



Carried interest schemes and transfer pricing: new rules enacted by the Italian Government

Highlights

- New rules introduced for qualifying carried interest schemes
 - minimum 1% investment
 - 5-year minimum holding period
- Transfer pricing rules reshaped
 - reference to the arm's length principle and international best practices
 - specific rules on corresponding adjustments

The Italian Government enacted Law Decree 24 April 2017, No. 50 which introduces several tax measures aimed at boosting economic development and stabilizing the State revenues. The Law Decree, which needs to be converted into law by Parliament within 60 days, contains - among others - specific provisions on the tax treatment applicable to carried interest schemes (previously unregulated) as well as on transfer pricing.

1. The new rules on "carried interest schemes"

The Law Decree provides that qualifying carried interest schemes are in any event apt to give rise to financial income currently subject to tax at the flat 26% rate (for non-substantial shareholdings). The characterisation as financial income applies to income deriving from the direct or indirect participation to companies or collective investment schemes received by employees or directors (the "**Beneficiaries**") of such companies or collective investment schemes (or of their related parties or managers) with respect to shares, or other similar financial instruments, that have enhanced economic rights (the "**Eligible Instruments**") subject to the following conditions:

1. the overall investment commitment of all Beneficiaries (the "Relevant Investment") must represent an actual investment of at least 1% of the overall investment made by the collective investment scheme or of the net equity of the issuer company; the Relevant Investment is calculated by taking into account also (a) any co-investment made by the Beneficiaries and (b) any amounts that are taxed as fringe benefit when the Eligible Instruments are granted (or, in case of non-resident Beneficiaries, any amounts that would have been so taxed had the Beneficiaries been subject to Italian taxation);
2. the enhanced economic rights must accrue only after all the shareholders or investors have obtained a return equal to the invested capital plus a minimum yield as provided in the bylaws or regulations or, in case of change of control, to the extent that the other investors have realized a sales price equal at least to the invested capital plus such minimum yield;
3. the Eligible Instruments must be held by the Beneficiaries (or by their heirs) for at least five years or, if earlier, until a change of control or a change of manager of the collective investment scheme;
4. the issuer of the Eligible Instruments must be resident for tax purposes (or incorporated, in the case of collective investment schemes) in Italy or in a State that allows an adequate exchange of information with Italy.

The new rules will apply to income deriving from the Eligible Instruments that is cashed as of the date of entry into force of the Law Decree.

2. Reshaping of domestic transfer pricing legislation

The Law Decree also introduces some important amendments to domestic transfer pricing rules.

A first amendment consists in the reshaping of the domestic fundamental rule which currently provides that the price for intercompany cross-border transactions is determined on the basis of the so-called "*normal value*" (*valore normale*).

This is a domestic law concept that is substantially similar to, but not entirely in line with, the OECD standards (arm's length principle).

In order to better align Italian legislation with international standards the new rule repeals the reference to the "*normal value*" concept and refers more generally to the "*conditions and prices that would have been agreed between independent parties acting on an arm's length basis and in comparable circumstances*".

The concept of "*normal value*" will however remain applicable for a number of other domestic provisions.

The Law Decree also grants the Ministry of Finance the authority to issue an implementing decree to set forth guidelines for the application of the new rules, taking into account international best practices. Even if the implementing decree has not been enacted yet, it may be expected that it will substantially reflect the most recent OECD Guidelines and override the previous main circular on transfer pricing which dates back to 1980.

Another important improvement concerns corresponding adjustments, which were previously allowed by domestic rules only following the conclusion of a mutual agreement procedure (MAP). The Law Decree introduces a new rule,

aimed at simplifying the procedure (Article 31-*quater* Presidential Decree No. 600/1973), that broadens the conditions under which corresponding adjustments can be made. Apart from the case of conclusion of a MAP, the new Article 31-*quater* contemplates two further cases where a corresponding adjustment is allowed:

- as a result of transfer pricing adjustments deriving from activities of international cooperation whose results have been shared between the participant States;
- upon formal application by the taxpayer to the Italian Revenue Agency following a final transfer pricing adjustment done in compliance with the arm's length principle in a foreign State (if such State has stipulated a treaty with Italy that provides for an adequate exchange of information). Revenue Agency will issue regulations setting the procedure for the filing of such application.

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