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Italian Patent Box regime:

a competitive advantage

Global Tax Services

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Italian Patent Box regime

Brief legislative background

The 2015 Finance Act, effective January 1, 2015, introduces a Patent Box regime, to partially exempt the income derived from qualifying intangible assets. Such regime is based on the "Nexus Approach" set forth by the OECD (i).

Overview of the Italian Patent Box regime

- The *Patent Box* regime allows taxpayers to partially exempt income derived from qualifying intangible assets from corporate income tax (IRES), generally levied at 27.5%, and local tax (IRAP), generally levied at 3.9%.

- The general exemption is 50%, but it is limited to 30% for 2015 and 40% for 2016.

- Qualifying intangibile assets include software protected by copyright, patents, know-how such as processes, formulas, industrial, commercial, or scientific information, trademarks, designs and models that are potentially capable of legal protection.

- The Italian *Patent Box* regime is available to both Italian and foreign taxpayers performing research and development activities aimed at the maintenance and development of intellectual properties.

    - *Foreign taxpayers can access the regime only if they have business income through a Permanent Establishment in Italy and are resident in a State which has both a double tax agreement with Italy and undertakes an effective exchange of information.*

- The income types covered by the exemption include:

    - *third party or intercompany royalties received in respect of the qualifying intellectual property;*

    - *an appropriate element of profit deriving from business activities where the intellectual property is used in producing goods or services for sale; and*

    - *gains arising on the transfer of ownership of relevant intellectual property, exemption of 100% available where 90% or more of the proceeds are re-invested in similar assets.*

Government intention to make the Italian tax system more competitive and friendlier to technological developments and local ownership of intangibles.

OECD's BEPS initiative on harmful tax practices is already considered.

The election for the Patent Box regime:
- *Is optional;*
- *lasts for five fiscal years;*
- *cannot be revoked once made can be renewed;*
- *can be used in conjunction with other special tax regimes or tax breaks.*

L'esclusione è limitata al 30% per il periodo di imposta 2015 e al 40% per l'esercizio 2016.

The full regime should be in place by 2017.

(i) Chapter 4 of its Base Erosion and Profit Shifting (BEPS) Project paper "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance: Action 5 2014 Deliverable".

Qualifying expenditure formula

- The income that can benefit of the reduced taxation is in proportion of a specific ratio. The ratio is equal to qualifying expenditure over total expenditure incurred to develop the assets as detailed below:

Qualifying expenditure is defined as R&D expenditure related to the asset and incurred by the taxpayer, by universities or commissioned from third parties.

A R&D expenditure incurred directly by the taxpayer (or through universities or third parties) related to the assets, borne for maintaining, increasing and developping the intangible

\+

Expenditure incurred by the taxpayer through group companies for the acquisition of the intangible or for R&D

New

(amount eligible up to 30% of A)

:

B Total expenditure, incurred for producing the intangible

= %

- The acquisition of intellectual properties and/or R&D activities performed by group companies can be included in the qualified R&D costs if not exceeding the 30% of the total qualified costs.
- The calculation of the ratio must be made separately for each IP item and is based on the relevant costs incurred in all fiscal years since the inception of the *Patent Box* regime in 2015.
- For Fys 2015-2016-2017 the ratio calculation does not requires distinction between individual items of IP and is calculated as the sum of the costs incurred in the year for which the claim is made and the three preceding fiscal years.
- If two or more items of IP are connected in that they are used together in a specific process or product, they can be considered together for the purposes of the *Patent Box* regime.

Expenditure by group companies can also be included in the qualified R&D costs but **in an amount not exceeding 30% of the total qualified costs** if related to the development and maintenance of the asset.

The ratio must be calculated separately for each IP.

IP used in connection with a specific process or product can be considered together for the regime.

APA procedure

- The procedure is mandatory and needs to be validated by tax authority under an *APA* procedure when it is necessary to calculate the appropriate element of profit deriving from business activities where the intellectual propriety is used.

- For royalties received from group entities *APA* is optional and can be requested if taxpayer wants to reach more certainty on the income exempt;

- Where an *APA* procedure is required the benefit has effect from the financial year in which the *APA* application is filed. The tax return cannot reflect the benefit until the *APA* has actually been signed. The taxpayer may amend the existing tax return and may claim reimbursement of the credit where necessary.

- The Decree requires further instructions to be issued to simplify the basis on which to define the portion of profit included in the price of goods sold attributable to IP in relation to small and medium sized entities

The APA process is not required if the income derives from royalties received.

Until the *APA* is signed no benefit can be claimed.

Taxpayer can amend previous tax return once *APA* process is finalized

Further instructions have to be issued to simplify the *APA* procedure for small and medium sized entities

A ***tracking system*** must be implemented to monitor the R&D expenses and the income subject to the regime

Tracking system

The Decree requires taxpayers to track both costs (R&D costs and total costs) and the relevant income for all IP items to which the regime applies.
This *tracking* must use systems which allow the Italian tax authority to audit the numbers.

The election of Patent Box

The election for the regime from FY 2017 can be made in the tax return. For FY 2015 and 2016 the communication has to be determined by the tax authority with a specific format and will be valid for the fiscal year when is noticed and the following four.

Overview of the implementation process

Possible project phases

Key Activities

Feasibility analysis

- Evaluation of the general tax benefit of the regime i.e. identification of the qualifying intangible assets and estimate of their profit potential;
- evaluation of the potential business combinations aiming at streamlining the structure in the light of the Patent Box Regime;
- evaluation of the opportunity to start an APA with Italian Tax Authorities;
- Analysis of R&D processes, cost accounting rules and supporting (IT) systems in order to identify the requirements needed to implement the *tracking&tracing* tool

Implementation *(without APA procedure)*

- Detailed analysis of the Patent Box exemption;
- management of all the aspects/issues related to the implementation of the Patent Box exemption following the feasibility analysis phase;
- detailed design and implementation of actions in IT, organization and processes fields to guarantee costs and revenues traceability.

Implementation *(with APA procedure)*

- Detailed analysis of the Patent Box exemption and management of all the aspects/issues related to its implementation;
- assistance during the APA procedure with Italian Tax authorities;
- detailed design and implementation of actions in IT, organization and processes fields to guarantee costs and revenues traceability.

Monitoring of the implementation

- Periodical monitoring and calculation of the tax benefit;
- update of the comparability analysis supporting the royalties applied (e.g. CUT analyses if needed);
- annual calculation of the percentage for the exemption taking into account the R&D costs incurred during the year;
- change management and check of complete implementation of new *tracking&tracing* tool.

Why PwC

Umbrella Assistance

Tax expertise

- *Transfer Pricing study and detailed calculations for the implementation of the Patent Box regime;*
- *advice on the potential business combination;*
- *complete assistance during the APA procedure and preparation of technical documentation.*

Audit expertise

- *Reconciliation of qualified costs;*
- *periodical monitoring of the implementation of the exemption regime.*

Advisory expertise

- *IP valuation (Corporate Finance);*
- *IT systems to create tracking of R&D expenses and results.*

Your contacts

Ugo Cannavale
Associate Partner
+39 02 91605503
ugo.cannavale@it.pwc.com

Alessandro Caridi
Partner
+39 02 91605003
alessandro.caridi@it.pwc.com

Carlo Romano
Associate Partner
+39 06 57127220
carlo.romano@it.pwc.com

Roberto Spotti
Partner
+39 0332 285039
roberto.spotti@it.pwc.com

Paolo Francesco Tripoli
Director
+39 02 91605517
paolo.francesco.tripoli@it.pwc.com

Claudio Valz
Partner
+39 02 91605831
claudio.valz@it.pwc.com

Torino
Alessio Rolando
Partner
+39 011 5922740
alessio.rolando@it.pwc.com

Bologna
Alessandra Cavina
Executive Director
+39 051 6167724
alessandra.cavina@it.pwc.com

Firenze
Simone Guidi
Director
+39 055 2482922
simone.guidi@it.pwc.com

Roma
Felice De Lillo
Partner
+39 06 57178530
felice.de.lillo@it.pwc.com

Selena Santiloni
Senior Manager
+39 06 57127246
selena.santiloni@it.pwc.com

Napoli
Egidio Filetto
Partner
+39 081 7161411
egidio.filetto@it.pwc.com

Verona
Giovanni Marano
Partner
+39 045 8051452
giovanni.marano@it.pwc.com

Or your usual PwC contact

www.pwc-tls.it