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Outline of the Italian Tax Reform
(D. Lgs. 12 December 2003, no. 344)

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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 implemented the tax reform effective the 1st January 2004 by publishing D. Lgs. 12 December 2003, no. 344.

The following outline may allow to identify certain advantages and disadvantages from the reform and, accordingly, may drive the attention on particular tax planning aspects.

At present there are still several uncertainties for certain specific aspects. Implementing decrees are also to be issued by the Ministry of Finance. To provide guidance as to the application of the Tax Reform, in particular in respect of the newly introduced tax regimes, the Ministry of Finance is expected to issue detailed interpretations.

The new rules are effective from tax periods starting from January 1, 2004.

2. Tax rates

Individuals: IRE (*Imposta sul Reddito delle Persone fisiche*) tax 23% up to € 100.000, 33% over € 100.000 (for 2003, IRPEF tax: 18%, 24%, 32%, 39%, 45%). Due to budget constraints current 2003 rates will be applied also for 2004.

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

3. Individuals:

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% and 33% rates (2003 rates for 2004) on 40% of dividends, on a cash basis, with no dividends tax credit (for 2003 ordinary taxation with the dividends tax credit offsetting the distributing company IRPEG tax)

Dividends from non qualified participations: 12.5% final withholding tax (for 2003, 12.5% final withholding tax, or ordinary taxation with the dividends tax credit)

Participation exemption: (capital gains and capital losses on qualified participations, also from liquidation): ordinary taxation on 40% on the amount net of capital losses at the 23% and 33% rates (2003 rates for 2004) (for 2003, 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, also from liquidation): 12.5% on the amount net of capital losses; capital losses net amount is carried forward over four subsequent years (for 2003, 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 (for 2003, 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 gains, also from liquidation): not taxable if held for more than one year in operating companies (Real Estates companies do not qualify as operating companies) (for 2003, 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 (capital losses, also from liquidation): not deductible if same above conditions are met (for 2003, deductible)

Participation exemption (recognition of devaluations): not deductible (for 2003, deductible under certain circumstances)

Participation exemption (recognition of revaluations): not taxable (for 2003, no difference)

Sale of business held for more than three years: ordinary taxation at the 33% rates over a maximum five years period (for 2003, 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 (however prior tax regime is applicable on operations approved by the extraordinary shareholders meetings until the 30th April 2004), nor to obtain tax deductibility on recognition of same merger loss by applying 19% substitute tax.

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). One single tax return will be filed by the parent company for the group.

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 and an application to the Tax Authorities is required.

7. Check-the-box (transparency)

The consortium relief is a regime alternative to tax consolidation.

Resident limited liability companies (mainly SRL and SPA) if owned by limited liability companies are entitled to elect for transparency for income tax (IRES) purposes, if ownership is at least 10% but no more than 50% (the elections should be made for all shareholders).

As a result, the taxable income or loss of the transparent company will be imputed to each shareholder, irrespective of any distribution, in proportion to its participation in the company held. The company will be treated therefore as if it were a partnership. In particular, losses can be imputed to the extent of the relevant net equity attributable to each shareholder.

If non-resident shareholders exist, the option may be exercised provided that they are not subject to withholding tax in Italy on the distributed profits, i.e. the non-resident shareholders are resident in the EU and therefore the EU parent-subsidiary directive applies.

Once exercised, the option for tax transparency is irrevocable for three fiscal years. The option must be communicated to Italian Tax Authorities and an implementing decree is to be issued by the Ministry of Finance in this respect.

The above regime is also applicable to SRL with an annual turnover lower than EUR 5,164,000 owned by owned by individuals in a number not exceeding 10.

8. Thin capitalization

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

- loans from or guaranteed by shareholders owning more than 25%: deductibility is limited to a certain extent based on a debt/equity ratio being 4:1 (5:1 for fiscal year 2004). Interest is deductible with no restriction only 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);

9. International Advance Ruling (L. 24 November 2003, no. 326)

Companies carrying out international activities are entitled to enter with Italian tax Authorities into an agreement in respect of:

- transfer prices
- interest
- dividends
- royalties

The agreement is binding for both parties for the fiscal year in which the agreement is entered and for the two following years.

The Italian Tax Authorities are supposed to promptly provide the foreign Tax Authorities involved with said agreement.

10. 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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