The Anti-Tax Avoidance Directive and its implementation in Italy

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Premise
The aim of this work is to provide an overview upon the implementation in the Italian Law System of the European Directive (2016/1164/EU), known as the Anti-Tax Avoidance Directive (from now on, “Directive”).

The Directive provides a number of tools in order to fight the so called “aggressive fiscal planning schemes” which can obtain advantages exploiting the existing differences between single national tax systems.

The purpose of the Directive is to remove regulatory differences existing within different national systems by adopting a common strategic approach, mandatory for each country, in order to prevent market fragmentation and to stop misalignments and distortions.

The main topics covered by the Directive are:
- Deductibility of interests expenses;
- Hybrids mismatches;
- CFC (Controlled Foreign Companies) provisions;
- General anti-abuse rule;
- Exit tax on company assets (Exit Tax).
Last August 8, the Italian Government approved the draft of the Decree through which the directive 2016/1164 will be transposed in the Italian Law system. The ultimate deadline for the implementation has been set on December 31, 2018, with effects starting from January 1, 2019. On last October 30, the Finance Commission of the House of Deputys has expressed its positive opinion upon the document.

**Deductibility of interest expenses**

Article 96 of TUIR1 allows deduction of interest expenses for each tax period, up to the amount of interest collected. The exceeding amount, is deductible within the threshold of 30% of the company’s gross operating margin, called ROL2, determined on the basis of the bookkeeping results. A surplus of non-deducted interest liabilities and unused ROL can now be brought forward, without any limit, to be cleared against future year’s interests expenses and ROL (if available).

Article 1 of Legislative Decree implementing Directive 2016/1164/EU in the Italian system, introduced the following modifications:

- The limit of 30% of the ROL also applies to capitalized interests (until now excluded from this computation) introducing a new definition of expenses and interest income and similar charges;
- The surplus of interest income not used against interest expenses in the current year can be brought forward (indefinitely);
- A new computation of ROL is adopted. It will be now calculated basing on fiscal values instead of accounting ones;
- Unused ROL can be brought forward with a time limit of 5 years.

Starting from 2019, interest expenses will be deductible not only within the limits of current interest income but also within the amount of unused interest incomes brought forward from previous tax periods and not yet compensated. Regarding ROL: it is limited the possibility to carry forward the unused amount of ROL generated, to a maximum of 5 years. When deducting ROL from previous years, it is introduced a pecking order that provides compulsorily to clear off exceeding interest expenses against current ROL and only if there is still a remaining surplus, to compensate it with carried forward ROL.

ROL will be now determined accordingly to fiscal values and not only accounting values. This means that, in case of expenses non fully deductible from a fiscal perspective, the inclusion in the ROL computation will be allowed only up to their fiscal deductible amount. Same in case of non-taxable incomes.

**Hybrid mismatch rules**

The ATAD is applicable also to those situations of double deduction or deduction without inclusion resulting from the use of hybrid financial instruments or hybrid entities. By the word “hybrid” it is intended a structure, a contract, an entity or any operation that, because of its own features, is qualified differently by the Member States in which the subjects involved in the operation are located.

The anti-hybrid rules applies to those cases that involve taxpayers located in two or more Member States or structured arrangements between parties located in different Member States which, taking advantages from the different treatment of the hybrid tool in each legal system, can produce:

- a double deduction (i.e. a deduction for the same payment, expense or loss in two different Member States);
- a deduction without inclusion (i.e. a cost that is deductible for tax purposes in one jurisdiction but is not included in the taxable income of another one).

The Directive provides two different levels of intervention: the primary level, that consists in the denial of the deduction of a cost / expense in one Member State. If the primary level is not applicable, the secondary level is activated, providing the compulsory inclusion as taxable income in the country of receipt. If the mismatch results in a deduction without inclusion, the deduction must be denied in the Member State of the payer.

**CFC rules (Controlled Foreign Companies)**

The CFC rule is established by article 167 of the TUIR. The regime provides a “transparent” allocation on head of the Italian controlling company of any income generated by foreign, directly or indirectly, controlled entities located in countries that provide a nominal level of taxation lower at least by 50% with respect to the Italian one.

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1 Italian law ruling upon direct-taxes
2 Essentially, a kind of EBITDA
The rule as it is now, allows to disregard the application of the CFC provision if the following conditions are met (par. 5 of article 167):
- the controlled entity performs an effective industrial/commercial activity on the country of establishment;
- the controlling relation does not realize the effect of de-localize income in a foreign country with a lower level of taxation.

If the controlled company is established in a EU member State or a country part of the EES, the CFC rule activates only if:
- the effective (and no more nominal) taxation is lower for more than 50% with respect to the Italian one;
- the foreign entity realized, for more than 50%, passive income (such as income deriving from interest, royalties, dividends and income from intragroup services).

The Decree amends the current CFC rules in order to make them more compliant with articles 7 and 8 of ATAD.
Firstly, there won’t be any more difference based on the country in which the foreign entity is located (within the EU or not). In fact, the CFC treatment will trigger if both of the following requirements are met:
- the effective taxation in the foreign country of establishment of the controlled Entity is lower for more than 50% with respect to the Italian one;
- The Entity realized more than one-third of its income as passive income (e.g. interest, royalties, dividends and income from intragroup services).

It is still applicable a safe-harbor rule for non-resident entities which carry out an effective economic activity, supported by staff, equipment and physical assets. The existence of this exemption can be demonstrated by the taxpayer that controls an alleged CFC, through an advanced ruling, filed accordingly to article 11, par. 1 lett. b) Law 27 July 2000 n. 212.

**General anti-abuse rule (GAAR)**
It has been implemented at EU level as a general anti-elusive rule, by article 6 of the Directive.
Italy actually already provided this clause, including it in article 10-bis of law 212 of 27 July 2000, the so called “Taxpayer’s right statute”.
The national principle foresees the abuse of the law in the presence of transactions lacking in economic substance which, even if formally compliant with the law, are performed with no other economic reason than the fiscal savings they produce. These transactions are automatically disregarded by the Tax Authority.

**Exit Taxation rules**
Exit Tax rules give to a member state the power to tax the event that income producing assets are transferred outside of the Country permanently, considering this transfer as a realization events for computation of capital gains. The new regulation deviates from the previous one introducing the concept of market value for the evaluation of such capital gains on business units and assets transferred (in replacement of the normal-value used in the past). The Directive also reduces the number of installments from 6 to 5 in case of installment payment of the tax due on such capital gains and eliminates the possibility of suspending the payment of the exit tax.
Furthermore, the scope of application has been broadened (other cases to which the exit tax applies have been introduced, explicitly provided by Article 5 of the Directive). For instance, the Exit Tax has also been extended to transfers of assets to permanent establishment entities, for which it has been exercised the option for the Branch Exemption.

Professionals at Andersen Tax & Legal in Italy are at your complete disposal to provide you with the necessary clarifications in relation to the subject detailed in this circular.

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