Italy

Riccardo Michelutti

ABOUT THE AUTHOR

Riccardo Michelutti

Riccardo Michelutti is partner of Maisto e Associati since 2003. He obtained in 1992 a Degree in Economics cum Laude specialised in Chartered Accountancy (Bocconi University in Milan), a Master Degree in Corporate Tax Law in 1993 (Bocconi University in Milan) and a Law Degree Cum Laude in 1997 (University of Milan). He was admitted to the Association of Chartered Accountants in 1995 and to the Bar in 2001. He is author of many publications on tax matters and is frequent speaker at congresses. He is specialized in corporate income taxation, mergers and acquisitions, group taxation and taxation in the capital markets. He headed the London office of Maisto e Associati from April 2000 to July 2002.
E-mail: r.michelutti@maisto.it
Telephone: +3902776931

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INTRODUCTION

Most Italian companies are closely held, and even listed companies often have only a small proportion of shares actually floating. Even major Italian companies are often controlled by a few shareholders or by close-knit groups of shareholders, making hostile takeovers or stake building difficult. In addition, shareholdings held by the Italian State – though decreased considerably following the wave of national privatisations – are still substantial in a number of relevant sectors such as local utilities.

Due to low interest rates and the declining value of stock markets, cash bids have been more usual than bids settled through shares or other financial instruments of the acquirer. The proper structuring of the acquisition debt therefore is a hot issue also in terms of its tax ramifications. The financing of private equity transactions requires sophisticated techniques in order to achieve the optimal leverage of the deal. Usually, the debt incurred by the acquisition vehicle (very often a newly established Italian company) needs to be hived down to the level of the target company, which provides credit support with its assets and cash flows. In such a case, the Italian rules on financial assistance deserve careful consideration and in this respect a greater degree of flexibility has been brought in by the comprehensive reform of Italian corporate law that took place in 2003, as illustrated in the following section. In addition, the strict criminal law provisions on usury (*usura*), which set tight thresholds to interest rates on debt, have led to financing of private equity acquisitions through high-yield bonds issued by a foreign vehicle along with the repatriation of the proceeds by way of inter-company loans, which triggers some tax complexities.

[A] Civil Law Background

Italy is a civil law jurisdiction and acquisitions are governed by the provisions of Italian Civil Code applicable to the relevant contractual arrangements governing the acquisition (e.g., sale, contribution in kind, etc.).

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Legislative Decree No. 6 of 17 January 2003, as subsequently amended (hereinafter the 'New Company Law'), which came into force on 1 January 2004, has significantly changed the provisions of the Italian Civil Code relating to companies.

With respect to joint-stock companies (*società per azioni*), the New Company Law made the following changes:

- The introduction of *new financial instruments*, which allow more flexibility in financing. In particular, companies may issue financial instruments that – though not participating in the equity of the company – bear economic or administrative rights (other than voting rights) equivalent to those of an ordinary shareholder, against contributions in cash or in kind, including the rendering of services.
- A significant relaxation of the rules regarding the maximum amount of *bonds* that can be issued by a single issuer as determined in relation to the issuer's net equity.
- The issuance of *different classes of shares and of shares with no par value* is permitted, i.e. the company may issue shares without voting rights, or with voting rights limited to certain matters or subject to certain conditions, provided that such shares are not in excess of one-half of the company's share capital. In addition, companies may issue tracking shares (comparable to *'tracking stock'* used in other jurisdictions) having economic rights tied to the company's results in a particular sector, or redeemable shares, that can be repurchased by the company or the other shareholders upon occurrence of certain events.
- *Shareholders' withdrawal from companies*, with a broadening of the terms upon which, and the manners in which, such right may be exercised, the criteria for determining the value of the shares and the procedure for their liquidation.
- The introduction of the possibility to make a *segregation of assets dedicated to a single business activity*, up to 10% of the aggregate net equity of the company.
- The introduction of new rules governing groups of companies, which codi[fy] the notion of *'group interest'* and the liability of the holding compan[y] exercising the *'direction and coordination'* for instructions given to its subsid[i]aries.
- The procedural requirements for corporate *transformations*, *mergers an[d] demergers* have become simpler and more flexible. In particular, a set of rule[s] has been introduced to allow the so-called *merger leveraged buy-out*, i.e. [a] merger by absorption of the target company into the acquiring compan[y] which had taken up debt collateralized by the assets of the target compan[y].

[B] Summary of Key Corporate Income Tax Principles

In recent years, the Italian tax system underwent a major reform. In particular, the Government has comprehensively modified corporate income tax rules by amending the Consolidated Income Tax Act, through Legislative Decree 12 December 2003, No. 344 (the 'New CITA'). The New CITA, which entered into force on 1 January 2004, provides for, *inter alia*:

- the abolition of the old corporate income tax (*IRPEG*) and the introduction of a new corporate income tax (*IRES*) at the rate of 33% (subsequently reduced to 27.5% as from 2008); the abolition of Dual Income Tax (consisting of the application of a reduced IRPEG rate of 19% to a certain amount of net taxable income);
- the repeal of the imputation system and its replacement with an exemption system for both domestic and foreign dividends;
- the introduction of a participation exemption regime for capital gains deriving from shareholdings satisfying certain requirements, along with the repeal of the possibility to deduct write-downs of shareholdings;
- the introduction of an optional system of taxation for groups of Italian resident companies on a single taxable base (domestic tax consolidation);
- the introduction of an optional system of taxation for groups including non-Italian resident companies on a single taxable base (worldwide tax consolidation);
- the introduction of a consortium relief system;
- the introduction of new mechanisms limiting the deductibility of interest expenses (i.e., thin cap rule; equity pro-rata rule, subsequently repealed as from 2008);
- the repeal of the option for a 19%-rate substitute tax on capital gains arising from disposals of going concerns.

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Following the changes mentioned above, several other pieces of legislation[1] have been enacted amending the rules contained in the CITA with the following major changes:

- reduction of the corporate income tax rate from 33% to 27.5%;
- improvement of participation exemption rules;
- reduction of statutory withholding tax on outbound dividends to EU resident corporate recipients;
- repeal of thin capitalization rules and introduction of a new interest barrier rule, shaped along the German rule;
- elimination of certain benefits associated with the tax consolidation regime;
- optional step-up in basis in tax free reorganizations through the payment of a substitute tax;
- a specific set of tax rules for IFRS adopters;

1. The most relevant changes have been brought forward by Budget Law for 2008 (Law No. 244 of 24 December 2007).

- introduction of the Allowance for Capital Employment (ACE), a special allowance granted for corporate income tax purposes on equity increases. The deductible amount is equal to 4% of the equity increases for 2014, 4.5% for 2015 and 4.75% for 2016;
- amendment and widening of scope of the provisions relating to controlled foreign companies (CFC).

In addition, the reforms set out in 2004 were intended to result in further decrees, providing, *inter alia*, for the phasing out of the regional tax on productive activities (*IRAP*) and the unification of different transfer taxes into one single tax. These decrees, however, have not yet been issued.

[C] Taxation of Dividends

As from 1 January 2004, Italy has abolished the imputation credit system and turned to the exemption system for the taxation of dividends. Exemption applies also with respect to profits distributed in cash or in kind in the event of a withdrawal (i.e., a redemption to the benefit of a single shareholder), reduction of share capital and liquidation. For resident companies, the exemption covers 95% of the dividend received, whereas charges relating to the management of the participation are entirely deductible from the corporate income tax base.

No condition has to be met in order to take benefit of the exemption with respect to domestic dividends. The exemption applies also to inbound dividends other than those sourced (directly or indirectly) by foreign companies and entities that are resident in countries or territories having a privileged tax regime.[2] However, when clearance from the Italian tax authorities is obtained that the holding of the participation does not involve sheltering income in low-tax jurisdictions, the exemption applies also to inbound dividends sourced from the above countries or territories.

The dividend exemption applies to shares as well as to other financial instruments that are treated as shares for tax purposes under the characterization rules laid down in Article 44, paragraph 2(a) of CITA. Under those rules, a financial instrument is characterized as a share for income tax purposes insofar as the remuneration to the holder is fully contingent on the profits of the issuer, an affiliated company of the issuer, or the specific business with respect to which the instrument has been issued (i.e., fixed rate preferred shares would not be eligible). In addition, shares and other financial instruments issued by a foreign issuer are eligible for the exemption if no

2. The Budget Law for 2008 has changed such requirement making reference to dividends directly or indirectly sourced by a company resident in a State or territory other than a white-listed State. The white list of countries and territories still has to be issued by a Ministerial Decree pursuant to Art. 168*bis* of CITA and will apply as from the tax year starting after the publication of the said decree. For five years thereafter, countries and territories will be treated as included in the white list if they are not already included either in the current white list laid down by the Decree 4 September 1996 (as subsequently amended and supplemented) or in the current black lists laid down by the Decrees 4 May 1999, 21 November 2001 and 23 January 2002 (as subsequently amended).

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portion of the payment in respect of the shares or instruments is deductible in the Issuer's residence country. This means that no exemption is afforded in case a dividend-paid deduction applies in the Issuer's residence country.

The tax regime of dividends distributed by foreign entities has superseded previous rules implementing the Parent-Subsidiary Directive, since it does not require a minimum shareholding and a minimum holding period and it applies also to dividends distributed by entities not having the legal forms listed in the Annex to the Directive (i.e., distributions made by foreign partnerships, even though they are not subject to tax in their country of incorporation).

Finally, it must be noted that a legal presumption has been introduced, both for domestic and foreign dividends, whereby distributions of capital reserves (e.g., share premium) are re-characterized for tax purposes as profit distributions to the extent of the amount of yearly profits or profit reserves, other than tax deferred reserves, resulting from the financial statements of the distributing company. Such presumption is highly relevant in leveraged buy-out transactions, whereby the debt is usually pushed down by way of a distribution of share premium made by the acquiring company.

Unlike the generally applicable accrual principle, dividends are included in the taxable income on a cash basis (i.e., when actually paid), also for IFRS adopters.

[D] Anti-avoidance Rules and Rulings

Italy does not have a general anti-avoidance provision allowing the tax authorities to disregard tax-driven transactions.

A (semi)general anti-avoidance provision is laid down in Article 37*bis* of Presidential Decree No. 600 of 29 September 1973, which empowers the tax authorities to disregard single or connected transactions aimed at obtaining tax savings or refunds that are undue, based on the principles underlying the Italia tax system. In order for the anti-avoidance rule to operate, however, it is necessary that the transactions include certain specifically listed operations such as mergers, divisions, liquidations, etc.[3]

From 2005 onwards, the judicial approach became more flexible and it was considered acceptable for the tax authorities, even in the absence of a specific tax provision concerning abuse of law, to declare the tax advantages of certain transactions ineffective on the basis of civil law instruments.[4]

Indeed, in the last ten years, Italian jurisprudence changed its line of judgment. Whereas between 2000 and 2002, the Supreme Court in three decisions relating to dividend washing transactions, held that tax benefits may be denied only if so provided

3. For a general description of Italian anti-avoidance rules, see the Italy report prepared by A. LUPO for the 2002 IFA congress in Oslo, in *Cahiers de Droit Fiscal International*, Volume 87a.
4. Supreme Court decision No. 20398 of 21 October 2005; Supreme Court decision No. 22932 of 14 November 2005.

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under a tax provision in force at the time the transaction is put in place, in recent years the Supreme Court reversed the previous case law and affirmed that the Italian tax system implicitly contains an 'abuse of law' principle which prohibits taxpayers from getting 'undue advantages from the distorted use, even though not breaching any law provision, of juridical instruments able to generate a tax benefit if no appreciable business reasons exist apart from the expectation of such a tax benefit that might justify the transaction.'[5]

Therefore, according to the Italian Supreme Court an 'abuse of law' arises whenever tax advantages are captured through the undue utilization of juridical instruments (legally viable) in the absence of sound business reasons able to justify the implementation of the specific course of action.

According to the Italian Supreme Court, the juridical ground of the abuse of law principle is to be found, with respect to harmonized taxes (typically VAT), in the EU Treaties and relevant European Court of Justice case law, whereas with respect to other taxes it is to be found in the Italian Constitution, in particular in Article 53 under which (i) everybody is required to concur to public expenses on the basis of its ability to pay and (ii) the Italian tax system shall be construed according to a principle of progressivity.

Indeed, with respect to non-harmonized taxes, the principle stated by the Italian Supreme Court is not really new as it was in effect relied on or implicated by previous decisions[6]; however, the new element – put forward by the Supreme Court decisions issued from December 2008 onwards[7] – is represented by the identification of the specific ground of such principle in the Italian Constitution and no longer, as previously affirmed, in the evolution of the ECJ case laws.[8]

As far as the onus of proof is concerned, the Italian Supreme Court affirmed that the proof of the abusive plan and the distorted use of one or more law provisions for the purpose of obtaining a tax benefit is to be provided by tax authorities, whereas the

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5. Quoted from Supreme Court decision No. 12042 of 25 May 2009.
6. See, e.g., Supreme Court, No. 8772 of 4 April 2008; Supreme Court No. 10257 of 21 April 2008; Supreme Court No. 25374 of 17 October 2008; Supreme Court No. 27646 of 21 November 2008. As an example, the Supreme Court stated the principle as follows: '*the 'abuse of law', intended as the use of juridical instruments which, even if legal, do allow to avoid the payment of taxes, by way of transactions that are not shams in fact but are still carried on essentially with the scope to obtain a tax benefit, requires to get to the actual nature of the transaction and establish the taxation on the basis of its actual content*' (Supreme Court decisions No. 8772 of 4 April 2008 and No. 12237 of 15 May 2008).
7. See Supreme Court Decisions, United Chambers, Nos. 30055, 30056 and 30057 filed on 23 December 2008. The constitutional base of the abuse of law principle affirmed in the decisions by the United Chambers of December 2008 is subsequently quoted by the Tax Chamber of the Italian Supreme Court, e.g., Supreme Court Decisions No. 1465 of 21 January 2009; No. 848 of 8 April 2009; No. 8487 of 8 April 2009; No. 10981 of 13 May 2009; No. 25127 of 30 November 2009; No. 4737 of 26 February 2010; No. 9476 of 21 April 2010; No. 11162 of 7 May 2010; No. 12449 of 19 May 2010; No. 20030 of 22 September 2010; No. 21693 of 22 October 2010; No. 688 of 13 January 2011; No. 1372 of 21 January 2011; No. 10549 of 13 May 2011.
8. See, as a main reference with regard to the European Court of Justice case law, the judgment on case C-255/02, 21 February 2006, *Halifax e a.c. Commissioners of Customs & Excise*.

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taxpayer has to prove the existence of alternative or concurrent sound business reasons able to justify the specific course of action as implemented.[9] As a further support to its reasoning, the Italian Supreme Court affirmed that the existence of certain specific anti-abuse rules in the tax system (such as Article 37*bis* of Presidential Decree No. 600/1973) is merely symptomatic of the existence of a general principle which is to be considered not in contrast with the law reserve in tax matter;[10] indeed the abuse of law principle does not generate additional obligations in the hands of the taxpayer but rather it consists of the re-characterization of the fiscal effects of transactions that are implemented with the sole or main purpose of avoiding the tax obligation.[11]

As for the application of penalties in case of abuse of law, it has been recently argued in jurisprudence that penalties are not applicable in situations where the application of the abuse of law principle is invoked, since it does not stem directly from a law provision and therefore the safe harbour of objective uncertainty in the application of law would be triggered.[12]

Subsequently, this conclusion has been confirmed by the Italian Supreme Court, which also affirmed that penalties may instead apply in case of violation of the aforesaid Article 37*bis*, of Presidential Decree No. 600/1973, since in the latter case the conduct violates a statutory provision.[13]

Besides the general abuse of law principle, specific anti-abuse provisions do exist in order to counteract specific practices aimed at obtaining undue tax advantages.

With Law No. 23 of 27 March 2014, the Italian Parliament has empowered the Government to implement the review of the existing anti-avoidance provisions in order to unify them with the general prohibition of the abuse of law based on the criteria indicated in the recommendation on aggressive tax planning n. 2012/772 / EU of December 6, 2012 issued by the European Commission. The draft of the legislative decree currently under discussion provides a concept of abuse of law that follows the guidance provided by the case law of the Supreme Court and provides for the elimination of the aforesaid Article 37*bis*. For the purposes of the delegated legislative decree is also discussed the possibility of applying penalties in case of the existence of

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9. Supreme Court Decision, Tax Chamber, No. 1465 of 21 January 2009: '*the prove of the abusive plan both in the way with which the juridical scheme were manipulated and altered, considered as not reasonable in a ordinary market logic and followed only to achieve such a tax benefit, is to be provided by tax authorities, whereas the taxpayer has to prove the existence of alternative or concurrent business reasons capable of justifying the transaction as implemented.*' The same decision affirms that tax authorities should bring forward the most straightforward transaction and justify to what extent the course of action utilized by the taxpayer breaches the tax system.
10. Based on Article 23 of the Italian Constitution, which states that: '*No obligations of a personal or a financial nature may be imposed on any person except than by operation of law.*'
11. Among others, see the aforementioned Supreme Court Decision, United Chambers, Nos. 30055, 30056 and 30057 of 23 December 2008.
12. See Supreme Court Decision, Tax Chamber, No. 12042 of 25 May 2009. Accord, Provincial Tax Court of Vicenza, No. 6 of 28 January 2009; Provincial Tax Court of Firenze, No. 90 of 29 September 2009.
13. See Supreme Court Decision, No. 25537 of 30 November 2011 and, recently, Supreme Court Decision, No. 4561 of 6 March 2015.

an abuse law. The concept of abuse of law should be included as a new article of the Law No. 212 of 27 July 2000 (Statute of the rights of the taxpayer).

[E] Ruling Procedures

An optional ruling procedure is available (pursuant to Article 21 of Law No. 413 of 31 December 1991) regarding the application of anti-abuse rules in specific situations (e.g., fictitious interposition,[14] corporate reorganizations addressed by Article 37*bis*, etc.).

Indeed, Italy does not operate a general ruling system, but rulings are available in certain statutory circumstances.

A first type of ruling (provided for by Article 11 of Law No. 212 of 27 July 2000) is aimed at obtaining the tax authorities' interpretation of a specific provision in relation to an individual case, provided that the provision is objectively uncertain. The interpretation rendered by the tax administration is binding upon the tax authorities solely with respect to the specific case. If the answer of the tax authorities is not received by the taxpayer within 120 days from the notification of ruling, it means that the tax authorities agree with the interpretation or the behaviour proposed by the taxpayer; consequently, any tax assessment notice contrary to the solution implicitly accepted by the tax authorities is null and void.

A second type of ruling (Article 37*bis*, paragraph 8, of Presidential Decree No. 600/1973) is aimed at seeking the non-application of certain provisions setting limitations with regard to deductions and tax credits with a view to countering abusive behaviours. In this case the taxpayer is given the possibility to demonstrate that no abusive effect may actually be obtained. Determinations regarding this type of ruling have to be communicated to the taxpayer by the Tax Authorities within 90 days from the submission of the request, even though the lapse of such period does not imply agreement of the proposed solution by the tax authorities.

As already mentioned, a third type of ruling (Article 21 of Law No. 413 of 31 December 1991) is available regarding the application of anti-avoidance rules to specific mentioned situations (e.g., fictitious interposition, corporate reorganizations addressed by Article 37*bis*, etc.).

Before the legislative amendment made in 2006 (Law Decree No. 223 of 4 July 2006, implemented into Law No. 248 of 4 August 2006, and Law Decree No. 300 of 28 December 2006, implemented into Law No. 17 of 26 February 2007), the body ultimately competent to respond to this type of ruling request submitted by the taxpayer was the Advisory Committee (*Comitato consultivo*). The legislative amendment abolished the Advisory Committee and gave ultimate responsibility for the repl

14. Fictitious interposition is a sham affecting the identity of one of the parties in a contractual agreement, aimed at formally disclosing one person as the contracting party, even if the legal effects of the contract are intended to bind another person.

to the ruling request to the Central Tax Agency. The Central Tax Agency is required to notify the taxpayer within 120 days from the request; if the response is not received within that period, the taxpayer may require the Central Tax Agency to comply within the next 60 days.

A failure to respond within the additional 60 days from the date of receipt of the request is deemed a tacit agreement with the taxpayers' solution.

II TAXABLE ACQUISITIONS AND DISPOSITIONS

[A] Tax on Capital Gains – General

Liability to tax on capital gains as a part of business income lies with persons that are either resident for tax purposes in Italy or non-resident in Italy but carry out a trade in Italy through a permanent establishment located therein. In the latter case, liability to tax arises only with respect to assets pertaining to the permanent establishment or, should a permanent establishment exist, also to assets situated in Italy and relating to a commercial activity performed therein, even if outside the permanent establishment.

Italian resident companies are liable to corporation tax at the ordinary rate of 27.5%, while individuals are liable to individual income tax at progressive rates up to 43%.[15]

In the case of partnerships, income is taxable pro-quota on each partner according to its own tax regime.

For private individuals, the disposal of shares triggers capital gains tax at a rate of 26% upon disposal of non-qualified shareholdings[16] or individual income tax at the ordinarily applicable progressive rates on 49.72% of the capital gain upon disposal of

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15. According to Article 11 of CITA, the Italian personal income tax (IRPEF) applies at the following progressive rates: 23% up to EUR 15,000 of net taxable income; 27% between EUR 15,000 and 28,000; 38% between EUR 28,000 and 55,000; 41% between EUR 55,000 and 75,000; 43% for the amount exceeding EUR 75,000. In addition, a 'solidarity surcharge' ('*contributo di solidarietà*') of 3% will be levied on the portion of taxable income exceeding EUR 300,000 for the fiscal years from 2011 to 2016. Taxpayers, however, will be entitled in the year of payment to a tax deduction for the amount of 'solidarity surcharge' paid (so, for example, an individual paying in 2015 a '*solidarity surcharge*' on 2014 income will be entitled to deduct from his 2015 income an amount equal to the 'solidarity surcharge' paid for 2014). In addition the following levies apply: (a) a '*regional surcharge*' generally fixed at 1.23%; according to the provision introduced with the Law Decree no. 138/2011, converted with Law no. 148/2011, such additional surcharge may be increased up to 2,33% for tax period 2014 and up to 3,33% starting from tax period 2015; (b) a '*municipal surcharge*' of up to 0.8% of the net taxable income, depending on the municipality of residence.

16. A 'qualified shareholding' consists of shares (other than saving shares), securities and rights representing more than 2% of the voting stock for listed companies (or 20% of the voting stock for non-listed companies) or more than 5% of the total share capital or equity for listed companies (or 25% for non-listed companies). A sale or disposal of a qualified shareholding consists of the sale of shares and/or the rights through which shares may be acquired that exceed these limits within a period of 12 months. The 12-month period begins at the time when the holding of the participation exceeds the above limits. A participation equal or lower than the above mentioned threshold constitutes a 'non-qualified shareholding.' Voting stock is measured by the rights to vote in the ordinary shareholders' meeting.

qualified shareholdings, other than shareholdings in companies resident in tax-haven countries, unless specific evidence of the actual payment of taxes in a non-tax haven jurisdiction is given in a ruling request submitted to the tax authorities.

[B] Sale of Shares

For fiscal years starting on or after 1 January 2004, Italy has introduced a participation exemption regime on capital gains realized through the disposal of shares by Italian resident companies and commercial entities as well as Italian permanent establishments of non-resident entities. Under the participation exemption regime, only 5% of the amount gain is taxable, and capital losses are fully non-deductible.[17]

The disposal of shares may occur through either a straight sale, a disposal in exchange for non-cash consideration, a contribution to the capital of another company or an assignment to the shareholders for no consideration. If the consideration for the disposal of the participation is wholly or partly dependent on certain parameters, including future earnings of the company (a so-called earn-out), the participation exemption covers also such price adjustments.

The key features of the participation exemption regime are the following:

- the participated company can either be a corporation or a commercial partnership, with or without legal personality;
- the participation must have been held uninterruptedly for the 12-month period preceding the date of disposal. A LIFO (*last in, first out*) method applies in case of partial disposals of participations acquired in different periods;
- the participation must be booked as a fixed financial asset in the first balance sheet closed during the ownership period. For shares already held on 1 January 2003, the condition must be met with respect to the 2002 balance sheet;
- the participated company may not be resident in a tax-haven country, unless specific evidence of the actual payment of income taxes by the participated company is given through a ruling request submitted to the tax authorities;
- the participated company must be engaged in a business activity. By operation of law, this requirement is not met by companies whose net worth is mainly represented by real property other than (i) property used directly by the owner in the exercise of its business activity or (ii) property held for trading. A safe harbour is provided for companies whose shares are listed on regulated markets and for capital gains realized through public tender offers. In the case of holding companies, reference is made to the activity carried out by

17. Before the entry into force of the law eventually amending this legislation (Law No. 244 of 24 December 2007), the exemption only pertained to 91% of the gain for sales made until 2006 and to 84% for sales made until 2007. In addition, in order to qualify for the exemption, the holding period of the participation had to equal 18 months or more. Currently, the minimum holding period is 12 months.

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companies whose shareholdings represent the main portion of the net worth of the holding company.

The exemption applies exclusively to companies subject to corporation tax and does not apply to partnerships. Capital gains realized by commercial partnerships are exempt up to 50.28% of their amount, provided the aforesaid requirements are met.

Capital gains realized through the disposal of shares and other participations not qualifying for the participation exemption are subject to corporation tax at the ordinary rate of 27.5%. Indeed, with respect to the disposal of shares and other participations in controlled[18] or affiliated[19] companies, the option for the application of a substitute tax at the reduced rate of 19% has been repealed for disposals made as from 1 January 2004. Yet, it is possible to spread the capital gains in up to five yearly instalments provided that the participations have been entered as fixed financial assets in the last three balance sheets prior to the disposal. This alternative, however, is not available for capital gains qualifying for the participation exemption, whose taxable amount (5%) cannot be spread in instalments.

The goodwill paid by the purchaser as part of the purchase price is generally not depreciable nor can it be recognized through a write down of the participation.

However, a special election has been introduced by Article 23, paragraph 12, Law Decree No. 98 of 6 July 2011 (as supplemented by Article 20 of Law Decree No. 201 of 6 December 2011), applicable to acquisitions prior to 2012. Under these rules, Italian resident companies that acquired controlling shareholdings (even through mergers, demergers and other corporate restructurings) at a price higher than the corresponding book net equity can elect for the tax recognition of the embedded goodwill, trademark and other intangibles stemming form the consolidated balance sheets, which can be tax depreciated in at least 10 instalments, by paying a substitute tax equal to 16% of the tax stepped-up values.

A special tax regime applies to shares and similar financial instruments held by companies preparing their financial statements according to IFRS. Such regime differs, depending on whether the shares are accounted for as 'held for trading' under IFRS. For shares that are not accounted for as 'held for trading' under IFRS, the unrealized gains and losses resulting from the mark-to-market valuation of the shares in the profit and

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18. Pursuant to Art. 2359 of the Italian Civil Code, controlled companies are:
    1. companies in which another company owns the majority of the voting rights in the general shareholders' meeting (*controllo di diritto*);
    2. companies in which another company owns enough votes to exercise a dominant influence in the general shareholders' meeting (*controllo di fatto interno*);
    3. companies in which another company has dominant influence in the general shareholders' meeting due to specific contractual obligations (*controllo di fatto esterno*).

19. Pursuant to Art. 2359, para. 3 of the Italian Civil Code, affiliated companies are companies in which another company exercises considerable influence. By operation of law, this is deemed to be the case where a company owns at least 20% of the voting rights (10% in case of listed companies) in the general shareholders' meeting.