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REPORT

From: General Secretariat of the Council
To: Permanent Representatives Committee/Council

Subject: Code of Conduct Group (Business Taxation)
– Report to the Council
= Endorsement

Italy's notional interest deduction regime (IT019)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 12 April 2018:

1. Name of the regime:

ACE Allowance for economic growth

2. Year of introduction / entry into force:

2011

3. Please attach (or provide a link to) the relevant legislation which introduced/amended your NID regime and any administrative guidance providing clarifications (if in a language other than English, please provide a translation):

- Law Decree n. 201 dated the 6th December 2011, amended and converted into Law n. 214 of 22nd December 2011.
- Minister of economy and finance's decree issued on the 14th March 2012
- Italian Revenue Agency Circular letter no. 12/E published on the 23th May 2014
- Italian Revenue Agency Circular letter no. 21/ E released on the 3rd June 2015
- Law n. 232 promulgated on the 11th December 2016
- Article 13-bis, of the Decree Law of 30 December 2016, n. 244, introduced by the law (conversion) 27 February 2017, n. 19 (mille proroghe 2017) (implementation of Legislative Decree 139/2015)
- Law Decree no. 50 dated the 24th April 2017, art. No. 7 amended and converted into Law n. 96 of 21 June 2017
- Minister of Economy and Finance's decree issued on the 3rd August 2017
- Italian Revenue Agency Circular letter no. 26/E published on the 26th October 2017

4. Please describe the scope of entities that can claim a NID deduction (companies based in your country / treatment of PE of foreign companies):

- Resident companies
- Individual resident entrepreneurs
- Resident partnerships
- Other commercial resident entities
- Permanent establishments in Italy of non-resident companies

5. NID formula:

5.1. Reference Rate: please describe the formula to determine the deductible interest rate; provide the applicable rates for the previous years (since entry into force):

The deductible interest is determined by applying a deemed rate to the “net equity increase” (i.e. the difference between equity increases and reductions) as compared to the equity result as of December 31, 2010 as shown on the balance sheet at year-end, without considering full year 2010 net income.

The deemed ACE rate was set at 3% for the first three years of the regime. The 2014 financial stability law increased the ACE notional rate to 4%, 4,5% and 4,75% for 2014, 2015 and 2016, respectively. After that, recently the deemed ACE rate was decreased to 1,6% for 2017 and 1,5% for 2018.

5.2. Equity: is your regime stock-based or an incremental regime?

Incremental regime

5.3. Equity: please define the equity on which the interest can be deducted:

In order to determine equity increase the factors to consider include:

- contributions in cash, starting from the payment date (loan forgiveness is considered as cash contribution)
- net profits allocated to reserves, except for those allocated to reserves that are designated as unavailable.

Are not considered as equity increase:

- except for entities operating in the banking and insurance sector, the increase of the value of Securities, other than shares, as compared to the one resulting from the financial statements for the year 2010;
- the increase of reserves to the extent that it is due to fair value of derivative financial instruments;
- unrealized capital gains recognized in case of business or part of business contributions;

In the case of newly established businesses and companies, the equity increase corresponds to the total initial equity contribution.

The following transactions qualify as equity reductions, with effect from the beginning of the tax year in which they occur:

- distributions to shareholders (i.e., as dividends) or to partners;
- shares buybacks.

6. Limitations applicable to the amount of notional interest deduction:

6.1: Does your legislation provide for a maximum amount of taxable income against which the NID can be claimed? If so, please describe the mechanism and state the lowest effective tax rate that can be achieved by using the maximum amount of NID:

The Italian legislation does not provide for a maximum amount of taxable income against which the NID can be claimed. However, the qualified ACE base cannot exceed the net equity of the company existing at the end of the tax year as resulting from the balance sheet. This limit was set in order to take into account the effect of losses on net equity.

6.2: Can the NID create losses? If so, please describe how those losses can be used by the taxpayers (carry-back, carry-forward, time and amount limitations):

The NID cannot create a loss. If the notional return exceeds the taxable income calculated for a given tax year, the excess may be rolled over to subsequent tax years for corporate equity allowance purposes.

7. Please describe the treatment of distributions made out of profits relieved from tax through a NID claim:

No specific provisions for distributions made out of profits relieved from tax through a NID claim.

8. Please describe any limitations of scope in your legislation (exclusion of some specific assets, participations, treatment of foreign PE of a domestic company):

Insolvent companies are out of the scope. Bankrupt companies, companies under compulsory liquidation procedure or extraordinary administration for large insolvent companies. The Italian NID applies to permanent establishments in Italy of non-resident companies.

9. Do you have specific anti-abuse provisions in your legislation that may apply in the following fields (if so, please explain the measure):

Article 10 of the above-mentioned decree dated August 3, 2017, provides for a Specific anti-avoidance Rule (SAAR) to avoid undue benefits multiplication. In particular the anti-abuse rule sets out cases that trigger corresponding decrease of ACE base. For instance it applies to the following intra-group transactions:

- cash contributions to group companies made from 2011;
- acquisition of controlling interests from other group companies;
- acquisition of business or part of a business from other group companies;
- the increase, compared to those resulting from the financial statements relating to the financial year in progress at December 31, 2010, of loan receivables from group entities.

Moreover, with regard to the cash contributions, the above-mentioned specific anti-avoidance rules apply to cash contribution from taxpayers, both inside and outside the group, that are located in countries that do not allow an adequate exchange of information in tax matters. In addition, it is also necessary to adopt a look-through approach when examining the ownership chain in order to ascertain whether or not behind the foreign “cash-contributor” there could be companies located in countries that do not allow an adequate exchange of information in tax matter, except for the two exceptions below:

- In the case of publicly traded companies, only the controlling shareholders, if any, need to be considered;
- In the case of regulated investments funds established in countries that allow an adequate exchange of information in tax matter there is no need to consider the investors' location/residence.

The taxpayer can file a tax ruling for the purpose of excluding the anti-avoidance rule, giving evidence to the Italian Revenue Agency that in the specific case there is not multiplication of ACE benefits. In the case, cash-contribution from taxpayers located in countries that do not allow an adequate exchange of information in tax matter.

9.1: Intra-group loans and loans involving controlled enterprises;

According to article 10, par. 3, let. C) of the decree dated August 3, 2017, financing provided, as of the 1st January 2011 granted to other group companies generates a corresponding decrease of “ACE base”, so far as they exceed the value resulting from the financial statement for the year 2010.

9.2: Cash contributions;

According to article 10, par. 2 of decree dated August 3, 2017, cash contributions to group companies made from 2011, to other group companies generates a corresponding decrease of “ACE base”.

9.3: Transfers of participations;

According to article 10, par. 3, let. A) of decree dated August 3, 2017, acquisition of controlling interests from other group companies generates a corresponding decrease of “ACE base”.

9.4: The re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

There are no specific rules tackling such schemes.

9.5: The creation of subsidiaries;

There are no specific rules tackling such schemes.

9.6: Acquisitions of businesses held by associated enterprises;

According to article 10, par. 3, let b) of decree dated August 3, 2017, acquisition of businesses held by associated enterprises generates a corresponding decrease of “ACE base”.

9.7: Double-dipping structures combining interest deductibility and deductions under the AGI;

There are no specific rules tackling such schemes.

9.8: Increases in the amount of loan financing receivables towards associated enterprises as controlled to the amount of such receivables at the reference date.

See point 9.1

10. Do you have a general anti-abuse provision in your legislation?

The Italian GAAR was introduced by the Law no. 212/2000, Article 10-bis .The rule defines Abuse of Law as “one or more transactions lacking any economic substance which, despite being formally compliant with the tax rules, achieve essentially undue tax advantages.”

Transactions are deemed to lack economic substance when they imply facts, actions and agreements, even related to each other, that are unable to generate significant business effects other than tax advantages.

Tax advantages are deemed to be undue where they consist of benefits that, even if not immediate, are achieved in conflict with the purpose of the relevant tax provisions and the principles of the tax system. In any event, the GAAR establishes that there is no Abuse of Law when a transaction is justified by not negligible business purposes (other than of a tax nature) including those aimed at improving the organizational and managerial structure of the business.

The new provision also clarifies that taxpayers are free to choose among different optional tax regimes provided by the law or between alternative transactions with a different tax burden.

Taxpayers can submit ruling requests to the Italian authorities to verify whether any envisaged or realized transactions are considered abusive.

11. Please describe the administrative procedures to benefit from the NID:

It is possible to benefit from the NID by filing the tax return.

Follow-up queries

12. Do you have any relevant data on the actual application of the regime?

Tax returns analysis as carried out by the Minister of Economy and Finance shows that over 2015 no. 302.700 entities (FY 2014, no. 279.600; FY 2013, no. 260.000) were entitled to the NID, with an increase by 8.3%.

Furthermore, with reference to the FY 2015, NID's entitlements were 18.9 billion EUR as a whole (2014, 12,3 billion EUR; 2013, 6,8 billion EUR).

13. Is there any general provision in your NID which prevents cumulating the benefit of the NID with benefits from other preferential regimes?

No.

14. With reference to question 8, could you please confirm whether the Italian legislation excludes participations from the NID base?

In general terms, Italian legislation does not exclude participation from the NID base.

However, to avoid that more than one company qualifies for the NID on the same injection of money, the special anti-fraud rule under Article 10 of ministerial decree 14/3/2012 provides for a penalization of the facilitation base equal to the amounts paid by the purchaser.

...or any other system to avoid that several companies qualify for the NID on the same equity injection?

The cash contributions to group companies by other group companies, carried out from 2011, trigger a corresponding reduction in the eligible basis for the transferring resident entity.

15. Do you exclude some specific types of assets (such as those not necessary for conducting business, luxury goods for instance)?

As of 2016, the increase of securities' value other than shares (participations), as compared to the one resulting from the financial statements for the year 2010, are not considered equity increases. It is worth to point out that such rule does not apply to financial institutions and insurance companies.

16. Finally, we understand that a PE of a foreign company can benefit from the NID (question 4). Could you also indicate whether the equity attributable to a foreign PE of an Italian company is excluded from the NID base?

Firstly, the “branch exemption regime”, entered into force as of 2016, treats the permanent establishment as an autonomous fiscal entity and recognizes the exclusive competence of the State in which that establishment is located to tax its profits and take into account its expenditure.

In this case, the allocation of free-capital to the branch does not give rise to a reduction of equity base for domestic head office. However, the “free-capital” allocated to the PE’s, as a whole, must not be higher than the NID attributed to the domestic head office.

Moreover, the rules for calculating both branch income and head office overall income operate in such a way to prevent a NID's double deduction tax outcome.

Secondly, allocation of “free-capital” towards a PE – treated as “taxable” (i.e. no subject to branch exemption regime) – does not give rise to any reduction of equity base for the domestic (Italian) head office, because such a foreign PE is not a legally autonomous entity (other than its head office).

4. With reference to question 9.2, could you please confirm whether your legislation contains a specific measure regarding contributions in kind?

Contributions in kind are out of scope.

NID notification - Additional questions to Italy

1/9.2 (add): Are there anti-abuse rules that prevent a group from changing existing equity to incremental equity e.g., when a parent company makes a cash contribution to its subsidiary or to relocate equity by using equity from other companies in the same group?

In the Italian tax legislation there are two anti-abuse rules aimed at countering cases of tax avoidance schemes used by the taxpayers:

- a GAAR (Article 10-bis of Law 212/2000);
- a specific anti-abuse provision (Article 10 of the Ministerial Decree of 3 August 2017).

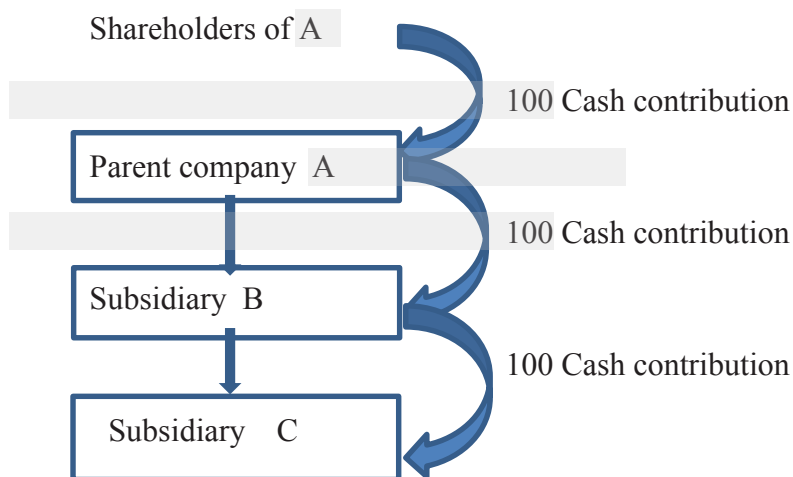
The specific anti-abuse provision is in particular intended to avoid undue NID benefits multiplication, especially within corporate groups.

With regard to intra-group transactions, the automatic decrease of the NID base is envisaged in the following cases:

- cash contributions made to resident taxpayers;
- acquisition of controlling interests or increase in their shareholding or acquisition of companies or branches of companies part of a business from other companies in the same group;
- cash contributions from taxpayers domiciled in countries that allow an adequate exchange of information in tax matters if they are controlled by residents or by persons domiciled in countries that do not allow such exchange;
- increase in loan receivables, compared to those resulting from the financial statements relating to the financial year in progress at 31 December 2010.

The ‘sterilization’ of NID base acts on companies making investments capable of generating the multiplication of the benefit, while the relevance of the contribution is maintained for the receiving company.

A parent company A receives a contribution of 100 and with the cash received it makes a contribution of 100 to its controlled company B. B, in turn, makes a contribution to controlled company C for the same amount.



Parent company A will have an NID base equal to zero since, against an increase of 100 for the contribution received, it will have a decrease of 100 for the contribution made to subsidiary B. Also company B will have an NID base equal to zero for the same reasons as parent company A. Subsidiary C will have an NID base increase of 100.

If yes, does the rules also cover existing equity originating from abroad, when a foreign company makes a cash contribution to its subsidiary resident in Italy?

Similarly, the anti-abuse rules do not refer directly to equity originating abroad, despite this, when a foreign company makes a cash contribution to its subsidiary resident in Italy the NID base is reduced accordingly if the foreign country does not allow an adequate exchange of information with Italy.

2/ In your reply to question 5.1, you provide with the applicable ACE rates since 2011. Could you present the economic rationale on which the NID rate is based?

The Italian NID is aimed at encouraging the strengthening of the capital structure of the companies. To this end, the law incentivises those companies self-financing through equity rather than through debt.

In general terms, the NID's rate is being linked to the average return on the public bonds, due the fact that it seeks to replicate the risk-free return.

It should be noted that the NID rate was set at 3% for the first three years and at 4, 4.5 and 4.75%, respectively, for the years 2014, 2015 and 2016.

The 2017 Budget Law began an organic rationalization of the measure to adapt it to the capital market conditions. The Law-Decree no. 50 of 2017 contained provisions (article 7) aimed at changing the reference base through the progressive replacement of the incremental criterion on a fixed basis (i.e. the "fixed" reference to equity as of 31 December 2010) and the introduction of a "mobile" base consisting of the increase in equity compared to that existing at the end of the fifth financial year preceding that to which the measure is applied.

However, when the Law-Decree no. 50/2017 was converted into law, the aforementioned article 7 was amended. The Law 96/2017 which converted into law the Law-Decree no. 50/2017 preserved the existing rules for determining the NID base, but introduced reduced rates (1.6% for 2017 and 1.5% from 2018) in order to take into account the trend in interest rates.

The current rate ensures the neutrality of the investment financing choices between equity and debt.

3/ In your reply to question 10, you explain your GAAR and that taxpayers can submit rulings requests to the Italian authorities to verify whether any transaction is abusive. Could you provide examples of cases where you made use of the GAAR and rejected transactions where the NID has been used without economic substance? Could you provide the number of rulings granted on the NID regime with detail on the number of cases where the ruling request had a positive/negative outcome?

We made use of the GAAR in a case, related to MLBO¹, where the equity injection was made by the previous Target Co's shareholders who sold their old controlling shareholding and then reinvested it in the Vehicle's shares. In these schemes, the NID has been used without economic substance, considering there are no new cash-flows in terms of equity at all.

With reference to the number of rulings granted on the NID regime please find below data referring to the application of the Italian GAAR:

Year	Number of Rulings	Positive outcome	Partial positive outcome	Negative outcome
2017	3	2	1	0

Please find below the relevant data for the years 2016-2018 on the number of rulings granted on the NID regime referring to the application of the Italian SAAR (Question 9 of the NID Questionnaire).

Year	Number of Rulings	Positive outcome	Partial positive outcome	Negative outcome
2016	91	62	14	15
2017	113	89	20	4
2018	36	29	6	1
Totale	240	180	40	20

¹ Merger leverage buy-out

4/ In your reply to additional question 3, you explained that to avoid that more than one company qualifies for the NID on the same injection of money, a special anti-fraud rule provides for a penalization of the facilitation base equal to the amounts paid by the purchaser. Could you explain how that rule works in practice?

The NID increase is reduced by an amount equal to any cash contributions made to the benefit of entities belonging to the group or entities. The rule is aimed at avoiding that the base for calculating the NID on the same injection of money be multiplied by means of chain equity injections among companies in the same group.

In practice, in order to prevent the automatic penalization provided for by the specific anti-avoidance provision, the taxpayer must prove that the increase of the company's net equity that is relevant for NID purposes has not resulted in a NID benefit duplication within the group, under penalty of "sterilization" in the hands of the company making the contribution.

In order to provide you with a clearer answer, find hereafter an example.

Assuming that, ITA1 Co. had the equity variations as indicated below. In so doing, it could be entitled to a NID of 1.282,5 euros with reference to the fiscal year 2016.

Year	Description	+	-
30/04/2012	Retained Incomes	10.000	
30/05/2012	Dividends		1.000
30/04/2013	Retained Incomes	10.000	
30/04/2014	Retained Incomes	10.000	
30/05/2015	Dividends paid		10.000
30/03/2016	<i>Price paid to buy participations in subsidiaries within the same Group</i>		2.000
30/04/2016	Retained Incomes	10.000	
		40.000	13.000
	NID Base	27.000	
	NID RATE 2016	4,75%	
	NID	1282,5	

5/ In your reply to additional question 3, you also explain that, regarding capital allocated to PEs, the rules for calculating both branch income and head office overall income operate in such a way to prevent a NID's double deduction tax outcome. Could you explain how that works in practice?

The NID benefit applies to permanent establishments with respect to increases in the "endowment fund" (fondo di dotazione) allocated by the head office, or in relation to the capital allocation of the permanent establishment compared to that existing at the end of the year that was current on 31 December 2010.

In this context, the endowment fund is the amount of "free capital" that the permanent establishment should be endowed with, if it were operating as an separate fiscal entity from the head office, taking into account the relevant functions performed and the risks assumed.

As far as the calculation is concerned, the starting point for any significant increase for the purposes of the NID benefit is represented by the higher between the endowment fund value for accounting purposes at 31 December 2010 (net of the profits) and the reasonable tax value of the fund on the same date (according to international accounting standards).

In particular, the endowment capital to be allocated to the permanent establishment should be determined - also in view of the level of capitalization of the company as a whole – according to the business activities performed by the company, the tangible and intangible assets available to it for its functions and the risks it has assumed (see Risoluzione² dell’Agenzia delle Entrate No. 44/E of 2006).

In view of the above, and in the light of the specific features of the permanent establishment, it should be noted that the variation in the endowment fund, which is relevant for NID purposes, is the algebraic sum of:

A. increases

- cash contributions made by the head company to the branch;
- profits set aside to reserves;
- "accounting adjustments" and / or "tax adjustments";

² When the issue underlying a ruling is new and relevant and it may apply to groups or types of taxpayers in the same situation, providing guidance on the position of the Italian tax administration on the matters, the response is issued as a general ruling and published in anonymized form (Resolutions) and can be applied or invoked by all taxpayers on their relevant activities or transactions.

B. decreases

- reductions in the endowment fund for accounting purposes of the permanent establishment with allocation to the head office, made for whatever reason.

Furthermore, in the case of the so called “Branch Exemption Regime” the foreign PE is considered such as an autonomous fiscal entity. In so doing, the NID allocated on the branch **must not be higher** than the overall NID granted to the head office. The NID allocated on the PE increases the head office’s tax base. In fact the exempt income of the branch is reduced by the NID allocated on the same branch. Taking into account that the tax base of the head office is net of the exempt income of the branch, the same tax base would be higher than the same situation without a NID allowance.

	Description	With NID allocated on the branch	NO NID - allocated on the branch
	Branch income	10.000	10.000
	NID allocated on the branch	3.000	0
	Branch exempt income to be deduct from the head office’s income	7.000	10.000
	Income of the head office	50.000	50.000
	Income of the head office net of the branch’s exempt income	43.000	40.000

6/ We thank you for the data you provided under additional question 1. We would be grateful if you could specify:

Amongst the 302.700 taxpayers benefiting from the regime in 2015, the proportion of directly or indirectly foreign owned companies, of PEs of foreign companies and of Italian owned companies. When providing data on foreign owned companies, could you please specify whether it is majority (over 50% owned directly or indirectly) foreign owned companies?

When concerning foreign owned companies, do you have data on the country of the parent company and when were these taxpayers incorporated?

Amongst the 18.9 billion EUR of NID entitlement, how much is attributable to each of the above categories?

Please provide similar detail on data for years 2013 and 2014.

See in the Annex data for 2015.

Data for 2013 and 2014 require further burdensome elaboration (i.e. matching between data on tax returns and external databases), but is reasonable to expect similar figures than for year 2015.

Annex to additional question 6

The Italian Allowance for Corporate Equity (NID)

by global ultimate owner

This note displays figures on the Italian Notional Interest Deduction (NID) **used** by companies and referred to tax year 2015. Please, note that the data already provided refer to the **due** notional interest deduction for tax year 2015, which includes also the NID that will be carried forward.

As regards **Permanent Establishments of non-resident companies**, data from 2015 tax returns show that only 330 companies benefited from NID (0.14% of the total number of beneficiaries), with a deduction amounting to 198 million euros (1.65% of the total deduction).

Amongst the companies benefiting from the regime in 2015, the focus is on companies that are directly or indirectly owned by a **Global Ultimate Owner (GUO) for at least 50%**.

Table 1 shows that more than **96%** (226,386 companies) of the 234,653 companies that benefited from the NID regime in 2015 were Italian owned companies, with around 4,500 (**1.94%**) of the remaining companies with a GUO located in Europe, nearly 2,800 benefiting companies (**1.18%**) with a GUO located in the Rest of the World and the residual 949 companies (**0.40%**) with no information available on the location of the Global Ultimate Owner.

Looking at the amounts of NID used by companies in 2015, around **75%** of the total 11.95 billion EUR of NID used is attributable to Italian owned companies (8.97 billion EUR), nearly **13%** to companies with a GUO located in Europe (1.53 billion EUR), around **9%** (1.09 billion EUR) to companies with a GUO located in the Rest of the World and the residual 0.36 billion EUR of NID used (**2.97%**) attributable to companies for which no information is available on the location of the Global Ultimate Owner.

The table also show the amount of **CIT savings** stemming from the application of the regime for each of the abovementioned categories.

Table 1 – Number of companies and NID used, by geographic region of the Global Ultimate Owner

Geographic region	Number of companies	NID used within taxable income	CIT savings
		Amount	Amount
Not available	949	355,142	85,172
Rest of the World	2.777	1,090,623	257,910
Europe (28)	4,541	1,534,469	370,551
Italy	226,386	8,974,117	2,190,112
TOTAL	234,653	11,954,351	2,903,745

Source: Ministry of Economy and Finance – Department of Finance. Tax Returns matched with Orbis data. Amounts expressed in thousand EUR

For each of the mentioned categories, data can be further disaggregated according to the country of the parent company. **Table 2** shows the percentage of companies that benefited from the NID regime in 2015

for the **top 30 countries**. The amounts of NID used and of CIT savings are also expressed in %. Figures for the remaining countries are aggregated under “Rest of the World”.

Table 2 – Number of companies and NID used, by country of Global Ultimate Owner, in %.

Country	Number of companies (%)	NID used within taxable income	CIT savings
		Amount (%)	Amount (%)
ITALY	96.48%	75.07%	75.42%
GERMANY	0.46%	2.62%	2.53%
UNITED STATES	0.46%	5.84%	5.51%
Not available	0.40%	2.97%	2.93%

LUXEMBOURG	0.31%	1.38%	1.40%
SWITZERLAND	0.30%	1.42%	1.49%
FRANCE	0.30%	3.81%	3.81%
UNITED KINGDOM	0.24%	1.71%	1.65%
NETHERLANDS	0,15%	1.74%	1.74%
SPAIN	0.11%	0.56%	0.56%
JAPAN	0.11%	0.44%	0.48%
AUSTRIA	0.10%	0.27%	0.29%
CHINA	0.06%	0.29%	0.26%
BELGIUM	0.05%	0.14%	0.14%
SWEDEN	0.04%	0.22%	0.23%
CAYMAN ISLANDS	0.03%	0.07%	0.07%
DENMARK	0.03%	0.05%	0.05%
IRELAND	0,03%	0.17%	0.18%
CANADA	0.02%	0.10%	0.10%
CYPRUS	0.02%	0.03%	0.03%
FINLAND	0.02%	0.08%	0.09%
HONG KONG	0.02%	0.01%	0.01%
INDIA	0.02%	0.02%	0.02%
BERMUDA	0.01%	0.07%	0.07%
ISRAEL	0.01%	0.10%	0.10%
LIECHTENSTEIN	0.01%	0.03%	0.03%
AUSTRALIA	0.01%	0.05%	0.05%
SAN MARINO	0.01%	0.01%	0.02%
KOREA, REPUBLIC OF	0.01%	0.04%	0.05%

MALTA	0.01%	0.00%	0.00%
ALTRO	0.16%	0.68%	0.69%
TOTALE	100.00%	100.00%	100,00%

Source: Ministry of Economy and Finance – Department of Finance. Tax Returns matched with Orbis data.

<u>II / FINAL ASSESSMENT</u>

[The following assessment was agreed by the Code of Conduct Group on 15 November 2018:]

Criterion	1a	1b	2a	2b	3	4	5	OA
Allowance for economic growth (ACE)	X	X	X	X	X	X	X	X

Significantly lower level of taxation: “Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code”

The general tax rate in Italy is 24%.

The allowance for economic growth (notional interest deduction, hereafter, “NID”) was introduced in 2011.

The Italian NID is calculated as a percentage of a company's net equity increase as compared to the equity result as of 31 December 2010.

The rate of the NID is respectively of 1,6% and 1,5% in 2017 and 2018.

This reduction of the tax base may lead to a significantly lower level of taxation.

Criterion 1: “whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a) concerns the *de jure* application of the measure. The NID applies and is available to all legal entities based in Italy without any restriction in terms of shareholding (resident or non-resident shareholders) or in terms of business sector.

1b) Criterion 1b) is used to complement the assessment under criterion 1a) which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b).

According to the information provided by Italy, more than 96% of the 234 653 companies that benefited from the NID in 2015 were Italian owned companies. Around 1.94% of the remaining companies had a Global Ultimate Owner (GUO) in Europe, 1.18% had a GUO in the rest of the world and 0.40% with no information on the location of the GUO.

Around 75% of the 11.95 billion EUR of NID is attributable to Italian owned companies, nearly 13% to companies with a GUO in Europe and 9% to companies with a GUO located in the rest of the world.

Looking at the number of companies and the amounts of NID granted, the regime is pre-dominantly used by residents.

Criterion 2: “whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a / 2b We refer to what is mentioned above under criteria 1a) and b).

Criterion 3: “whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages”

According to the standard practice for the evaluation of the potentially harmful measures against criterion 3, a measure is caught by this criterion if there are no express requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

Such express requirement aims at ensuring that the activities generating the income are undertaken by the taxpayer benefiting from the preferential tax regime.

Notional interest regimes such as the Italian Allowance for economic growth are different from other preferential tax regimes in that their tax benefits are not based on income generated or the activity performed but on the policy goal to tackle the debt bias, making it difficult to expect a correlation between income-generating activities and benefits.

Such a regime should nonetheless be properly contained by appropriate anti-abuse measures in order to tackle tax-planning opportunities.

Paragraph L of the Code of Conduct states that: "*anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion*". In past assessments, the Code Group has taken into account, in the overall assessment of various regimes, the existence of appropriate anti-abuse provisions or countermeasures. In order to avoid tax planning and address abusive situations in applying NID, the below enumerated *limitations of the scope* and *anti-abuse measures* have been identified in a previous assessment³.

³ Limitations of scope:

- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.
- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the ACE through chains of equity injection.
- The application of the allowance may not create nor increase tax losses. Consequently, a negative result due to this deduction does not generate a loss carry forward.
- Assets not necessary for conducting business: this is a classical exclusion in NID systems to avoid benefiting from NID on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).
- No deduction of NID with regard to capital which is allocated to a foreign permanent establishment. If the foreign PE was a legal person (a subsidiary), the parent company holding its capital would have to exclude those shares from the ACE base.

Anti-abuse rules targeting specifically transactions between related parties: The proposal for an EU Directive on a common consolidated tax base (CCCTB) contains an allowance for growth and investment (AGI). Art. 11(6) of the CCTB reads as follows:

The Commission shall be empowered to adopt delegated acts in accordance with Article 66 to lay down more detailed rules against tax avoidance, and more particularly in the following fields relevant to the AGI:

- (a) intra-group loans and loans involving associated enterprises;
- (b) cash contributions and contributions in kind;
- (c) transfers of participations;
- (d) the re-categorisation of old capital as new capital through liquidations and the creation of start-ups;
- (e) the creation of subsidiaries;
- (f) acquisitions of businesses held by associated enterprises;
- (g) double-dipping structures combining interest deductibility and deductions under the AGI;
- (h) increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date.

Italy's NID includes the following limitations of its scope:

- Firstly, it is worth noting that the Italian regime is an incremental regime that limits the windfall effect associated with a regime based on the stock of equity. Its base is limited to cash contributions (including debt cancellation) and retained earnings set aside in reserve (other than unavailable reserves).
- In general terms, the Italian legislation does not exclude participations from the NID base. However, the special anti-fraud rule under Article 10 of the ministerial decree of 14 March 2012 provides for a penalization of the facilitation base equal to the amounts paid by the purchaser.
- The application of the notional deduction may not create nor increase tax losses. If the notional interest exceeds taxable income for a given tax year, the excess may however be carried forward to subsequent tax years.
- The following are not considered as equity increases:
 - o The increase of the value of securities, other than shares, as compared to year 2010;
 - o The increase of reserves to the extent that it is due to fair value of derivative instruments;
 - o Unrealized capital gains in case of business contributions.
- The following elements are considered as reductions of the NID base:
 - o The distributions to shareholders or partners (i.e. dividends);
 - o Share buybacks;
- Contributions in kind are out of the scope (only cash contributions are relevant for the equity increase).

Italy's NID regime includes specific anti-abuse measures that address several intra-group abusive situations. Article 10 of the 3 August 2017 decree contains a rule to avoid undue multiplication of NID benefits by setting out various cases that trigger an automatic corresponding decrease of the NID base:

- Financing granted to other group companies, insofar as they exceed the value resulting from the financial statement for the year 2010 (this rule would avoid intra-group loans);
- Cash contributions :
 - o to resident group companies made from 2011;
 - o from taxpayers, both inside and outside the group, that are located in countries that do not allow an adequate exchange of information in tax matters⁴

⁴ In addition, Italy also adopts a look-through approach when examining the ownership chain in order to ascertain whether behind the foreign cash contributor there could be companies located in countries that do not allow adequate exchange of information in tax matters, except in two cases:

- In the case of publicly traded companies, only the controlling shareholder need to be considered;

(this rule would cover duplication of the NID through cash contributions except for cases where a cash contribution originates from a foreign country that allows adequate exchange of information).

- Acquisition of controlling interests from other group companies (this rule would prevent intra-group transfer of participations);
- Acquisition of business or part of business from other group companies (this rule would prevent acquisition of business held by associated enterprises);
- The increase, as compared to the 2010 financial statement, of loan receivables from group entities (this rule would prevent multiplication of NID through intra-group loans).

The taxpayer can ask for a ruling for excluding the anti-avoidance rule, giving evidence that in the specific case, there is no multiplication of the NID benefits.

Italy also has a general anti-abuse rule introduced by Law no. 212/200, article 10 bis. This law defines the abuse of law as one or more transactions lacking any economic substance, which, despite being formally compliant with the tax rules, achieve essentially undue tax advantages.

The GAAR could be used in the case not covered by the SAAR in which a cash contribution is originating from a country allowing adequate exchange of information. In such a situation, abusive relocation of equity through cash contribution would need to be tackled by tax authorities based on information exchanged with foreign tax authorities.

The combination of the specific and general anti-abuse rules seems to target most of potential abusive cases and especially intra-group transactions.

Criterion 4: “whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

The measures do not contain such elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code.

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- In the case of regulated investment funds established in country that allow for adequate exchange of information in tax matters, there is no need to consider the investors' residence.

Criterion 5: “whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

Overall assessment: “Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community”

With respect to the overall evaluation of the Italian NID and considering the targeted specific anti-abuse measures regarding transactions between related parties combined with the general anti-abuse rule, the regime is considered as not harmful.