CLIFFORD CHANCE

Briefing note

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Italy: tax measures included in the economic growth and competitiveness package

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On 24 January 2012 the Italian Government issued Decree Law 1/2012 ("**Decree 1/2012**") containing a set of urgent measures to address the economic growth and the competitiveness of Italian enterprises. The new measures include a ll number of significant tax measures, such as amendments to the VAT regime of leases and sales of certain residential properties, new limitation to deduction of interest expenses for certain public entities and further amendments to the taxation of financial investments.

Key issues

- Further amendments to the taxation of financial investments
- Collective investment vehicles eligible for the application of tax treaties
- Taxation of real estate – Changes to the VAT regime of residential properties
- New exemption for unitholders of non-EU harmonised venture capital vehicles
- Italian exit tax
- Other measures

Decree Law 1/2012 must be converted by the Parliament into law, with eventual amendments, within 60 days; if not converted, it would cease to produce any further effect.

The most significant tax measures can be summarized as follows.

Further amendments to the taxation of financial investments

Decree 1/2012 contains additional amendments to the new system of taxation of income from financial investments introduced by Decree 138 of 13 August 2011 ("**Decree 138**") which entered into force effective 1 January 2012 (see our client briefings of 17 August 2011 and 4 January 2012).

Dividends paid to EU pension funds

Dividends paid to pension funds established in EU Member States or EEA Member States deemed to allow an adequate exchange of information are subject to withholding tax at 11%. Prior to the change, such dividends would have been subject to tax at the general 20% rate.

Proceeds from repo and securities lending transactions on State bond and similar securities

For repo and securities lending transactions on (i) Italian State bonds and similar securities or (ii) State bonds issued by one of the States deemed to allow an adequate exchange of information, the repo spread and proceeds of the securities lending are subject to tax at 12.5%. Prior to the change, such interest would have been subject to tax at the general 20% rate.

Collective investment vehicles eligible for the application of tax treaties

According to Decree 1/2012, collective investment vehicles established in Italy are expressly considered Italian resident entities for income tax purposes and therefore subject to Italian corporate income tax ("**IRES**"). This amendment would be in accordance with the provision of paragraph 6.12 of the Commentary to Article 1 of the OECD Model Tax Convention, providing the granting of treaty benefits to collective investment vehicles.

Thus, while prior to Decree 1/2012 the application of tax treaties to collective investment vehicles was subject to interpretation as applied from time to time by scholars and the tax authorities, from 24 January 2012 collective investment vehicles established in Italy would be entitled to benefit from tax treaties according to an Italian law provision stating that such vehicles are resident in Italy for tax purposes.

Moreover, collective investment vehicles that invest in securities (i.e. other than real estate investment vehicles) and that are established in Italy, or are Luxembourg investment vehicles authorized for placement in Italy, are exempt from IRES provided that the relevant vehicle or the relevant vehicle fund management company are subject to surveillance of a supervisory authority. Prior to Decree 1/2012, such a condition was not provided.

Taxation of real estate – Changes to the VAT regime of residential properties

New VAT regime of leases and sales of residential properties

As a general rule, leases and sales of residential properties are subject to VAT but exempt.

Before Decree 1/2012, that general rule was subject to certain exceptions, namely:

- leases of residential properties were subject to VAT if the properties were leased:
  - by the building company or the enterprise carrying out rebuilding, restoration and repair work and urban renewal of town centres ("**Qualifying Works**") other than ordinary and extraordinary maintenance;
  - within the four years following completion of the construction or Qualifying Works;
  - made under tender contracts, lasting at least 4 years, connected with social housing projects ("**Social Housing Tender Contracts**").

If all of the above conditions were met, leases of residential properties were subject to VAT at the 10% rate.

- sales of residential properties were subject to VAT if the properties were sold:

  - by the building company or the enterprise carrying out Qualifying Works;
  - (i) within five years following completion of the construction or Qualifying Works or (ii) at any time (i.e. even after five years starting from the completion of the construction or Qualifying Works) in relation to properties connected with Social Housing Tender Contracts.

If all the above conditions were met, sales of residential properties were subject to VAT at the ordinary 21% rate (reduced to either 10% or 4% if certain conditions were met).

Under the new rules:

- leases of residential properties are subject to VAT at the 10% rate if:
  - the lessor opts for the application of VAT in the relevant lease agreement; and
  - either (i) the relevant lease agreement qualifies as a Social Housing Tender Contract or (ii) the residential properties qualify as social houses within the meaning laid down by Ministerial Decree of 22 April 2008 ("**Social Houses**"). To qualify as Social Houses, residential properties must have been built using public funds or incentive schemes and must pursue the public interest of providing homes for certain social categories.
- sales of residential properties are subject to VAT at the 21% (reduced to either 10% or 4% if certain conditions are met) rate if:
  - the residential properties are sold (i) by either the building company or the enterprise carrying out Qualifying Works (ii) within the five years period following completion of the construction or Qualifying Works;
  - or the seller opts for the application of VAT in the relevant sale agreement and the residential properties either (i) are sold under Social Housing Tender Contracts or (ii) qualify as Social Houses.

New exemption for unitholders of non-EU harmonised venture capital vehicles

In order to encourage investments in new Italian companies, Decree 1/2012 extends the exemption provided for unitholders in certain EU harmonised collective vehicles to non-harmonised venture capital collective vehicles which (i) invest at least 75% of their capital in non-listed companies and (ii) operate in seed financing, start-up financing, early stage financing or expansion financing. These collective vehicles shall be entitled to distribute proceeds to unitholders not holding the investment within the conduct of a business without any taxation provided that vehicles invest in companies:

- not listed;
- directly and mainly controlled by individuals;
- having the place of business in Italy;
- carrying out a commercial activity from no more than 3 years;
- having a turnover of less that 50 million Euro, based upon their most recent financial statements prior to the investment by the vehicle.

Italian exit tax

Companies which transfer the tax residence into other EU countries after 24 January 2012, will be allowed to defer the taxation of unrealized capital gains until those gains are realized their realization and will no longer be subject to tax upon transfer of tax residence. The amendment is the outcome of an infringement procedure notified to Italy after ECJ C-371/10 - National Grid Indus case, which states that the immediate taxation, on the date of transfer, of unrealised capital gains relating to the assets of a company transferring its place of management between Member States is in breach of the principle of freedom of establishment under Article 49 of the Treaty of the Functioning of the EU.

Other measures

New measures on deduction of interest expenses for certain public entities

From the fiscal year as at 24 January 2012, companies whose share capital mainly subscribed by public bodies, which build or operate plants for the supply of water, energy, district heating, and disposal and purification plants, will be allowed to the deduction of interest expenses provided the following limitation:

- interest expenses will be deductible up to the interest income accrued in each fiscal period;
- any excess of interest expenses over interest income will be deductible to the extent of 30% of "gross operating income" ("**EBITDA**") of the core business of the company. EBITDA is equal to the difference between (i) the value of production (item A of the profit and loss accounts scheme contained in Article 2425 of the Italian Civil Code) and (ii) costs of production (item B of the profit and loss accounts scheme contained in Article 2425 of the Italian Civil Code), excluding depreciation, amortization and financial leasing installments relating to business assets;
- any excess of interest expense over the above threshold (i.e. 30% of EBITDA) may be carried forward for deduction in the following tax periods to the extent that the net interest expense (i.e. exceeding interest income) accrued in such tax periods are lower than 30% of EBITDA;
- any excess of 30% of the EBITDA over net interest expenses realized, may be used to increase the relevant threshold for the following tax periods.

Before the entry into force of Decree 1/2012, the above mentioned limitation did not apply to suc entities. The aim of the introduced limitation is to avoid discrimination between public entities and private entities operating in the same market.

Right to charge VAT paid further to assessments of the Italian Tax Authorities

Before Decree 1/2012 entered into force, a VAT taxable person ("**Assessed Person**") was not entitled to charge VAT paid further to an assessment issued by the Tax Authorities ("**Assessed VAT**"), to the person to whom the goods or services had been supplied.

Decree 1/2012 now provides that an Assessed Person is entitled to charge Assessed VAT, to the person to whom the goods or services had been supplied provided the Assessed VAT (and relevant interest and penalties) has already been paid by the Assessed Person. Hence, the person supplied with the goods or services may deduct any Assessed VAT charged by an Assessed Person (i) at the latest in the VAT return for the second year following that in which the Assessed VAT was charged and (ii) under the VAT deductibility right at the time of the assessed transaction.

The amendment is the outcome of the infringement procedure No. 2011/4081 notified to Italy by the Commission of the European Communities.

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