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Doing business in Italy
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Outline of the Incoming Income Tax Reform

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1. General

Objective: to achieve a more competitive tax system and harmonize it with the more efficient regimes of the other European Union Countries.

The framework for the tax reform was approved by the Government on 28 December 2001 and enacted as L. 7 April 2003, No. 80. The Government is implementing the tax reform effective the 1st January 2004. Such date is now expected to be met.

Since the tax reform will reduce the tax payers tax burden, the timing and content for its full implementation mostly depends upon the obligation of matching Maastricht EU constraints in terms of public deficit and debenture in respect of the annual gross national product. Therefore the pace for such implementation mostly depends upon how much the GNP will grow over subsequent years. However several changes will occur effective the 1st January 2004.

The Government published the first draft of the implementation act last May. Such draft was recently amended and made available few days ago. The following outline is based on such new draft and though general in nature may allow to identify certain advantages and disadvantages from the expected reform and, accordingly, may drive the attention on particular tax planning aspects.

At present there are still several uncertainties for certain specific aspects. The current draft can also be amended.

2. Tax rates

Individuals: IRE tax 23% up to € 100.000, 33% over € 100.000 (at present IRPEF tax: 18%, 24%, 32%, 39%, 45%). Due to budget constraints current 2003 rates will be applied also for 2004.

Companies: IRES tax 33% (IRPEG tax 36% up to 2002, 34% for 2003 and DIT-Dual Income Tax reduction). IRES 33% is confirmed applicable from 2004.

3. Individuals:

Interest income: expected 12.5% (at present 12.5% or 27%)

Dividends from qualified participations (ownership over 2% for companies listed on the Stock Exchange, or over 20% for non listed companies): ordinary taxation at the 23%/33% rates (2003 rates for 2004) on 40% of dividends, on a cash basis, with no dividends tax credit (at present ordinary taxation with the dividends tax credit offsetting the distributing company IRPEG tax)

Dividends from non qualified participations: 12.5% final withholding tax (at present 12.5% final withholding tax, or ordinary taxation with the dividends tax credit)

Participation exemption: (capital gains and capital losses on qualified participations): ordinary taxation on 40% on the amount net of capital losses at the 23%/33% rates (2003 rates for 2004) (at present 27% on the amount net of similar capital losses, with four years losses carryforward)

Participation exemption: (capital gains and capital losses on non qualified participations): 12.5% on the amount net of capital losses; capital losses net amount is carried forward over four subsequent years (at present no difference)

4. Companies (SPA/SRL)

Dividends from qualified and non qualified participations: ordinary taxation (at the 33% rates) on 5% of dividends received, with no dividends tax credit (at present ordinary taxation with the dividends tax credit), both from any domestic and foreign participated companies. Dividends from low tax jurisdictions are fully subject to taxation unless advance ruling is obtained

Participation exemption (capital losses): not deductible (at present deductible)

Participation exemption (capital gains): not taxable if held for more than one year in operating companies (at present taxable by means of a substitute 19% tax if controlled or associated companies, or ordinary taxation over a maximum five years period if held for more than three financial years)

Participation exemption (recognition of devaluations): not deductible (at present deductible under certain circumstances)

Participation exemption (recognition of revaluations): not taxable (at present no difference)

Sale of business held for more than three years: ordinary taxation at the 33% rates over a maximum five years period (at present either 19% substitute taxation, or ordinary taxation over a maximum five years period)

Merger losses: no longer possible to recognize for tax purposes any merger loss, nor to obtain tax deductibility on recognition of same merger loss by applying 19% substitute tax. However present tax regime is applicable on operations approved by the extraordinary shareholders meetings until the 30th April 2004.

5. Tax consolidation/Domestic

New concept by which controlled companies and their parent company (only those selected) can elect to determine the taxable income on a consolidated basis (total amount of taxable profits and tax losses of each participating company).

Dividends between companies of the same tax group are fully tax exempt.

The election is for a three years period.

6. Tax consolidation/International

New concept by which all foreign controlled companies can be included in a consolidated tax return (total amount of taxable profits and tax losses of each participating company).

Tax credit for foreign income taxes paid in foreign countries are deductible based on percentage of ownership, on a company by company basis, with 5 years carry back and 5 years carry forward.

Dividends are fully tax exempt.

Financial statements must be audited.

The election is for a five years period.

7. Thin capitalization

New concept by which deduction of interest charges is limited in the case of:

- loans from or guaranteed by shareholders: deductibility is limited to a certain extent based on a debt/equity ratio being 4:1. Interest is deductible with no restriction also in the case that credit facility is granted based on the borrower own credit capacity.

- purchase of participations: interest charges are not deductible to the extent of the proportion between the participation book value less the participating company net equity and the total outstanding loans (companies participating into tax consolidation are not relevant);

8. IRAP

IRAP 4.25% will be progressively abolished. At present for IRAP taxable base it is not relevant:

- Personnel costs
- Financial costs and revenues
- Extraordinary items

In perspective, firstly the personnel cost will be deductible from the IRAP tax base.

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