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We have taken the greatest care in preparing the information contained herein, considering the need to make it as concise and timely as possible. However if you intend to use the information in making business decisions or in applying the relevant legal regulations, you are welcome to contact us for a more thorough examination of any specific matters.

Subject: The new “VAT Group” system

Law 232 dated December 11, 2016 (the so-called 2017 Budget Act) introduced the VAT Group system in Italy, thereby implementing an EU regulation aimed partly at simplifying taxpayers’ obligations.

1. Introduction of the new VAT Group system in implementation of the EU rules

The 2017 Budget Act has introduced in Italy the VAT Group system, which had been established on an optional basis by art. 11 of Directive 2006/112/EC. In this way Italy has filled a competitive gap, thereby bringing the country back up to the level of the other EU countries.

The new VAT Group system is very different from the well-known “Group VAT Payment” system. In the latter, members are not relieved of their VAT liabilities. The Group VAT payment system is simply a VAT payment method that allows companies that belong to the same group to offset their respective credit and debit positions. Conversely, in the new VAT Group system (which is alternative to the Group VAT Payment system) the Group is the sole entity liable for VAT payments, just as for the purposes of dealings with third parties the Group uses a single VAT number, while the VAT obligations of the Group’s members are “frozen”.

2. Entities excluded from the VAT Group system

In general, the following entities are not allowed to join a VAT Group:

- places of business and permanent establishments operated outside Italy by companies that are resident in Italy;
- entities whose business is under judicial restraint pursuant to art. 670 of the Italian Code of Civil Procedure. If an entity has multiple businesses, it cannot join a VAT Group even if only one of its businesses is subject to judicial restraint;
- entities subjected to a settlement proceeding under art. 70-decies.3, third sentence, of Presidential Decree 633/1972;
- companies in ordinary liquidation.

3. Characteristics of VAT Groups

The salient characteristics of VAT Groups can be summarized as follows:

- the VAT Group enjoys all rights established by VAT regulations and is liable for all VAT obligations;
- “internal” transactions between members of the same VAT Group are not relevant for VAT purposes (the resulting simplifications are obvious: the parties to such transactions are not required to invoice, note or declare them). Briefly, for VAT purposes such transactions are not considered to be sales of goods or services. A further advantage of the VAT Group system is that the parties to “internal” transactions need not determine the fair value of the goods sold or services provided, as they would have to do in respect of intercompany transactions with customers whose rights to deduct costs are limited;
- the only transactions that are relevant for VAT purposes are sales of goods that a member of a VAT Group makes to (or services it performs for) a company that does not belong to its own VAT Group. Such sales are considered to have been made by the VAT Group;
- the companies that are allowed to join together to form a VAT Group must be connected by financial, economic or organizational ties;
- the formation of a VAT Group is an optional choice, but generally speaking, once that choice has been made the Group must include all VAT a/c holders that interrelated by the three aforesaid ties, according to the “all in or all out” principle, though with some mitigations.

4. Requirements for the (optional) formation of a VAT Group: financial, economic and organizational ties

As explained above, for multiple entities to join together in a VAT Group they must be connected by the financial, economic and organizational ties defined in the new art. 70-ter of Presidential Decree 633/1972.

Of the three kinds of ties, the financial one is the key one. If the financial tie exists, the economic and organizational ties are presumed to exist as well. An exception is made for credit companies, as explained below.

Once the VAT Group option has been taken, all companies connected by the financial tie can join the Group, and – based on the aforesaid presumption – the tax administration cannot object that no economic tie and/or organizational tie exists among them. As explained in the report that illustrates the 2017 Budget Act, that presumption can be overcome only by the taxpayer (if, for example, the intention was to exclude certain companies from the VAT Group), which can submit a query to the tax administration, seeking to demonstrate that no economic tie or organizational tie exists, though the financial tie does.

5. The financial-tie requirement

Under the new rules, a **financial tie** is deemed to exist at least since the first of July of the prior calendar year among VAT a/c holders established in the territory of Italy if – pursuant to art. 2359, first paragraph, no. 1, of the Italian Code of Civil Procedure (control by the majority of votes in the ordinary meeting of the shareholders):

- a) a relationship of control exists directly or indirectly among the companies concerned;
- b) all the companies concerned are controlled directly or indirectly by the same company, provided that it resides in the territory of Italy or of another country with which Italy has signed an agreement that guarantees an effective exchange of information.

6. The economic-tie requirement

An economic tie is considered to exist between taxpayers established in the territory of Italy if they are connected

by at least one of the following forms of economic cooperation:

- a) they engage in the same main business;
- b) they engage in complementary or interdependent businesses;
- c) they engage in businesses that provide full or substantial advantages to one or more of them.

In any case, the law considers that an economic tie does not exist between companies in respect of which the financial tie exists as a result of equity interests acquired in the course of credit-recovery actions undertaken by credit companies, or that arose upon the conversion into newly issued shares of credits claimed from companies in temporary financial straits, pursuant to art. 113, paragraph 1 of the Italian Income Tax Code (Presidential Decree 917 dated December 22, 1917). In fact, in the cases described here the financial tie is occasional or at any rate was not the result of an economic strategy aimed at acquiring control, hence an economic tie likely does not exist.

7. The organizational-tie requirement

An **organizational tie** is considered to exist de jure between companies established in the territory of Italy if a **coordination** exists between them, as provided in Book 5, Title V, Chapter IX of the Italian Civil Code (this chapter contains the rules on corporate direction and coordination), or de facto between their respective governing bodies, even if such coordination is provided by another entity.

8. Procedure for opting to form a VAT Group, and the date when the option goes into effect

A VAT Group is formed after the relevant **option** has been taken by all the entities that have financial, economic and organizational ties to each other. The option can be exercised by the Group's representative, by filing electronically a statement form that is pending approval by the Revenue Agency.

If the statement is filed between January 1 and September 30, the option will go into effect as of the next year; if the statement is filed between October 1 and December 31, the option will go into effect as of the year after the next one. Accordingly, since the 2017 Budget Act provides explicitly that the rules on the new VAT Group will go into effect as of January 1, 2018, the option in question cannot be exercised sooner than together with the statement filed in 2018 (by September 30, 2018), hence it will become applicable **starting** from the VAT transactions consummated on or after January 1, 2019. The option will be binding for three years, starting from the year in which it goes into effect, and will be renewed automatically for each year thereafter unless and until it is revoked.

9. Cessation of the VAT Group

If a VAT Group's members are no longer more than one, the whole Group ceases to exist. Conversely, one or more members will cease to belong to the Group if any one of the cases of exclusion occurs (for example, if a member company has been placed in ordinary liquidation), or if the financial tie no longer exists, or if the economic and organizational tie ceases to exist.

No later than thirty days after the event that has caused the Group to cease to exist, its representative will be required to notify its cessation by means of an ad-hoc statement to be filed electronically.

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