tax notes international
Volume 78, Number 4 ■ April 27, 2015

(C) Tax Analysts 2015. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Thoughts on Italy's New Patent Box Regime

by Piergiorgio Valente and Federico Vincenti

Reprinted from *Tax Notes Int'l*, April 27, 2015, p. 395

taxanalysts®

PRACTITIONERS' CORNER

Thoughts on Italy's New Patent Box Regime

by Piergiorgio Valente and Federico Vincenti

Piergiorgio Valente and Federico Vincenti are with Valente Associati GEB Partners.

Italy's 2015 stability law introduces a new optional privileged tax regime for income deriving from the use of specific kinds of intangibles. The authors provide insights on Italy's new regime, the so-called patent box.

The cross-border transfer of intangibles may involve several interesting tax planning aspects for multinational groups; governments are, in turn, especially sensitive to issues linked to transactions involving intangible assets because of their concern about any possible erosion of the taxable base.

The analysis of transactions involving intangibles generally presents several critical areas, including the difficulty in determining the arm's-length price. This difficulty is mainly because of the inherent characteristics of intangibles, which may cause complications in the identification of comparable goods or assets and the determination of value.

Law No. 190 of December 23, 2014 (the 2015 stability law), introduced in Italy a new optional privileged tax regime (a patent box regime) for income deriving from the use of specific categories of intangibles.

As the explanatory report on the 2015 stability law indicates, the introduction of the regime supports research and development investments and also creates incentives for the placement in Italy of intangibles held abroad, or to encourage that intangibles be kept in Italy.

This is in line with the OECD's base erosion and profit-shifting project, the main objective of which is to counter taxable base erosion through the shifting of profits abroad.

International tax rules and regulations provided by national systems are mainly the expression of the ''old'' economy; they no longer satisfy a reality strongly characterized by the high-level integration of a cross-border economy. Particular significance should also be ascribed to the fundamental changes in the ''new'' economy, in which intellectual property and communication technologies play a primary role.

To that effect, the February 12, 2013, OECD BEPS report pointed out how many tax planning structures provide for the allocation of significant risks and high-value intangibles in jurisdictions with patent box regimes, with a consequent erosion of the tax base through profit shifting.

Application of the Regime

As noted above, the 2015 stability law introduced in Italy a new patent box regime for incomes deriving from the use of specific categories of intangibles. The regime was further amended by article 5 of Decree-Law No. 3/2015.

The new regime, applicable as of the tax period following the one in progress as of December 31, 2014, may be adopted by entities earning corporate income.

Entities listed under article 73(1)(d) of Italy's Income Tax Code, namely companies and entities of any category including trusts, may qualify for the patent box if they are a resident of a country where income tax treaties are in force and where effective information exchange has been implemented.

The above entities may qualify for the patent box if they carry out R&D activities, even by means of research agreements entered into with universities or research entities and similar organizations, the purpose of which is to produce intangibles that may be eligible for the patent box regime.

(C) Tax Analysts 2015. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Intangibles eligible for the patent box's benefits include intellectual property; industrial patents; corporate trademarks; and design and models such as processes, formulas, and information or data concerning experiences acquired in the industrial, commercial, or scientific fields that may be protected by the law.

The tax benefit consists of excluding the following from total income:

- 50 percent of income deriving from a license or from direct use of the above intangibles; for fiscal years 2015 and 2016, the percentage to be excluded from income will be 30 percent and 40 percent, respectively.
- Capital gains deriving from the transfer of the above-stated assets. Exclusion of capital gains is applicable if at least 90 percent of the consideration deriving from the transfer of the above assets is reinvested in the maintenance or development of other intangibles that may benefit from the patent box, before the closing of the second tax period after that in which the transfer was effected.

The patent box regime option is valid for five fiscal years, is irrevocable, and is relevant to determine income tax and the Italian regional tax on productive activities.

The tax benefit pertains to:

- incomes deriving from the license to third parties of the above intangibles; and
- direct use of the intangibles.

When intangibles are used directly, one must identify an amount corresponding to the economic contribution that the intangibles add to the aggregate income by activating an international standard ruling procedure (article 8 of Legislative Decree No. 269/2003).

The main purpose of international rulings is to achieve cooperation between tax authorities and taxpayers, with special reference to entities operating in international markets, in order to prevent future conflicts while avoiding double taxation.

The international tax ruling draws the Italian tax system closer to those existing in European countries that have already adopted advance pricing agreements. The international tax ruling is the expression of a special form of inquiry that allows the taxpayer the opportunity to define, with the tax authorities, what is the applicable tax treatment to be expected for both financial and income-related components referring to the enterprise.

Thus, a twofold result may be achieved:

- the enterprise may avoid any litigation proceedings against the tax authorities regarding behaviors that are subject to a ruling; and
- the tax authorities can become better acquainted with transactions entered into by the enterprise, mitigating the scarce information situation in which they find themselves and, above all, restricting thus the subtraction of taxable matter.

In that sense, the international tax ruling is an effective tax planning tool.

Decree-Law No. 145/2013 amended the regime on the international tax ruling by setting forth an extension that goes from three to five tax periods of the legal validity of the ruling agreement. During that period the tax authorities may carry on their auditing activities according to the terms of the signed agreement, while verifying whether any changes might have been made to the de facto and de jure conditions underlying the agreement.

Regarding the application of the new patent box regime, for enterprises that use their own structure directly to produce intangibles internally developed, a precise amount of the related proceeds has not been established (given its being implicitly included in regular proceeds typically accrued by the enterprise within the context of its own economic activities); consequently, the share of income cannot be precisely identified either, in view of the absence of a true and proper activity to exploit the intangible. For that reason, in case of direct use of the goods/assets indicated, one must establish precisely which income is eligible for that benefit and what does the use of the intangible add to the production of the aggregate income. When no consideration is paid by third parties, the quantification of the economic contribution is discretionary, depending upon the subjective evaluations of the enterprise.

To reduce any subjective aspects, the 2015 stability law states that the determination of implicit positive income components, and of the criteria for the identification of negative components linked to them, must be carried out under a predefined protocol and the activation of a ruling procedure.

As a general rule, in order to apply the new patent box regime, the income share that may be eligible is defined on the basis of the ratio between costs on R&D incurred for the maintenance and development of the eligible asset and total costs incurred to produce the asset. Decree-Law No. 3/2015 intervened by increasing the first amount (to a maximum of 30 percent of its own amount) of costs incurred for R&D activities through companies of the same group.

The above provision finds its justification through the will to find a nexus between the tax benefit and the bearing of the expenses, and therefore, of the performance of real economic activity in Italy (that is, the OECD's ''substantial'' activity), in line with the OECD's nexus approach within the framework of the various initiatives created to prevent harmful tax competition among states.

EU Work on R&D Tax Incentives

In November 2014 the European Commission published a report titled ''A Study on R&D Tax Incentives'' to clarify the functioning of R&D tax incentives

(C) Tax Analysts 2015. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

for several countries examined (EU member states, Canada, Israel, Japan, Norway, and the United States).

A previous study by the European Commission, ''Corporation Tax and Innovation: Issues at Stake and Review of European Union Experiences in the Nineties,'' had analyzed the impact of tax incentives for R&D activities. The study highlighted that many European countries with high innovation performance levels, such as Finland, Sweden, and Germany, preferred using financial rather than tax incentives to provide targeted support toward key technological sectors. This indicates that in countries bearing expenses that are already too onerous for technological innovation, proposals for additional tax incentives are rare.

Conversely, many EU countries with low innovation-related performance, such as Portugal, Spain, and Italy, tend to adopt general tax incentive programs to promote an ample range of activities involving technological innovation, with the main purpose of stimulating the economy as a whole.

R&D tax incentives are rather widespread in all advanced economies (with the exception of Germany and Estonia). The report indicates that even if tax incentives are rather common, they are far from being consistent — they vary substantially among the 33 countries that were investigated, with most countries offering more than just one kind of incentive.

Most tax incentives concern income taxes, while some countries provide for tax incentives that are applicable to social contributions or wage taxes. Further, the study emphasizes that patent box regimes are more frequently being introduced in various countries.

The study specifies several best practices by attributing an evaluation index to each of them. What is especially noteworthy is the following:

- Volume-based R&D tax credits are preferred over incrementally based ones. In volume-based credits, the tax benefit is provided for the entire amount of expenses incurred by the enterprise in R&D activities and involves minor administrative and compliance costs. In incrementally based credits, however, the tax benefit compares expense increases with the prior fiscal year.
- There is a positive evaluation of tax policies in Canada and the United Kingdom, where tax incentives are strictly targeted at activities that contribute to enhance a collective innovation rate, and not uniquely the one for the enterprise.
- It is generally more useful to grant benefits to start-ups than to small and medium-size enterprises.
- It would be convenient to provide periodic evaluations of benefits to be found only in few countries, among which are France and the Netherlands.

◆

Call for Entries:

Tax Analysts' 2015

Student Paper Competition

Tax Analysts is now accepting submissions for its 2015 student paper competition.

Winning contestants will have their papers published in either *Tax Notes*, *State Tax Notes*, or *Tax Notes International* in August 2015.

Submissions will be judged on originality of argument, content, grammar, and overall quality.

- Students must be enrolled in a law, business, or public policy program.
- Papers should be between 2,500 and 12,000 words and focus on an unsettled question of tax law or tax policy.
- Deadline for entries is May 31, 2015.

Submissions should be sent to:
studentpapers@taxanalysts.org

Complete competition rules can be found at:
www.taxanalysts.com/2015competition

taxanalysts®

(C) Tax Analysts 2015. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.