LEGAL INFORMATION NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

A GENERAL OVERVIEW ON THE TAXATION OF SHAREHOLDERS OF RESIDENT COMPANIES IN ITALY

Introduction – Both corporate and personal income taxes apply to shareholders of Italian resident companies. Corporations pay taxes on their earnings and then pay shareholders dividends out of the after-tax earnings.

Shareholders receiving dividend payments from a company must then pay taxes on that income as part of their own income taxes. In addition, capital gains apply on disposal of shares and other similar interests in resident companies. This newsletter provides a general overview on how taxes apply to shareholders of Italian resident companies.

Dividends in general - For tax purposes, dividends include:

- distributions of profits derived from the participation in the capital or equity of a company;

- payments made under a silent partnership and similar agreements, unless the silent partner only contributes his personal services;

- yields of domestic securities and financial instruments that are fully tied to the economic results of the issuer (or of other companies belonging to the same group as the issuer) that are not deductible in the computation of income of the resident paying entity; and

- yields of foreign shares, securities and financial instruments that are fully tied to the economic results of the issuer (or of other companies belonging to the same group as the issuer), provided that they are not deductible in the jurisdiction of the issuer.

From 1 January 2004, Italy applies a traditional mechanism of taxation of corporate profits. The former imputation system and corresponding equalization tax are abolished and replaced by a partial exemption for qualifying corporate and individual shareholders.

Individual shareholders - Resident individuals are liable to individual income tax (IRPEF), which is levied at progressive rates up to 43% on income exceeding EUR 75,000.

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The tax treatment of dividends derived by individual shareholders depends on whether or not the shareholder holds the participation in the context of his business activity.

Individual shareholders holding their participation in the context of their business activities do not include 41.86% of the dividends they receive in respect of such shares in their income; thus, only 58.14% of the dividends is included in taxable income subject to the progressive rates of IRPEF.

For dividends received by individual shareholders who do not hold the participation in the context of their business activity, the taxation has been amended by L 205/2017.

With regard to dividends paid out of profits realized until the fiscal year that was current on 31 December 2017 and declared before 31 December 2022, their taxation depends on whether their participation is substantial (qualifying).

A participation is substantial (qualifying) if the individual shareholder holds either more than 20% of the voting power (2% in the case of listed companies) or more than 25% of the stated capital (5% in the case of listed companies).

If the participation is substantial, dividends are treated the same way as dividends received by individual shareholders who hold the shares in the context of their business.

No withholding tax is levied on these dividend payments.

However, if the participation is not substantial, dividends are subject to a final withholding tax at a rate of 26%. In this case, the dividends have to be declared in the tax return and are not included in aggregate taxable income subject to progressive tax rates.

For dividends paid out of profits realized from 2018 and dividends paid out of profits realized until 2017 and declared from 1 January 2023, resident individual shareholders are generally subject to a 26% final withholding tax.

Resident non-business entities not holding the shares in the context of a secondary business activity include 100% of the dividends they receive in respect of such shares in their income.

The exempted amount was equal to 95% until 31 December 2014.

Substantial corporate shareholders - Dividends derived by resident companies from other resident companies are not included in the corporate income tax base for 95% of their amount.

The 5% portion that is taxable is included in the taxable income on a cash basis.

As of 1 January 2016, the dividend tax treatment (i.e. the 95% exclusion from IRES taxable base) is also granted to yields of securities and financial instruments that are not considered equity-like securities for tax purposes, to the extent that the issuer cannot deduct the yield for IRES purposes.

A special tax regime applies to shares and similar financial instruments held by IAS/IFRS adopters.

The regime to apply depends on whether the shares are booked as financial assets held for trading under

IAS/IFRS. If the shares are booked as financial assets held for trading:

• dividends received on such shares are fully included in the IAS/IFRS adopter's taxable income; and

• realized and unrealized gains and losses resulting from the mark-to-market valuation of the shares in the company's P&L according to IAS/IFRS are fully relevant for IRES purposes.

If the shares are not booked as financial assets held for trading under IAS/IFRS:

• 95% of the dividends on such shares are not included in the IAS/IFRS adopter's taxable income; and

• gains and losses resulting from the mark-to-market valuation of the shares in the company's P&L according to IAS/IFRS are not relevant for corporate income tax purposes.

Dividends received by commercial and manufacturing enterprises are not subject to IRAP. Different rules apply to financial intermediaries and insurance companies.

Specific rules apply to foreign dividends derived by resident companies and dividends derived by non-resident companies from resident companies.

Capital gains – The tax treatment of capital gains on shares and other similar interests in resident companies (and partnerships) that are realized by individual shareholders depends upon whether or not the shareholder holds the shares in the context of his business activity.

If an individual shareholder holds the shares in the context of his business activities and certain conditions are met, 41.86% of the capital gain realized on such shares is exempt from IRPEF (50.28% for capital gains realized before 1 January 2018); thus, only 58.14% (49.72% for capital gains realized before 1 January 2018) of the capital gain is included in taxable income subject to the progressive rates of IRPEF.

The partial exemption applies if:

• the shareholder has continuously held the shares since the first day of the 12th month preceding the disposal (the LIFO method applies);

• the shares were booked as fixed financial assets in the first balance sheet closed after their acquisition (or resulted as such by other reliable accounting documents); and

• the participated company has continuously been engaged in a business activity since the beginning of the third fiscal year preceding the disposal.

If an individual shareholder does not hold the shares in the context of his business activities, related capital gains are subject to a final substitute tax at the rate of 26%.

For capital gains realized until 31 December 2018, the treatment of these capital gains (i.e. capital gains realized by shareholders who do not hold the shares in the context of a business activity) depended on whether their participation was substantial.

A participation is substantial if it represents either more than 20% of the voting power (2% in the case of listed companies) or 25% of the stated capital (5% in the case of listed companies) of the company.

If individual shareholders (i) disposed in any 12-month period of as many shares as represent a substantial participation and (ii) had held at least once in the 12-month period as many shares as represented a substantial participation, then they did not include 41.86% (50.28% for capital gains realized before 1 January 2018) of the related capital gain in their income.

Otherwise, capital gains derived by individuals were subject to a final substitute tax at the rate of 26%.

The same regimes apply to capital gains realized by non-resident individual shareholders. However:

- if the non-resident shareholder sells a participation that is not substantial in a resident company whose shares are listed on a regulated market, the capital gain is not deemed to be sourced in Italy and therefore it is not subject to Italian income taxation; and

- if the shareholder is a resident of a country included in the white list (i.e. a country that allows an adequate exchange of information), capital gains that would be subject to the substitute tax (i.e. capital gains on the disposal of shares that do not represent a substantial participation) are exempt in Italy.

Substantial corporate shareholders - Subject to certain conditions, capital gains from the disposal of qualifying participations is 95% exempt from IRES.
In case of disposal of participations that do not qualify for the participation exemption, are booked as fixed financial assets and have been held for at least 3 years, the corporate shareholder may elect to include the capital gain in its income (and subject it to IRES) in equal instalments in the year of realization and in the following 4 years.

Specific rules apply to capital gains derived by resident companies from the disposal of shares of non-resident companies and to capital gains derived by non-resident companies from the disposal of shares of resident companies.

Purchase by a company of its own shares - Several statutory restrictions apply on a company's purchase of its own shares. If a company reduces its stated capital by cancelling treasury shares (i.e. previously acquired own shares), the difference between the cost of these shares and the corresponding reduction of the company's net equity is neither taxable nor deductible.

As regards the seller, the sale of shares to the issuing company is, in principle, treated as any other sale of participations.

However, the tax authorities have taken the position that a share buy-back must be treated as a shareholder's withdrawal if the issuing company purchases the shares in order to cancel them (Court of Cassation rulings n° 24/1992 and n° 36/E/2004).

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