RSM PALEA LAURI GERLA

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TAX NEWS

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LAWS AND REGULATIONS

Hong Kong is excluded from the Black List (Italian Ministry of Economy and Finance, Italian Ministerial Decree dated November 18th, 2015)

In the last month of July the Treaty against double taxation between Italy and Hong Kong was ratified (Law no. 96/2015).

As the content of this Treaty is in line with OECD standards, and in particular it provides for the exchange of information among the Tax Authorities of the two countries, as a result of this agreement two special ministerial decrees have been issued in the last few weeks, by which the Asian country is excluded from the "Black List" provided by the Italian law regarding the deductibility of costs for the purchasing of goods and services by operators located in tax havens (provisions contained in Art. 110 of the TUIR, i.e. Income Tax Consolidation Act) and provided by the rules concerning the tax residence of individuals (art. 2-bis of the TUIR).

It shall be reminded that with the Italian Ministerial Decree of March 30th, 2015 Hong Kong had already been removed from the list of those countries included in the provisions of the "Controlled Foreign Companies" ("CFC"), as per art. 167 of the TUIR.

JURISPRUDENCE

Restricted share-based company and attribution of hidden income to shareholders (Italian Tax Court of the Province of Varese, judgment no. 422/04/2015)

In recent years an assessment activity towards "family" corporations has been gradually gaining more and more ground. "Family" corporations means those which have a restricted "share base" and in which the shareholders (and even the managing directors) are the member of the same family.

In such cases, against the challenge of income evasion carried out by the company, the "presumption" that those profits have been *distributed* in a "hidden" way to the shareholders follows. Therefore, the taxation of such income in the hands of these latest (normally as dividends) is also determined.

Even in the dispute in question, the Italian Revenue Agency has challenged to the shareholders of a limited liability company the alleged distribution of profits which shall allegedly be the result of higher income objected to the company (and the result of the recovery of costs regarded as tax deductible).
The defence of the taxpayers claimed the illegality of such presumption, challenging the inappropriateness from several points of view.

The Court of first instance ruled in favour of the taxpayer, stating that the notification of such an act requires a preliminary acquisition of evidence aimed at showing that the "off-balance sheet profit", even if it is actually achieved, has *actually* been distributed : This is because the higher income attributed to the shareholder shall be based on facts and not on mere automatism.

It shall be pointed out that the Supreme Court has repeatedly expressed the contrary, by stating that this kind of presumption is in favour of the Exchequer and by providing that the existence of such "restricted share base" represents alone a circumstance "expressing complicity" among the shareholders and that therefore legitimates the presumption of the occurred division of non-accounting higher profits among the same ones, with (evil) evidence proving the contrary to be burdened by the taxpayer.

FOCUS ON EMPLOYMENT
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Contacts
De Luca & Partners
Largo A. Toscanini, 1
20122 Milan
Tel. +39 02 365 565 1 Fax +39 02 365 565 05 email: info@delucapartners.it;
www.studiodeluca.it

HR Capital
Gall. San Babila 4/B
20122 Milan
Tel. +39 02 365 930 1 Fax +39 02 365 930 00 email: info@hrcapital.it
www.hrcapital.it

Ruling of the month

Milan Court of Appeals: termination of independent contractor relationship

With its ruling the Milan Court of Appeals, in confirming the decision of the lower court judges considered the application of art. 2119 of the Civil Code to independent contractors to be correct. This is due to the general scope of the principle it is based on, according to which the immediate withdrawal from the relationship is possible if an event occurs attributable to one of the parties which prevents continuation even if only temporarily. The Court concluded that the similar interpretation of article 2119 of the Civil Code however did not entail the extension of the independent contractor relationship to all of the remaining protections established by the law in terms of a regular employment relationship, including the obligation of previous notice of violation.

LAWS

Jobs Act: independent contractors and VAT registered individuals – amnesty

Pursuant to article 2 of Legislative Decree 81/2015 enacted 25 June 2015, as of 1 January 2016, collaborations which are organised by others, with the exception of certain exclusions, shall be considered regular employment. Starting on the same date, article 54 of Legislative Decree 81/2015 offers customers/employers the possibility of stabilising workers who are already part of consultant contracts, including project based, and VAT registered subjects with whom they have independent contractor relationships, with the advantage of an amnesty, i.e. the elimination of administrative, contribution and fiscal unlawful acts connected with the incorrect qualification of the employment relationship.

Jobs Act: obligation of correct information notice

With the new article 4 of Law 300/1970, rewritten by the Jobs Act, the obligation to adequately inform workers on the procedures for using equipment from which remote control of work activities and work instruments may occur as well as the procedures for performing controls becomes the requirement for being able to use information collected for all purposes connected with employment. This duty to inform is in addition to the already existing requirement to inform workers as per article 13 of Legislative Decree 196/2003 (so-called Privacy Code) on the purposes and procedures for processing their data. In light of the new provision, employers will be required to prepare a detailed and correct information notice for workers in order to be able to legally use any collected information, and thus avoiding the risks of sanctions and liability.

Jobs Act: mandatory employment when the threshold of 15 employees is reached

Legislative Decree 151/2015, implementing the Jobs Act in terms of rationalization and simplification of requirements, has repealed, effective as of 1 January 2017, paragraph 2, of article 3 of Law 68/1999. Therefore, starting on 1 January 2017, employers who employ more than 15 to 35 employees will have the obligation of hiring disabled workers as soon as they reach the threshold of 15 employees. Thus the gradual system we are currently familiar with will be abandoned, which entailed an obligation to hire disabled workers for these employers "in the event of new hirings".

Draft law: Whistleblowing

Draft law 1751 currently before the Justice and Labour Commissions of the Chamber of Deputies, regulates "whistleblowing", i.e. employee reporting of unlawful acts encountered at work- This is a system which guarantees legality that is not very widespread in Italy, but is much more so abroad, especially in Great Britain and the USA. It provides for the legal protection of workers who report irregular situations, if they are subjected to retaliation by the person they report due to such reporting.

CASE LAW

European Court of Justice: interpretation of the directive on collective redundancies

The Court of Justice of the European Union, with sentence no. C-422/14 of 11 November 2015, intervened on two central points of the European directive on collective redundancies (98/59/EC). In this case (i) the calculation criteria for company size which makes the law governing collective redundancies applicable and (ii) the notion of redundancy useful for determining the numeric limit above which the

directive on collective redundancies applies. In terms of the first point, the Court observed that, for the purposes of calculating the number of employees for application of the directive on collective redundancies, that workers employed for a fixed term form part of "normally employed workers". In terms of the second point, the Court established that for the calculation of the five redundancies "any termination of the employment contract not desired by the worker and, thus, without his consent" is considered a redundancy, including resignations submitted by an employee due to unilateral changes made by the employer to an essential element of the employment contract for reasons not related to that individual worker. The impact of this ruling on Italian law will be mitigated in terms of the first point, since the Jobs Act requires that the calculation of employees . for the purposes of applying any legal or contractual provision – must take into account workers employed under a contract for a fixed term, by applying a specific calculation criteria (article 27 Legislative Decree 81/2015). The repercussions regarding the second point could be significant, since dismissals, according to our laws, even if for "just cause" have always been excluded from the calculation of the numeric threshold for application of the aforesaid law.

Cassation Court: term for challenging including for managers

With its ruling no. 22627 of 5 November 2015, the Cassation Court confirmed the lower court decision, declaring that, following the introduction of the Collegato Lavoro (Law 183/2010), the statute of limitations and ineffectiveness of the challenge of a dismissal as per article 6 of Law 604/1996 also applies to managers. Basically a manager, like other employees, must challenge the dismissal within 60 days from receiving notice of such and apply to the competent court within the following 180 days, or forfeit the right to do so.

Cassation Court; layoffs and selection criteria as per article 5, Law 223/1991

With its ruling no. 23609 of 18 November 2015, the Court of Cassation returned to the subject of the selection criteria followed by the employer at the outcome of the personnel layoff procedure. Specifically, the Court reiterated that the employer, when he defines the selection criteria as per article 5 of Law 223/1991 in the letter to start the procedure, cannot later deviate from it and decide to partly apply it. By ruling in this manner, the Court adhered to the case history whereby the application phase for the selection criteria represents the only time when it is possible to verify that the employer has acted fairly and in good faith during the information and consultant procedure with the involved trade unions.

SPECIAL FOCUS

Patent Box – Ministerial clarifications and implementation measures

Last month a first analysis of the "Patent Box" was provided, by giving the main features and highlighting the absence of clarifications by the Italian Revenue Agency and the failure to define certain operating rules, necessary to start the activity to obtain the tax benefit.

On December 1st, the Italian Revenue Agency has issued the first interpretative resolution (resolution no. 36/E) and has issued an Order defining how to use the "ruling", a necessary step in case of direct use of intangibles.
Previously, the Order dated November 10th made the form for requesting access to the procedure available.

Please find below the in depth-analysis of last month integrated with the news of the beginning of December.

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The Stability Law of last year (Art. 1, paragraphs 37-45, Law dated December 23rd, 2014, no. 190) introduced in the Italian tax system a so-called "Patent Box" regime, that is a tax relief regime aimed at promoting investment in intangible assets.
The creation of such a regime is based on the recognition that the increasing globalization of the world economy has made it increasingly clear that intangible assets (trademarks, patents and know-how) play a fundamental role in the creation of added value.
Therefore, assuming that many advanced Countries have already introduced similar disciplines since long, an optional system *promoting tax relief* of *income coming from the use* of the aforementioned intangible assets, was introduced to the extent of:

- encouraging the placement in Italy of intangible assets currently held abroad by Italian or foreign companies;
- encouraging the maintenance of intangible assets in Italy (or rather, preventing their relocation abroad);
- encouraging investments in research and development activities.

On October 20th, the final text of the *implementation decree* of the Patent Box discipline (Decree of the Italian Ministry of Economic Development dated July 30th, 2015), was published, making the discipline effective.
Briefly, please find below an initial summary of the favourable tax regime.

Who is entitled

Those subjects *holding a business income* can benefit from the favourable tax regime, regardless:

- the legal form,
- the size,
- the accounting regime adopted.

Holders of business income *not resident* in the State's territory also fall within the subjective field of favourable taxation, provided that:

- they are resident in Countries with which an agreement to avoid double taxation is in force and with whom the exchange of information is real,
- they have a permanent establishment in the State's territory, to which intangible assets object of the tax relief are attributable.

The following companies are excluded from the favourable regime:

- companies subject to the bankruptcy proceedings (from the beginning of the tax year in which the bankruptcy declaration is issued);
- companies subject to the procedures of compulsory liquidation (from the beginning of the tax year in which the provision ordering the liquidation is issued);
- companies subject to procedures of extraordinary administration of large companies in crisis (from the beginning of the tax year in which the grounded decree declaring the opening of the extraordinary administration procedure is issued).

In the event of mergers, divisions and transfer of assets, the subject eligible person takes over the exercise of the option made by the assignor.

Eligible activities

The essential condition to benefit from the Patent Box is that the subjects **carry out research and development activities** (also being outsourced, by entering into research agreements with companies – not belonging to the same group – with universities or research institutions and similar organizations), aimed at the production of intangible assets object of the favourable tax regime.

More specifically, the research and development activity, aimed at *developing*, *maintaining* and *increasing* the value of intangible assets benefitting from the tax relief, is identified by the Decree of July 30th:

- the **"fundamental" research**, meaning the experimental or theoretical work carried out to acquire new knowledge, if subsequently used in applied research and design;
- the **"applied" research**, meaning the planned research to acquire new knowledge and skills, to be used to develop new products, processes or services or to make improvements in existing products, processes or services, in any field of science and technology;
- the **experimental and competitive development**, meaning the acquisition, combination, structuring and use of the existing knowledge and skills bearing a scientific, technological, commercial nature or being of other kind, in order to develop new or improved products, processes or services. Other activities aiming at the conceptual definition, concerning new products, processes or services, and the tests, experiments and trials necessary to obtain the authorizations for the marketing of the products or the use of processes and services also fall within this definition. The construction of prototypes and samples, the demonstration, the realization of pilot products, testing and validation of new or improved products, processes or services, and the construction of plants and equipment required for this purpose fall within the experimental development;
- the **design**, meaning the activities of creation and design of products, processes and services, including the external appearance of them and of each part of them, and the activities of brand development;
- **the design and realization of** copyrighted **software**;
- the **preventive research, tests and market research** and other studies and interventions also aimed at adopting anti-counterfeiting systems, the storage, the obtaining and maintenance of the related rights, the renewal of the same latter once expired, the protection of these latter, also jointly and in relation to the prevention activities of counterfeiting and the handling of related disputes and agreements;
- the **activities of presentation, communication and promotion** that increase the distinctive character and/or the reputation of the brands and that contribute to promote the knowledge, the commercial success, the image of the products or services, of the design, or of the other materials that can be protected.

  - **The companies can take advantage, reducing the taxable income related to the use (either internally or by third parties) of intangible assets arising from R&D activity.**

The option relates to *income derived from the use of*:

- copyrighted software;
- industrial patents (either granted or about to be granted), including patents for invention, the biotechnological inventions and the related supplementary protection certificates, the patents for utility model, as well as patents and certificates for plant varieties and the topographies of semiconductor products;
- company trademarks, including collective marks, whether registered or about to be registered;
- drawings and models that can be legally protected;
- business information and technical-industrial experiences, including the commercial or scientific ones which ca be protected as secret information, legally protectable.

The implementation decree points out that for the *definition* of said types of intangible assets and of the requirements for their existence and protection it is necessary to refer to the national, European Union and international provisions and to those contained in the European Union regulations, international treaties and conventions in the field of industrial and intellectual property applicable in the related protection territory.

As mentioned above, the favourable tax treatment is recognized both in case the right to use intangible assets is granted to third parties and in case of direct use[1].
In the first case (right to use granted to third parties) income subjected to tax relief consists of the rental income derived from the right to use intangible assets, through netting of the direct and indirect costs subject to taxation and related thereto; in case of direct use, instead, it is necessary to identify, for each intangible asset object of the option, the *economic contribution* resulting from this latter and that algebraically contributed to create the business income or the loss.

- ***News***

With Order dated December 1st, the Italian Revenue Agency has defined the procedures for accessing the ruling, procedure, as well as the content of the related application for access.
Considering the tight deadline for the submission of the application being effective for 2015 (December 31st), it has been provided that the content of the application shall be minimal, being substantially considered as a "reservation" of the ruling: the company shall then provide the necessary documentation within four months from the application submission.

More specifically, in the application (to be submitted on unstamped paper to the office in charge of Milan or Rome, by means of registered letter with acknowledgment of receipt or direct deposit) the indication of the object of the prior agreement is provided, consisting alternately of:

1. the prior definition of the methods and criteria to determine the "economic contribution" to the production of business income or loss, in case of direct use of the assets;
2. the prior definition of the methods and criteria to calculate the income resulting from the use of intangible assets, in cases other than those referred to in paragraph 1 above, realized in connection with transactions with companies that directly or indirectly control the enterprise, that are controlled by it or that are controlled by the same company that controls the enterprise;
3. the prior definition of the methods and criteria for the calculation of the capital gains from the sale of intangible, realized in connection with transactions with companies that directly or indirectly control the

[1] In case of direct use, it is necessary to elect the Ruling procedure in order to define the income object of the tax relief. To such an extent, simplifications in favour of micro-, small- and medium –sized enterprises are expected.

enterprise, that are controlled by it or that are controlled by the same company that controls the enterprise.

It is also necessary to indicate the type of intangible asset from which the income subjected to tax relief results and the type of research and development activity carried out, and the direct connection of the same one with the development, the maintenance, as well as the enhancement of the value of intangibles.

The documentation supporting the ruling can be submitted or integrated within 120 days from the submission of the application, along with supplementary statements aimed at showing and integrating the application.

At the end of the preliminary activity, the Office will invite the company to appear in order to check the completeness of the information provided, to formulate any request for further documentation deemed necessary and to define the terms of the adversarial proceedings, which can consist in many meetings. It is provided that, during the proceedings, the employees of the Italian Revenue Agency can have access to the premises where the enterprise activity or the permanent establishment activity is carried out, within the time agreed with this latter, in order to take direct knowledge of the information useful for the preliminary activity.

The procedure (which can require, when it involves companies located in different countries, the activation of instruments of international cooperation among tax Authorities) is finalized with the undersigning of a special agreement, which becomes mandatory for both parties that have signed and which remains in force for the tax year in which the application for prior agreement is submitted and for the four subsequent tax years.

The compliance with the agreement is subject to inspection by the tax Authorities and such agreement may vary (if the conditions on which it is based change) or be no more effective (if it is not observed).

Within 90 days from the expiration of the agreement, the enterprise can submit a proper application for starting a new cross-examination with the Italian Revenue Agency.

How it works

The tax relief consists in the exemption from taxation (for IRES/IRPEF-IRAP purposes) of a share of income resulting from the exploitation/use of intangible assets.
More particularly, the agreed percentage of exemption from taxation is the following:

- for the tax year following the year in progress as at December 31st, 2014 and for the one following the current year as at December 31st, 2015, respectively, it is equal to 30 and 40 percent;
- from the taxable period ending at December 31st, 2016 onward, it is equal to 50%.

The share of income subjected to tax relief is determined for each intangible asset mentioned above, based on the ratio[2] between:

- costs relevant for tax purposes, incurred for the maintenance, increase and development of the intangible asset;

[2] The Decree of July 30th introduces further specifications related to the modalities to determine the costs to be included to the numerator and denominator of the ratio.

- the overall costs relevant for tax purposes, incurred to produce such asset.

For the proper calculation of this ratio it is also necessary to distinguish between the various tax years subjected to tax relief:

- ✓ for the first tax period of effectiveness of the option, and for two following ones, the costs are those incurred during the tax period the tax return is referred to and in the three previous tax periods and they are considered *altogether*;

- ✓ from the 3rd tax period following the effective one, the relevant costs are those incurred during the tax periods in which those provisions shall apply and are considered separately for each intangible asset.

The direct connection between research and development activities and the intangible assets, as well as between these latter and the related income subjected to tax relief and resulting from *an adequate system of accounting or non-accounting recognition.*

Therefore, briefly, the determination of the amounts subjected to tax relief requires three steps:

- ➢ determining the income flows potentially subjected to tax relief, with different rules depending on whether it is a direct or indirect use of the *intangible asset*;
- ➢ definition of the share of income subjected to tax relief (provided by the ratio between the cost categories identified by the regulation);
- ➢ application of the rate subjected to tax relief (30%-40%, or 50%, depending on the year in question) to the share of income subjected to tax relief.

For a better understanding, let's consider the case of a company that achieves an income equal to Euro 100,000 derived from the granting of the right to use one of its own intangible asset to third parties.
If the ratio between the relevant costs was equal to 85%, this would mean that the rate subjected to tax relief would be applied to Euro 85,000 of income: assuming that the tax year is 2015 (rate equal to 30%), therefore, the favourable tax treatment would amount to 30% of Euro 85,000 (Euro 25,500), as a corresponding reduction from the taxable base.

The legislation on the Patent Box facilitates even in case of *sale of assets subjected to tax relief*: *the exemption from taxation* of the gain achieved is agreed, provided that 90% of the resulting consideration is *reinvested* – before the closing of the 2nd tax period following the one in which the sale occurred – in the maintenance or development of other intangible assets subjected to tax relief.

News

The Italian Revenue Agency has provided the following information

- *the option shall not necessarily be exercised with reference to all intangible assets held by the beneficiaries.*

- *If, following the exercise of the option, it is not possible or convenient to carry out any decrease in the tax return in order to benefit from the tax relief, the taxpayer will have no consequences.*

- *The income produced by the intangible asset subject to tax relief, especially in the early stages of the research, could be negative, generating a loss. By way of interpretation, the Italian Revenue Agency has considered, in this case, the enterprise as being under the Patent Box regime and will*

carry on the positive effects of the option to the tax years in which the same asset will produce income.

- *If the method for the determination of the tax relief lead to a loss, resulting from the excess costs to be burned for the intangible asset compared to the revenues attributable to it, this negative result will contribute to the production of the business income for the period: the positive and negative elements that can be attributable to the intangible asset contribute, in an ordinary way, to the determination of the business income for the period even when any decrease is applied to benefit from the tax relief.*

- *The losses generated under the Patent Box regime shall be "recaptured" in the field of the same Patent Box regime, when the intangible asset starts producing income. These losses will therefore be calculated as a reduction of the gross income subject to tax relief (equal to the excess of revenues compared to the costs referable to the single intangible asset), until they finish.*

- *Extraordinary transactions (mergers, spin-off and transfer of company) through which the intangible assets are reallocated within a group of enterprises, determining a new subject being holder of intangible assets subject to tax relief – who could grant their use to other companies, carrying out an indirect economic exploitation – shall not be regarded as abusive.*
  According to the Italian Revenue Agency such extraordinary transactions, neutral for tax purposes, from an organizational point of view, could allow an easier management of tax relief and, at the same time, could make the management of the research and development activity[3] more efficient: it is however necessary that the beneficial company carries out a "substantial activity".

How to carry out the election

The option has a term of five tax years, it is irrevocable and is renewable.

For the first two tax periods following the one in progress as at December 31st, 2014, the option must be communicated to the Italian Revenue Agency according to the modalities and terms that will be mentioned in a proper Provision of the Director of the Italian Revenue Agency: the option concerns the tax period during which it is communicated and the following 4 ones.

From the 3rd tax period following the year in progress as at December 31st , 2014, the option will be directly carried in the tax return, and will be effective from the tax period to which the same tax return refers.

- ***News***

With the provision dated November 10th, the form to communicate the access to the Patent Box procedure was issued.
The form is simpler and only consists of sections containing the personal data of the subject exercising the option, together with the indication of the tax periods in which the tax relief is intended to be applied.
The form shall electrically be submitted by the Italian Revenue Agency.

[3] Such transactions can also make the ruling procedure, which is obligatory for those who directly exploit intangibles, optional.

RSM PALEA LAURI GERLA

Foro Buonaparte 67, 20121 - Milano
Tel +39 02 89095151
Fax +39 02 89095143

Roma – Via delle Terme Deciane 10 – 00153, (registered office and operating office)
Torino – Via Ettore De Sonnaz 19 – 10121 (operating office)

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