Executive summary

On 22 December 2014, the Italian Parliament approved the budget law for 2015 (the Law) which is effective as of 1 January 2015. The most relevant measures contained in the Law, aimed at promoting economic growth, are related to:

- Introduction of a patent box regime
- Introduction of a new research and development (R&D) tax credit
- Full deduction for local income tax (IRAP) of labor costs related to employees hired on a permanent basis
- Restoration of the 3.9% standard IRAP rate
- Revision of the criteria to identify black listed countries
- One-off opportunity for nonresident companies to step up Italian participations
- Extension of voluntary disclosure program

As a consequence of the new changes, companies with Italian operations should review the impact of each of the new provisions on their activities in order to identify available tax benefits, manage any risks, and comply with any documentation requirements associated with the addressed measures.

This Alert outlines the most significant changes relevant to multinational companies.

Detailed discussion

**Patent box regime**

The proposed measure intends to introduce a favorable tax regime for income generated through the use of certain intangible assets similar to regimes already provided by other EU jurisdictions.
R&D tax credit
To promote economic growth, in addition to the introduction of the Patent Box regime, the Law also introduced a new R&D tax credit replacing the 2014 budget law provision. The measure applies starting from the fiscal year (FY) that follows the taxpayer’s current year as of 31 December 2014 and is in force until the current year as of 31 December 2019.

The regime allows resident companies performing qualified R&D activities to benefit from a tax credit (up to €5 million) calculated on sustained qualified expenditures (if higher than €30,000). The tax credit is 25% of the exceeding qualified expenditures in a given FY in respect of the average of the three previous FYs. A wide range of R&D activities qualify for the regime.

The qualified expenditures are related to the costs for (i) high qualified personnel, (ii) depreciation of laboratory equipment, (iii) R&D activities outsourced to universities and to similar bodies, and (iv) technical expertise related to industrial or biotech intellectual properties.

The credit is increased from 25% to 50% in connection with expenditures mentioned under (i) and (iii) above.

IRAP
Under the old IRAP rules, companies were allowed limited lump sum deductions for any category of employees. The budget law introduced a full deduction with specific reference to labor costs sustained for employees hired on a permanent basis. However, to mitigate the loss of revenue resulting from such allowance, the 3.5% IRAP rate introduced in 2014 is replaced by the previously effective rate of 3.9% with retroactive effect to FY 2014 without the application of interest and penalty. Labor intensive companies should benefit from the new measure.

In addition, a tax credit equal to 10% of the amount of IRAP due for a given FY is also provided for companies without employees.

Revision of the criteria to identify black listed countries
Article 110(10)(11) of the Italian income tax code requires an additional burden of proof to allow Italian entities the deduction of costs incurred in transactions with entities located in black listed countries. In the awaiting of a thorough review of the applicable list of countries, the proposed measure empowers the tax administration to amend the said list by excluding those states which have an adequate level of exchange of information with Italy, irrespective of their effective level of taxation.

The practical consequence of such provision could be an exclusion from the black list of countries with which Italy has already an exchange of information clause in place such as Ecuador, Mauritius, Philippines, Singapore, South Korea and the United Arab Emirates. Hong Kong could also be potentially excluded as soon as the relevant bilateral treaty with Italy becomes effective.

In addition, the Law empowers the tax administration to amend the black list for the application of the controlled foreign corporations (CFC) regime. The new list will be based on less restrictive criteria compared to the one currently adopted.

One-off opportunity for nonresident companies to step up Italian participations
The Law revamps the special one-off opportunity for nonresident entities to elect for a tax step up of participations in unlisted Italian companies held at least from 1 January 2015 through the payment of a substitute tax.

The provision may be of specific interest to foreign entities which could realize a capital gain subject to tax in Italy and not be eligible for exemption under an applicable treaty.

The rates of the substitute tax are doubled in respect of those provided for previous FYs and, in particular, are equivalent to 4% for non-qualified participations and 8% for qualified participations.

The basis of the substitute tax is represented by the value of the participation as of 1 January 2015 and needs to be certified by a sworn appraisal prepared no later than 30 June 2015.

The substitute tax may be either paid in full by 30 June 2015 or through three annual installments beginning 30 June 2015 (an annual 3% interest will be due on the second and third installments).
Extension of voluntary disclosure program
The law introduced a specific measure intended to amend the existing voluntary disclosure regime which allows taxpayers to disclose undeclared income by benefiting from reduced penalties. The new measure permits taxpayers to also disclose undeclared income after the beginning of a tax audit but prior to the issuance of the relevant tax assessment.

The voluntary disclosure implies an extension of the ordinary statute of limitation with reference to the items of income subject to the procedure.

Endnotes
1. The Law has been published in the Official Gazette on 29 December 2014.
2. For a detailed discussion, see EY Global Tax Alert, Italy enacts Patent Box regime, dated 24 December 2014.
3. In principle, if Italian CFC rules apply, the income of the CFC must be allocated to the Italian resident in proportion to the participation held, even in the absence of a dividend distribution. The CFC rule applies to the profits earned by controlled foreign companies which are either (i) resident or located in states or territories having privileged tax regimes (black list CFC) or (ii) located in states or territories other than those having privileged tax regimes (e.g., EU Member States) if the effective tax burden borne by the foreign entity is lower than 50% of the tax burden that the entity would bear if it were resident in Italy and more than 50% of its profits derive from passive income (white list CFC).
4. The tax systems of states and territories are deemed to be privileged if at least one of the following criteria is met: (i) level of taxation lower than 50% of the Italian tax rate; or (ii) level of taxation formally higher than 50% of the Italian rate but substantially lower than such threshold by virtue of special privileged tax regime to be further identified by the Italian tax authorities.
5. The reason could be either the absence of a tax treaty in force or an existing tax treaty which does not protect from the Italian taxation.
6. Qualified participations represent at least 20% of the voting rights in the ordinary shareholder meetings or at least 25% of the issued capital of the Italian subsidiary.
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