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PRACTITIONERS' CORNER

Italian Taxation of Corporate Residence Transfers

by Piergiorgio Valente

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The decision to transfer an enterprise's corporate seat abroad generally includes a thorough assessment of several tax and civil law issues. The possibility for the source country to lose its tax sovereignty has led governments to introduce exit tax regimes, but these regimes have been deemed by the Court of Justice of the European Union to be incompatible with EU rules.

To remain in compliance with EU regulations, the Italian legislature reformed the tax regime of Italian companies transferring their corporate seat abroad.

Transferring a Corporate Seat Abroad

Article 166 of the Italian Income Tax Code (Testo Unico delle Imposte sui Redditi, or TUIR) provides the rules for the transfer of a corporate seat abroad and allows for the taxation of latent capital gains on transferred corporate assets, except when the assets are diverted to a permanent establishment located in Italy.

Article 166(1) of the TUIR deals with the following situations:

- Transfer abroad of the residence of entities carrying out business activities.
- Transfer of the residence abroad involving loss of residence in the Italian territory. Residence abroad should be determined based on article 4 of the OECD model tax treaty.
- Absence, in the Italian territory, of the transferred company's PE, toward which all of the company's assets might be channeled.

The Italian Association of Chartered Certified Accountants (Associazione Italiana Dottori Commercialisti, or AIDC) fought back, and the European Commission initiated infraction proceedings against the Italian state (No. 2010/4141).

The AIDC's Study Commission asserts that the provisions set forth by article 166 of the TUIR:

> constitute a serious restraint to the freedom of establishment, which were enforced notwithstanding their being in conflict with the dictates expressed by Article 43 of the EC Treaty, and is hopeful that the European Commission, within the context of its mission to supervise and safeguard community laws, may soon implement some adequate actions vis-à-vis the Italian State for the purpose of a prompt settlement of the regulatory conflict as above indicated.[1]

According to the Study Commission, taxation of latent unrealized capital gains, as provided by article 166 of the TUIR, is a suitable measure to hinder, dissuade, or cause the exercise of freedom of establishment, as guaranteed by the Treaty on the Functioning of the European Union, to become less attractive for Italian entrepreneurs. On the other hand, no advance taxation is provided for Italian taxpayers that transfer assets from a head office to a subsidiary or branch that remains within the Italian territory.

The Study Commission maintains that the norm provided by article 166 of the TUIR, concerning taxation of latent capital gains upon their transfer abroad to the company's seat, is:

[1]Associazione Italiana Dottori Commercialisti, Denuncia del Mar. 1, 2009, n. 5, *available at* http://milano.aidc.pro/elencoIncompatibilita.aspx?idNorma=104.

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- excessive, as far as its aim to counter practices exclusively intended to avoid taxes generally due on income tax;

- excessive, regarding increasing tax inspections' effectiveness, as it indiscriminately hits all Italian taxpayers intending to leave Italy and to establish themselves in other EU states with entrepreneurial opportunities; and

- disproportionate, because by taxing latent capital gains immediately during the tax period in which the company's corporate seat is transferred, neither the onerous financial burden nor the fact that capital gains recorded only on paper might in time be reduced or entirely annulled is considered.

Amendments to Article 166

The Italian legislature, after the CJEU's pronouncement on the exit tax issue[2] and in order to forestall the infraction proceedings instigated by the European Commission, intervened by amending article 166 of the TUIR.

In particular, article 91(1) of Legislative Decree No. 1/2012 introduced into article 166 of the TUIR the following paragraphs, which provide that:

> Entities transferring their residence, for income tax purposes, in states belonging to the European Union or states adhering to the European Economic Area, included in the list ex Decree issued under Article 168-bis, with which Italy may have entered into an agreement for mutual assistance on the subject matter of credit collection comparable to the one guaranteed by Council's Directive No. 2010/24/EU of March 16, 2010, as an alternative to the provision set forth under paragraph 1, may apply for suspension of such effects deriving from realized income therein provided, in compliance with the principles ratified by *National Grid Indus BV* (C-371-10), November 29, 2011.[3]
>
> By (non-regulatory) Decree of the Minister of Economy and Finance, the implementing provisions ex paragraph 2-quater have been adopted in order to identify, among other things, such cases that determine the suspension's lapse, the determination criteria of tax due, as well as relevant payment procedures.[4]

[2]*National Grid Indus BV* (C-371-10), Nov. 29, 2011.

[3]Article 91(1), para. 2-*quater* of Legislative Decree No. 1/2012.

[4]Article 91(1), para. 2-*quinquies* of Legislative Decree No. 1/2012.

Article 91(2) of Decree-Law No. 1/2012 establishes that the new provisions are applicable to transfers carried out after the effective date of the decree.[5]

Therefore, in line with the new provisions, taxation of latent capital gains — as of the date of the corporate seat's transfer abroad — may be suspended and postponed upon realization of those corporate assets.

Under paragraph 2-*quater* of article 166 of the TUIR, the suspension of the effects deriving from the realization of corporate assets is an optional regime that may be activated as an alternative to the ordinary regime, which remains unchanged.

Therefore, paragraph 2-*quater* of article 166 of the TUIR grants entities carrying out business activities and transferring their own residence abroad the option to request suspension of those effects deriving from realization, at arm's-length value, of the company's corporate assets (in compliance with the principles expressed by the CJEU) in the following cases:

- Transfer of tax residence to an EU member state or to another state of the EEA, according to article 168-*bis*, paragraph 1.
- Transfer of tax residence in one of the states indicated above if Italy had entered (with those states) into an agreement on mutual assistance on tax credit collection.
- Absence, in the Italian territory, of any of the company's transferred PEs. Absence of any PE, in fact, determines the effects deriving from realized assets at arm's-length value, under article 166(1) of the TUIR; or in the alternative, on the basis of paragraph 2-*quater* of article 166 of the TUIR, to opt for tax deferral, in compliance with principles ratified by the CJEU in *National Grid Indus*.

Suspension is not applicable when the transfer of residence abroad is neither final nor effective, or when the enterprise resolves to transfer its own residence abroad, keeping a PE in the Italian territory. Therefore, the link with the Italian state — allowing the latter to exercise its taxing authority on the PE — remains.

On August 2, 2013, the Ministry of Economy and Finance approved the decree adopting such implementing provisions set forth under article 166, paragraph 2-*quater* of the TUIR. The implementing regulation grants the possibility to suspend income tax collection on latent capital gains of transferred companies or their subsidiaries that were not channeled to a PE in Italy.

The implementing decree regulates the determination criteria of the exit tax, alternative procedures for tax due, and the causes for losing the right to the suspension regime.

[5]Decree-Law No. 1/2012 entered into force on January 24, 2012.

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In calculating the capital gains, in article 1 of the implementing decree, the company's value includes the goodwill and the value of functions and risks proper to the enterprise determined according to the arm's-length principle.

Article 7 of the implementing decree provides as an alternative to the payment of taxes during the year in which the capital gains were realized, that such payment be made:

> on a straight-line basis with reference to the year during which the transfer becomes effective and in the subsequent nine ones, including interests accumulated within the measure provided by Article 20 of Legislative Decree No. 241 of 9 July 1997.

Providing taxpayers with appropriate guarantees for the outstanding amount is especially important. Accurate determination of the relevant guarantees will be remitted to subsequent tax authorities' provisions.

The implementing decree specifies that any guarantee request consider the amount of outstanding tax due and provide for exemption thresholds for immaterial sums; as the Association of Italian Joint Stock Companies (Associazione fra le Società Italiane per Azioni, or Assonime) stated:

> the provisions at issue entail that, further to the need of avoiding that the constitution of a guarantee be actually economically assimilated to an immediate payment of tax, their apparent aim is to keep the community proportionality principle of the measure vis-à-vis the intended purpose in due consideration.[6]

Furthermore, the decree at issue specifies how suspended capital gains must be monitored, which shall occur during tax return filing or by means of a special communication.

[6]Assonime, Circular No. 5 of Feb. 20, 2014.

It is useful to note how the One-Off Tax Return Form 2014 for corporations (Modello Unico Società di Capitali 2014) provides for the introduction of Section TR, which deals with the transfer of residence of an Italian company abroad.

In Section TR, the options are:

- Suspension of tax payment for capital gains jointly determined, also separately for each of the various income sources or assets that were not channeled to a resident PE; the capital gain refers to each income source or asset transferred on the basis of the ratio between its higher value and the total of the higher values transferred.
- Payment by installments of the tax according to each income source. The quotas due will be increased by the relevant accumulated interests within the measure provided by article 20 of Legislative Decree No. 241 of July 9, 1997.

On July 10, 2014, the Italian Revenue Office issued a new provision that illustrates the conditions for the application of such option under article 166. Specifically, the tax authorities established:

- the obligation to keep and retain specific documentation, such as the inventory of the company's components, the aggregate amount of the capital gains and of the suspended tax, and, for each good, the tax cost, the arm's-length value, its capital gain or capital loss, an explanation of the methods for determining the arm's-length value, the country of destination, and so forth; and
- specific monitoring requirements in tax returns.

The Revenue Office also specified that the suspension may be subordinated to the submission of an appropriate guarantee, whenever a serious risk of noncollection exists, and it outlined the requirements for the provision of that guarantee. ◆

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