Italy's patent box regime should escape criticism because of alignment with OECD nexus approach

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By Sophie Harding, Piergiorgio Valente and Davide Bergami

Italy has introduced a patent box regime based on the OECD's nexus approach, which will grant exemptions for profits derived from certain intangible assets for corporate and regional tax purposes. Italy's alignment with the OECD should keep the usual patent box-related criticism at bay.

The patent box regime was enacted with the passing of the 2015 Finance Act and came into force on January 1 2015. The regime allows taxpayers to exclude a percentage of the income generated from relevant intellectual property (IP) from its tax base.

Exemptions:

- Third party or intercompany royalties sourced from the relevant IP;
- Gains arising from the transfer of ownership of relevant IP; and
- An appropriate element of profit generated from business activities where IP is used in producing goods or services for sale.

In 2015, 50% of relevant income could be excluded, however, and in 2016, exemptions will be restricted to 30% and 40% respectively.

The regime is available to both Italian and foreign taxpayers as long as certain conditions are met.

Foreign taxpayers must:

- Have residence in both states; and
- Both states must have a double tax agreement with Italy and carry out an effective exchange of information.

"*Intangible resources play a key role that has become increasingly significant for both management processes and the strategic positioning of enterprises. As a matter of fact, intangibles are regarded as being fundamental for businesses as they are employed within the diffusion and value-creation process,*" said Piergiorgio Valente, managing partner at Valente Associati GEB Partners.

Investment Compact Law Decree

The government has also proposed the Investment Compact Law Decree, in conjunction with the regime, which extends benefits to trademarks, eliminating the requirement that trademarks be "*financially equivalent to patents*".

This will reduce the cases where an advance pricing agreement (APA) is necessary. APAs are still obligatory where exclusions are requested for a portion of the income from the sale of goods incorporating research and development (R&D). Previously, APAs were mandatory in all cases.

Additional improvements:

- R&D activities contracted out to third parties now fully qualify;
- R&D activities outsourced to related parties may also be eligible up to a maximum limit;

- IP acquisition costs are not included in the qualified expenditures up to a maximum limit; and
- A ruling procedure is no longer compulsory to determine income attributable to an IP for intercompany transactions.

The Investment Compact will be converted into law within 60 days of its publication in the Official Gazette which took place on January 24 2015.

"The hope is to find a new leverage to couple operations with legitimate tax optimisation," said Davide Bergami, tax partner at EY.

Italian tax climate

The patent box regime highlights the Italian government's desire to create an investor friendly tax environment, specifically with regards to technology and the local ownership of intangibles. The investment compact goes one step further, providing additional policies to make the regime more attractive and user friendly.

"*We understand that the government's choice [to implement the regime] is aimed at facing profit shifting schemes, countering IP transfers abroad and protecting its tax base. This is probably part of a reconciliation path whereby the Italian government is now available to introduce measures to support the repatriation of IPs created and developed by Italian businesses as well as to attack foreign and domestic investments on R&D activities and IP exploitation,*" said Bergami.

By applying the OECD's nexus approach, the Italian government has also demonstrated its willingness to cooperate with the OECD and its desire to avoid conflicts over its tax incentive policies.

Countries such as the UK and the Netherlands have received criticism over their patent box regimes which allow for an effective tax rate of 10% and 5% respectively.

Bob Stack, deputy assistant secretary (international tax affairs), US Department of Treasury, said countries with patent box regimes imply "we tax our corporates at one rate but if you bring IP into the country we're going to give it a special deal".

The nexus approach enables a taxpayer to benefit from an IP regime if the taxpayer can prove that its employees incurred expenditures which gave rise to income, such as R&D.

Following the OECD's recommended approach should mean that Italy is safeguarded from the criticism received by the UK and the Netherlands.

Impact on taxpayers

"*The introduction of the patent box regime, further to supporting R&D activities, also intends to create incentives for the placement in Italy of intangibles held abroad and/or to encourage that intangibles be kept in Italy, thus avoiding repositioning abroad,*" said Valente.

While the regime is attractive, taxpayers will have to await final approval of the Investment Compact to understand exactly how the provisions will apply.

Although the Investment Compact removes the limitation that trademarks must be financially equivalent to patents, the extent to which taxpayers will benefit is unclear in situations where trademarks rely heavily on activities other than R&D.