Overview of Italy's Corporate Tax Reforms for 2008

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to:

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Summary

- Reduction of corporate tax rates
- Improvement of participation exemption rules
- Reduction of withholding tax on outbound dividends
- Stepped-up basis in tax-free reorganizations
- New limitation on deduction of interest
- Reduction of certain benefits of tax consolidation regime
- Deferral of certain deductions
- New tax measures effective for tax years beginning on or after 1.1.08

Tax Rates

- Corporate tax (IRES) rate is reduced to 27.5 per cent (from 33 percent)
- Regional tax (IRAP) rate is reduced to 3.9 per cent (from 4.25 percent)
- The combined tax rate is 31.4 per cent

Participation Exemption

- The exempt portion of the gain from the sale of stock by corporate shareholders is increased to 95 percent (previously 84 percent).
- The minimum holding period for the exemption of gain is reduced to 12 months (previously 18 months).
- The exemption applies to stock held as investment and booked as long term asset (the only exception is dealer's stock held as inventory).
- The exemption applies to stock of foreign entities qualifying under a "White List" (based on exchange of information and level of foreign tax).

Participation Exemption - cont.d

- Foreign shareholders qualify for the 95 percent exemption only for gains from sale of stock of Italian corporations owned through an Italian branch (permanent establishment).
- For stock owned directly, either treaty protection or 60 percent exemption (equal to 13.2%, now 11% corporate tax rate).
- Government will revisit the 60 percent exemption to make sure that the reduced corporate tax rate does not result in reduced tax on shareholders.
- For stock of real estate holding corporations, usually there is no treaty protection, and no participation exemption (unless they are engaged in a real estate active business).

Outbound Dividend Withholding Taxes

- The general withholding tax rate on outbound dividends is 27 percent (12.5 for “saving” shares), reduced or eliminated under treaties or EU parent subsidiary directive.
- Withholding tax on outbound dividends to corporate shareholders that are resident in a EU Member State, or in a State that belongs to the EEA and is included in the “White List”, is reduced to 1.375 percent (equal to 27.5 per cent - new corporate tax rate - of 5 percent - dividend taxable portion).
- The reduced rate applies to dividends distributed out of earnings and profits accumulated on or after 1.1.08.
- EU parent-subsidiary directive and tax treaties still apply.

Tax Basis Step-Up

- The basis step-up applies to tax-free contribution of all or part of a business as going concern, mergers and de-mergers (spin-offs).
- The transferee can elect to increase the tax basis of acquired (or retained) assets up to fair market value and pay a substituted tax on the built-in gain.
- Substituted tax rates are 12% up to 5 million euros, 14% from 5 to 10 million euros and 16% over 10 million euros of the gain amount.
- Shall transferor take a fair market value basis in the stock received in the exchange?

Tax Basis Step-Up - cont.d

- The substituted tax applies in lieu of ordinary corporate income taxes and can be paid in three yearly installments (30-40-30 percent) with a 2.50% interest charge on last two installments.
- The basis step up applies from the tax year in which the transaction is carried out, for assets depreciation purposes, and from the fourth year after the tax year in which transaction is carried out, for gain purposes.
- The election for step up is available for transactions carried out in tax years beginning on or after 12.31.2007, or to eliminate tax/book differences existing at the end of the tax year in course as of 12.31.2007 or the immediately following tax year.

New Limitation on Interest Deduction

- Net interest expense (interest expenses over interest income) in excess of 30 percent of accounting gross profit (EBITDA) is nondeductible.
- Excess interest can be carried forward to future years (indefinitely).
- Excess limitation (starting from the third tax year) can be carried forward to (and increase the limitation available in) future years (indefinitely).
- Excess interest can be transferred to and deducted by affiliated companies that are members of the same tax consolidated group (subject to the 30 percent limitation applied on a per-company basis).
- Excess limitation can be transferred and allocated to affiliated members of a tax consolidated group.
- For above purposes, members of tax group include foreign affiliates that qualify for consolidation.
- Thin-capitalization, equity pro rata and general pro rata rules are repealed.

New Limitation on Interest Deduction - cont.d

- New limitation applies to the interest component of financial lease payments, interest from loans, debt obligations and other financial instruments or contractual arrangements that are treated as debt for tax purposes.
- General and limited partnerships are not subject to the new limitation.
- Anti-abuse provision: a corporate partner's share of partnership's losses can be offset only against the partner's share of that partnership's income passed through in future years (up to five years).
- Anti abuse rule does not apply to limited liabilities companies treated as partnerships for tax purposes under check the box.

Tax Consolidation

- Dividends are only 95 percent exempt.
- The new provision applies to dividend declared on or after September 1, 2007.
- Dividends out of earnings and profits of tax years preceding the tax year under way as of 12.31.2007 will remain totally exempt.
- Transfer of appreciated assets is a taxable transaction (carryover basis treatment is repealed) unless it qualifies for non-recognition treatment under other rules unrelated to the group relief regime.

Tax Consolidation - cont.d

- Group members can realign the tax basis of shares previously written down for tax purposes under the old transitory regime by paying a 6 percent substituted tax on the gain (in lieu of IRES and IRAP).
- In case of termination of worldwide tax consolidation, losses of foreign affiliates deducted by the group are recaptured to the extent of dividends paid by or gains realized from the sale of stock of such foreign affiliates after termination of consolidation.

Computation of Taxable Income

- Deduction of certain costs (depreciation, write downs, allowances, R&D costs) is allowed only if and to the extent that the corresponding items are accounted for and deducted also for book purposes.
- Computation of taxable income is strictly linked to financial accounting and book profits.
- Treatment of deductions for book purposes is subject to scrutiny under anti-abuse standards.
- Tax deductions in excess of book deductions are recaptured (with realignment of the tax basis of assets or items they refer to) with payment of a substituted tax at 12-14-16 percent tax rate.
- Reserves subject to claw back in the event of distribution in excess of corresponding profits can be freely distributed by paying a 1 percent substituted tax.

Tax Depreciation and Lease Payments

- As a general rule, depreciation is deducted under a straight line method on the basis of depreciation rates/schedules approved by the tax administration for different classes of assets.
- Accelerated depreciation (equal to two times the ordinary depreciation rate in the first three year of purchase for new assets, and in the first year of purchase for used assets) is repealed.
- Anticipated depreciation based on particularly intense use of the asset (determined on a case-by-case basis) is also repealed.
- The minimum length of financial lease transactions for the purposes of deduction of leases payments is increased to 2/3 of the depreciation schedule for the leased asset (with a minimum of 11 and a maximum of 18 years in case of immovable property).

New White List for Cross Border Transactions

- Various anti-abuse and anti-deferral rules (CFCs, limitation on deductions, full taxation of dividends and gains, increased withholding tax on outbound interest payments, denial of portfolio income exemption for foreign in investors and others) shall apply on the basis of a new "White List" of foreign jurisdictions.
- Transactions with entities organized in a foreign country included in the new "White List" shall no longer be subject to the anti abuse rules.
- The new "White List" shall be based on exchange of information and significantly lower lower level of taxation.

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