TAXATION

Taxes and Taxation: a general overview

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Taxation

TAXATION is the process by which the people pay the expenses of carrying on the government. Taxation is as old as government.

Even the earliest and simplest societies needed some methods of maintaining order and providing for justice, and those services couldn’t be provided without cost. So early systems of public finance, or of collecting and spending taxes, developed.

Kinds of taxes

In earliest times taxes were paid in goods rather than money. This is called payment in kind.

Many kinds of taxes have been used and are being used throughout the world. One important way to classify these taxes is into direct and indirect taxes.

Kinds of taxes

A DIRECT TAX is one that the taxpayer pays directly to the government. The income taxes are direct taxes.

AN INDIRECT TAX is one that is paid by a manufacturer or dealer, who then passes its cost on to the buyer of his product.

The manufacturer or dealer who pays this tax to the government passes its cost on to the consumer in the form of a higher price.

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Kinds of taxes

The VALUE ADDED TAX (VAT) is the main italian indirect tax. This is a form of sales tax that is assessed not only on retail sales, but also on production, distribution, and wholesaling.

At each stage a tax is paid on the value added at that stage.

When the person who pays a tax passes the cost on to someone else, the tax is called a SHIFTED TAX. The value added tax is a shifted tax.

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Kinds of taxes

Another important way to classify taxes is according to the way the rates of the taxes are varied.

For example a tax is called PROPORTIONAL if the rate of taxation remains the same whether it's applied to a small sum or a very large one.

The amount of tax paid is proportional to the sum to which the tax is applied, because the rate is a constant flat rate. The Corporate income tax is a proportional tax.

Kinds of taxes

A tax is called PROGRESSIVE if the rate of the tax goes up as the sum to which it’s applied increases. The Individual income tax is the most common progressive tax because its rates are higher for large incomes than for smaller ones.

Taxes may also be identified according to the base on which they’re applied.

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Kinds of taxes

The most common taxes classified according to the base on which they're levied include the following ones:

The INHERITANCE TAX, which is placed on the value of the property a person inherits;

the LOCAL PROPERTY TAX, which is paid by the owners of real estate properties and land properties as well. It is assessed on the LAND RENT and the CADASTRAL INCOME, and it depends on the various rates fixed by Local Administrations;

Kinds of taxes

the EXCISE TAXES are those placed on a specific commodity or thing. Oil and liquor taxes are called excise taxes;

CUSTOMS DUTIES, or TARIFFS, are taxes placed on imports or exports;

Kinds of taxes

a LICENCE TAX is placed on the right to do something, such as to sell liquor or tobacco, or to go hunting or fishing;

a FRANCHISE TAX is a payment for a special privilege, such as the right to run a bus line or a public utility.

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Principles of taxation

The fundamental problem of a tax system is to make it produce enough money to pay Government expenses. Even if the system provides enough revenue, that doesn't mean that it is perfect.

Most economists agree on certain desirable principles for taxation. It should be possible to expand the tax system to collect more money in periods of emergency, when the Government must spend more money.

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Principles of taxation

It should also be possible to reduce the amount of taxes in normal times, when government expenditures are at a minimum. This is called the principle of elasticity.

Unless the tax system is elastic, the government is likely to go into debt in periods of emergency and be forced to borrow money to meet current expenses.

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Principles of taxation

Everyone agrees that the tax system should be simple. Those who pay taxes and those who collect them should be able to understand and easily obey the tax laws.

The tax system should be stable. If the taxpayer knows in advance that he must pay a certain tax, he will be able to save money to pay that tax. If the system is unstable, the taxpayer cannot make plans.

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Principles of taxation

There are other common principles of taxation. These include the beliefs that taxes should be fair and just, that they should be convenient as to the time and method of payment, and that they should be inexpensive to collect.

There should be no favouritism in levying or collecting taxes. All citizens should be treated equally. Taxes should also come at times when taxpayers have the means of paying them.

Principles of taxation

For example, the Value Added Tax is so convenient that it is used widely in spite of its other defects.

The Local Property Tax, if at very high rates, may be inconvenient, since property does not always yield an income with which to pay taxes.

For example, land where timber is grown doesn't produce any incomes until the timber is mature.

Principles of taxation

Some economists consider that the tax system should be used to reduce differences in individual incomes.

These economists argue that the easiest way to accomplish this is to tax the rich at a much higher rate than the poor. They say that if the funds raised in this way are spent on social services which benefit the poor, the equalizing effect would be even greater.

Principles of taxation

Other economists insist that taxation must be guided by the desire to do minimum damage to the economic system of the country.

These economists argue that all types of taxes, even the best, do some damage to a free enterprise economic system. This, they say, is a strong reason for keeping government activities and expenses to a minimum in order to reduce the need for tax revenues.

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Principles of taxation

In particular, these economists argue against taxes that tend to destroy the incentive system of a free enterprise economy. “Double taxation” of income from corporations and steeply progressive income taxes are examples of the taxes which the economists say are undesirable.

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Principles of taxation

Still other economists, say that the tax program should be designed to accomplish the goal of economic stability, with full employment for all workers. These economists argue that taxes, but not government expenditures, should be reduced when depression threatens. This, they say, would leave more money for consumers and would help prevent a depression. If the threat is inflation, taxes but not government expenditures should be increased, they say, in order to leave less money for consumers to spend, so as to avoid prices to swing up.

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Taxation policy

The levying of taxes aims to raise revenue to fund governing or to alter prices in order to affect demand. States and their functional equivalents throughout history have used the money provided by taxation to carry out many functions.

Taxation policy

Some of these include expenditures on economic infrastructure (roads, public transportation, sanitation, legal systems, public safety, education, health-care systems), military, scientific research, culture and the arts, public works, distribution, data collection and dissemination, public insurance, and the operation of government itself. A government's ability to raise taxes is called its fiscal capacity.

Taxation policy

When expenditures exceed tax revenue, a government accumulates debt. A portion of taxes may be used to service past debts. Governments also use taxes to fund welfare and public services. These services can include education system, pensions for the elderly, unemployment benefits, and public transportation. Energy, water and waste management systems are also common public utilities funded through taxation.

Main italian taxes

RESIDENCE

A company is resident for tax purposes if its legal seat, place of effective management, or main business activity is in Italy for the greater part of the fiscal period (i.e., at least 183 days in a year, or 184 days in a leap year). A foreign company that holds a participation in an Italian company is deemed to have its place of effective management in Italy and, therefore, to be resident in Italy for corporate tax purposes if the foreign company is controlled by an Italian resident or managed by Italian residents representing the majority of its board of directors.

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Main italian taxes

BASIS

Resident companies are taxed on worldwide income; non-resident companies are only taxed on Italian-source income. Italian branches of a foreign company are taxed the same way as Italian subsidiaries.

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Corporate Income Tax

TAXATION RATE

The corporate income tax (IRES) rate is 24%, plus the regional tax on productive activities (3,9% in general). For banks and other financial institutions (excluding asset management companies (SGRs) and brokerage companies (SIMs)), the corporate income tax rate is 27,5%. Non-operating companies are subject to a 34,5% corporate income tax rate.

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Corporate Income Tax

CAPITAL GAINS

Capital gains derived from the sale of assets are normally treated as ordinary income and taxed at the 24% corporate income tax rate, plus IRAP at 3.9% rate.

However, capital gains derived from the sale of participations, are not generally subject to IRAP (except for banks and financial institutions, or financial companies), and are 95% exempt from corporate income tax if the following requirements are met:

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Corporate Income Tax

(i) the participation has been held for a minimum continuous period that may range between 12 and 13 months;

(ii) the participation is classified as a financial fixed asset in the first financial statements closed after the participation was acquired;

(iii) the company in which the participation is held is not considered as a “low tax jurisdiction” (LTJ) entity for purposes of Italy’s CFC regime;

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Corporate Income Tax

iv. the company in which the participation is held carries on a business activity (this requirement shall not be met if assets are represented primarily by real property not used in the business activity). The last two conditions must have been continuously satisfied over the last three years, or over the company's lifetime, if shorter.

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Corporate Income Tax

Capital gains realized by non-resident companies on the sale of participations, are ordinarily taxed at a 26% flat rate. In some cases, capital gains from participations may be exempt, according to specific rules or a relevant tax treaty.

Corporate Income Tax

Under rules that are generally effective as of January 1st 2023, capital gains realized by a non-resident from the sale of a participation in a non-resident company are subject to taxation in Italy if, at any time during the 365 days preceding the transfer, more than 50% of the non-resident company's value is derived (directly or indirectly) from certain real estate property located in Italy.

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Corporate Income Tax

LOSSES

Losses may be carried forward and offset against corporate taxable income. However, 20% of taxable income in any year cannot be offset by carried-forward losses and will be subject to corporate income tax in accordance with the "minimum tax" rule.

Corporate Income Tax

Losses incurred by a company during its first three taxable periods may be carried forward and used to fully offset corporate taxable income, but only if the losses relate to a new business activity (e.g., the losses may not have been incurred during a merger or business contribution). The carryback of losses is not permitted.

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Corporate Income Tax

FOREIGN TAX RELIEF

A tax credit is allowed against Italian net tax for final foreign taxes paid on foreign-source earnings in the year in which the taxes were paid. The amount of the foreign tax credit may not exceeed the amount of due Italian tax.

Corporate Income Tax

PARTICIPATION EXEMPTION

Domestic and foreign-source dividends paid by subsidiaries to Italian resident corporate taxpayers, are generally 95% exempt from corporate income tax. There is no holding period or minimum ownership percentage to qualify for the exemption.

Corporate Income Tax

However, the 95% exemption does not apply (i.e. the income may be 100% taxable) if the foreign subsidiary is an LTJ entity and, in some cases, where the dividends are distributed by an LTJ entity through an interposed foreign non-LTJ entity, unless it can be evidenced that an adequate level of taxation was borne by the foreign entity.

Corporate Income Tax

Budget law for 2023 introduced an optional regime that allows Italian resident companies and individual entrepreneurs to pay an advance substitute tax on the retained earnings of a foreign subsidiary that is an LTJ entity and exclude the dividends paid from these retained earnings from the resident's taxable income upon distribution.

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Corporate Income Tax

The substitute tax is applied to the retained earnings not yet distributed as of January 1st 2023, resulting from the financial statements for the FY (Financial Year) preceding the FY running as of January 1st 2022. The substitute tax is equal to 9% for taxpayers subject to corporate income tax, and 30% for taxpayers subject to individual income tax.

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Corporate Income Tax

CONSOLIDATED RETURNS

Tax consolidation is available to domestic groups, i.e. an Italian parent company and its resident subsidiaries that are under its direct and indirect control. The control requirement is met where the parent company holds more than 50% of the share capital of another company and is entitled to more than 50% of the profits of that company.

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Corporate Income Tax

Under domestic consolidation, a single taxable income is calculated for all consolidated companies. Once an election for consolidation is made, it may not be revoked for three years, unless the subsidiary company ceases to be controlled by the parent company. Domestic tax consolidation is not available to companies benefiting from a reduction in the corporate income tax rate.

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Corporate Income Tax

If certain requirements are met a worldwide tax consolidation regime is available, under which all foreign controlled companies must be included in the tax group (i.e. the “all in all out” principle). Said requirements are:

Corporate Income Tax

- residence in Italy of the parent company;
- identity of the tax period;
- Financial Statements' auditing, either for the parent company and for the subsidiary companies;
- mandatory consolidation of all foreign subsidiary companies.

Tax consolidation is not available for IRAP purposes.

Corporate Income Tax

FILING AND PAYMENT

A company must file the annual corporate income tax returns (IRES and IRAP) electronically, within 11 months following the end of the financial year, unless extraordinary transactions (e.g., mergers or demergers) have been carried out during the year (companies that have carried out extraordinary transactions must file by the end of the ninth month following the date of the juridical effect of the extraordinary transaction).

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Corporate Income Tax

Companies with a calendar year end, have enough time till the end of November 2023 to file the tax return related to FY (Financial Year) 2022.

Two advance payments of corporate income tax must be made: the first instalment is generally 40% of the amount of corporate income tax paid in the previous year, the second is 60% of the previous year's tax.

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Corporate Income Tax

For companies subject to “tax reliability synthetic indicators”, the two advance payments are 50% each of the previous year’s tax. A company must perform such advance payments by the end of the sixth month and by the end of the 11th month of the financial year.

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Regional Tax on Productive Activities (IRAP)

The regional tax on productive activities (IRAP), is levied on the net production value derived in each Italian region by resident companies. IRAP is calculated on the “net added value” of production, as defined by the relevant tax rules (but basically derived from the statutory accounts).

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Regional Tax on Productive Activities (IRAP)

The ordinary IRAP rate applicable for manufacturing or trading companies is 3.9%. For banks and other financial institutions or financial companies (including holding companies), the ordinary IRAP rate is 4.65%, and for insurance companies the rate is 5.9%.

If the taxpayer has net interest expense, 10% of the annual IRAP paid is deductible from the IRES taxable base. IRAP paid in connection with non-deductible employment expenses is also deductible from the IRES taxable base.

Individual Income Tax (IRPEF)

RESIDENCE

For income tax purposes, individuals are deemed to be resident if they are registered at the civil registry or are domiciled in Italy for more than 183 days in a year (or 184 in a leap year).

BASIS

Residents are taxed on worldwide income; non-residents are only taxed on Italian-source income.

Individual Income Tax (IRPEF)

TAXABLE INCOME

Individual income tax is imposed on income from employment, income from self-employment, income from capital, business income, income from immovable property, and other miscellaneous income.

Individual Income Tax (IRPEF)

A special regime is applicable for inbound employees under certain circumstances; if all relevant requirements are met, 70% of their Italian-source income from employment is tax exempt for five years (increased to 90% if the inbound employee establishes residence in certain Italian regions).

Individual Income Tax (IRPEF)

Under certain conditions, it is possible to extend the regime for an additional five-year period, during which 50% of the Italian-source income from employment of the inbound employee, is tax exempt (increased to 90% if the employee has at least three minor/dependent children).

Individual Income Tax (IRPEF)

TAXATION RATES

The individual income tax is progressive, it ranges as of 23% (income not exceeding € 15,000) up to a top rate of 43% for income exceeding € 50,000. Additional regional tax applies at rates ranging as of 0.7% up to 3.33%, depending on the region in which the individual is domiciled. An additional municipal tax ranging as of 0% up to 0.8% may also apply; it depends on the taxpayer's municipality.

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Individual Income Tax (IRPEF)

Under certain circumstances private employees may apply a flat tax of 5% only for the FY (Financial Year) 2023 (ordinarily, the flat tax is 10%) on bonuses earned up to € 3,000.

Under certain circumstances, as from FY 2023, self-employed individuals may apply a 15% flat tax on up to € 85,000 of business and professional gross income realized in the previous fiscal year, without being subject to additional regional and municipal tax. A reduced flat tax of 5% applies for new activities if all relevant requirements are met.

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Individual Income Tax (IRPEF)

CAPITAL GAINS

Capital gains derived by an individual on disposal of Italian immovable property, are normally taxed as miscellaneous income (which ordinarily is subject to progressive taxation, although there is an option to apply 26% flat rate if a request is made to the Notary Public at the time of the transfer);

Individual Income Tax (IRPEF)

However, such gains are exempt from tax if the individual held the property for more than five years.

Gains derived from the sale of a principal residence are not subject to tax.

Individual Income Tax (IRPEF)

DEDUCTIONS AND ALLOWANCES

Deductions for employees, certain expenses relating to employment income, social security contributions, and other specific expenses (e.g. family charges, medical expenses, etc.) are available for calculation of taxable income.

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Individual Income Tax (IRPEF)

FOREIGN TAX RELIEF

A tax credit is allowed against Italian net tax for final foreign taxes paid on foreign-source earnings in the year in which taxes were paid. The amount of the foreign tax credit may not exceed the amount of Italian tax due.

Individual Income Tax (IRPEF)

FILING AND PAYMENT

All resident and non-resident taxpayers who derive income subject to individual income tax must file an annual tax return, except for individuals deriving only exempt income or income subject to a final withholding tax and other specific categories of income.

Individual Income Tax (IRPEF)

The 730 form tax return (Modello 730) – which is a simplified tax return for qualifying individuals receiving only certain types of income – must be filed by September 30th of the calendar year following the relevant FY, while form concerning tax return for individuals (Modello Redditi Persone Fisiche) must be filed by November 30th of the year following the relevant FY. Deadlines not falling on business days are postponed to the next business day.

Digital Service Tax (DST)

A 3% tax on gross revenue (net of VAT or indirect taxes) from certain digital services applies to taxpayers that, at a group level, have annual global turnover of more than €750mn in the previous calendar year and annual revenue from digital services rendered in Italy of more than €5.5mn in the previous calendar year, regardless of whether the taxpayer is resident in Italy.

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Digital Service Tax (DST)

The definition of digital services includes the following activities:

- the placement of advertising on a digital interface targeted at the users of the interface;
- making available a multi-sided digital interface that allows users to be in contact and iteract, including interaction to facilitate the direct supply of goods and services between users; and
- the transmission of data collected from users and generated by the use of digital interface.

Digital Service Tax (DST)

Digital Service Tax applies if the user of the digital services is located in Italy; however, intercompany transactions are outside the scope of the tax.

Digital Service Tax due for a year must generally be paid by February 16th of the subsequent calendar year, and the relevant tax return must be filed by March 31st of the same year; in case of companies belonging to a group, a single company may be appointed to carry out the compliance activities.

Value Added Tax (VAT)

VAT is levied on supply of goods and services, and on imports.

Where deductible input VAT is charged on purchases of goods and/or services, the deduction must be taken in the VAT return for the year in which the related right arises or, at the latest, in the VAT return for the year in which the relevant invoice is received.

Value Added Tax (VAT)

TAXATION RATES

The standard rate is 22%, with reduced rates of 4%, 5%, and 10%. VAT exemptions apply to financial services, medical services, gaming and gambling, export sales, and the contribution of assets to a company (e.g. purchases of capital goods).

Value Added Tax (VAT)

REGISTRATION

A taxpayer carrying out taxable supplies in Italy is required to register for VAT purposes. Electronic invoicing (e-invoicing) is mandatory in relation to transactions carried out by VAT taxable persons established in Italy that make supplies to VAT taxable persons (B2B) established in Italy and private consumers (B2C) resident in Italy.

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Value Added Tax (VAT)

FILING AND PAYMENT

Taxpayers are required to submit an annual VAT return electronically, by the end of April of the following calendar year.

Taxpayers are also required to submit quarterly reports on their VAT calculations by the end of the second month following the relevant quarter.

Value Added Tax (VAT)

As from July 1st 2022, for certain individuals, it is mandatory to transmit data through the interchange system (SDI) – by using the same format as for e-invoicing – on transactions carried out with non-resident counterparts.

Retailers must electronically store and transmit – on a monthly basis – data on their daily B2C transactions that are not required to be documented by e-invoices (e.g., sales of products in shops).

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Real Property Tax

Municipal authorities impose tax on possession of immovable property at various rates, depending on the municipality.

Property owners, whether they are resident in Italy or not, are liable for a property tax on buildings and land owned in Italy for their own use or as investment, which is imposed by municipal authorities.

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Real Property Tax

The tax comprises two different elements: IMU (wealth tax) and TARI (tax on garbage). The basic rate of IMU is 0.86% of the taxable value of the property, but the competent municipality can increase the rate up to 1.06% or reduce it to as low as 0.76%. IMU normally does not apply to an individual's main residence, with some exceptions; TARI rates also vary depending on the municipality.

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