Italian exit tax remains an obstacle for European integration

Paolo Ruggiero of LED Taxand takes a closer look at the applicability of the PEX regime and considers how the exit tax law in Italy could be amended.

With the Principle of Law No. 10/2021, the Italian tax authorities dealt with the computation of the taxable base for exit tax purposes in cases where the going concern transferred includes participations that, in principle, may benefit from the participation exemption (PEX) regime.

The Italian tax authorities reached the conclusions that in these situations the PEX regime would not be applicable because:

- As already pointed out in the Circular Letter February 13 2006, No. 6 (Circular Letter No. 6/2006), even when the going concern sold includes participations that meet the PEX requirements, from an accounting and tax perspective the computation of the capital gains deriving from the disposal of such going concern should be 'jointly determined' because referred to the assets 'as a whole' and not to each single asset. Therefore, it is not possible to carve out the part related to the participations; and
- The same principle should not be applicable just in case of sale but also in all those situations in which a going concern is transferred, such as the transfer of residence of an Italian company that does not allocate the assets to an Italian permanent establishment. Indeed, according to the Italian exit tax provisions, as set forth by Article 166 TUIR, the capital gains deriving from the transfer of residence should be jointly determined by comparing the overall fair market value of the going concern and its tax basis and such provision shall be understood not only with regard to the quantification of the taxable amount but also to the substantial unity of the assets transferred which does not allow an evaluation of the single components.

The cases affected by the Principle of Law No. 10/2021 are those relating to business entities:

- Tax resident in Italy that transfer their tax residence to another state, except for those assets which remain effectively connected with a permanent establishment (PE) in Italy (Article 166(1)(a) TUIR);
- Tax resident in another state that have a PE in Italy and transfer the business carried on by their permanent establishment from Italy to another state (Article 166(1)(c) TUIR); and
- Tax resident in another state that have a PE in Italy and transfer assets from their Italian PE to their head office or another PE in another state (Article 166(1)(e) TUIR).

In such cases, it appears that when the participations are a part of a going concern transferred, the PEX regime would be unavailable, both in situations where such participations are a minority part and where they represent the majority one. This is the case, for example, of active holding companies involved in the management and coordination of its subsidiaries or mixed holding companies that carry out secondary activities.

Conversely, it seems that the PEX regime should continue to be applicable in case of transfer of participations on a standalone basis. With respect to the exit tax regime, the same conclusion may be also reached in case the Italian company decides to transfer abroad single assets (i.e. participations) instead of a going concern.

An analogous solution would appear logical in case of passive holding companies, i.e. those companies whose sole purpose is to acquire and hold shares in subsidiaries, without being involved in their management. Indeed, given that they do not carry out any economic activity, it could not be identified any going concern. This would lead to the conclusion that passive holding companies may benefit of the PEX regime also when they transfer, for example, *tout court* their residence.

The applicability of the PEX regime

The fundamental issue raised by the Italian tax authorities concerns the applicability of the PEX regime when the participations are included in a going concern that is the object of the transfer.

A first interpretation was given by the Italian tax authorities in the Circular Letter August 4 2004, No. 36 (Circular Letter No. 36/2004) where it was stated that the PEX was also relevant in the cases ruled by Article 166 TUIR and, therefore, it was applicable for example in case of transfer of residence by an Italian resident company.

A completely opposite conclusion was reached by the Italian tax authorities in the aforementioned Circular Letter No. 6/2006, in which it was stated that when a going concern transferred includes participations, the capital gains attributable to the participations may not benefit of the PEX regime because the consideration received from the sale represents an overall amount referable to the going concern as such and not to the single assets that form it.

This interpretative guidance was partially superseded by another non-published tax ruling where a tax resident holding company – at the time of the transfer of its tax residence abroad – was allowed to apply the PEX regime to the participations owned because the assets transferred were predominately comprised of participations fulfilling the PEX requirements.

Having said that, with the principle of law in question, the Italian tax authorities come back to confirm its position taken with the Circular Letter No. 6/2006. This change of route was strongly criticised by predominant doctrine for the following reasons.

The PEX regime was introduced in Italy in order to align the Italian tax system to those implemented by the other major states, with the purpose to make Italian holding companies more competitive and to attract in Italy foreign holding companies. Therefore, first of all, what is puzzling is that the position taken by the tax authorities denies such regime precisely to the active and mixed holding companies.

In addition, given that the participation exemption regime was introduced with the purpose to avoid economic double taxation on the profits of the controlled entity, the central role of this provision should not be relegated to the attic when the participations are included in a going concern. Indeed, the PEX regime should have a stronger and more important value than other provisions, such as the exit tax, because it is aimed – together with the dividends regime – to coordinate the taxation of the company with the shareholders' one.

Ironically, a further consequence could be that the single sale of a participations may be challenged by the Italian tax authorities under the general anti-abuse provision because in case of sale of a going concern such regime should not have been applied!

According to Assonime, namely the main association of the Italian joint stock companies, the underlying problem is the relevance that should be given to the concept of 'jointly determination' of the capital gains to which Articles 86 and 166 TUIR make reference to.

With respect to Article 86 TUIR, the concept of 'jointly determination' should reflect the will of the Italian legislator to tax the assets of a going concern under a single tax regime. It is in this perspective, for example, that inventory goods included in the going concern does not give rise to autonomous profits but are included in the computation of the capital gains.

However, this does not mean that the concept of unity should not be superseded when other overriding principles may come into play with the purpose to avoid distortions that may harm the coherence of the tax system. This is precisely the case of the PEX regime.

For such reason, it appears logical to believe that in case of sale of a going concern the computation of the capital gains 'as a whole' should give way to the need to ensure an

uniform applicability of the PEX regime and, therefore, the capital gains referred to the participation should continue to be subject to its specific exemption treatment.

Obviously, the separate application of the PEX regime compared to the other assets of the going concern should not only be valid in cases where the difference between the market value of the participations and their tax cost would give rise to capital gains but also when from this comparison a non-deductible capital losses would arise.

In this respect, there should not be particular issues in the identification of the value of the capital gains related to the participations. Indeed, given that a going concern is neither a sole asset nor a set of non-separable components but a complex of assets and liabilities, including goodwill, that can be specifically identified in their existence and evaluation, it would be possible to compute the specific capital gains/losses.

Indeed, the fact the purchase price refers to the overall going concern, it does not prevent the purchaser to allocate it from an accounting and tax perspective to each asset and liabilities transferred, leaving the power to the tax authorities to audit and challenge such allocation.

Therefore, if, from one hand, the selling price should be deemed to be a sum of the single considerations referred to each component of the going concern transferred, on the other hand, the tax administration should have the authority to challenge the allocation made by the seller for the quantification of the capital gain/losses related to the participations.

With respect to Article 166 TUIR, the Ministerial Decree July 2 2014 (MD 2014) – that supplemented the application of the previous version of Article 166 – in relation to going concerns of companies transferring abroad their tax residence provided, from one hand, that the tax deferral regime should have been applied on the capital gains jointly determined. On the other hand, it noted that the capital gains must be split among each asset transferred in proportion to the higher value of each asset and the overall higher value of the assets transferred.

Even though such a tax deferral regime is no longer applicable, Article 1(5) MD 2014 establishes a leading principle, namely that the parts of the capital gains jointly determined related to the going concern transferred can be split as long as another provision could not correctly be applied. Therefore, it appears logical to assume the same conclusion in respect of the PEX regime.

In addition, with particular reference to the exit tax regime, the issue of quantification of the capital gain related to the participations should be overcome by applying the transfer pricing rules, as ruled by the same Article 166.

Finally, from a tax policy perspective, it is clear that the Italian tax provisions promote the protection of the tax system with the twofold objective to both attract in Italy new taxpayers, new investments and new business and to tax the capital gains accrued in Italy when the taxpayers decide to leave the country. Having said that, it would not sound reasonable to deny the application of the PEX regime with the aim to prevent revenue losses.

Indeed, if it is true that the scope of the PEX regime is to tax the profits at the time of their production at company level, the facts involving the participations occurred after the relocated abroad should be irrelevant for the outbound country. In other terms, the Italian system taxes the profits at the level companies if resident in Italy and – except for controlled foreign corporations (CFCs) – does not tax the profits of foreign companies provided that they are taxed in their residence states. At the same time, the Italian system does not tax the dividends received by Italian resident shareholders and the capital gains deriving from the disposal of the participations.

Having that in mind, there would not be any need to protect the Italian taxing rights when moving a participations abroad.

Conclusion

In Italy, the parliament is discussing a new tax reform that should help the economy to recover from the COVID-19

Paolo Ruggiero
Partner
LED Taxand
T: +39 0249 4864
E: pruggiero@led-taxand.it

Paolo Ruggiero is a partner at LED Taxand. He began his career in a Milan boutique tax firm, then moved to work at Di Tanno e Associati and Fantozzi & Associati, before joining the firm in January 2018.

Paolo has more than 15 years of experience in practice areas involving international taxation. He mainly focuses on private equity and real estate transactions, as well as international tax planning merger and acquisitions. He is also the author of several publications on international tax matters.

Paolo has a degree in economics from Bocconi University and an advanced LLM in international taxation from Leiden University.

crisis. It would be desirable if the exit tax law could be amended, so that participation, forming as a part of a business going concern, will no longer be taxed both in the case of transfer of going concern, and in case of transfer of tax residence outside Italy.

This would be important because – as seen in the Fiat/CFA case – an Italian holding group may transfer their tax residence outside Italy in order to merge with other European groups and form an international player that may compete in a challenging economy. Taxes should never be an obstacle but rather should help create a level playing field in Europe, where European groups may grow and compete against international groups from jurisdiction such as China and the US.

LED TAXAND

About us

LED Taxand is an Italian tax law firm with a recognised quality and high reputation of its professionals. With currently approx.30 tax advisors and office in Milan, LED Taxand is the Italian member of Taxand (*www.taxand.com*), the world's largest independent tax organisation with more than 400 tax partners and 2.000 tax advisors in over 50 Countries. LED Taxand offers customized tax assistance, providing consultancy relating to direct and indirect taxes, fiscal and corporate aspects and opinions. The firm offers expert advice on tax and corporate issues related to extraordinary transactions.

LED Taxand operates in areas of general fiscal planning and structuring, tax compliance, real estate tax, indirect tax, International taxation and transfer pricing. The firm develops innovative solutions that allow the optimization of the tax framework and assists also in the phases prior to the conclusion of partnership agreements even through the activities of tax due diligence. For international groups such activity is carried out in partnership with Taxand.

Service Lines

- Corporate Taxation
- International Tax
- M&A Tax
- Real Estate Tax
- Tax Disputes
- TP & Business Restructuring
- Corporate Tax Governance
- Financial Services
- Indirect Tax
- Company Welfare
- Private Client Services

- Taxand Network
- LED Taxand Services

LED Taxand Studio Legale Tributario
Via Dante, 16 – 20121 Milan
tel: +39 02 494864 - fax: +39 02 494864864
email: studiomi@led-taxand.it - www.led-taxand.it