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Circular
No. 32/2023

Bolzano, 31 August 2023

Subject: Favourable assignment or favourable sale of business assets not used for business purposes to the shareholders, or conversion into a simple partnership (società semplice)

By 30 September 2023, partnerships and corporations may assign real property and vehicles not used for business purposes to their shareholders on favourable terms, transfer such assets to them by way of a contract of sale, or, in certain circumstances, convert the company itself into a simple partnership (società semplice). The rules are contained in Art. 1, para. 101, of the Budget Law for 2023 (Law 197/2022). No official guidelines have been issued to date; since, however, this is essentially a re-enactment of an identical relief measure dating from 2016, reference may also be made to the guidelines issued at that time by the Italian Revenue Agency (Circular No. 26/E of 1 June 2016 and Circular No. 37/E/2016). In recent days, calls for the deadline to be extended to 30 November 2023 have been made in particular by the national chamber of auditors and tax advisors. To date, however, no official statements on this point are available. We therefore set out below the legal position as it stands today:

Scope of application as to persons

The relief applies to partnerships and corporations, but not to other commercial or non-commercial entities. The favourable assignment or the favourable sale may be made to those shareholders who were registered as such as at 30 September 2022.

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The only exception concerns heirs in the event of a death occurring after the aforementioned 30 September 2022. It is not necessary, on the other hand, for the size of the shareholding to have remained unchanged since 30 September 2022. The shareholders may be either natural persons or legal entities.

Under company law, the assignment of the assets (not the sale!) corresponds to a distribution of capital or of capital reserves, or of profits or of retained earnings, to the shareholders in the form of assets in kind. Accordingly, the assignment may also be accompanied by a reduction of the company's capital coupled with the withdrawal of a shareholder or, in extreme cases, even by the winding-up of the company.

Still not entirely clear is the assignment of real property in the case of shareholdings subject to a usufruct (with the usufructuary holding the voting right in the shareholders' meeting); at least according to the interpretation of the notaries of the Triveneto region, the assignment would have to be made to the bare owner, and the usufructuary would, where applicable, retain the right of usufruct encumbering the property. It is to be hoped that official clarifications on this question may still be forthcoming.

Scope of application as to assets

Assets that may be assigned are real property and assets entered in public registers (e.g. vehicles, aircraft and boats) which, at the time of the assignment, are not used for business purposes. In practice, the relief is in fact of interest only for real property. The assignment may relate to land, to residential units and also to commercial property, provided that these are let or lent for use or are otherwise not used for business purposes. The assignment of real property held as current assets (e.g. residential units held by property developers or property dealers) is also expressly permitted. Conversely, the favourable assignment of property used by the company for the pursuit of its activity is excluded.

An important statement in Circular No. 26/E/2016 concerns the point in time at which this substantive requirement of non-direct use must be met: it must exist at the time of the actual assignment (that is, possibly on 30.09.2023). A change in use, even shortly before the assignment, is expressly not regarded as abuse. This is evidently a lawful use of a tax advantage. It must be noted, however, that no sham transaction may be carried out in this context, since this would constitute tax evasion, which is no longer covered. The notaries additionally recommend (Study No. 20-2016/T) that the non-business use be specifically recorded in the deed of assignment.

Procedure for the transfer to the shareholders

The transfer of business assets not used for business purposes to the shareholders may be effected by means of 3 legal transactions:

- assignment of the assets to the shareholders with a simultaneous reduction of capital reserves and/or retained earnings;
- sale to the shareholders without any effect on the company's net assets;
- conversion of the partnership or corporation into a simple partnership (società semplice).

An assignment is only ever possible where it can be carried out proportionally in favour of all shareholders (where appropriate also with balancing payments to the other shareholders) and where the necessary capital reserves or retained earnings are also available.

Taxation of the capital gains at the level of the company and the release of reserves in suspension of tax at the level of the company

The tax relief consists in the application of a substitute tax on any capital gains and in a substitute tax on the taxation of reserves in suspension of tax which are, where applicable, „distributed“.

The substitute tax on the latent capital gains amounts to 8%, increased to 10.5% where the company was non-operating in 2 of the last 3 years. The gain, i.e. the taxable base for the substitute tax, is determined as the difference between the assignment value and the value recognised for tax purposes. In the case of buildings and non-building land, the assignment value may alternatively be determined on the basis of the cadastral value. This is the cadastral value determined in accordance with the rules governing registration tax by applying a prescribed multiplier or coefficient:

Property	**Coefficient**
Land	112,5
Cat. C/1 and E	42,84
Cat. A/10 and D	63
Cat. B	176,40
First home	115,5
All other buildings	126

For building land, on the other hand, the general market value must be used.

Incidentally, any capital losses arising from the favourable assignment are not recognised for tax purposes at the level of the company, subject however to one exception: where assets held as current assets are assigned at their cadastral value and a capital loss results therefrom, that loss may be offset or deducted.

Retained earnings in suspension of tax released as a result of the assignment (e.g. revaluation reserves that have not been released, or reserves arising from old aid measures) are settled by way of a substitute tax of 13%.

At this point it should be noted that Circular No. 37/2016 clarified that the favourable assignment or the favourable sale to the shareholder is not detrimental as regards the lock-up period applicable to favourable revaluations. On that interpretation, it should therefore be possible for real property which was revalued on favourable terms in connection with the Covid emergency measures (above all Art. 110 of Law Decree 104/2020) (substitute tax of 3%, or free of charge in the tourism sector) and which is in principle subject to a 3-year ban on sale (as a rule until 31.12.2023) to be assigned or sold to the shareholders already now, without the effects of the revaluation being forfeited as a result; in plain terms: the substitute tax of 8% is calculated only on the difference between the revalued market value and the assignment value. It would certainly be helpful if this point were confirmed once again by the tax authorities.

Taxation of the assignment at the level of the shareholder

In the case of corporations, the assignment also has effects at the level of the shareholder: where profits or retained earnings are assigned, these must be taxed as dividends and are then subject to the substitute tax of 26%; the shareholder receives a dividend in kind. Only that portion is to be taxed, however, which has not already been subjected at the level of the company to the aforementioned substitute tax of 8% or 10.5% as a capital gain.

In the case of partnerships, on the other hand, only the value of the shareholding recognised for tax purposes is reduced by the normal value of the assignment, and only where this results in a reduction „below zero“ may taxable income also arise for the shareholder.

Assignments of capital reserves lead to a reduction in the value of the shareholdings recognised for tax purposes.

<u>No assignments of profits are to be taxed at the level of the shareholder where the latter acquires the property not by way of assignment but by way of a contract of sale.</u>

Payment of the substitute tax

The substitute tax of 8% or 10.5% and also the substitute tax of 13% on the release of reserves in suspension of tax must be paid in two instalments, namely 60% by 30 September 2023 and 40% by 30 November 2023. Payment must be made by means of form F24, and offsetting against tax credits is permitted under the general provisions. The payment codes were confirmed by Resolution No. 30 of 22 June 2023 and are the same as in 2016:

1836 for the substitute tax of 8% or 10.5% on the capital gains arising in the course of an assignment, sale or conversion, and

1837 for the substitute tax of 13% on the release of reserves in suspension of tax which are disclosed in the course of an assignment or conversion.

Capital gains on a subsequent sale by the shareholder

Irrespective of whether the transfer to the shareholder takes place by way of sale or by way of assignment, future capital gains are taxed at the level of the shareholder within the meaning of Art. 67 of the Income Tax Code (TUIR). In the case of buildings and non-building land, a speculation period of 5 years from the assignment must therefore be observed before any subsequent sale; otherwise any capital gains are taxable at the level of the shareholder. Capital gains on building land are always taxable, irrespective of any speculation period.

In this context it may therefore well be worthwhile to carry out the assignment or the sale at a value higher than the cadastral value, since the substitute tax of 8% will as a rule be lower than the tax on any future capital gains. The substitute tax may therefore quite properly also be regarded as a revaluation tax in the broader sense.

Value added tax, registration tax and mortgage and cadastral tax

As was already the case with the last favourable assignment in 2016, there are no specific reliefs for value added tax purposes, not least because any such reliefs would be contrary to the EU directives in force. The assignment is in principle equivalent to a self-supply, and accordingly the normal value must be subjected to VAT.

Incidentally, there is no self-supply and no supply for VAT purposes in all those cases where no input VAT was deducted upon acquisition (e.g. purchase from private individuals, purchase before 1 January 1973 or purchase of residential units without deduction of input VAT).

In the case of buildings, attention will have to be paid to whether completion took place more than 5 years ago; if this is the case, VAT applies to residential units (for construction undertakings) and to commercial property (for all undertakings) only where the deed expressly opts for its application. Although at first sight the application of VAT is hardly advantageous, particularly in the case of assignments to private individuals, the effects of a VAT-exempt sale on the input VAT deduction of the company carrying out the privatisation (keyword: pro rata) must also be taken into account, and there may well be cases in which opting for VAT makes sense. In the case of exempt assignments of depreciable buildings (as a rule commercial buildings), the specific input VAT deduction in connection with the property over the last 10 years must also be adjusted on a pro rata basis. Each individual case will therefore have to be examined here!

In the case of land, a distinction must be drawn between building land and non-building land. In the former case the assignment is subject to VAT, whereas the transfer of agricultural land is outside the scope of VAT within the meaning of Art. 2 of the VAT Act.

Where the assignment is subject to VAT (including in the case of VAT-exempt supplies), registration tax, mortgage tax and cadastral tax apply at the fixed amount.

Rate of registration tax halved

Where, on the other hand, buildings and agricultural land are transferred within the scope of registration tax, the rates are halved as follows:

- generally 4.5% for buildings (instead of 9%);
- 1% (instead of 2%) for first homes;
- 7.5% (instead of 15%) for agricultural land;
- 2% (instead of 4%) for the assignment of building units specifically intended for commercial activities, together with the corresponding building land (as a rule not applicable because of VAT).

Finally, the mortgage and cadastral taxes are settled at the fixed fee of 50 or 200 euro respectively.

The application of the cadastral value within the meaning of the so-called automatic determination of value must be expressly applied for in the deed of assignment.

Sale to shareholders

The reliefs outlined above also apply to transfers for consideration, that is, to the sale of assets to the shareholders, provided that the purchase price corresponds at least to the normal value or to the cadastral value of the buildings, as set out above. In that case the provisions on the use of reserves and on the taxation of dividends do not apply.

A sale will always have to be chosen where no assignable reserves are available. In addition, however, the sale offers a number of interesting tax advantages, as the Italian Revenue Agency expressly confirmed in Circular No. 37/2016:

- Any losses on real property held as current assets are deductible not only where the sale is made at the normal value (cadastral value), but where applicable also at a lower sale price.
- The tax deductibility of capital losses is not limited to real property held as current assets, but is permitted in accordance with the general criteria.
- Whereas assignments must be made at the normal value/cadastral value, the sale may also be made at a different value, and the cadastral value is to be taken into account only where it exceeds the sale price.
- In the case of future sales by the shareholder, reference is made not to the cadastral value stated in the deed of assignment, but to the agreed purchase price.

For the sake of completeness, it should be mentioned that the statements made in the aforementioned Circular No. 37/2016 were subsequently partly contradicted by the Agency in its Reply No. 101/2017, although account must be taken of the limited scope of such replies. A timely clarification of this question as well by the tax authorities would be desirable.

Finally, it should be noted that in the case of a sale the shareholder also owes the agreed purchase price to the company!

Conversion into a simple partnership (società semplice)

Companies whose object is predominantly or exclusively the management of real property not used for business purposes (as a rule property companies) may be converted into simple partnerships (società semplici) by 30 September 2023. Specifically, apart from letting, no material other commercial activities may be carried on within the company.

In the case of corporations, the existing retained earnings are taxable at the level of the shareholder as a result of the conversion. A conversion is possible only where, at the time of the conversion, the same shareholder structure exists as at 30 September 2022; a change merely in the size of the shareholdings of individual shareholders is not, however, detrimental in this respect.

The taxation at the level of the company and of the shareholders is essentially identical to that applicable to the favourable assignment, including for value added tax purposes.

Registration tax, mortgage tax and cadastral tax are, by their nature, always payable at the fixed amount.

There is, however, one further major difference: in the case of conversions into simple partnerships, the period during which the property was held by the company is also taken into account when calculating the 5-year speculation period for a future sale. Particularly in cases where buildings or non-building land are to be sold on immediately, the conversion is therefore a welcome alternative.

Should you wish to carry out one of the transactions outlined above in your company, we kindly ask you to contact our office as soon as possible.

We remain at your disposal for any further information.

Yours sincerely
Josef Vieider