

The "transparent" flow-through regime and the domestic consolidation system

From 1 January 2004 a "transparent" flow-through regime and the domestic consolidation system have been introduced in the Italian tax system.

THE "TRANSPARENT" FLOW-THROUGH REGIME

If all the shareholders of an Italian-resident company are corporations, each with a holding interest of at least 10%, but not more than 50%, the company can opt for the "transparent" flow-through tax system. This option is also available to companies with non-resident shareholders provided that the latter are not subject to withholding tax in Italy on dividend distributions (e.g. in case of distribution of EU dividends under the provisions of the parent-subsidiary directive).

Under this rule, the taxable income of companies whose shareholders have voting rights and profit entitlements of at least 10% but not more than 50% is imputed proportionally to each shareholder on an accrual basis, regardless of distribution. This option is not available for companies that opt for the domestic consolidation regime. The option remains in force and is irrevocable for three tax periods of the company in which the participations are held and must be exercised by all the companies involved.

Any losses incurred by the participated company for tax periods prior to 2004 are offset against the income produced during the term of validity of the flow-through option on the basis of the ordinary tax rules regarding losses carried forward. With specific reference to losses incurred by the participated company while subject to the flow-through regime, such losses are imputed to the shareholders in proportion to their relative shareholdings and within the limits of the accounting net equity of the participated company before covering the loss.

The transparency regime does not apply for Irap (Regional tax on business activities) purposes.

GROUP CONSOLIDATION: DOMESTIC CONSOLIDATION

The option for domestic consolidation of controlling/controlled companies is available to resident corporations. A non-resident company may only exercise the option as a controlling company and provided that (i) it is resident in a country that has signed a tax treaty with Italy (ii) it carries on business activities in Italy through a permanent establishment to which the participation in the controlled company is effectively connected.

The control requirement must be met from the beginning of each tax period for which the controlling company or entity and the controlled company elects to exercise the option. Under the domestic tax consolidation system a single taxable income is determined for all the companies in the consolidated tax group. This is achieved by adding up the companies' taxable incomes after making the appropriate and specific adjustments.

This means that income/losses of the controlled companies are attributed 100% to the controlling company, even if the investment is less than 100%. The controlling company must therefore effect the single tax payment, use the single refundable excess or excess to be carried forward and carry forward any consolidated loss. Any consideration received or attributed in exchange for tax benefits is tax-exempt.

The domestic tax consolidation option can be exercised at the discretion of the companies concerned for a period of three years, during which time the option is irrevocable, unless a company leaves the group because the control requirement is no longer satisfied. The option must be exercised jointly by each controlled company and the controlling company or entity. Group consolidation rules do not apply for Irap (Regional tax on business activities) purposes.



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