Law delegating the Italian government to reform the tax system

Tax & Legal Alert
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Office

Milan
Via Vittor Pisani 31, 20124
T: +39 02 676441

Ancona
Via I° Maggio 150/a, 60131
T: +39 071 2916378

Bologna
Via Innocenzo Malvasia 6, 40131
T: +39 051 4392711

Florence
Viale Niccolò Machiavelli 29, 50125
T: +39 055 261961

Genoa
P.zza della Vittoria 15/12, 16121
T: +39 010 5702225

Naples
Via F. Caracciolo 17, 80122
T: +39 081 662617

Padua
Piazza Salvemini 2, 35131
T: +39 049 8239611

Perugia
Via Campo di Marte 19, 06124
T: +39 075 5734518

Pescara
P.zza Duca D'Aosta 31, 65121
T: +39 085 4210479

Rome
Via Curtatone 3, 00185
T: +39 06 809631

Turin
C.so Vittorio Emanuele II 48, 10123
T: +39 011 883166

Verona
Via Leone Pancaldo 68, 37138
T: +39 045 8114111

This Tax & Legal Alert summarises the main aims of Law no. 111 of 2023 (the “Law”), which came into force on 29 August 2023 and delegates the Italian government to introduce a fiscal reform.

In particular, the Law delegates the government to issue, within 24 months of its entry into force, one or more legislative decrees to overhaul the tax system, which is one of the priorities identified in the National Recovery Plan.

The Law is divided into three main sections: the first sets out the general principles of the fiscal reform, the second establishes the criteria for the reform of certain taxes, and the third focusses on procedures and sanctions.

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The general aims of the tax reform (articles 2-4)

The general aims that the fiscal reform must set out to achieve include:

— a **more efficient tax framework and a lower tax burden** (also in order to stimulate economic growth and a higher birth rate);

— the **prevention of and reduction in tax avoidance and evasion, also through greater use of technology** (AI and e-invoicing) and the establishment and enhancement of **reward-based forms of cooperation between taxpayers** and the tax administration (e.g. cooperative compliance);

— a reorganisation of the **tax reporting and payment system**;

— the alignment of Italian tax law with **EU principles and OECD recommendations** (in particular, implementation of the BEPS Project);

— the introduction of measures to ensure **greater international tax competitiveness**, also by providing investment incentives, while adhering to the principle of non-harmful tax competition;

— a **review of the Charter of Taxpayer Rights**, in order to: place a stronger obligation on tax authorities to explain the reasons for notices of assessment; reinforce the principle that **the law should offer certainty and reliability**; simplify the tax ruling system (e.g. by simplifying dialogue with business associations and professional practices about less complex questions, or by imposing a fee for tax ruling applications); **extend the 'right to be heard' principle** as a precondition for valid notices of assessment; strengthen the possibility for the authorities to apply **the self-correction and cancellation mechanism**.

The criteria for the reform of certain taxes (articles 5-13)

Section II of the Law is dedicated entirely to the principles and criteria guiding the reform of certain taxes.

Personal income tax (IRPEF): there will be an overhaul of the system and a gradual reduction in taxation, while the way in which taxpayers can deduct various types of spending from their tax bills (tax expenditures) will be rationalised. This rationalisation will take account of the purposes of such spending and, in particular, household composition and the costs of raising children, with a special focus on protecting homes, health, education and pension schemes, and on improving the energy efficiency and earthquake proofing of existing housing stock.

Corporate income tax (IRES): there will be an overhaul of the system, based on the introduction of a lower IRES rate, which will be applicable provided that, in the two financial years subsequent to that in which it is produced, 'income' is: (i) reinvested, also by recruiting new workers; (ii) set aside and not used for purposes outside the business. Other goals are to:

— simplify the systems by which tax bases are realigned with book values (especially in the case of extraordinary transactions and first-time adoption of accounting principles);

— rationalise the system by which tax is calculated from accounting data;

— review the deductibility of interest expenses in line with the ATAD provisions;

— overhaul the regime governing the offsetting of tax losses and the circulation of tax losses of companies participating in extraordinary transactions or tax groups, also through the introduction of a definition of "final losses" based on CJEU decisions;

— eliminate distortions deriving from the application of the rules on business contributions and those on share exchanges made through contributions;

— review the tiebreaker rules for residential status, to align them with international best practices and with double tax treaties concluded by Italy, and to coordinate them with the permanent establishment concept and the tax-break rules for workers who move to Italy;

— implement the Pillar Two provisions (EU Directive 2022/2523), by identifying an Italian minimum tax and by introducing an effective penalty regime to avoid violation of these rules;

— simplify taxation of third-sector entities;

— rationalise the Italian tax status of foreign entities.

There will also be an overhaul/rationalisation of the:

— rules governing inactive companies;

— identification and tax treatment of foreign entities that are tax-disregarded by their countries of residence, to avoid "hybrid entities";

— criteria for determining business income;

— tax incentives for businesses and the mechanisms for calculating and claiming them;

— territorial tax aid, in compliance with the EU rules on State aid;

— taxation of enterprises that access mechanisms governed by the Business Crisis and Insolvency Code.

IRAP: there will be an organic overhaul of this tax, designed to gradually phase it out and simultaneously introduce a surtax.

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VAT: all the criteria (who and what the rules apply to, where they apply, etc.) will be reviewed in order to bring them closer into line with EU law and the principles set out by the CJEU. The exemption rules will be rewritten (with particular reference to cases where the taxpayer can opt for the application of VAT rather than applying the exemption regime) and the number of VAT rates will be reduced (in line with EU law). The rules on the recoverability of input VAT will be revised, with a view to aligning them more closely with the actual use of the goods and services purchased by the taxpayer, restricting the 'pro rata' rule (i.e. the rule on the recoverable percentage of input VAT) to goods and services used for more than one activity (special rules are being planned for the real estate sector). In addition, the timing for the recovery of input VAT will be revised in cases where the tax point of a transaction is in one FY while the invoice is received in the next FY. The VAT group rules will also be rationalised in order to simplify the procedures for accessing and applying this mechanism (also by eliminating the 'all in, all out' criterion), as will the rules for third-sector entities. Finally, taxpayers can expect to benefit from a reduction in VAT compliance obligations, due to the digitalisation of VAT procedures.

Indirect taxes other than VAT: there will be a simplification of registration tax, inheritance and gift tax, and stamp duty.

Customs legislation: the intention is to modernise the Italian rules in order to align them with developments in EU law. Among other things, this will involve enhancing the customs one-stop shop to simplify interaction between customs bodies and businesses, completely digitalising goods import and import processes, and streamlining the procedures by which duties are calculated, assessed and collected.

Excise duty and other indirect taxes on production and consumption: the Law envisages, inter alia, new rates for energy products (motor and other fuels) and electricity, and the promotion - within the limits imposed by EU rules on excise duty exemptions and reductions - of electricity, methane gas and natural gas generated from biomass or other renewable sources.

Regional and municipal taxes: these will be rationalised, while ensuring the level of income needed to guarantee fiscal federalism.

The criteria for the reform of tax procedures and sanctions (articles 16 – 20)

Section III of the Law is dedicated to the principles and criteria guiding the reform of tax procedures and sanctions.

Among other simplification measures, the Law proposes the **alignment of the deadlines for reporting and paying taxes, the introduction of reward-based mechanisms to encourage the use of pre-populated returns**, and the suspension of service of notices in August and December.

During tax assessments, there will be greater use of **digital technology** and, in particular, AI, in order to acquire more data and information and thus prevent errors by taxpayers, confine audits to taxpayers posing the highest risk, and reduce tax avoidance and evasion, maximising levels of voluntary compliance.

The cooperative compliance system will be reinforced by gradually reducing the entry threshold, **increasing the associated rewards** (especially with regard to administrative and criminal penalties), and introducing special endorsement mechanisms in the form of certificates issued by qualified professionals.

The increased rewards will involve (i) a further reduction in administrative penalties for all tax risks promptly disclosed (and, in some cases, even the exclusion of these penalties), (ii) the exclusion of criminal penalties for taxpayers who have cooperated and fully disclosed significant tax risks in advance, (iii) a reduction of at least two years in the statute of limitations for tax assessments.

Penalties will also be excluded or reduced in the case of voluntary implementation of an effective tax control framework and prior disclosure of possible tax risks by entities that do not qualify for the cooperative compliance regime.

For smaller firms, **a two-year advance tax agreement** will be introduced: primarily, any additional income earned by the taxpayer over and above the level agreed with the Italian Revenue Agency (which will also use new digital technology) will be disregarded.

Application of the **'right to be heard' principle** will be a condition of validity for all tax assessments.

The fiscal reform intends to **boost the efficiency of the tax collection system,** also through annual planning of collection processes and **gradual elimination of the system of listed debts and tax bills**, and to speed up collection times and the start of precautionary and enforcement measures.

In tax litigation, **proceedings will become increasingly digitalised,** through simplified procedures, an obligation to use standard submission templates, the introduction of penalties for failure to use online facilities, and, upon request by one of the parties, remote hearings (the other party being entitled to attend in person).

The Law contemplates **wide-ranging changes to tax**, **administrative and criminal sanctions**, including those for infringements of customs and excise rules.

In particular, it requires the government to **avoid the duplication of sanctions, which is incompatible with the principle that no offence can be punished twice**, and to review **cases that**, because they have been settled through tax proceedings, are not punishable or are subject to lighter penalties.

Tax penalties are to be rendered proportional, reducing the burden and bringing them into line with the standards of other EU Member States. A further goal is the effective application of tax penalties.

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The criteria for the tax system overhaul and codification (article 21)

Section IV of the Law is dedicated to the principles and criteria guiding the overhaul and codification of the tax system.

The Law gives priority to a **systematic overhaul of the current tax rules**, to be undertaken within 12 months of its entry into force.

Financial and final provisions (article 22)

The final section of the Law sets out the financial principles guiding the reform, establishing that it must be accomplished according to the criteria of financial neutrality and unchanged tax revenues. The technical report accompanying the Law clarifies that the legislative decrees must not result in a higher tax burden for taxpayers.

Document prepared by Giorgio Dal Corso

Contacts

KPMG in Italy, Tax & Legal

Tax & Legal Professional Practice Team
E: it-fm-tpp@kpmg.it

kpmg.com/it

kpmg.com/it/socialmedia

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