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Art.1 paragraph 36 to 45 of Law no.190 of 2014

The New Italian Patent Box Regime

By Dr Massimiliano Russo

After a recent debate as to the possible introduction of new tax tools and incentives to attract foreign investments in Italy as well as a long period in which we have seen measures increasing the tax burden for both companies and individuals, this newly introduced legislation on the Patent Box Regime as a tax incentive is most welcome (in the following also referred to as the “incentive”). Unfortunately, as with most the newly introduced legislation in Italy, some aspects have not yet been committed and will be further regulated in future ministerial decrees. The interpretation of the newly introduced rule by tax authorities is also still awaited.

However, it is already possible to evaluate the regime as it is now drafted under the Law in force and raise a few questions that domestic or foreign investors would possibly ask based on the current information available. Before analysing the Patent Box Regime and its key elements, it is useful to briefly look at the current tax environment for company business in Italy.

Under current Italian tax legislation, resident corporations are taxed on their worldwide income. A company is considered to be resident in Italy when its registered office, its place of effective management or its main business operations are located in Italy for the greater part of the year. Resident companies are currently subject to Corporate Income Tax (IRES) at a flat rate of 27.5% and to Local Income Tax (IRAP) at a 3.9% rate (a 1% increase to IRAP is allowed on a



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regional basis).

From a general tax standpoint, all income earned by a resident company or commercial entity qualifies as business income. Revenues, expenses and other positive and negative items of income shall be included in the taxable base of the tax period to which they relate. The taxable business income is determined under the accrual principle, with certain exceptions, such as dividends and social security contributions. Interest and royalty income earned by resident companies are taxed as ordinary business income.

The subjective scope of the law

The incentive generally applies to business income earned by individuals

or companies resident in Italy according to principles summarised above. The Patent Box Regime recently introduced in Italy aims to create a competitive tax regime similar to those for Italian resident companies developing intangibles and deciding to opt for such incentive that are already applicable in Luxembourg, the Netherlands, Portugal and the UK. Non-resident companies with a permanent establishment in Italy will benefit from the same incentive, provided they are resident in countries that have double tax conventions (DTC) with an exchange of information clause with Italy and opt for the incentive.

The objective scope of the law

Those who conform to the subjective scope of the legislation may select a five-year period for the incentive, provided that the business income is derived from the use of intangibles, such as payments received as a consideration for the use of or the right to use any patent, trademark, design or models or information concerning industrial, commercial or scientific equipment.

International ruling procedure with tax authorities may apply in a domestic context in order to determine the cost attributable to the intangible's development. This is the first time Italian tax legislation has adopted and created a procedure for cross-border transactions such as intra-group policy pricing (for ...next page

example, transfer pricing purposes), applying to a purely domestic scenario where a higher degree of discretion may be exercised by the tax authorities.

The measure of the tax incentive

Since 1 January 2015, taxpayers may opt for the Patent Box Regime with the purpose of excluding from the taxable income for both IRES and IRAP purposes, 50% of the revenues derived from the use or right to use directly or indirectly the intangibles, patents, trademarks, secret formulas process and information concerning industrial, commercial or scientific experience.

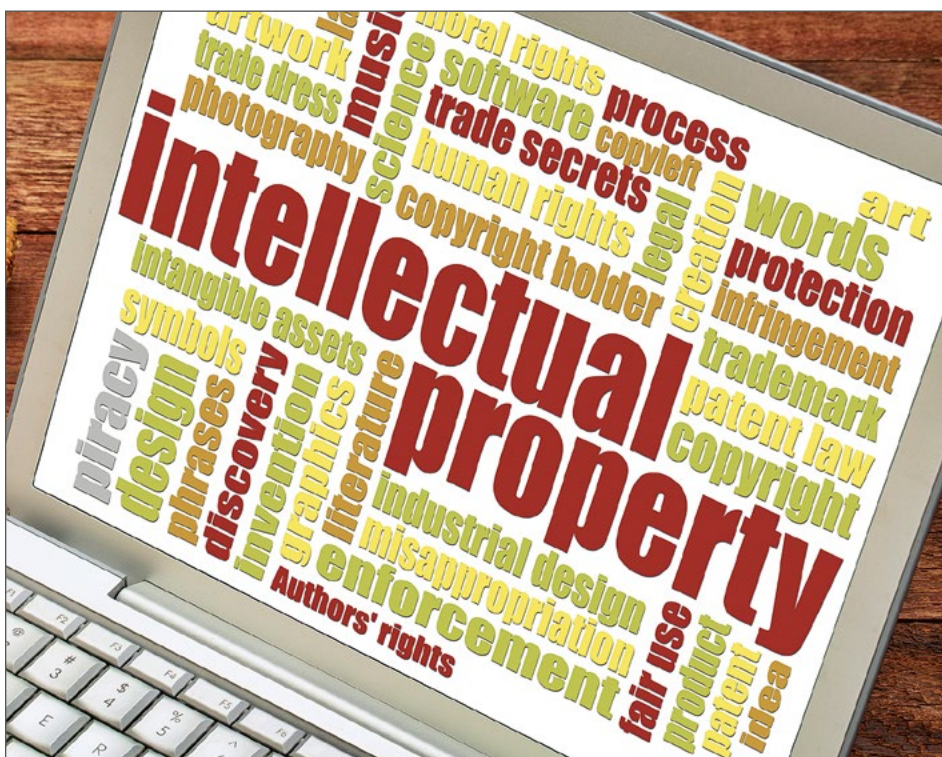
The incentive is also extended to capital gains arising from the sale of the intangibles. Capital gains would be 100% exempt provided that 90% of the gains are again invested in development and or maintenance of intangibles in the two years following the sale. However, the amount of the gain realised that can benefit from the exemption is to be determined with a shared procedure with Italian tax authorities.

Limitation of the incentive

The legislation on the Patent Box Regime introduces a significant taxable income cut for companies that develop intangibles.

However, to determine the reduced taxable income, net of the "revenues exclusion allowed" each taxpayer will have to go through a more detailed calculation each year for the duration of the option that takes into account a ratio between the cost of research and development and the overall costs, and multiply this ratio for the taxable income. The outcome will be the figure to which the 50% reduction can apply.

Example: R&D expenses: EUR 350,000; overall cost: EUR 1,000,000; royalties from licensing agreements: EUR 5,000,000.



$350,000 : 1,000,000 \times 5,000,000 =$ taxable income that benefits from the incentive, so only 35% of EUR 5 million royalties could be reduced by 50% and excluded from the ordinary income tax levy (i.e. EUR 1.75 million in this example).

Furthermore, the 50% exclusion applies progressively as only 30% and 40% of the taxable income reduction apply in the first and second year of the option. Consequently, if a taxpayer opts for the incentive starting from 2015, they will only benefit from the 50% reduction for financial year 2017.

Preliminary comments

The Patent Box Regime in Italy is a welcome measure, especially in the European arena where similar measures have already been introduced.

The rule already applies, but some aspects will be further defined in the anticipated ministerial decrees as delegated by the current legislator.

At this stage, it is still unclear whether, once a taxpayer opts for application of the incentive, it can be used for all intangibles or whether a single election applies for each intangible of a single entity. Furthermore, it should be clari-

fied if the benefit of the regime is just for the beneficial owner of the intangible or if it would also be available for a group company that acts as licensing company receiving the royalty payments. A last question might be raised with respect to the procedure, where tax authorities should provide greater clarity on which cost are included and excluded from the previously mentioned ration as well as the steps of the international ruling procedure, especially for small and medium-sized start-up companies that might find it cumbersome and more expensive to run the overall Italian procedure to benefit from a more favourable tax regime for their ideas compared with other countries.

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