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In this article, the author examines an Italian Revenue Agency ruling that treats a holding company transferring abroad as a single going concern for exit tax purposes and thus finds it cannot benefit from the participation exemption. He concludes that the ruling is contrary to both Italian and EU law.

On May 25 the Italian Revenue Agency (Agenzia delle Entrate) released an official position statement regarding the application of the exit tax regime to a holding company that is transferring its tax residence abroad.[1] The ruling responds to a question about whether a holding company can — assuming that the relevant requirements are met — enjoy the participation exemption regime for the exit tax calculation.

The Italian Revenue Agency held that the governing law refers to the tax base resulting from one calculation because the transfer involves one going concern rather than single assets. It should therefore not be possible to adopt "an atomistic enhancement of the elements of the company, even if prevalent."[2] On one hand, the position confirms that from an exit tax perspective, the transfer of a company's tax residence is subject to the same taxation that would apply to a sale of the company as a going concern. On the other hand, the decision does not expressly state that all holding companies must be treated as going concerns for exit tax purposes.

The Italian Revenue Agency's position cannot be upheld, and it is not good news for multinational groups. That said, it does not close all potential opportunities for enjoying the participation exemption, and there should still be room for pure holding companies to access the regime.

Italian Tax Law Framework

The Participation Exemption

The participation exemption in article 87 of the Italian income tax code (Testo Unico delle Imposte sui Redditi, or TUIR)[3] provides for a 95 percent exemption of the relevant capital gain. In a nutshell, for a shareholding to qualify for the participation exemption regime, the following conditions should be met:

(i) the seller maintained uninterrupted ownership starting the first day of the 12th month before the month when the sale occurs (considering the last acquired shares as first sold);

(ii) the investment was recorded as a fixed financial asset on the first balance sheet closed during the uninterrupted ownership period;

(iii) the participated company (that is, the subsidiary):

[1] Principle of Law (Principio di Diritto) No. 10/2021 of May 11, 2021 (in Italian).

[2] Unless otherwise noted, all translations are the work of the author.

[3] Presidential Decree No. 917 of Dec. 22, 1986.

- is a resident of a state or territory other than a tax haven; or
- has been issued a tax ruling stating that the participation does not result in profits being localized in a tax haven; and

(iv) the participated company is carrying on a commercial activity.

Requirement (iii) must be met at the time of disposal with no interruption since the first day of the fifth tax period before the one of disposal (that is, for five years) in case of a transaction with third parties and since the beginning of the ownership period for intragroup transactions. Requirement (iv) must be met continuously since the first day of the third tax period before the one of disposal (that is, for three years).

With no possibility of proving the contrary, the requirements for the exemption are not met if the participation is in a company the value of which is mainly represented by real estate assets unless the production or trading of those assets is the effective object of the activity carried out by the company or when the assets (equipment or buildings) are directly used in the company's business activity (including leased real estate assets). Conversely, listed companies are always considered to be carrying on a commercial activity.

Corporate Tax Residence and Transfer Abroad

Article 73(3) of the TUIR provides that a company or other entity (including trusts and other noncorporate entities) is resident in Italy for corporate income tax purposes if its legal seat, place of management, or the main object of its corporate activity is in the Italian territory for most of the tax period.

The legal seat criterion is a formal requirement, and it is established in the articles of association of the company.

The place of management (*sede dell'amministrazione*) is generally understood as the place where the management and control functions of the entity are located and managerial decisions concerning the entity are made. The place of management must be ascertained using a substance-over-form approach.

The main object of the business activity carried on by the company (*oggetto principale dell'attività*) is a factual criterion, and it includes the activities that the company performs. The criterion is met if the activity necessary for the realization of the company's aims is performed in Italy, regardless of whether decisions are made there.

The above criteria may be overridden by the provisions of a double tax treaty. In accordance with article 4(3) of treaties that follow the OECD model, when a company is treated as resident in both contracting states based on domestic law criteria, the actual tax residence should be determined by taking into account "its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors."

Because a company is deemed resident in Italy for corporate tax purposes if one of the tax residence links is met, an entity would lose its Italian tax residency only if — for most of the tax period — none of the residency criteria pointed to Italy.

Italian tax law does not contemplate a split residence during a tax period. Under articles 76 and 73 of the TUIR, the tax residence of a company is determined for each fiscal year, and a company is either deemed tax resident in Italy for the whole tax period or deemed nonresident for the entire period. Thus, if an entity transfers its tax residence out of Italy before July 1, it will not be deemed tax resident in Italy for the tax year ending December 31 because, for most of the tax period, none of the links pointed to Italy. If the entity changed its tax residence after July 1, it would be deemed tax resident in Italy for the entire tax period.[4]

From a corporate law perspective, the transfer of an Italian company's residence to a foreign jurisdiction does not trigger a deemed liquidation and the extinction of the transferred company per se as long as the company continues to exist under the laws of the state of destination and that state considers the migration to be an event of continuation.

Also, if the company continues to exist after the transfer of residence, its financial (and tax) period would not be deemed interrupted.

[4] *See* Italian Revenue Agency Resolution No. 9/E of Jan. 17, 2006.

Article 166 of the TUIR provides the applicable tax regime for the migration of Italian enterprises abroad. Under that provision, entities carrying out business activities that transfer their tax residence to another jurisdiction, thus resulting in a loss of Italian residence for income tax purposes, are subject to taxation.

Under article 166 of the TUIR, the transfer of an Italian enterprise's tax residence to a foreign country triggers taxation of the latent capital gains (and deductions for latent losses) on all assets and liabilities of the enterprise that do not remain effectively connected to a permanent establishment in Italy. This taxation occurs during the last tax period that the company is deemed resident in Italy for income tax purposes. Fair market value is determined by applying transfer pricing principles. Paragraph 4 of article 166 of the TUIR states that if the transfer involves a going concern or a branch of a going concern, then the goodwill value should be taken into account.

As an alternative to immediate taxation, article 166(9) of the TUIR provides that taxpayers transferring their tax residence to EU member states or European Economic Area countries with which an agreement on mutual assistance for the recovery of tax claims is in force may elect for a five-year deferral of the exit tax. This provision was introduced into the TUIR to ensure the freedom of establishment set forth in the Treaty on the Functioning of the European Union and the related case law of the Court of Justice of the European Union. In this respect, scholars have debated whether the freedom of establishment applies to pure static holding companies because those companies do not carry out business activities. Some believe that the freedom of establishment should apply to pure holding companies, but there are no official interpretations from the Italian tax administration on this point.

The Notion of Going Concern

The notion of going concern does not have a specific definition under tax law, but article 2555 of the Italian Civil Code states that a "going concern is the set of assets organized by the entrepreneur for carrying on the business." It is commonly understood as a combination of assets, agreements, and relationships that are jointly used by the entrepreneur in business activity. The organization that the entrepreneur gives to the assets and relationships suggests the creation of something different from the sum of the assets standing alone. It is the interplay of and the complementary relationships among the distinct elements of the going concern — and the entrepreneur's ability to make them work together — that result in the creation of a going concern, the value of which is usually greater than the sum of the values of the single assets of which it is composed. This increased value is commonly referred to as goodwill.

Understanding whether a transaction involves a going concern or single assets is not always a simple task. For example, the distinction can be difficult to make in the case of a transaction involving a set of agreements and intangibles with no premises or employees. Uncertainty regarding the qualification can lead to litigation.[5] When there is uncertainty regarding whether a set of assets qualifies as a going concern, it is possible — and can be useful — to request a preliminary ruling from the Italian Revenue Agency to obtain an official opinion on the qualification in advance.

The Agency on Calculating Exit Taxation

Article 166(3)(a) of the TUIR provides that the capital gain (or loss) is unitarily determined and is the difference between the FMV and the corresponding tax value of all the assets and liabilities transferred abroad that are not flowing into an Italian PE. Paragraph 4 expressly refers to the notion of a "going concern or a branch of a going concern" when determining the exit tax due.

The Italian Revenue Agency maintains that because it is not possible to separately determine the capital gain from specific assets, it is also impossible to enjoy the participation exemption regime on the relevant capital gains for shareholdings; that is, in the case of one capital gain, it is also impossible to apply the same taxation that would apply to commodity goods that would give rise to revenues if they were

[5] The main tax issue that arises in recharacterizing the sale of a going concern as a sale of single assets (or vice versa) involves the indirect taxation regime — the former is outside the scope of VAT and subject to proportional registration tax, while the latter is subject to VAT.

individually transferred. In other words, for the exit taxation calculation, the transferring company must be considered as one going concern — including any shareholdings — and the capital gain refers to all the assets jointly considered, not the single components.

The agency bases its position on article 86 of the TUIR, which addresses the sale of a going concern under pure domestic situations and states that the capital gains are unitarily determined. The authority argues that exit taxation should follow the same tax regime because the rules (articles 86 and 166 of the TUIR) have same wording.

This interpretation implies that neither the transfer of the tax residence of holdings that actually carry out the direction and coordination of the participations (an activity that should entail the existence of a going concern) nor the transfer of companies that carry out an independent activity in addition to holding the participation can enjoy the participation exemption regime when calculating the exit tax.

If this is the rationale behind the Italian Revenue Agency's position, then the participation exemption regime should, conversely, apply to the transfer of a single asset[6] or a pure static holding company because neither qualifies as a going concern. The exit taxation regime in article 166 of the TUIR applies to "entities carrying out business activities"; although pure static holding companies do not carry out business activities, articles 73 and 81 of the TUIR create a presumption that all Italian entities established as, *inter alia*, joint stock companies (*società per azioni*) or limited liability companies (*società a responsabilità limitata*) actually carry out business activities and produce business income and are therefore theoretically subject to the exit tax regime. However, a static holding company cannot, from a corporate or a tax perspective, be regarded as carrying out an actual business activity through a going concern — therefore, the agency's rationale no longer makes sense.

Also, as the Association of Italian Joint Stock Companies (Associazione fra le Società Italiane per Azioni, or Assonime) points out, the rule at stake provides that the exit tax calculation must follow the transfer pricing principles: Since the FMV of a static holding company corresponds to the shareholdings held, it would not be possible to determine a capital gain different from the value of the participations.[7]

Critical Analysis of the Agency's Position

The Italian Revenue Agency's position on the "one calculation" is mistaken and cannot be upheld for two main reasons:

(i) the assumption that the sale of a going concern cannot enjoy the participation exemption is questionable;[8] and

(ii) as interpreted by the agency, article 166 of the TUIR does not seem to comply with article 5 of the EU's anti-tax-avoidance directive (ATAD, 2016/1164) of which it is the implementing rule.[9]

To begin, it is paramount to emphasize that the participation exemption regime is not a tax relief. Rather, it is a rule with a specific and fundamental purpose common among all the tax systems that adopt it — that is, avoiding double taxation of a company's earnings when the earnings remain in the company and are not paid to the noncorporate shareholders**.** The relevant earnings include both those accrued, which have already been taxed in the hands of the participated entity, and those that the company is expected to realize in the future, which are taken into account in determining the company's FMV. Moreover, as Assonime points out, the Italian participation exemption regime provides that the capital losses are not deductible from the taxable income.[10] The Italian Revenue Agency's position could therefore imply an (equally undue) tax advantage for the taxpayer. Lastly, TUIR articles 86 (regarding the taxation of a going concern's capital gains) and 87 (regarding the participation

[6] Under article 166(1)(b), exit taxation applies to the attribution of assets to a PE for which the branch exemption regime is in force.

[7] Assonime, "Il coordinamento tra la nuova disciplina in materia di exit/entry tax e il regime di participation exemption," Circular Letter 16/2021 (May 25, 2021).

[8] *See id*.

[9] *See* Gianluigi Bizioli, "Partecipazioni delocalizzate con l'azienda: Pex da applicare" *Il Sole 24 ORE*, June 7, 2021.

[10] Assonime, *supra* note 7.

exemption regime) were drafted during the same corporate tax reform effort, and nothing in the parliamentary working papers suggests that the legislator intended to introduce any exceptions to the participation exemption regime beyond those expressly identified in article 87.

Disregarding the participation exemption regime based on the alleged need to determine "one taxation" when a participation is sold as part of a going concern does not seem either correct or well founded from a systematic perspective. If we assume that there are no reasons for determining "one capital gain" in the case of a sale of a going concern, it follows that the Italian Revenue Agency's position on the exit tax calculation fails too. Moreover, even assuming the correctness of the purported domestic tax regime for the sale of a going concern, the agency's position on exit taxation calculation would still be illegitimate.

Article 166 of the TUIR was introduced in 2018 to implement article 5 of the ATAD, which does not make any reference to a going concern or to the need to determine "one taxation," into Italian law.

Article 5, paragraph 1 of the ATAD states:

> A taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes, in any of the following circumstances:
>
> . . .
>
> (c) a taxpayer transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State.

Moreover, paragraph 6 of article 5 provides that:

> For the purposes of paragraphs 1 to 5, "market value" is the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction.

The ATAD does not make any reference to a going concern. Instead, it quite clearly indicates that the only elements to be evaluated and subject to taxation are the taxpayer's assets. This is also true for the calculation rule set forth in paragraph 6 of article 5, which the Italian legislator should have transposed in paragraph 4 of article 166 with no different or additional requirements.

The ATAD's wording — and its meaning — should have guided the Italian lawmakers as they implemented the directive. Despite the debatable wording of the Italian law, the Italian Revenue Agency should have taken the directive into account when analyzing the rule and rendering its opinion. It is a well-known, foundational element of Community law that national authorities and courts must interpret national law, to the largest possible extent, in accordance with EU law — that is, "in the light of the wording and the purpose of the directive."[11] Also, they must do whatever lies within their jurisdiction[12] to ensure the full effectiveness of EU law — a concept known as reconciliatory interpretation or the principle of directive-compliant interpretation.[13] EU case law clearly states that in order to achieve this result, national courts may be obliged to change their established case law, if it is based on an interpretation of national law that is incompatible with the objective of a directive.[14]

In conclusion, the agency's position cannot be upheld because it is grounded in a problematic interpretation of the domestic taxation regime regarding the sale of going concern. In any case, the ATAD does not support the claimed position: The ATAD requires considering the tax value of each of the assets that the transferring company held — and, based on well-established EU law, this principle should have guided the interpretation of the exit taxation rule.

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[11] This was explicitly stated for the first time in *Von Colson v. Land Nordrhein-Westfalen*, C-14/83 (CJEU 1984), at para. 26.

[12] *See* opinion of Advocate General Juliane Kokott in *Herst s.r.o. v. Czech Republic*, C-401/18 (CJEU 2019), at para. 68.

[13] *See Adeneler and Others*, C-212/04 (CJEU 2006), at paras. 109 and 110; *Pfeiffer and Others v. Deutsches Rotes Kreuz, Kreisverband Waldshut eV*, joined cases C-397/01 to C-403/01 (CJEU 2004), at paras. 113 and 114; *Mau v. Bundesanstalt für Arbeit*, C-160/01 (CJEU 2003), at para. 34; *Faccini Dori v. Recreb Srl*, C-91/92 (CJEU 1994), at para. 26; and *Marleasing SA v. La Comercial Internacional de Alimentacion SA*, C-106/89 (CJEU 1990), at para. 8.

[14] *See, e.g.*, *Egenberger v. Evangelisches Werk für Diakonie und Entwicklung eV*, C-414/16 (CJEU 2018), at para. 72; *Dansk Industri v. Estate of Rasmussen*, C-441/14 (CJEU 2016), at paras. 33 and 34; and *Centrosteel Srl v. Adipol GmbH*, C-456/98 (CJEU 2000), para. 17.

Given all the above, a change of the Italian Revenue Agency's official position is desirable. Regardless, the agency's position should not affect the transfer of static holding companies because, both from a corporate and from a tax perspective, they cannot be regarded as carrying out an actual business activity through a going concern. ■