MAISTO E ASSOCIATI **TAX ALERT 2024/02**

NEW MEASURES AFFECTING CORPORATIONS AND MULTINATIONAL GROUPS

Main tax measures potentially affecting companies and multinational groups enacted in Italy at the end of 2023:

- Extension of the Italian participation exemption regime to capital gains realized by EU/EEA companies in relation to Italian substantial shareholdings
- Amendments to the notion of tax residence for companies
- Simplification of Italian CFC legislation
- Special incentive for reshoring of foreign activities to Italy
- Implementation of the Global Minimum Tax (Pillar Two)
- Penalty protection for hybrid mismatch arrangements
- Repeal of the Notional Interest Deduction regime
- Revision of tax ruling procedures

*The end of 2023 saw the introduction of several important tax measures as a result of the publication of Law No. 213 of December 30, 2023 ("**Finance Act 2024**") and the first tranche of legislative decrees enacted by the Government to implement the new tax reform (the "**Implementing Rules**") in accordance with the guidelines and principles set forth in Law No. 111 of August 9, 2023.*
*The Implementing Rules not only introduced the Global Minimum Tax in Italy according to Council Directive (EU) 2022/2523 of December 14, 2022 (the "**Pillar Two Directive**"), but also provided many new tax measures that should in principle aim at creating a more favorable tax environment for cross-border activities.*
This newsletter provides an overview of the main measures that are expected to affect corporations and multinational groups.

Extension of the Italian participation exemption regime to capital gains on substantial shareholdings realized by EU/EEA companies (Article 1(59) of Finance Act 2024).

In line with recent decisions of the Italian Supreme Court holding that the Italian participation exemption regime ("**PEX**") was contrary to EU law as it was available only to Italian resident companies (see our **tax alert of September 7, 2023**), Finance Act 2024 extended the PEX regime to EU/EEA companies and other business entities which are subject to tax in their home jurisdiction. Under the new statute, Italian-source capital gains realized by EU/EEA companies on the disposal of substantial shareholdings (mainly shares in Italian-resident companies) are 95% exempt if all the conditions generally required to apply the PEX regime are met.
Even if these new rules are certainly more favorable for foreign entities, they might still be not fully compatible with EU law. Indeed, the extension of the PEX regime:

- Is only effective starting from January 1, 2024; and

- Only covers EU/EEA shareholders and, therefore, it could be explored whether a potential breach of the free movement of capital might still exist with respect to capital gains realized on substantial shareholdings by non-EU/EEA entities.

The new rule will be relevant for EU/EEA companies and business entities resident in jurisdictions whose double tax treaties entered with Italy allow source taxation on capital gains on shares (i.e., those with France and Cyprus).

Amendments to the notion of corporate tax residence (Article 2 of Legislative Decree No. 209 of December 27, 2023).

The Implementing Rules revise the notion of tax residence for companies effective from fiscal years starting after December 29, 2023 (fiscal year 2024 for calendar-year companies).
Based on the previous notion, companies were deemed to be resident in Italy for income tax purposes if they had in Italy, for the greater part of the tax year:

1. the registered office (statutory seat); or
2. the place of administration; or
3. the main business purpose.

Meeting one of the three alternative criteria was enough to be considered an Italian resident company under domestic rules.
The residence criterion relating to the registered office is unchanged. The other residence criteria were amended as the residence criterion based on the location of the "main purpose" of the company was repealed, and the notion of "place of administration" was replaced by two different criteria:

1. The "place of effective management" which is defined as the "continuous and coordinated assumption of the strategic decisions relating to the company or the entity as a whole"; and
2. A new residence criterion based on the place where the company's day-to-day management primarily takes place. In particular, this is defined as the "continuous and coordinated carry out of the current management activities relating to the company or the entity as a whole".

The Government's explanatory memorandum to the decree indicates that the introduction of the place of effective management test aims at aligning the domestic residence criteria with those applicable at international level and by double tax treaties. The explanatory notes also indicate that the place of effective management shall not be interpreted as the place where the shareholders take decisions in their capacity as such and, therefore, should ignore decisions other than those pertaining to the management of the company. The ordinary management test looks at the day-to-day management and can attract the tax residence of the company if it is primarily carried out in Italy for the greatest part of the tax period.
The elimination of the residence criterion based on the "main purpose" of the company may be relevant for foreign holding entities owning shares in Italian companies (or other Italian assets) because they may no longer be considered Italian residents simply because their main asset is in Italy, if they are managed and controlled abroad.
In any event, if applicable, treaty residence tie-breaker rules will still prevail over the domestic definition.

Simplification of Italian CFC legislation (Article 3 of Legislative Decree No. 209 of December 27, 2023).

The Implementing Rules revisit the Italian CFC rules effective from the first fiscal year starting after December 29, 2023 (fiscal year 2024 for calendar year companies) by introducing certain simplifications and other measures aimed at achieving more consistency with the newly enacted Global Minimum Tax.

A new simplified test to check the effective tax rate ("**ETR**") of a foreign controlled entity applies if (i) the foreign controlled entity's financial statements are audited by an authorized external auditor, and (ii) the analysis made by the foreign auditors is taken into account for the purpose of the auditors' opinion on the annual or consolidated accounts of the controlling entity (the "**Auditing Requirement**"). In such case, the foreign controlled entity is deemed to be a low-taxed entity if its statutory ETR (i.e., the sum of current and deferred taxes divided by the pre-tax profit, as resulting from the financial statements) is lower than 15%.
If the foreign controlled entity does not meet the Auditing Requirement or if the statutory ETR is lower than 15%, then the ETR test is carried out according to the criteria already in force in previous fiscal years (i.e., by testing whether the foreign controlled entity is subject to an effective taxation lower than 50% of the corporate taxation that would have been applicable if that entity had been resident in Italy).
The foreign ETR is calculated taking also into account any equivalent domestic minimum tax as defined in accordance with the Pillar Two Directive (to be allocated among the various companies in the foreign jurisdiction that contribute to the payment of such equivalent domestic minimum tax).
Finally, with reference to foreign controlled entities that meet the Auditing Requirement, Italian controlling shareholders can opt for the application of a 15% substitute tax to be applied on the accounting profit (grossed up by write-downs, corporate taxes and risk provisions) instead of running the ETR tests described above. If such an option is exercised, however, the substitute tax must be applied for three consecutive fiscal years (with automatic renewal unless formally withdrawn) and for all foreign controlled companies that meet the passive income test for Italian CFC purposes.

Special incentive for reshoring of foreign activities to Italy (Article 6 of Legislative Decree No. 209 of December 27, 2023).

The Implementing Rules introduced a new tax incentive to foster the reshoring of foreign economic activities to Italy. In particular, the new rules provide that only 50% of the business income deriving from economic activities carried out in non-EU/EEA jurisdictions that are transferred to Italy is subject to corporate tax and regional tax. The 50% tax relief applies in the fiscal year in which the reshoring occurs and in the following five fiscal years. The taxpayer must keep separate accounts to determine the income that can benefit from the relief.
To prevent potential abuses, the tax relief does not apply to economic activities that were already carried out in Italy in the 24 months preceding the reshoring. The incentive is forfeited in case of subsequent (total or partial) relocation of the migrated economic activities abroad (including to other EU/EEA countries) during the five fiscal years (ten, in the case of large enterprises identified pursuant to of Recommendation 2003/361/EC) following the expiration of the tax incentive.
The effectiveness of this new measure is conditional upon clearance of its compatibility with EU state aids legislation by the European Commission.

Implementation of the Global Minimum Tax (Pillar Two) (Articles 8-60 of Legislative Decree No. 209 of December 27, 2023).

The implementation of the Global Minimum Tax in Italy is effective as from fiscal year starting following December 31, 2023 (fiscal year 2024 for calendar year companies), except for provisions concerning the undertaxed payment rule (UTPR) whose entry into force is postponed by one year. The Italian provisions are mostly in line with the Pillar Two Directive and the OECD GloBE Model Rules. The Implementing Rules give taxpayers an option to apply for a mutual agreement procedure (MAP) to solve, in accordance with the Pillar Two Directive and the OECD GloBE Model Rules, issues regarding the interpretation or the application of the Pillar Two rules, also for the purpose of eliminating double taxation. A decree of the Italian Ministry of Finance will provide the implementing rules for this MAP.

Penalty protection for hybrid mismatch arrangements (Article 61 of Legislative Decree No. 209 of December 27, 2023).

The Implementing Rules enact an optional regime that grants a protection from administrative penalties in case of violations regarding the Italian anti-hybrid mismatch legislation.
Consistently with the existing penalty protection regime for transfer pricing and patent box purposes, the access to the penalty protection on hybrid mismatches is subject to the condition that (a) taxpayers prepare appropriate documentation, and (b) the date of such documentation can be verified with legal certainty. The protection from penalties may also cover past fiscal years back to 2020 if (i) the required documentation is prepared by the deadline to file the tax return for the fiscal year in which the provision becomes effective (i.e., the tax return for fiscal year to 2024 for calendar year companies) and (ii) no tax audits have been started yet.
Having documentation available which clearly describes the transactions that may trigger hybrid mismatch arrangements may also have a positive influence on criminal tax risks. The documentation may indeed be regarded as evidence that there was no intention to disguise the existence of any hybrid mismatch. A forthcoming decree of the Ministry of Economy and Finance will set forth the contents of the documentation.

Repeal of Notional Interest Deduction regime (Article 5 of Legislative Decree No. 216 of December 30, 2023).

The notional interest deduction ("**NID**") regime is repealed effective as of the fiscal year following the year that was current on December 31, 2023 (fiscal year 2024 for calendar-year companies).
However, taxpayers should be able to benefit from the excess NID available for carryforward at the end of fiscal year 2023 until this excess NID is fully utilized.

Revision of tax ruling procedures (Article 1(1)(n) of Legislative Decree No. 219 of December 30, 2023).

The Implementing Rules amended the existing statute that governs the standard tax ruling procedures. The main changes to the existing rules are the following:

1. The Revenue Agency will have to reply to tax ruling applications within 90 days of their submission, regardless of the type of ruling application filed (past provisions containing longer terms to issue a reply are therefore repealed);
2. The term for the Revenue Agency to reply is suspended between August 1 and August 31 and also when the Revenue Agency asks a formal opinion from other administrations. In this latter case, however, the reply to the ruling needs to be given within 60 days. If the deadline for the Revenue Agency to reply to the ruling application expires on a Saturday or on a public holiday, the deadline will be extended to the first following business day;
3. The ruling application is subject to the payment of a fee. A decree of the Ministry of Economy and Finance will set forth the amount and the payment modalities of the fee. The fee amount will depend on the type of taxpayer, the amount of its revenues or income, and on the relevance and complexity of the matters dealt with in the ruling applications.

The new rules should be applicable starting from the date of entry into force of the decree that introduced the changes (i.e., as from January 18, 2024).

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