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2023 ITALIAN BUDGET LAW HAS BEEN ENACTED

On the 29th December the 2023 Italian Budget Law has been finally enacted.

The most relevant provisions of such law with respect to international taxation are described below.

Provisions on costs suffered for transactions with non-cooperative jurisdictions

The 2023 **Budget Law** stipulates that expenses and other costs arising from transactions, which have been effectively carried out, or entered into, with undertakings resident or located in jurisdictions that are deemed to be non-cooperative for tax purposes are deductible under certain conditions.

In principle, these costs might be deducted up to their fair market value. However, where the Italian person suffering the costs is able to demonstrate that it had a sound economic interest in order to enter into the relevant transactions, then the consequent costs might be entirely deducted.

In any case, new Budget Law provides for the administrative obligation to communicate the deductible costs in a separate specific form of the **tax return**.

The jurisdictions of relevance for this new administrative obligation are those that have been identified in Annex I to the EU List of Non-cooperative Jurisdictions for Tax Purposes, adopted by conclusions of the Council of the European Union (American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, U.S. Virgin Islands and Vanuatu).

New rules on real estate investment structures in Italy

The 2023 Budget Law contains a provision that potentially impacts on the taxation of Italian located real estate structures in Italy.

In particular, two are the new main amendments on that topic:

- a new **sourcing rule** has been introduced. Pursuant to such rule, capital gains derived by foreign investors from the sale of foreign entities deriving their value (even indirectly) mainly from real estate located in Italy are going to be considered as taxable in Italy; and
- the sale of portfolio participations by foreign investors in both Italian and foreign entities deriving their value (even indirectly) mainly from real estate located in Italy are going to be taxed in Italy, regardless on where the foreign investors are located. Prior to these amendments, a generic exemption was provided for by Italian law with respect to gains derived by non-resident investors on the sale on **portfolio participations** to the extent that such foreign investors were resident in a white-listed jurisdictions.

The new provisions:

- do not apply with respect to capital gains realised by EU regulated collective investment funds;
- does not take into consideration certain kind of real estate properties, namely the ones owned by enterprises whose business activity consists in building or selling such properties or the ones directly used for business purposes.

Substitute tax on foreign undistributed profits

Foreign-source profits, derived from jurisdictions with preferential tax regimes, received by individuals engaged in entrepreneurial activities and legal persons, may be freed up through the payment of a substitute tax, so that the same profits would no longer be subject to taxation upon receipt.

In other words, Italian taxpayers holding participations in foreign companies as part of their business activity, to repatriate the undistributed profits and profit reserves of a foreign source by paying a substitute tax of 9% for legal entities or 30% for individuals engaged in entrepreneurial activities. This rule shall only apply should such undistributed profits resulting from the financial statements of foreign investees relating to the fiscal year 2021.

Thus, where this option is exercised, such profits – when received – shall not suffer any further Italian taxation from income taxes.

The substitute tax shall be further reduced to 6% for legal entities or 27% for individuals where the profits are repatriated within the deadline for the payment of the balance of income taxes due for the fiscal year 2023 and the same profits must be set aside, for a period of not less than two fiscal years, in a specific equity reserve of the receiving person.

Introduction of the Investment Management Exemption

The 2023 Budget Law enacted a specific rule according to which certain activities carried out in Italy shall not amount to a **permanent establishment**.

In details, a non-resident investment vehicle would not be deemed to have a permanent establishment in Italy with respect to the activities of its investment manager(s) to the extent that certain conditions are met.

The requirements provided for by the proposed law are the following:

- the non-resident investment vehicle and its controlled companies must be resident or established in a jurisdiction allowing for a satisfactory exchange of information with Italy;
- the non-resident investment vehicle needs to meet some specific requirements related to its independency;
- the investment manager operating in Italy shall not have a seat in the administrative and control bodies of the investment vehicle and its direct or indirect subsidiaries, and shall not hold an interest in the non-resident investment vehicle granting it rights to more than 25% of the relevant proceeds;
- the remuneration for the activities rendered by the resident investment manager other entities of the group must be remunerated at an arm's length for price.

The tax authorities are required to issue a specific regulation to cover some implementation and compliance aspects of such new regulation.

Extension of the 5% tax regime on Swiss AVS and LLP proceeds

The 2023 Budget Law extends the 5 percent tax regime applied by resident intermediaries which intervene in the collection on sums paid in Italy by the Swiss Invalidity, Old-Age and Survivors' Insurance (AVS) and the Swiss Occupational Old-Age, Survivors' and Disability Pension Fund (LPP) also to taxpayers which receive the relevant sums abroad (without the intervention in the collection of the above-mentioned Italian financial intermediaries).

Introduction of a 5% tax regime on proceeds related to certain insurance and pension Monegasque scheme

As of 2023, sums wherever paid by the invalidity, old-age and survivors' insurance of the relevant Monegasque institution, including early retirement benefits paid by entities or institutions in the Principality of Monaco also accrued on the basis of social security contributions taxed at source in the

Principality of Monaco received by Italian resident persons without the intervention in the payment of any Italian financial intermediaries, are subject to a 5 percent substitute tax.

Miscellaneous domestic law related provisions

In addition to all provisions just described above, the 2023 Italian Budget Law provides for several relevant new tax provisions, listed below;

- the turnover threshold for the Italian 15% flat tax for self-employed and entrepreneurs to apply has been raised from 65,000 to 85,000 Euros;
- another 15% flat tax has been introduced. This flat tax only applies with respect to the additional income earned in 2023 with respect to the highest income registered in the previous three fiscal years;
- the substitute tax for obtaining the step-up of the value of shares and lands;
- the substitute tax for obtaining the step-up of the value of quotes in **CIVs,** insurance policies and crypto-assets;
- the tax relevance for the correction of accounting errors;
- new rules related to the taxation of crypto-currencies.

ENACTMENT OF THE LAW DECREE N0. 198/22 (SO-CALLED "MILLE PROROGHE")

The so-called "*Mille Proroghe*" decree contains several provisions aimed at postponing or extending the application of certain rules.

In particular, such decree:

- extends, for fiscal year 2023, the prohibition to issue electronic invoices for healthcare services to individuals and postpones to January, 1st 2024 the obligation to electronically store and transmit receipts;
- the postponement, from 1.1.2023 to 1.7.2023, of the effective date of a part of the regulations contained in Legislative Decree 36/2021, a decree relating to the reorganisation and reform of the provisions on professional and amateur sports bodies, as well as on sports work;
- the non-application of the accounting depreciation rates for certain fixed assets with respect to 2023.

INTERPOSED TRUST DIVIDED INTO SEVERAL COMPARTMENTS

With the ruling no. 796 of 1 December 2022, the **Italian Tax Authorities** have analysed the taxation features of a transparent trust having its assets into sort of internal "sub-funds". The applicant asked confirmation to the tax authorities on how such kind of trust should have been treated for tax purposes.

The Italian Tax Authorities claimed that, from an Italian tax perspective, the trust should be deemed as a disregarded entity. Indeed, from a reading of the relevant trust deed, it emerged that the trustee was bound to seek the opinion of the protector before taking any decision. The protector, in his turn, was appointed and might have been revoked by the beneficiaries. According to the Italian Tax Authorities, this means that the beneficiaries may actually – even though indirectly – affect the independence of the trustee and allowed such beneficiaries to interfere in the management of the trust.

As a consequence, the trust qualifies as an interposed entity and it must be disregarded for tax purposes.

FURTHER CLARIFICATIONS ON THE TRANSITORY REGIME ON DIVIDENDS DISTRIBUTIONS

As of 1 January 2018 the taxation of dividends received from non-portfolio participations are subject to a 26% withholding tax. Prior to that, however, such dividends were subject to a different tax regime (partially taxed with the ordinary progressive tax rates).

To manage this change in the regime, for profit distributions occurred upon until 31 December 2022, however, a transitional granted the possibility to apply the old tax regime.

With the Law Principle no. 3 of 6 December 2022, the Italian Tax Authorities have clarified that this transitional regime applies to profits generated in financial years prior to the first application of the new regime provided that the relevant distribution has been validly approved by a shareholders' resolution adopted by 31 December 2022, regardless of whether the actual payment takes place at a later date or not.

This interpretation supersedes a previous interpretation of the Italian Tax Authorities (ruling reply no. 454 of 16 September 2022) which, inconsistently with the language of the provision, had deemed the 26% rate taxation applicable only to dividend distributions both deliberated and occurred (*i.e.* paid) before 1 January 2023.

IRRELEVANCE OF COMPENSATIONS PAID TO EMPLOYEES WITH CONTRACTUAL OBLIGATION TO PASS IT ON

In an unpublished response to a ruling request, the department of the Italian Tax Authorities competent for the **SMEs** clarified that the remuneration paid by an Italian company to an employee of a foreign affiliated company (who was appointed as a director of the Italian paying company) through a direct payment to the foreign company, in the presence of a contractual obligation for the employee to pay the amount back such foreign company, does not qualify as an income in the hands of the employee and it is a deductible cost in the hands of the Italian paying company.

This kind of remuneration, indeed:

- does not qualify as employment income pursuant to Art. 51(2)(e) of TUIR;
- it is a cost deriving from the acquisition of supply of services for the benefit of the Italian company.

In addition, in the absence of a permanent establishemnt in Italy of the foreign company, the remuneration paid by the Italian company qualfies as business income of such foreign company, which is only taxable in the State of residence of the latter.

INTERACTION BETWEEN THE ITALIAN "HORIZONTAL" AND "VERTICAL" CONSOLIDATION SYSTEM

In the ruling no. 596 of 27 December 2022, the Italian Tax Authorities analysed the effects of the election for the "horizontal" tax consolidation regime by companies already involved in pre-existing "vertical" consolidation regime.

With respect to that, the Italian Tax Authorities maintained that, to the extent that all of the companies part of the previous consolidated tax regime elect for the new "horizontal" **tax consolidation regime**:

- no recapture for misalignments relating to the assets transferred in tax neutrality applies;
- tax losses to be carried forward by the consolidated companies are considered as "pre-consolidation" losses. Hence, they can only be used by the companies that have generated them against their own income;
- The excessive taxes carried forward under the previous "vertical" consolidation regime remain at the exclusive disposal of the former consolidating companies.

PROPORTIONALITY OF SANCTIONS ON INTERMEDIARIES FOR CERTAIN MONITORING OBLIGATIONS

Penalties set forth by Art. 5(1) of DL 167/90 relating to tax monitoring obligations on financial intermediaries (ranging between 10% and 25% of the amounts not reported) do not infringe the EU proportionality principle.

This is how the Italian Supreme Court ruled on its decision no. 28432 dated 8 November 2022 by also clarifying that what was maintained by the European Court of Justice ruled on its decision on the Case C-788/19 dated 27 January 2022 regarding the Spanish tax monitoring penalties is not applicable to the Italian tax frame as the Spanish penalties are 10 times higher (150%) roughly than the Italian ones.

VAT DEDUCTION RELATED TO INVOICES ISSUED IN THE CONTEXT OF A VAT FRAUD

With the decision on Case C-512/21 of 1 December 2022, the European Court of Justice maintained that EU law does not preclude, in principle, a domestic law provision that denies VAT deduction where it is established that the taxpayer which issued the relevant **invoice** was actually not a VAT person – as it was part of a VAT fraud scheme – and the customer was aware that a fraudulent scheme was set-up.

However, the ECJ also clarified that:

- the taxpayer receiving the invoice cannot be expected to investigate on its counterparty;
- it is in principle irrelevant that the persons involved in the fraud knew each other;
- it is not necessary for the Tax Authorities to identify all the parties to the fraud

RELEVANT ENTITY FOR VAT GROUP REGIME PURPOSES

In its decision on the Cases C-141/20 and C-269/20 of 1 December 2022, the European Court of Justice maintained that the German law which identifies the parent company as the VAT relevant entity of a VAT group (instead to the group itself) is compatible with EU law.

Indeed, Art. 4 of Directive 77/388/EEC (the so-called "Sixth Directive"), partially transfused in Art. 11 of Directive 2006/112/EC, allows several legally independent entities to be considered as a single entity if they are bound to each other by "financial, economic and organisational links", without any further conditions being laid down for that purpose.

When a VAT group is created, there must be a single entity which assumes the group's obligations vis-à-vis the tax authorities. The European legislation does not, however, contain any requirement as to which entity should be designated.

As a result, the provision contained in German law, according to which the group's parent company may take these responsibilities is compatible with EU law.

PROFESSIONAL PRIVILEGE OVERRIDES EU ADMINISTRATIVE TAX COOPERATION RULES

In its decision on Case C-694/20 of 8 December 2022, the EU Court of Justice ruled that Article 8ab(5) of Directive 2011/16/EU on administrative cooperation in the field of taxation is invalid insofar as it requires lawyers, when they are covered by legal and professional privilege, to inform other intermediaries of the risk of aggressive tax planning by the client they are assisting and not to be able to directly inform the competent authorities.

The aforementioned provision infringes confidentiality between the client and his lawyer, since the latter, by means of the notification of which he is burdened, discloses to third parties information related to his client.

According to the EU Court of Justice, moreover, such disclosure by the lawyer is not even necessary to achieve the anti-avoidance purpose pursued by the Directive, since all intermediaries are already obliged under EU rules to transmit the requested information to the competent tax authorities.

DAC 8 AMENDED DIRECTIVE PROPOSAL

On the 8 of December 2022, the European Commission proposed a text amending Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC8).

The new piece of legislation DAC8 provides for several amendments to the previous existing administrative cooperation Directive, and namely:

- new crypto assets reporting obligations (miming the OECD's Crypto-Asset Reporting Framework, so-called CARF);
- rules on advance cross-border rulings for high-net-worth individuals; and
- other miscellanea amendments to the current changes to the existing DAC rules.

NEW DIRECTIVE ON ECONOMIC AND SUSTAINABILITY REPORTING

On the 16 December 2022, the Corporate Sustainability Reporting Directive (CSRD) was published in the Official Journal of the European Union. Some of the key points of the new EU Directive 2022/2464 on sustainability reporting concern:

- the significant enlargement of the subjects obliged to adhere to the reporting;
- the provision of European standards for such reporting;
- the mandatory use of digital formats;
- requirement for an independent auditor or certifier to issue a certificate once it has assured that the sustainability reporting complies with the standards that have been adopted by the EU.

In connection with the transposition of the CSRD, it is stipulated that Member States shall adopt laws, regulations and administrative provisions necessary to comply with the Directive by 6 July 2024.

EU DIRECTIVE 2022/2523/EU SHALL TRANSPOSE THE PILLAR 2 RULES INTO EU LAW

On the 14 December 2022, the EU Council unanimously approved the proposal for a directive COM(2021)823, which provides a set of rules to ensure a minimum effective tax rate for multinationals groups (both national and international), with a parent company or a subsidiary in an EU Member State with a total revenue that exceeds € 750 million per year. On 22 December 2022, the official text of the Directive (no. 2022/2523/EU) was published in the EU Official Journal.

The agreement formalises the EU's commitment to implement the OECD's Pillar 2 tax reform. A minimum tax rate of 15% has been agreed upon worldwide by 137 countries.

Clauses have been included in the EU Directive that allow for the Member State of the parent company to levy an additional tax in the event that the minimum effective tax rate is not imposed by the Country where its subsidiaries are located.

The EU Directive also ensures the effective taxation where the parent company is located outside the European Union, in a low-tax Country that does not apply equivalent rules.

Member States must start implementing the new rules from 31 December 2023.

VAT DEDUCTION LIMITATIONS ON THE ACQUISITION OF MOTORISED ROAD VEHICLES AND RELATED COSTS

With EU Decision no. 2411 of 6 December 2022, the EU Council accepts Italy's request to provide a flat-rate deduction of 40% on the VAT paid on expenses relating to motorised road vehicles not wholly used for business purposes.

Should Italy wish to further extend this regime, a request will have to be submitted to the European Commission by 31 March 2025. The request must be accompanied by a report reviewing the VAT deduction rules.

OECD PUBLIC CONSULTATION ON THE DYNAMICS OF AMOUNT B UNDER PILLAR ONE

With respect to the developing project of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) to implement the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, on the 8 December 2022 the OECD published a consultation document where it seeks public feedback on the design and implementation of Amount B under Pillar One.

Amount B refers to a simplified and streamlined system of applying the arm's length principle (based on the guidance provided in the OECD Transfer Pricing Guidelines) to in-country baseline marketing and distribution transactions, through the establishment of a set of qualitative and quantitative tests.

The document that has been released for public consultation outlines the main design elements of Amount B which are the scope, the pricing methodology and the appropriate implementation framework.

Interested parties may send their comments by 25 January 2023.

REPEALING OF THE TRANSITIONAL COVID-19 RULES FOR ITALIAN FRONTIER WORKERS IN SWITZERLAND

In an agreement signed in Rome and Bern on 22 December 2022, the competent authorities of Italy and Switzerland ended, with effect from 1 February 2023, the exceptions mechanisms for cross-border workers stipulated in the friendly agreement of June 2020. Under the aforementioned agreement, the Italian and Swiss competent authorities agreed that, on an exceptional and interim basis, days worked in the State of residence, at home and on behalf of an employer located in the other contracting State, as a result of the measures taken to combat the spread of COVID-19, are considered days worked in the State where the person would have worked and receive in return the salary, wage and other similar remuneration in the absence of such measures.

By virtue of the new agreement of 22 December 2022, the aforementioned special rules on the taxation of remote smart working will remain in force until 31 January 2023.

As of 1 February 2023, on account of the current health situation, they will cease to have effect.

AGENCY PE FEATURES UNDER TAX TREATIES ACCORDING TO THE ITALIAN SUPREME COURT

In its decision no. 36679 of the 14 December 2022, the Italian Supreme Court held that, where an agent plays an important role in the negotiations of contracts in Italy, then such agent qualifies as permanent establishment of the foreign enterprise even if the contract is formally concluded abroad.

According to the **Italian Supreme Court**, this principle also applies with respect to tax treaties concluded by Italy with States (in case analysed by the decision at stake, Switzerland) that are still based on old OECD Models where such principle is not expressly contained in the wording of Art. 5. Even in the absence of such wording, the Italian Supreme Court maintained that the principle still applies as it was already contained in the **OECD Commentary** to those old models.

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We remain at your disposal for any clarification and we take this opportunity to extendour best regards.

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