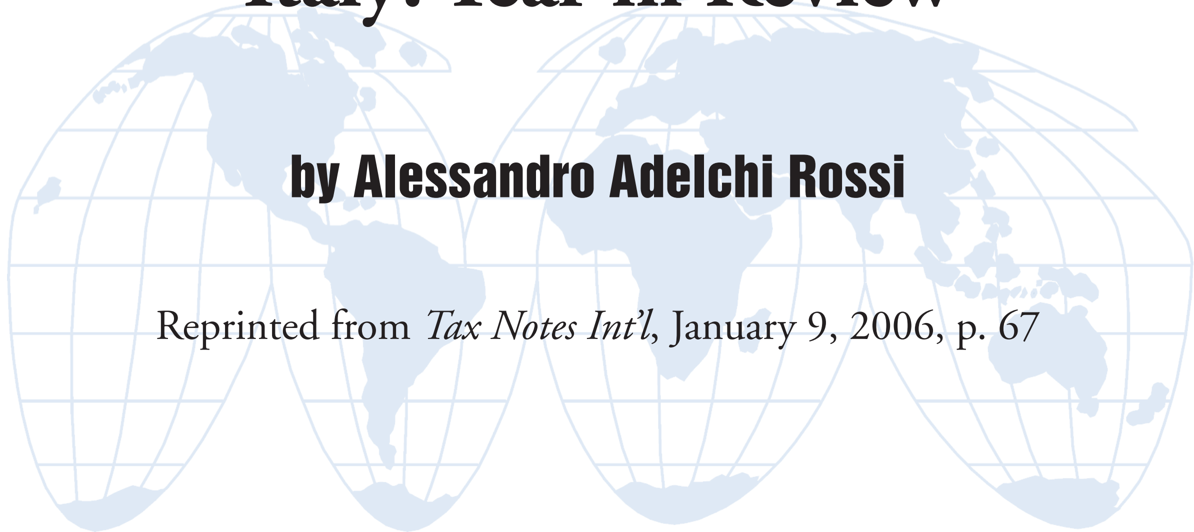
taxanalysts
Respectfully disagreeable since 1970.

tax notes international

Volume 41, Number 1 ■ January 9, 2006



Italy: Year in Review

by Alessandro Adelchi Rossi

Reprinted from *Tax Notes Int'l*, January 9, 2006, p. 67

(C) Tax Analysts 2006. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Reprinted from *Tax Notes Int'l*, January 9, 2006, p. 67

(C) Tax Analysts 2006. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Italy: Year in Review

by Alessandro Adelchi Rossi

The Italian income tax is not nearly as complex or as pervasive as the income tax laws of other countries, possibly because Italy does not make the income tax bear all of its fiscal burdens. It has been only over the past few years that Italy has tried to achieve a more comprehensive and internationally competitive income tax. The fine-tuning process continued during 2005, as discussed below.

Legislative Developments

The Italian government tightened the participation exemption provisions, most notably by increasing the investment holding period from 12 to 18 months and by reducing the exemption from 100 percent to 95 percent. (For prior coverage, see *Tax Notes Int'l*, Oct. 31, 2005, p. 422.)

Italy also implemented the EU interest and royalties directive. (For related coverage, see *Tax Notes Int'l*, Aug. 8, 2005, p. 541.) As a result, no withholding tax should be imposed on payments of interest or royalties made to EU group companies (including permanent establishments) that have a qualifying relationship. Under domestic law, in the absence of a tax treaty with the country of residence of the recipient, interest paid to a foreign payee is subject to a 12.5 percent withholding tax (27 percent if the payee is resident in a low-tax jurisdiction). Royalties paid by an Italian payer to a foreign payee are generally subject to an effective 22.5 percent withholding tax.

Lawmakers have introduced legislation that will allow the write-up of the value of business assets to their 2006 fair market value by paying, over a three-year period, a 19 percent tax in lieu of the regular income tax on the resulting step-up in basis. For tax purposes, the new basis will become effective in 2008.

Also introduced were antiavoidance provisions to prevent taxpayers from claiming the benefit of a capital loss when buying dividend-paying stock and selling the same stock shortly thereafter.

A bill to designate certain areas, or a group of business entities performing certain functions, as manufacturing districts eligible for certain benefits was enacted. The government will provide additional guidance as to the criteria to follow to meet the statutory requirements for the designation. Also, Italy will have to seek EU approval for the related tax benefits.

Administrative Developments

In what constitutes yet another change of policy, the Italian tax authorities ruled, for EU parent-subsidiary directive purposes, that exemption from Italian withholding tax on dividends paid by an Italian subsidiary to its nonresident EU parent company is applicable only if, at the time of the dividend distribution, the required one-year holding period has been met. (For prior coverage, see *Tax Notes Int'l*, Aug. 8, 2005, p. 492.)

The authorities also ruled that a Dutch corporation that is resident in Italy by virtue of its place of management is eligible to file a consolidated return with its Italian subsidiaries. (For related coverage, see *Tax Notes Int'l*, Aug. 29, 2005, p. 801.) Presumably, that opens the door to other non-Italian incorporated, but Italian-resident, entities to file consolidated returns in Italy even though the entities do

not technically have the same corporate form provided under the Italian consolidation rules.

EU-Related Developments

The European Commission announced that Italy's reduced tax rate for open-ended collective investment vehicles holding stocks of small and medium-size EU companies, is in violation of the EU state aid rules and that the resulting tax savings must be recovered. The break was introduced in 2004, when Italy reduced the tax in lieu of income tax applicable to these investment vehicles from 12.5 percent to 5 percent.

The European Court of Justice rejected the opinion of Advocate General Francis Jacobs, in *Banca Popolare di Cremona v. Agenzia Entrate Ufficio Cremona* (C-475/03) (Mar. 17, 2005), that IRAP violates article 33(1) of the Sixth VAT Directive because it is a turnover tax. (For the advocate general's opinion, see *2005 WTD 52-12* or *Doc 2005-5554*.) The ECJ will reassign the case to a new advocate general to reconsider the substantive question of EC Treaty violation. (For related commentary, see *Tax Notes Int'l*, Nov. 7, 2005, p. 496.)

Treaty Developments

Another year passed without the pending Italy-U.S. treaty, signed on August 25, 1999, seeing the light of day. (For related coverage, see *Tax Notes Int'l*, Aug. 29, 2005, p. 791.) It is no wonder that, after the U.S. Senate rejected the Treaty of Versailles concluding World War I, President Wilson deemed that body the "graveyard of treaties."

During 2005, however, Italy did sign an income tax treaty with Belarus. Once in force, the treaty will replace the 1985 income tax treaty between Italy and the former Soviet Union as it applies to relations between Italy and Belarus. Both countries are expected to ratify the treaty, which would then enter into force before the end of the year.

Also, after more than eight years from the date on which it was signed (April 8, 1997), the 1997 Ethiopia-Italy income tax treaty entered into force on August 9. Its provisions apply retroactively from April 8, 1997.

Finally, while the 1971 treaty currently in force between Italy and Ireland is being renegotiated, the Irish Revenue questioned the application of the treaty to Ireland's capital gains tax. (For related coverage, see *Tax Notes Int'l*, Oct. 3, 2005, p. 26.) The 1971 treaty predates the introduction of Ireland's capital gains tax in 1975. While it had previously considered the tax covered under the treaty, the Irish Revenue is now reconsidering the issue, and until it reaches a final determination, it is taking the position that the current treaty does not apply to the capital gains tax. ◆

♦ *Alessandro Adelchi Rossi is with Funaro & Co., P.C., in New York.*

(C) Tax Analysts 2006. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.