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by Luigi Perin

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During 2004, Prime Minister Silvio Berlusconi's government implemented the most comprehensive reform of Italy's tax system since the early 1970s. The reform is based on principles of administrative simplicity, fairness, and efficiency and is intended to achieve a more modern and internationally competitive tax system. As part of the reform process, IRES (*imposta sul reddito delle società*), the new corporate income tax, replaced IRPEG (*imposta sul reddito delle persone giuridiche*), effective January 1, 2004. (For prior coverage, see *Tax Notes Int'l*, June 7, 2004, p. 1033.)

IRES's most noteworthy features are a participation exemption for dividends and capital gains, a flat tax rate of 33 percent, the option for taxpayers to file consolidated tax returns, the option for corporate taxpayers to elect to be taxed as partnerships, the introduction of thin capitalization rules, and a domestic definition of permanent establishment.

One More Nail in IRAP's Coffin

Since its enactment in 1997, Italy's regional tax on productive activities, IRAP (*imposta regionale sulle attivita produttive*), has been subject to strong criticism by taxpayers. The ECJ held a public hearing on November 16 in *Banca Popolare di Cremona v. Agenzia Entrate Ufficio Cremona* (C-475/03), which addresses the issue of whether IRAP violates EU law on VAT. EU VAT law prohibits member states from adopting domestic turnover taxes that are similar to VAT. (For prior coverage, see *Tax Notes Int'l*, Dec. 6, 2004, p. 830.)

A final ECJ ruling in the case is expected in early 2005. Regardless of the outcome of that case, the Berlusconi government has reiterated its intention to eventually repeal IRAP.

Expansion of Treaty Network

In 2004, Italy updated and expanded its network of income tax treaties with the ratification of treaties with Georgia, Mozambique, Syria, and Uzbekistan and the signing of treaties with Azerbaijan, Ghana, and Jordan.

Parliament's ratification of various tax treaties during the year raises concerns about the status of the ratification of the new Italy-United States income tax treaty, signed August 25, 1999.

Transfer Pricing

The Italian tax authorities have opened new offices in Milan and Rome to administer a new international ruling program. The program has jurisdiction over unilateral advance pricing agreements between taxpayers and the Italian tax authorities. (For prior coverage, see *Tax Notes Int'l*, Aug. 30, 2004, p. 791.)

The Italian Parliament in 2004 approved the renewal of the EU Arbitration Convention of July 23, 1990, on the "elimination of double taxation in connection with the adjustment of profits of associated enterprises." The convention provides a helpful mechanism to resolve cross-border transfer pricing disputes within the European Union.

Personal Income Tax Cuts

The Berlusconi government moved forward with its promised tax cuts. The government presented Parliament the 2005 budget in November, introducing four personal income tax rates of 23 percent, 33 percent, 39 percent, and 43 percent, while keeping the projected deficit below the 3-percent-of-GDP limit set by the EU Stability and Growth Pact. ✦

✦ *Luigi Perin is a partner with George R. Funaro & Co., P.C. in New York.*