.

These deadlines may vary slightly for non–calendar-year taxpayers, and should be discussed on a case-by-case basis according to the fiscal year-end date.

Formal requirements

The anti-hybrid documentation must be prepared in Italian and digitally signed by the legal representative (or another proxyholder) of the Italian entity. Additionally, a timestamp must be applied to the documentation within the specified deadlines. The possession of the anti-hybrid documentation must be flagged in each relevant tax return or communicated to the ITA. The taxpayer does not need to file the documentation; it should be provided by the ITA upon request only.

Content

The anti-hybrid documentation must include a per-entity mapping for the entire corporate group, as well as an analysis of relevant cross-border transactions.

According to the scheme in the Decree, the documentation for each entity in the corporate group must describe:

- the percentage of shareholding in the corporate chain, the jurisdiction of tax residency or localization, and its tax treatment in its jurisdiction and that of its investors;
- the presence of foreign and Italian permanent establishments;
- adherence to local tax units.

To map potential 'direct' hybrid mismatches in transactions directly involving the Italian entities, the documentation must analyze relevant transactions that may trigger hybrid mismatches, describing:

- the counterparties and the item of income potentially generating a mismatch, as well as its tax treatment in the jurisdictions involved;
- the expected hybrid effect and the hybrid cause(s) in play, such as a hybrid financial instrument or a hybrid mismatch caused by a branch or hybrid entity;

- the applicability or reasons for non-activation of the linking rules to neutralize the mismatch.

Transactions can be grouped into homogeneous classes to simplify the mapping. Only transactions outlined in the documentation will be covered by the penalty protection.

Additionally, the anti-hybrid documentation should include an analysis of imported mismatches, based on information provided by the group's headquarters.

Leverage of the documentation on tax assessment procedures

The anti-hybrid documentation can be prepared only for fiscal years where the ITA has not formally initiated inquiries, investigations, or audits on the presence of anti-hybrid mismatches before December 29, 2023.

In all other cases, drafting the anti-hybrid documentation is essential for Italian taxpayers not only to shield against penalties, but also as evidence in case of a tax audit or litigation.

During the tax audit, the ITA will request the taxpayer to provide the anti-hybrid documentation within 20 business days. Additional supporting documentation may be provided upon request within 30 business days from the date of inquiry, which can be extended by a maximum of another 60 days.

Let's talk

For a deeper discussion on the possible implications of the hybrid rules, please contact:

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