

DOING BUSINESS IN ITALY

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Introduction

Geography

Located in southern Europe, Italy consists of the Italian peninsula, the islands of Sardinia and Sicily, several smaller islands, and Campione d'Italia, situated within Switzerland. The independent city-state of Vatican City and the Republic of San Marino are located within Italy.

Italy borders France, Switzerland and Austria to the north and Slovenia to the east. The Italian peninsula extends into the Mediterranean Sea, and Libya and Tunisia are located across the Mediterranean to the south. This geographical location makes Italy a natural link between Europe and the Middle East. The country is small, covering an area of only 301,266 square kilometers (approximately 116,300 square miles).

Rome is the capital city. Other large cities include Milan, Naples, Turin and Genoa. Milan and Turin are the country's primary industrial centers.

Population and Language

Italy has approximately 58 million inhabitants, with an average population density of 190 people per square kilometer (490 per square mile). The population is predominantly Roman Catholic, with substantial Jewish and Protestant communities, and growing Muslim immigrant community.

Italian is the official language, although dialects vary throughout the country as a result of the cultural development of the various regions and cities and of the small French-speaking group in the Valle d'Aosta region, the German-speaking group in parts of the Trentino-Alto-Adige region and the small Slovene-

speaking group in the Friuli-Venezia-Giulia region. English, French and German are widely spoken within the business community.

Time

Italy is one hour ahead of Greenwich Mean Time (GMT). During Daylight Saving Time, observed from the last Sunday in March to the last Sunday in October, clocks are advanced one hour.

Time differences between Italy and major world cities are shown in the following table.

<i>City</i>	<i>Hours Ahead of or Behind Italy</i>
Beijing	+7
Buenos Aires	-4
Cairo	+1
Cape Town	+1
Hong Kong	+7
London	-1
Los Angeles	-9
New Delhi	+4 ½
New York	-6
Paris	0
Sydney	+9
Tokyo	+8

Public Holidays

The following table presents public holidays for 2009. The date of Easter Monday varies from year to year.

<i>Holiday</i>	<i>Date</i>
New Year's Day	1 January
Epiphany	6 January
Easter Monday	13 April
Liberation Day	25 April
Labor Day	1 May
Assumption	15 August
All Saints' Day	1 November
Immaculate Conception	8 December
Christmas	25 December
Boxing Day	26 December

A. Government Structure and Economic Climate

A.1 Government Structure

Italy is a republic divided into regions, provinces and municipalities.

Parliament is the legislative body of the republic and consists of a Senate and Chamber of Deputies. Its members are elected by popular vote to five-year terms of office.

The President of the Republic is elected by parliament for a seven-year period and must be an Italian citizen of at least 50 years of age. The president has many political duties but little political power. The president serves as the head of the armed forces and of the Supreme Council of Magistracy (see below), has the authority to dissolve parliament and appoints the prime minister, who selects the other members of the Supreme Council.

The Government of Ministers has executive power, and parliament may delegate to it legislative power for specific matters within defined limits. In emergencies, the Government of Ministers may issue temporary decrees, which are subject to parliamentary ratification or veto within 60 days from their publication.

The national political situation has changed radically in the last ten years. Italy has switched to a purely proportional electoral system (which used to cause political instability) to a majority system. As a result, two aggregate coalitions – one representing the right-center, the other orientated to the left – have replaced Italy's traditional political parties. Since the 2001 national elections, the right-center-wing coalition has governed the country. In the second quarter of 2006, national elections will be held.

The regional governments have legislative power in certain areas including health and hospital services, local taxes, urban planning and transportation.

Italy has the following three levels of courts: local courts (*tribunali*), courts of appeal; and the supreme court of appeal (*Corte di Cassazione*). Beside this three-tier system of courts, which constitutes the core of the judicial power, the Constitutional Court, a body of high magistrates, has the power to determine whether a disposition is constitutional. If the disposition is not constitutional, it is repealed. The Constitutional Court also has the power to settle any conflicts among the different powers of the State. Regional administrative courts (*Tribunali Amministrativi Regionali*, or TAR) preside over administrative suits. Supervision of the body of magistrates is entrusted to the Supreme Council of Magistracy (*Consiglio Superiore della magistratura*).

Tax commissions preside over tax suits between taxpayers and the tax authorities. These suits are initially heard by the Provincial Tax Commission. Judgments of the Provincial Tax commission may be appealed to the higher Regional Tax commission.

A.2 Type of Economy

Economic Structure

Italy has a capitalist free-market economy. Under a reform of last few years, which is designed to modernize the national economy, small shops and street peddlers operating in the retail sector are no longer required to obtain specific administrative authorization for their business activities.

Economic development varies greatly by region. The north is highly industrialized and has a good infrastructure and a highly skilled workforce. The south ranks low in industrial sites and infrastructure, but it has a highly skilled workforce. To develop the south, significant incentives are offered to investors in the area (see Section B.1).

Italy is among the seven most industrialized economies in the world. The predominant sectors are services, which represent about 70% of gross domestic product (GDP), and manufacturing, which accounts for about 28% of GDP. In recent years, agriculture, forestry and fishing have accounted for a decreasing percentage of GDP.

Significant economic issues in Italy include unemployment, the quality of public services, the modernization of infrastructure, the government's management of pensions and the privatization of state-owned industries.

The public sector includes autonomous state agencies and large industrial groups in which the state has controlling interests or a dominant influence. The state actively participates in the high-technology undertakings of many key sectors, including chemicals, electronics, energy, banking, public transportation and telecommunications. However, the government has started to privatize certain of its holding companies (see Section B.2).

The private sector consists of large private companies and the small business sector, which is the most diversified area of the Italian economy. It consists of small and medium-sized businesses that either cooperate with large producers or create their own specialized niches. Advanced manufacturing technology has traditionally provided this sector with a competitive advantage in export markets. Because subcontracting and other cooperation within this sector are common, industrial districts have developed in which businesses specialize in a particular product. Districts exist for the production of machinery, tiles, textiles, shoes and furniture.

General Economic Trends

After a steady decline in GDP growth average rate of the European Union (EU) from 3.7% in 2000 to 0.5% in 2003 as a result of a global recession, the GDP growth rate increased to 1.8% in 2004 encouraged by a general economic recovery.

However, in 2005 some factors have caused GDP growth of EU countries to slow and the rate decreased to 1.3%. The slowdown of GDP growth has been affected by a significant increase in the exchange rate of Euro against US dollar, reallocation of the international trade towards emergent countries and increasing peaks of crude oil. According to economic forecasting, the GDP growth rate should increase to 1.9% in 2006.

In this framework, the GDP of Italy grew somewhat lower than the EU average, and between the end of 2004 and the beginning of 2005 it showed an opposite trend compared to EU average as a result of a decline in the industrial production, internal demand and exports. The GDP growth expectations are of 0.2% in 2005 (1.3% in Euro area) and 1.6% in 2006 (1.9% in Euro area).

The decline of Italian economy experienced between the end of 2004 and the beginning of 2005 has affected the occupational dynamics. The unemployment rate, decreased gradually until 2004 when it was 8%, should remain steady in 2005. In 2006, an improvement of the domestic industrial production should cause the unemployment rate to decline to 7.8%.

The inflation rate for 2004 was 2.3%. The expectations of inflation rate are of 2.1% in 2005 and 2.0% in 2006, lined up with the EU average (2.1% and 1.9%, respectively).

The Italian government has succeeded in implementing a structural adjustment of public finances. Government interest payments as a percentage of GDP dropped steadily from 8.1% in 1998 to 5% in 2004 as a result of a decline in yields. This percentage should stabilize in 2005 and 2006. However, a large public deficit remains a major problem. In 2004 the deficit was equal to 3% of GDP and the expected rate is 3.9% for 2005 and is 4.6% for 2006, unless remedial measures are adopted.

A.3 Leading Industries

Although Italy ranks among the seven most industrialized countries, Italian industry does not dominate world markets in any particular industry sector, except perhaps in fashion. Steadily growing service industries include commerce, transportation, communications, property rental, banking and insurance. Major manufacturing industries include construction, textiles and apparel, machinery, chemicals, pharmaceuticals, nonmetal minerals and transportation vehicles.

The following are Italy's principal agricultural products: wheat, rice and other cereals; vegetables; fruit; wine; olive oil; and dairy products.

A.4 Financial System

Central Bank

Italy's central bank, the Bank of Italy (Banca d'Italia), stabilizes the money supply and the supervises banking and credit institutions with operations in Italy.

Historically, the primary function of the Bank of Italy was the assurance of the stability of the credit system. The bank was responsible for issuing new charters, supervising bank investments, maintaining a clear separation between banks and nonfinancial enterprises, and ensuring that territorial expansion was justified by economic reasons and local utility. The bank also oversaw the consolidation of the banking industry, including the merger of smaller banking institutions with larger institutions. However, the role of the Bank of Italy has gradually shifted from an administrative role to a supervisory role. Entities supervised by the Bank of Italy now include financial intermediaries, which may take the form of a stock brokerage company (*società di intermediazione mobiliare*, or SIM) an open-end investment company (*società di investimenti a capitale variabile*, or SICAV) or other forms allowed under the law. These entities act as intermediaries between buyers and sellers, usually charging a commission, in the credit, stock and insurance markets. To carry on their activities, financial intermediaries must fulfil certain criteria set by law.

The central bank also serves to promote the technological development of banks and to assist in the modernization of the payment system. In addition, the bank acts as treasury on behalf of the Italian government.

In 1992, the government issued a decree designed to integrate Italy's banking sector with those of other EU member states. Legislative Decree No. 646 of 14 December 1992, forms the foundation of the Italian government's efforts to coordinate Italy's legislative, regulatory and administrative provisions concerning access to credit and capital markets with the frameworks of other EU countries. The decree represents an effort to reconcile the often conflicting principles of reciprocal recognition and home country control.

Stock Exchange

The Italian Stock Exchange (Borsa Valori Italiana) is almost synonymous with the Milan Stock Exchange, although several less important stock exchanges operate in Italy's other major cities. These exchanges were formed before the unification of Italy, which is the reason why so many exist. The Milan Stock Exchange is by far the most active and handles almost 95% of the listed securities transactions. Each exchange trades shares for listed companies, and six of the exchanges also trade shares from the regulated unlisted securities markets.

Historically, the trading of company shares has not played a significant part in the Italian economy. The volume of shares traded is particularly low compared to the volume of Italian government bonds traded. However, share trading has increased as a result of post-war industrialization, a 1974 law establishing the National Commission for Corporations and the Stock Exchange (*Commissione Nazionale Società e Borsa*, or CONSOB), improvements in company financial statement disclosures and favorable fiscal provisions for equity income. Italy has further encouraged the growth of the stock market through the introduction of antitrust and insider trading regulations in 1990 and securities brokerage companies in 1991. The elimination of exchange-control regulations (see Section B.2) has greatly increased the number of investors who may invest in securities on other markets, including Italian securities quoted on international exchanges.

National Commission for Corporations and the Stock Exchange

The National Commission for Corporations and the Stock Exchange (*Commissione Nazionale Società e Borsa*, or CONSOB) is the public authority responsible for regulating the Italian securities market. Its activities are aimed at the protection of the investing public. To achieve its purpose, the CONSOB acts to ensure the following: transparency and appropriate behavior by securities market participants; disclosure of complete and accurate information to the investing public by listed companies; accuracy of the facts represented in the prospectuses related to offering of marketable securities to the investing public; and compliance with regulations by auditors entered on a special roll. It conducts investigations with respect to potential infringements of insider dealing and market manipulation law.

Investment Companies

An investment company that manages an investment fund must be formed as a joint stock company (*Società per Azioni*, or SpA; see Section C.1) with a minimum share capital ranging from €1,164,569 to €2,911,422, depending on the activities performed. The Bank of Italy regulates investment activity to control risk concentrations. The Bank of Italy and CONSOB have established standard filing requirements for investment funds, which take into consideration Italy's application of the Fourth EU Directive. Italian investment funds are exempt from corporate and local income taxes; they pay only a minimal tax (*imposta sostitutiva*) based on a percentage of assets managed.

Securities Brokerage Companies

By 1991, almost 80% of share transactions were being performed outside the official market; as a result, a stock-exchange reform was enacted in January 1991. The reform regulates the securities industry by imposing formal controls on banks and active intermediaries, including finance companies, which played a dominant role in the securities business. In addition, the reform created a new type of entity called securities brokerage company (*società d'intermediazione mobiliare*, or SIM), which has exclusive responsibility for securities dealing, brokerage, market-making and underwriting and is regulated by CONSOB and the Bank of Italy.

SIMs must be established as either public limited liability companies or limited partnerships (see Section C.1) with required minimum share capital ranging from €347,000 to €1 million, depending on the activities

performed. SIMs must have capital adequate to undertake the activities they plan to conduct and must adopt a specified accounting and organizational structure.

A.5 Currency

The Italian currency unit, the lira (lire in the plural), commonly abbreviated as Lit, was replaced by the Euro (€) as from January 1, 2002. Euro is also the currency of Vatican City and the Republic of San Marino.

B. Investment Climate and Foreign Trade

B.1 Investment Incentives

General

Italy encourages foreign investment by offering foreign-owned entities the same incentives available to entities owned by Italian nationals. Incentives take the form of grants on capital accounts, subsidized loans, leasing assistance, tax concessions and subsidized labor costs. Financial assistance and advice are available from banks, special credit institutions and state agencies. Foreign investors may obtain other incentives from regional and provincial administrations and from the EU.

In general, incentives are intended to enhance the economic development of the country, particularly the acceleration of the industrialization of the “*Mezzogiorno*”, which encompasses southern Italy, including Sicily and Sardinia Islands, and of certain localities in central and northern Italy that are recognized as depressed areas. In the past, the enormous public deficit and certain EU regulations had limited the government’s ability to offer investment incentives in less economically developed regions, such as southern Italy and other depressed or rural areas.

Most incentives are obtained through special credit institutions, which assess the feasibility of business plans and the creditworthiness of the applicants. Qualifying investors include industrial enterprises, trading companies, service enterprises, artisans, consortia (groups of entities) and wholesale trade centers. Projects eligible for incentives include the construction of new plants, the expansion of existing plants, the development of abandoned factories, plant modernization, the transfer of existing plants, company reorganizations, industrial conversions, research projects, innovative initiatives and services (such as services related to the design of environmentally friendly products), information technology services and information intermediation (services provided by newspapers, press agencies and similar enterprises). Incentives are also available to encourage technological innovation and to assist in the development of exports.

Grants

Grants on capital account (grants that are equal to a percentage of the amount invested) are provided for investments in southern Italy, depressed areas and rural districts in central and northern Italy.

At least 50% of these incentive grants is reserved for small and medium-sized enterprises. In accordance with a decision of the EU Commission, Italian law defines small and medium-sized enterprises based on the number of employees and the annual turnover or the total assets of the enterprise. An industrial enterprise is considered to be a small enterprise if it has fewer than 50 employees and its annual turnover does not exceed €7 million or its net assets do not exceed €5 million. A medium-sized enterprise is defined as one that has fewer than 250 employees and whose annual turnover does not exceed €40 million or whose net assets do not exceed €27 million. Small and medium-sized enterprises are not eligible for incentives if more than 25% of their corporate capital is owned by a company that is not a small or medium-sized enterprise, as defined by the criteria above. Such enterprises may benefit from other grants available to the following types of companies: companies operating in the mining, construction or manufacturing sectors; companies that perform information technology services or business/technical consulting for companies in such sectors; and companies that transfer technology to companies in such sectors. Grants on capital accounts range between 10% and 50% of the investment value, depending on the enterprise’s size and localization.

The ratio of grant amount to total investment amount is higher for investments in Mezzogiorno than for investments in central and northern Italy.

The grant for an investment in Mezzogiorno may range from 10% to 50% of the total investment, and the amount granted in central and northern Italy may not exceed 20% of the total investment.

Applications for grants on capital account must be submitted annually by 31 December to a credit institution authorized by the Ministry of Industry (*Ministero dell'Industria*). The application must include a feasibility study (business plan) enabling the credit institution to evaluate whether the investment is consistent with the financial condition of the enterprise and is likely to be profitable. Within four months after the application is submitted, the credit institution compiles a report, which is sent to the ministry. If the ministry agrees to award a grant, the investor is included in a list of enterprises entitled to grants on capital account and receives the grant if adequate funds for investment incentives are available in the relevant region. If the funds are unavailable, a qualifying enterprise may receive the grant in the following year.

Subsidized Loans

Subsidized loans are available for industrial enterprises to encourage the implementation of new manufacturing processes and the production of technologically improved goods. The amount of a subsidized loan ranges from 35% to 70% of the total investment. Applications for subsidized loans are made directly to the Ministry of Industry.

Government-Assisted Leases

Small and medium-sized enterprises that do not operate in the iron and steel sector may enter into government-assisted leases for plant, machinery and equipment, which provide for reductions in monthly rental payments.

Export Incentives

Special export insurance is available from the Agency for Export Credit Insurance (*Società per Assicurazione del Credito all'Esportazione*, or SACE) for exports of the following: durable goods, including machinery, equipment and transport vehicles; services, including studies and design projects; and civil engineering works carried out abroad. In addition, to encourage exports of durable goods, funding is available from special credit institutions in the form of medium-term loans at below-market interest rates. A consortia of small and medium-sized businesses may obtain cash grants and subsidized loans for exports to facilitate market penetration outside the EU, to assist projects designed by Italian businesses in less developed countries, to encourage the formation of joint ventures in less developed countries, and to finance the establishment of companies in association with local investors in certain Eastern European countries.

Other Incentives

Minor incentives are available for investments in central and northern Italy. They are designed primarily to assist small and medium-sized enterprises. In addition to national government incentives, assistance is available from regional authorities and provincial chambers of commerce, usually in the form of interest subsidies or rental assistance for leased assets. Several regional and provincial entities provide sites and infrastructure for the construction of plants.

EU Incentives

Because Italy is a member state of the EU, a business established in Italy may benefit from incentives provided by the EU. These may be grants derived from provisions of the Treaty of Rome, related to the EU policies of integration or employment, or connected to special programs of the EU. Alternatively, the incentives may be loans at below-market interest rates obtained through the European Investment Bank.

Tax Incentives

For information regarding tax incentives available in Italy, see Section C.4.

B.2 Particular Investment Considerations

Regulated Industries

Italian banking, insurance and utilities industries are subject to legal constraints, which limit various transactions including investment in industrial entities, the establishment of new branches and the formation of captive insurance companies.

Government-Owned Industries and Privatization

The government is privatizing entities whose operations are not critical to accomplishing the state's strategic interests. The government's privatization policy represents a reversal of state policy from the 1960s and 1970s when social and political concerns prevailed over economic goals in the government's approach to managing public-sector companies (for example, the government's acquisition of struggling companies to protect employment).

The state-controlled companies were owned by Istituto di Ricostruzione Industriale (IRI), which was a government holding company for banks, insurance companies, telecommunication companies, and companies in the energy, transports, and defense and space industries.

Privatized entities include Ente Nazionale Idrocarburi (Eni; government holding company for oil and gas industry), Istituto Immobiliare Italiano (Imi; Italian financing institute), Banca Commerciale Italiana (COMIT), Credito Italiano, Banca Nazionale del Lavoro (BNL), Telecom Italia, and Istituto Nazionale delle Assicurazioni (INA; National insurance institute).

Restrictions on Foreign Investment

In general, Italy does not impose percentage limitations on foreign ownership of domestic entities. Foreigners may establish or acquire businesses and purchase securities. Companies formed with foreign capital are treated in the same way as national companies with respect to incorporation, taxation and eligibility for incentives.

Foreign-Exchange Controls

The underlying principle of the foreign-exchange control system is that transactions with nonresidents are permitted unless expressly prohibited. Inbound and outbound investments are virtually unrestricted.

Antitrust Law

An antitrust law enacted in 1990 preserves free-market competition by prohibiting practices aimed at dominating a market through the use of controlling influences, agreements and concentrations. This law complements the 1989 EU antitrust regulation. The antitrust authorities (*Autorità Garante della Concorrenza e del Mercato*) has the power to enforce the antitrust law.

Environmental Law

Increased awareness of the dangers of pollution prompted officials to enact Legislative Decrees Nos. 22 and 389 of 1997 (the Ronchi decrees), which contain measures regulating environmental issues, including measures implementing relevant EU directives.

B.3 Regional and International Trade Agreements and Associations

Italy is a member state of the EU. The barriers between EU member states are gradually dissolving, and regulations governing transactions carried out within the EU are becoming increasingly uniform. Italy is a founding member of the European Monetary Union (EMU), which introduced the euro, the common European currency. For further details regarding the euro, see Section A.5.

Italy is a member of the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Food and Agricultural Organization (FAO), International Bank for Reconstruction and Development (IBRD), International Labor Organization (ILO), International Monetary Fund (IMF), North Atlantic Treaty Organization (NATO) Organization for Economic Cooperation and Development (OECD), United Nations (UN), and World Trade Organization (WTO).

B.4 Leading Imports and Exports and Major Trading Partners

Leading Imports and Exports

Italy's primary imports are machinery, chemicals, energy, transportation vehicles, ferrous and nonferrous minerals, timber, paper, rubber, food products and agricultural products.

Italy's primary exports are machinery, textiles and apparel, rubber and plastic products, furniture, transportation vehicles, chemicals, ferrous and nonferrous metals, nonmetallic minerals, food products and agricultural products.

Major Trading Partners

Leading import sources are the EU countries (particularly, Austria, Belgium, France, Germany, the Netherlands, Sweden and the United Kingdom), Romania, Switzerland and the republics of the former USSR.

Principal export destinations are the EU countries (particularly, Austria, France, Germany, Spain and the United Kingdom) and other European countries, including Switzerland, and Eastern Europe (primarily the republics of the former USSR).

B.5 Importing and Exporting

Restrictions

As a result of the liberalization and harmonization of customs rules within the EU as well as Italy's membership in the EU, the Italian rules on imports generally follow the principle of importation without restriction. However, the EU retains certain rights of control and may impose restrictions if EU interests are prejudiced. In addition, the EU imposes specific norms on the importation of goods in the food, textile and steel sectors in accordance with the necessities of EU foreign policy (this policy covers economic, trade and political relations between EU countries and nonmember countries and international organizations), Special procedures apply to the movement of goods within the EU.

Under the standard EU classification system, the importation of certain goods requires advance authorization. After authorization is granted, the goods must generally be imported within six months. In addition, importers must file a statement listing the goods they intend to import, with an exception for goods that are admitted only temporarily. This system permits the competent authorities to control demand.

Antidumping regulations are enforced at the EU level.

Exports are generally unrestricted, except for certain items related to the national interest and situations covered under international agreements. Currently, certain goods, including nuclear materials, armaments, high-technology products, radar equipment, numerically controlled machine tools and complex electronic equipment, require export authorization in advance, regardless of the recipient country.

Customs Duties

Products from countries outside the EU are subject to customs duties based on standard EU tariffs.

Exports are not subject to value-added tax (VAT; see Section C.6). If exporters import goods that will be subsequently exported, with or without transformation, they are exempt from payment of VAT on the imports, if the value of the supplies abroad is at least 10% of the exporters' annual turnover.

C. Companies

C.1 Forms of Enterprise

Introduction

Italian company law has recently been the subject of comprehensive reform. The reform (contained in Legislative Decree No. 6 of 17 January 2003) come into effect on 1 January 2004 and include a series of provisions relating to corporate governance through the introduction of three models of governance, as well as making a number of changes to the existing rules on corporate management and directors duties. It is likely that further laws and regulations will need to be introduced in order to clarify some of the new provisions and to ensure the proper co-ordination of the new provisions with existing legislation and regulations, including the Code of Corporate Governance for listed companies.

Major Forms of Business Entities

Limited Liability Companies

The two primary forms of limited liability companies are the joint stock company (*società per azioni*, or S.p.a.) and the company limited by quotas (*società a responsabilità limitata*, or S.r.l.). Limited liability companies are also known as corporations. S.r.l. are the most commonly used corporate vehicles in Italy for small businesses, while the corporate entity used for medium to large businesses (and for listed companies) is the S.p.a.

The articles of incorporation must be executed before a notary public and then filed with the competent Companies' Register. A company is considered incorporated when the registration is completed.

S.p.a. and S.r.l. may be incorporated for an unlimited period of time; in such event, the shareholders may freely withdraw from the company in accordance with the law and the company's bylaws.

The minimum share capital is EUR 120,000 (about US\$150,000) for an S.p.a. and EUR 10,000 (about US\$12,800) for an S.r.l.. There are no maximum amounts. S.p.a. and S.r.l. may issue shares for non-cash consideration.

A parent company is not liable for its subsidiaries' obligations. However, a sole shareholder of an insolvent company is liable for the obligations assumed during the period in which it was that company's sole shareholder provided that the sole shareholder's shares were not fully paid and certain Companies' Register filing requirements were not fulfilled. Parent companies directing or coordinating a group of companies can be held liable to the shareholders or creditors of group companies for any damages suffered as a result of directions given by the parent to group members.

The internal management of S.p.a. and S.r.l., are regulated by Italian law and also by the company's bylaws, and its objectives are limited to those set out in the deed of incorporation. The objectives clause, as well as any clause of the bylaws, may be altered by resolution of the shareholders.

An Italian S.p.a. can be managed by a sole director or by a board of directors. The corporate governance of an S.r.l. is very flexible and the managing body may consist of a sole director, a traditional board of directors or a number of directors acting separately or jointly. Non-Italian nationals may be directors or members of the management board. For nominee companies (*società fiduciarie*), at least two-thirds of the directors or members of the management board must be Italian nationals. In all cases, non-Italian directors and members of the management board may be domiciled outside Italy, but they must obtain an Italian tax code.

Directors and members of the management board may have ordinary general powers, which do not require them to carry out specific management roles or special powers, which are delegated to them by the board of directors/management board and which empower them to carry out the management of the company.

The board of directors/management board of listed companies must be composed by executive directors (i.e. directors performing management functions) and non-executive directors. The number and standing of the non-executive directors must allow their views to carry significant weight in the decision making process. In addition, certain non-executive directors must not have business relationships with, or own shares in, the

company of which they are directors which enables them to control or exercise a considerable influence over it.

There is no requirement for directors/members of the management board to be employees of the company, although employees are entitled to be directors/members of the management board. There is no service contract for directors. The directors accept the office on the terms proposed by the company (that is, as specified in the deed of incorporation or as approved by the ordinary shareholders' meeting). Directors/members of the management board are permitted, although not required, to hold shares in the company.

Directors are jointly liable to the company, shareholders, creditors and third parties, unless a single director or the executive committee performed the specific action that actually caused damage to the company. Employees are not entitled to representation on the board of directors or the management board. Provided that certain conditions are met and with the limitation set forth by the Italian Law, both S.p.a. and S.r.l. are entitled to issue financial instruments.

Dividends may be paid out of income only, not out of invested capital; in addition they may not be distributed before losses that are carried forward have been recouped. If, as a result of losses, the corporate capital is reduced by more than one-third, the directors are required by law to take certain formal steps, including calling a special shareholders' meeting to assess the situation. If, as a result of losses, the capital falls below the minimum required by law, the capital must be replenished or the company reorganized. Such a reorganization might be implemented, for example, by the transformation of a joint stock company into a company limited by quotas.

Every year, S.p.a. and S.r.l. must file their balance sheets and a list of their shareholders with the Companies' Register.

Joint Stock Companies. In an S.p.a., the corporate capital is represented by shares. The company is entitled not to issue shares certificates.

Provided that certain conditions are met, an S.p.a. is allowed to create one or more assets designed for or dedicated to a specific transaction or project ("Dedicated Asset(s)").

The company may buy its own shares if authorized by a shareholders' meeting, but its ownership may not exceed 10% of total share capital. As treasury stock, these purchased shares do not carry voting rights.

Companies Limited by Quotas. In such case, the Dedicated Asset(s) constitutes a pool of assets separate from the company's other assets and general creditors of the company are not permitted to bring actions in respect of such asset(s) or of the project's revenues. Only the project's creditors are entitled to bring actions against the Dedicated Asset(s).

S.p.a. are also entitled to enter into financing loan agreements relating to specific projects where all or part of the revenue deriving from the project is reserved in favour of the lender. In such cases, the revenue from the project constitutes a pool of assets separate from the company's other assets. This segregation of revenue from the company's general creditors is permitted only if certain conditions relating to the contents of the financing agreement and its filing, and the company's accounting systems, are met. Under this procedure, general creditors of the company are not permitted to bring actions in respect of the project revenue pending repayment of the lender's loan. However, the loan can only be repaid out of revenue from the project, and the lender is not permitted to bring an action in respect of the company's other assets unless the company is being wound up.

The main changes introduced by the recent reform of Italian company law with regard to S.p.a. relate to their governance. Under the new regime, S.p.a. will be able to adopt one of three types of corporate governance models:

- "Traditional". It applies where the shareholders have not specified a different management structure in the articles of association. The company has a management board (*consiglio di amministrazione*) and a supervisory board (*collegio sindacale*), and members of both boards are appointed and removed by the shareholders.
- "Two-tier". The company has a management board (*consiglio di gestione*) whose members are appointed and removed by a supervisory board (*consiglio di sorveglianza*), whose members in

turn are appointed and removed by the shareholders. At least one member of the supervisory board must be registered with the Registro dei Revisori Contabili (*Certified Public Accountants Registry*) at the Ministry of Justice.

- “Single-tier”. The members of the management board (*consiglio di amministrazione*) are appointed and removed by the shareholders. The supervisory board (*comitato per il controllo di gestione*) is appointed by the management board from its own members. The number of members of the management board is determined by the articles of association, but the management board of a listed company must have at least three members. This is the simplest and most flexible model as the supervisory board is part of the management board.

The board of directors under the traditional system must be composed of one or more members and the board of directors under the single-tier system must be composed of at least two members. There are no further regulations other than as may be provided in the by-laws. The management board (for the two-tier system) must be composed of at least two members with the exact number of members being set by the company’s by-laws.

The regulatory framework for corporate governance and directors’ duties in S.p.a. is the following:

- Italian Civil Code which contains mandatory rules for both listed and private companies.
- company’s by-laws.
- Legislative Decree No. 58 dated February 24 1998 containing mandatory rules for listed companies.
- mandatory rules for listed companies issued by CONSOB (*Commissione Nazionale per le Società e la Borsa*) which is the public authority responsible for regulating the Italian securities market.
- The Italian Stock Exchange (*Borsa Italiana*) which provides regulations containing mandatory rules for listed companies.
- The Code of Corporate Governance which is a non-mandatory code of best practices for listed companies issued by the Committee for Corporate Governance of the Italian Stock Exchange (*Comitato per la corporate governance*).

Directors' duties and corporate governance of companies carrying out certain activities (in particular banks and insurance companies) are regulated by specific rules.

Private companies which by law are required to prepare consolidated annual accounts and which use the traditional system, as well as private companies which use the one-tier and two-tier systems, are required to have their annual financial statements reviewed by external auditors. All companies controlling a subsidiary must usually prepare a consolidated financial statement.

The by-laws of non listed companies that use the traditional system of corporate governance and which are not required by law to publish consolidated accounts, are not under an obligation to have their accounts audited. However, they may provide for the board of statutory auditors to evaluate and express an opinion on the non-consolidated annual accounts. Listed companies must have their annual financial statements audited by external auditors and their bi-annual financials subjected to a limited review by external auditors. Any audit must be carried out by an individual external auditor or by an auditing company registered with the Ministry of Justice.

For listed companies only, audits must be performed by an auditing company whose activities are subject to control by CONSOB.

In an S.r.l., the corporate capital is represented by quota (no certificates have to be issued).

The quotas must be recorded in a register of quota holders (the Shareholders’ Ledger) and may be transferred by sale, assignment or inheritance in accordance with the company’s bylaws provisions. The company may not purchase its own equity capital.

Although S.r.l. need not establish a board of statutory auditors if its capital is less than EUR 120,000 , its articles of association may provide for the appointment of a board of statutory auditors. Regardless of the

amount of capital, however, a board of statutory auditors is in any case required if, for two subsequent years, two of the following parameters are exceeded:

- Total assets of EUR 3.125.000,00;
- Sales of EUR 6.250.000,00; and
- An average labor force during the year of at least 50 employees.

Quotaholders must normally make any resolutions concerning the company's activities at a properly convened meeting, but the Reform enables them to make resolutions by means of a written deed provided that this procedure is regulated in the company's by-laws. A quotaholders' meeting must however always be convened to amend the articles of association or change the company's objects to a significant extent, or if it is requested by a director or by quotaholders representing one-third of the company's capital.

The written deed procedure can also be adopted to approve resolutions of the board of directors.

Partnerships

General Partnerships. In a general partnership (*società in nome collettivo* or S.n.c.), partners have unlimited liability for the partnership's obligations. An Snc may conduct business, acquire property, and sue or be sued in its own name. It must operate under a business name that includes the name of one or more of the partners and indicates the partnership relationship. A general partnership may have a corporate partner.

No minimum level of capital contribution to an S.n.c. is required, and contributions may be in the form of cash, property, or services.

The consent of all partners is required for the transfer of a partnership interest. Partnership profits and losses are distributed in proportion to each partner's contribution, unless stated otherwise in the partnership agreement. Any stipulation in the partnership agreement limiting the extent of a partner's losses is void. The financial information of a S.n.c. does not necessarily need to be made available to the public.

Limited Partnerships. A limited partnership (*società in accomandita semplice*, or S.a.s.) is composed of at least one partner with unlimited liability and at least one partner with liability limited to the extent of the partner's capital contribution. The partner with limited liability may not participate in partnership management.

The S.a.s.' name must include the name of at least one general partner and indicate that it is a limited partnership. Unless otherwise stated in the partnership agreement, partners' interests may be transferred only by the votes of partners representing a majority of the S.a.s.' capital.

In general, provisions relating to general partnerships also apply to limited partnerships.

Italian law, near to the limited partnership (S.a.s.) provides also the share limited partnership (S.a.p.a.) that is a joint stock company whose shareholders are divided in two groups: (i) non limited liability shareholders, (shareholders that are jointly and severally liable for the company's obligations) and limited liability shareholders.

A S.a.p.a. is regulated by the rules provided for an S.p.a., within the limits provided by the law.

Branches

A foreign corporation that forms an Italian branch (*sede secondaria*) is subject to Italian law because a branch, unlike a subsidiary, is not an entity separate from the company that is responsible for its obligations.

At the time the branch is formed, the foreign company must publish the names, date and place of birth of the resident persons who are the permanent representatives of the company in Italy, with an indication of their respective powers. In addition, the resident persons' respective signatures and specified documents relating to the creation of the branch must be filed with the Register of Enterprises.

Structures Most Often Used by Foreign Investors

Although they are free to choose any of the forms of business entities regulated by the Italian Civil Code, foreign investors usually establish a subsidiary in the form of a S.p.a. or S.r.l. to minimize potential liability exposure.

Alternatively, a foreign corporation may set up a branch, which is considered the same legal entity as the foreign corporation. Establishing a branch may require disclosure of the head office's financial statements to the Italian tax authorities.

Another frequently used alternative is a representative office. Although similar to a branch, a representative office is administered by a person or persons who do not take part in management decisions or conclude revenue-producing contracts.

C.2 Mergers and Acquisitions

Mergers

Italian law provides for two types of mergers. Two separate companies can merge to form a single a new company, and the two separate companies then cease to exist. In the other type of merger, which is more common, a company absorbs one or more other companies, and the absorbed companies then cease to exist.

Italy has implemented an EU directive on mergers, which is designed to protect the rights of shareholders and creditors of predecessor corporations.

The authorization of the Bank of Italy must be obtained prior to the merger or transfer of ownership of any bank.

For details on the income tax consequences of mergers, see Section C.7.

Corporate Divisions

Italian law provides for the division of limited liability companies. A dissolving company transfers all of its assets and liabilities to existing companies or companies established for this purpose, and the shareholders of the dissolving company receive shares in the continuing companies. The rules also apply to a company transferring only part of its assets and liabilities to one or more new or existing companies.

C.3 Corporate Taxes at a Glance

Corporate Income Tax Rate (%)	33 (a)
Capital Gains Tax Rate (%)	0/33 (b)
Branch Tax Rate (%)	33 (a)
Withholding Tax (%) Dividends	0/12.5/27 (c)
Interest	0/12.5/27 (d)
Royalties from Patents, Know-how, etc.	22.5 (e)
Branch Remittance Tax	0
Net Operating Losses (Years)	
Carryback	0
Carryforward	5 (f)

- (a) A regional tax on productive activities (imposta regionale sulle attività produttive, or IRAP) is imposed on the net value of production. For further details regarding the IRAP, see Section C.4.
- (b) For details concerning capital gains taxation, see Section C.4.
- (c) Withholding tax is not imposed on dividends paid to resident companies. The 12.5% rate applies to dividends paid to resident individuals with non-substantial participations (for information on substantial and nonsubstantial participations, see discussion of capital gains taxation in Section C.4). The 27% rate applies to dividends paid to nonresidents. Nonresidents may be able to obtain a refund of the withholding tax equal to the amount of foreign tax paid on the dividends. However, the maximum refund is 4/9 of the withholding tax paid. Tax treaties may provide for a lower tax rate.
- (d) The 0% rate applies to interest derived by nonresidents from demand deposits, deposit accounts, and bank and postal accounts. The 12.5% rate applies to interest paid to residents and nonresidents on bonds issued by companies with a minimum maturity of 18 months. In general, the 27% rate applies to interest paid to residents on the following: deposit certificates; savings deposits; and bonds issued by companies with a maturity of less than 18 months. For resident individuals carrying on business activities in Italy and resident companies, the interest withholding taxes are advance payments of tax. For other

resident individuals and nonresident individuals and companies, the interest withholding taxes are final taxes. For residents in tax havens, a final withholding tax at a rate of 27% is imposed on all interest payments.

(e) Applicable to nonresidents. The rate may be reduced under tax treaties.

(f) Loss carry-forwards are allowed only for corporate income tax purposes. Losses incurred in the first three tax years of a activity may be carried forward indefinitely. Anti-abuse rules may limit loss carry-forwards.

C.4 Taxes on Corporate Income and Gains

Corporate Income Tax

Resident companies are subject to corporate income tax (IRES, formerly known as IRPEG) on their worldwide income. A resident company is a company that has any of the following located in Italy for the majority of the tax year:

- Its registered office;
- Its administrative office; or
- Its principal corporate activity.

Nonresident companies are subject to IRES on their Italian-source income only.

Rates of Corporate Tax

The IRES rate is 33%.

Local Income Tax

Resident and nonresident companies are subject to a regional tax on productive activities (*imposta regionale sulle attività produttive*, or IRAP) on their Italian-source income.

For manufacturing companies, IRAP is imposed at a rate of 4.25% on the net value of production, which is calculated by subtracting the cost of production from the value of production. An 8.5% rate applies to public entities performing commercial activities.

Special rules for the calculation of the tax base for IRAP purposes also apply to banking institutions, insurance companies, public entities and noncommercial entities.

Each region may increase or decrease the rate of IRAP by maximum one percentage point. Companies producing income in more than one region will be required to allocate their tax base for IRAP purposes among the various regions and pay the applicable tax to the local tax authorities.

Certain deductions are not allowed for IRAP purposes, such as certain extraordinary costs, credit losses, labor costs (excluding certain compulsory social contributions), and interest expenses (except for banks and holding companies registered under Article 113 of Legislative Decree No. 385/1993).

Capital Gains

Resident Companies and Nonresident Companies with a Permanent Establishment in Italy

In general, capital gains derived by resident companies or nonresident companies with a permanent establishment in Italy are subject to IRES and IRAP. Gains derived from disposals of participations and extraordinary capital gains are excluded from the tax base for IRAP purposes. Extraordinary gains are gains not related to the core business of the company, such as those derived from transfers of going concerns.

Capital gains on assets that have been held for at least three years may be taxed, at the taxpayer's option, entirely in the year of sale or spread over a maximum period of five years.

Under the 2004 tax reform, effective for fiscal years beginning on or after 1 January 2004, Italian corporate taxpayers (that is, companies and branches) may benefit from a participation exemption regime for capital gains derived from disposals of Italian or foreign shareholdings that satisfy all of the following conditions:

- The shareholding is classified in the first financial statements closed during the holding period as a long-term financial investment;
- The Italian parent company holds the shareholding for an uninterrupted period of at least 12 months before the disposal;

- The subsidiary actually carries out a business activity; and
- The subsidiary is not resident in a tax haven as identified in a “black list” contained in a ministerial decree.

Beginning with the third financial year (three full book years) before the year of the disposal, the last two conditions described above must be satisfied uninterruptedly.

Investments in real estate companies are eligible for the participation exemption only under certain limited circumstances.

Capital losses incurred on disposals of shareholdings that qualify for the participation exemption regime are not deductible.

If the conditions described above are not satisfied, capital gains on disposals of shareholdings are included in the calculation of the tax base for IRES purposes. Capital gains on investments that have been recorded in the last three financial statements as fixed assets may be taxed over a maximum period of five years. In addition, any capital losses derived from disposals of such shareholdings may be deducted.

Under a tax-free restructuring regime, capital contributions of going concerns between resident companies may be carried out as tax-neutral transactions. The recipient company records the assets and liabilities at the same value used by the transferor company for tax purposes, and the transferor company receives the newly issued shares of the receiving company at the same value as that of the transferred going concern.

Nonresident Companies without a Permanent Establishment in Italy

If no treaty protection is available, capital gains derived from sales of shares in Italian companies and partnerships by nonresident companies are subject to tax in Italy. Only 40% of capital gains on shares qualifying as a “substantial participation” is included in taxable income for corporate income tax purposes and taxed at the standard rate of 33%. A “substantial participation” in a company listed on a stock exchange requires more than 2% of the voting rights at ordinary shareholders’ meetings or 5% of the company’s capital. For an unlisted company, these percentages are increased to 20% and 25%, respectively.

Capital gains on “non-substantial participations” are subject to a substitute tax of 12.5%. However, certain exemptions may apply.

Administration

Income tax returns must be filed by the end of the 10th month following the end of the company’s fiscal year. Companies must make advance payments of their corporate and local tax liability equal to a specified percentage of the tax paid for the preceding year. This percentage is normally 99%. However, for the 2005 fiscal year, the percentage for advanced payments is 102.5%.

Tax Rulings

Several tax ruling procedures are available in Italy.

Taxpayers may request ordinary tax rulings in order to obtain clarification regarding the application of tax measures to transactions if objective uncertainty exists regarding the tax law. The request for an ordinary tax ruling must include the identification data for the taxpayer, a description of the transaction and a list of applicable measures, circulars and court decisions.

Specific tax rulings are available with respect to a limited range of operations that could result in tax avoidance, including the following:

- Corporate reorganizations;
- Transactions subject to fictitious interposition legislation (legislation under which the tax authorities may attribute income to the beneficial owner);
- Deduction of advertisement and entertainment expenses;
- Exchanges of tax credits and excess taxes;
- Tax-haven transactions; and
- International group companies.

The specific tax ruling request must be submitted to a special committee. In the event of litigation, the burden of proof is on the party that did not comply with the opinion. In practice, the rulings are not binding on the tax authorities but they shift the burden of proof to them.

During 2004 the Italian government introduced a new international ruling scheme, which specifically deals with transfer pricing and cross-border interest, dividends, and royalties. An international ruling is binding for the fiscal year in which the ruling is entered into and for the following two fiscal years, unless material changes in legal or economic circumstances arise.

Dividends

The 2004 tax Reform modified the existing participation exemption regime for dividends. Dividends distributed by companies to Italian entities subject to IRES (companies and branches) are 95% exempt from corporate taxation regardless of the source (domestic or foreign) of such dividends.

Dividends received from subsidiaries located in tax havens qualify for the 95% exemption only if this has been confirmed through an advance tax ruling.

The exemption percentage increases to 100% for taxpayers that elect for tax consolidation or the consortium relief (see *Group of Companies* below).

A 27% withholding tax is imposed on dividends paid from Italian companies to nonresident companies without a permanent establishment in Italy (double tax treaties may provide for lower rates). Nonresidents may obtain a refund of dividend withholding tax equal to the amount of foreign tax paid on the dividends, but the maximum refund is 4/9 of the withholding tax paid. Companies from European Union (EU) member states that receive dividends from Italian companies may be exempted from the dividend withholding tax or obtain a refund of the tax paid if they hold at least 25% of the shares of the payer for at least one year.

For nonresident companies with branches in Italy that are considered permanent establishments (PEs), the treatment of dividends is based on the principle of “PE’s attraction”. Under this principle, dividends are deemed to flow through the Italian branch for tax purposes, and no withholding tax is applicable.

Foreign Tax Relief

A foreign tax credit may be claimed for foreign-source income. The amount of the foreign tax credit cannot exceed that part of the corporate income tax, computed at the standard rate, that is attributable to the foreign-source income. Accordingly, the foreign tax credit may be claimed up to the amount that results from prorating the total tax due by the proportion of foreign-source income over total income.

If income is received from more than one foreign country, the above limitation on the foreign tax credit is applied for each country (per-country limitation). A significant change introduced by the 2004 tax reform is that excess foreign tax credits may be carried forward or back for eight years.

For corporate groups that elect the worldwide tax consolidation (see *Group of Companies* below), an Italian parent company may consolidate profits and losses of its foreign subsidiaries joining the tax group and compute a single group tax liability. Such group tax liability may be offset by a direct foreign tax credit granted to the resident parent company with respect to taxes paid abroad by foreign subsidiaries that are members of the tax group.

C.5 Determination of Business Income

General

To determine taxable income, profits disclosed in the financial statements are adjusted for exempt profits, nondeductible expenses, special deductions and losses brought forward. Exempt profits include interest on government bonds issued on or before 30 September 1986 and income subject to Italian withholding tax at source as a final tax. Interest on government bonds issued after 30 September 1986, however, is not exempt from tax.

Deductions

The following general principles govern the deduction of expenses:

- Expenses are deductible if and to the extent to which they relate to activities or assets that produce revenue or other receipts that are included in income.
- Expenses are deductible in the fiscal year to which they relate (accrual basis rule). Exceptions are provided for specific items, such as compensation due to directors, which is deductible in the fiscal year in which it is paid.

Only one-third of entertainment expenses is deductible. The deductible amount may be deductible in equal installments over five years.

Effective from 2004, decreases in the value of Italian and foreign shareholdings may no longer be deducted.

Companies may not deduct expenses incurred in transactions with enterprises resident in non-EU tax-haven countries. However, this limitation does not apply if it is established that either of the following conditions is satisfied:

- The foreign enterprise is effectively involved in an actual business activity in the country or territory in which it is located; or
- The relevant transactions had a real business purpose and actually took place.

The Ministry of Finance issued a decree dated 23 January 2002, which identifies the tax-haven countries.

Thin Capitalization and Other Limitations on Interest Deduction

The 2004 tax reform introduced two sets of limitations on the deductibility of interest expenses accrued on the following:

- Loans obtained from or guaranteed by shareholders or their related parties (thin capitalization); and
- Loans obtained to finance the acquisition of shares qualifying for the participation exemption (pro rata rule).

Thin Capitalization. The thin-capitalization limitation applies to interest accrued on debts granted or guaranteed by a shareholder, or its related parties, that holds directly or indirectly a participation representing the majority of the voting rights or at least 25% of the share capital of the company. Companies in which the qualified shareholder holds a controlling interest are considered the shareholder's "related parties".

The thin-capitalization restriction applies when the ratio between the yearly average of related-party debt and the company's net equity exceeds 4:1. Under the restriction, the deduction of interest on the debt exceeding the ratio is disallowed. The relevant debts include debts granted by direct or indirect shareholders or their controlled subsidiaries and third-party debts that are guaranteed by shareholders or their controlled subsidiaries.

To the extent that interest paid to related parties is disallowed because the debt-to-equity ratio exceeds 4:1, such interest is treated as a dividend distributed by the company to the related-party lender.

Banks and other financial companies (with the exception of insurance companies) are not subject to the thin-capitalization rules, except for companies that carry out exclusively or principally a holding activity. Accordingly, banks and financial companies may deduct without restriction interest accrued on debt granted or guaranteed by related parties. Companies, other than holding companies, that generate revenues of less than €5,164,569 are not subject to the thin-capitalization restriction.

Pro Rata Rule. The deductibility of interest may be restricted by the pro rata rule even if it is not restricted by the thin-capitalization rules. Under the pro rata rule, the company's net equity is compared to its investment in subsidiaries (Italian and foreign) eligible for the participation exemption regime. The relevant net equity is subject to certain adjustments designed to account for unpaid capital and uncovered operating losses. If the book value of investment in subsidiaries eligible for the participation exemption exceeds the

adjusted net equity, the tax deduction for interest on related and unrelated debts is restricted in proportion of the ratio between:

- a) the excess, and
- b) total assets in excess of the same net equity increased of trade payables.

The pro rata rule does not apply to subsidiaries that elect for tax consolidation or the consortium relief (see *Group of Companies* below).

Foreign-Exchange Losses

Gains and losses resulting from the revaluation at the year-end exchange rate of assets and liabilities denominated in foreign currencies that are not classified for financial statement purposes as long-term investments (excluding those hedged against exchange risk), are included in taxable income.

For assets and liabilities denominated in foreign currencies that are classified for financial statement purposes as long-term investments (excluding those hedged against exchange risk), companies may deduct foreign-exchange losses resulting from the revaluation at the year-end exchange rate. However, a foreign exchange-loss that is deducted from income is recaptured if the average exchange rate for each of the two following financial years is more favorable than the exchange rate used for computation of the deducted loss. The recaptured amount of loss is computed taking into account the lower average rate recorded in the relevant two years.

Non-operating Companies

Italian resident companies and permanent establishments of nonresident companies are deemed to be “non-operating companies” if the total of their average non-extraordinary proceeds (proceeds from the ordinary activities of a company as shown on its financial statements) and increases in inventory are less than the sum of the average of the following during the preceding three years:

- 1% of financial assets;
- 4% of the gross book value of real estate and ships, and 15% of the gross book value of other fixed assets, including, in either case, the price of assets leased from other parties. In this context, the price of leased assets is the cost incurred by the lessor if properly documented. Otherwise, it is the total of the rent and the redemption price payable under the lease.

The above amounts are derived from the company’s annual financial statements.

The taxable income of non-operating companies is deemed to be the sum of the values of the assets described above multiplied by the following percentages: financial assets, 0.75%; real estate and ships, 3%; and other fixed assets, 12%. For this purpose only, the values in the preceding year are taken into account. Non-operating companies are not entitled to value-added tax refunds.

Certain companies are specifically excluded from the non-operating companies’ regime.

Inventories

Inventory is normally valued at the lower of cost or market value for both fiscal and accounting purposes. However, companies may select other methods of inventory valuation specifically provided in the law, such as first-in, first-out (FIFO), last-in, first-out (LIFO) or average cost.

Provisions

Italian tax law provides a limited number of provisions.

Bad and Doubtful Debts. A general provision of 0.5% of total trade receivables at the year-end may be made each year until the total doubtful debt provision reaches 5%. Bad debts actually incurred are deductible to the extent they are not covered by the accumulated reserve and only if they have become irrecoverable or if there are bankruptcy proceedings.

Banks may deduct on a straight-line basis over seven years the write-down of receivables that exceeds the 0.5% limitation described in the preceding paragraph.

Redundancy and Retirement Payments. Provisions for redundancy and retirement payments are deductible in amounts stated by civil law and relevant collective agreements.

Depreciation and Amortization Allowances

Depreciation at rates not exceeding those prescribed by the Ministry of Finance is calculated on the purchase price or cost of manufacture. Incidental costs, such as customs duties and transport and installation expenses, are included in the depreciable base. Depreciation is computed on the straight-line method. Rates for plant and machinery vary between 3% and 15%. Land is not depreciable. The established rates may be increased if assets are more intensely used than they are normally. For the first three years of an asset's life, anticipated depreciation of up to two times the ordinary rate per year may be claimed.

Goodwill that is purchased may be amortized over a period of 10 years.

Patents and know-how may be amortized at amounts not exceeding one-third of the cost each year. The amortization period for trademarks is 10 years.

Research expenses and advertising expenses may be either entirely deducted in the year incurred or written off in equal installments in that year and in the four subsequent years, at the company's option.

Amortization allowances of other rights may be claimed with reference to the utilization period provided by the agreement.

Relief for Losses

For IRES purposes only, losses may be carried forward and deducted from income of the five subsequent tax periods. Stricter rules apply to loss carryforwards if ownership of the company is transferred and if the company changes its activities. Losses incurred in the first three years of an activity may be carried forward for an unlimited number of tax periods.

The company resulting from or surviving after a merger may carry forward unrelieved losses of the merged companies against its own profits for the unexpired portion of the loss carryforward periods. In general, tax losses carried forward may not exceed the lower of the net equity at the close of the last fiscal year or the net equity shown on the statement of net worth prepared for the merger of each company involved in the merger. This limitation is applied on a company-by-company basis. Contributions to capital made in the 24 months preceding the date of the net worth statement are disregarded. Special rules further limit the amount of the losses that can be carried forward.

Groups of Companies

The 2004 Tax Reform introduced tax consolidation and consortium relief for groups of companies. These new regimes allow the offsetting of profit and losses of members of a group of companies.

Tax Consolidation. Italian tax consolidation rules provide two separate consolidation systems, depending on the residence of the companies involved. A domestic consolidation regime is available for Italian resident companies only. A worldwide consolidation regime, at slightly different conditions, is available for multinationals.

To qualify for consolidation, at least 50.1% of the voting rights of each subsidiary must be owned, directly or indirectly, by the common Italian parent company.

For a domestic consolidation, the election is binding for three fiscal years. However, if the holding company loses control over a subsidiary, such subsidiary must be immediately excluded from the consolidation. The tax consolidation includes 100% of the subsidiaries' profits and losses, even if there are other shareholders. The domestic consolidation may be limited to certain entities, leaving one or more otherwise eligible entities outside the group filing election.

Under a domestic consolidation, transfers of assets (other than goods produced or traded by the company, shares, bonds, and other similar securities) between group members may be carried out as tax-neutral transactions if both the seller and the buyer elect the domestic consolidation regime.

Consortium Relief. Italian parent corporations can elect consortium relief if they hold more than 10% but less than 50% of the voting rights in their Italian subsidiaries. Under this election, the subsidiaries are treated as look-through entities for Italian tax purposes and their profits and losses flow through to the parent company in proportion to the stake owned. These profits and losses can offset the shareholders' losses or profits in the fiscal year in course at the date of the closing of the transparent company.

For the Italian corporate shareholders, the consortium relief's benefit consists in the avoidance of the corporate income tax on 5% of the dividends received in addition to corporate income tax paid by the eligible transparent company. Dividends distributed by the transparent company are not taken into account for tax purposes in the hands of the recipient shareholders. In any case, the election does not change the tax treatment of the dividends distributed out of reserves constituted with profits accrued before the election has been exercised.

The Consortium Relief election may be beneficial for joint ventures that are not eligible for tax consolidation because the control test is not met. In addition, the election is also available for nonresident companies that are not subject to Italian withholding tax on dividend payments (that is, EU corporate shareholders qualifying under the EU Parent-Subsidiary Directive).

It must be taken into account that the consortium relief requires the consent of all the shareholders. Therefore, if both EU corporate shareholders qualifying under the EU Parent-Subsidiary Directive and Italian corporate shareholders hold an Italian subsidiary, the former would want to elect the consortium relief in order to allow the Italian corporate shareholders benefiting from the tax transparency.

The Consortium Relief election is binding for three fiscal years.

Group Value-Added Tax. For groups of companies linked by more than a 50% direct shareholding, net value-added tax (VAT; see section C.6) refundable to one group company with respect to its own transactions may be offset against VAT payable by another, and only the balance is required to be paid by, or refunded to, the group.

C.6 Other Significant Taxes

The table below summarizes other significant taxes.

<i>Nature of Tax</i>	<i>Rate (%)</i>
Value-added tax, on goods, services and imports Standard rate	20
Other rates 4/10 Municipal real property tax, imposed on property's cadastral value	0.4 to 0.7
Social security contributions (2005 rates)	
<i>Industry</i> (paid on gross remuneration by employers with more than 50 employees)	
Workers	43.07
Office staff	40.85
Executives	37.49
Executives (additional contributions payable to the National Institute for Social Security Contribution of Industrial Sector Executives, or PREVINDAI, up to €150,000.00)	4.00
Executives (additional contributions payable to other social insurance fund, or FASI)	€2,292.00
<i>Trade</i> (paid on gross remuneration by employers with more than 200 employees)	
Workers	40.87
Office staff	40.87
Executives	37.29

C.7 Miscellaneous Matters

Foreign-Exchange Controls

The underlying principle of the foreign-exchange control system is that transactions with nonresidents are permitted unless expressly prohibited. However, payments by residents to foreign intermediaries must be channeled through authorized banks or professional intermediaries. In addition, transfers of money and securities exceeding €10,329.14, must be declared to the Italian Exchange Office. Inbound and outbound investments are virtually unrestricted.

Transfer Pricing

Italy imposes transfer-pricing rules on transactions between related resident and nonresident companies. Under these rules, intra-group transactions must be carried out at arm's length. A circular of the Italian Ministry of Finance, dated 26 February 1999, states that tax avoidance may result from intercompany transactions carried out with non-arm's length prices. The circular confirms that the existing transfer-pricing rules do not apply to domestic transactions. As a result, adjustments of the prices in these transactions must be based on other anti-abuse provisions.

Controlled Foreign Companies

Law No. 342 of 21 November 2000 introduced a controlled foreign company (CFC) regime. The CFC rules apply if a resident of Italy controls a nonresident company that is subject to a "privileged tax regime." The rules for determining whether an Italian company controls a nonresident company are contained in Article 2359 of the Italian Civil Code. A decree of the Ministry of Finance dated 21 November 2001 provides a "black list" of countries regarded as having privileged tax regimes and entities and activities considered to be subject to such regimes. If the CFC rules apply, the Italian resident is taxed on the resident's share of the profits of the CFC, regardless of the actual distribution of such profits.

Anti-avoidance Legislation

Under Italian anti-avoidance rules (Article 37-bis of Presidential Decree No. 600/1973), in principle, the tax authorities may consider a transaction that involves single or connected acts to be a tax-avoidance transaction if it meets all of the following requirements at the same time:

- The transaction involves one or more of the following operations:
 - Contributions to companies or transfers or use of going concerns;
 - Assignments of credits;
 - Assignments of excess tax credits;
 - Transactions provided for in EU Directive No. 90/434/CEE; and
 - Transactions, including appraisals, regarding participations, securities, certificates, currencies, precious metals, swaps, options, hedging instruments and other specified items;
 - Transfers of assets carried out as tax-neutral transactions between members joining the domestic group taxation regime.
- The transaction was entered into without a sound economic reason.
- The transaction was entered into in order to get around the law.
- The transaction was entered into in order to achieve an undue income tax savings or tax refunds.

The tax authorities may disregard a tax-avoidance transaction for tax purposes. The anti-avoidance rules may be applied for income tax purposes only.

C.8 Financial Reporting and Auditing

Sources of Accounting Principles

Situation until 2004

In 1991, Italy enacted a law that incorporated the EU's Fourth and Seventh Directives into the Italian Civil Code. These directives concern companies' annual accounts and consolidated accounts. The 1991 law established a financial statement format for all limited liability companies other than those subject to special laws, such as banks.

In 2004, several modifications were made to the Civil Code with respect to the rules related to corporate governance and financial statements. Further modifications are expected in the near future in order to align local rules to the ones enacted by the EU for the adoption of international accounting principles in preparing financial statements (see below).

The Civil Code provides detailed guidance concerning the classification of accounts and the format of financial statements. The code also provides limited general guidance concerning specific accounting principles.

In addition, the National Council of Certified Public Accountants (Consiglio Nazionale dei Dottori Commercialisti), a body consisting of university graduates who have passed a special examination and are tax and accounting consultants, has undertaken the establishment of Italian accounting principles and auditing standards. To date, the National Council has issued 30 pronouncements on basic accounting principles that expand the requirements of the Civil Code and also cover matters not contained in the code. The pronouncements do not establish principles or encourage practices that are prohibited by the Civil Code¹.

The National Commission for Corporations and the Stock Exchange (CONSOB; see Section A.4) strongly suggests that publicly owned companies follow the pronouncements of the National Council in the preparation of their financial statements. Although a similar measure does not apply to private companies, the Association of Italian Auditing Firms (Associazione Italiana Revisori Contabili, or Assirevi) has also adopted the principles established by the National Council and recommends that private companies voluntarily comply with those principles. Companies are not legally required to follow Assirevi's recommendation, however. Consequently, the only means by which auditing firms can encourage companies to observe the pronouncements of the National Council is by qualifying, under certain conditions, their reports on the financial statements of those companies that do not comply.

In addition to the activities of the National Council, the Ministry of State - Controlled Companies, which has been merged into the Ministry of Industry, established a committee to develop accounting standards for companies under its jurisdiction. The committee, which includes members of the accounting profession, has issued statements of accounting principles and recommended their immediate adoption by the state-controlled companies. These accounting principles are similar to those promulgated by the National Council.

The Association of Joint Stock Companies (Associazione fra le società italiane per azioni, or Assonime), a large and prestigious private association that publishes interpretations of Italian tax laws and performs business research services, has conducted extensive research on the subject of accounting practices and published recommended standards. These recommendations have no legal force, but they serve as a useful reference.

In summary, Italian companies are subject to the accounting requirements contained in the Civil Code. The additional requirements and recommendations described above are applied by public companies and state-owned companies, which are the most significant business entities in Italy.

¹ ¹ The National Council became a member of the International Accounting Standards Committee (IASC) in 1980. ¹

Situation starting from 2005

In addition to the situation described above, it should be noted that, based on the EU's rules, starting from 2005 companies listed on a stock exchange, banks, insurance companies and certain other companies are required to prepare their consolidated financial statements in accordance with international principles contained in IAS and IFRS.

Public companies and their subsidiaries should prepare also their separate financial statements in accordance with IAS and IFRS starting from 2006 (although early application in 2005 is allowed).

Actually, nonpublic are not required, although they are allowed, to follow IAS and IFRS. Therefore they should continue to prepare their separate and consolidated financial statements based on the rules contained in the Italian Civil Code and in the Italian accounting principles.

In the follows, reference will be made to the rules under the Italian Civil Code and the Italian accounting principles. No reference will be made to rules and accounting treatment under the International accounting principles, considering that such principles and accounting treatment are outside the scope of this document.

Fundamental Concepts

Financial statements must present a true and fair view, and, accordingly, a company's situation must be evaluated using the going concern concept.

Assets are generally stated at historical cost in the balance sheet. At the end of each period, the cost of assets is compared with their market value, realizable value, future benefit or prospects of use, as applicable, and the lowest value is used in preparing financial statements. This approach is implicit in the philosophy that pervades the Civil Code.

Exceptions to the historical cost convention occur in two situations described below. These exceptions apply if the balance sheet would not otherwise provide a true and fair view

The first exception is the existence of exceptional and rare circumstances. In this case, the directors may elect not to adhere to the historical cost convention, and the directors' report must disclose the deviation and its effect on the financial statements. A special circumstance that would justify a departure from historical cost is a change in the way an asset is economically used. For example, if land originally acquired as an investment was subsequently used to build a plant or for other industrial purposes, it may be appropriate to change the valuation basis for the land from cost to market value.

The second exception is the revaluation of assets in accordance with special legislation. Laws permitting the revaluation of fixed assets, intangible assets and certain equity investments are enacted periodically. These laws include the requirement that the revalued amounts may not exceed net realizable or market values. The amount of the revaluation is accounted for as part of shareholders' equity and is taxable only when distributed to the shareholders. Depreciation must be taken on the revalued amounts.

Significant Accounting Principles for Investors

Method of Accounting

The accrual basis of accounting is the only acceptable basis for financial statements prepared in accordance with the Civil Code.

Consolidation

Under the Civil Code, if a limited liability company (S.p.A. or S.r.l.) or a partnership limited by shares controls another entity, it must prepare consolidated financial statements (for details concerning these entities, see Section C.1). The same requirement applies to other forms of entities that control an S.p.A., an S.r.l. or a partnership limited by shares.

A company is deemed to control another company if any of the following apply:

- It has a voting majority in an ordinary shareholders' meeting;
- It has sufficient voting rights to exert a dominant influence; or

- It is able to exert a dominant influence because of its contractual relationships with the other company.

Companies are considered to be affiliated if one exerts a significant influence on the other. A significant influence is presumed if a company has at least one-fifth of the voting rights (one-tenth if the company is listed) of another company.

Inventory

Under the Civil Code, inventories must be valued at the lower of cost or market value. The National Council provides definitions of the various types of costs that may be capitalized in inventories and the methods acceptable for their valuation (these include LIFO, FIFO and average cost). In general, all costs that contribute, directly or indirectly, to the physical production of inventory may be capitalized, excluding sales, administrative and indirect financial expenses.

Deferred Tax Accounting

The Civil Code makes no specific provision for accounting for deferred taxes. However, the accounting treatment applicable to deferred tax under Italian GAAP is defined in the accounting principle number 25 issued by the National Council of Certified Public Accountants. It states that deferred tax assets and liabilities on temporary difference between financial reporting under the Civil Code and tax returns should be determined based on the liability method. Accounting principle number 25 determines also the rules for the accrual of such tax assets and liabilities (e.g. recognizing deferred taxes as an asset assumes that taxable income will exist in years when the applicable timing differences reverse). Temporary differences are often due to the fact that certain expenses are subject to maximum allowable percentages under the tax rules and may need to be adjusted accordingly in arriving at taxable income, resulting in timing differences between the books and the tax return. For example, the Civil Code requires that receivables be stated at net realizable value, which requires an estimation of an appropriate provision for doubtful accounts. In contrast, the tax laws permit the deduction of only a certain percentage of total receivables in a year; similarly, repairs and maintenance expenses are deductible for tax purposes only up to an annual maximum of 5% of total fixed assets.

Revenue and Expense Recognition

Under the Civil Code, in general, revenues must be recognized only when their realization is reasonably certain and objectively measurable, while expenses must be accounted for when they are expected to be incurred. Observance of this rule generally results in accounting issues because expenses are generally deductible for tax purposes only when they are incurred. Compliance with this rule generally causes operating income to differ for tax and financial accounting purposes and necessitates the use of deferred tax accounting (see Deferred Tax Accounting above).

Disclosure, Reporting and Filing Requirements

Disclosure Requirements

Based on the Civil Code, the financial statements of companies must include a balance sheet, an income statement, and notes containing specified information, and they must be prepared according to a standard format.

The standard balance sheet format requires the classification of assets, net of depreciation and any devaluation adjustments, into four categories, which are further subdivided into classes. Each class contains individual accounts and allows for new accounts as necessary. Similar groupings are specified for liabilities. A minority interest is included in consolidated equity instead of being classified as a liability.

Companies not exceeding two of the following parameters in two consecutive years may use an abridged version of the standard format:

- Total assets of €3.125 million;
- Turnover of €6.250 million; and
- An average labor force of 50 employees during the year.

Occasional departures are permitted from the standard formats if the departures are adequately justified and additional information is provided if needed. The additional information must be included in notes to the financial statements.

Companies in control of other entities (see Consolidation for the definition of controlling companies) must prepare consolidated financial statements consisting of a balance sheet, an income statement and related notes. The statements must generally follow the same format as the controlling company's separate financial statements. Exceptions to the requirement to prepare consolidated financial statements apply based on various criteria, including the group's size. The reasons for applying the exceptions must be stated in the notes to the financial statements.

The directors of the controlling company are responsible for the preparation of the group's consolidated financial statements, and verification is entrusted to the subject in charge of the statutory audit (a certified auditor or an auditing firm). For public companies the consolidated financial statements should be audited by an auditing firms registered with CONSOB (for further details regarding audits, see Audit Requirements).

Reporting Requirements

The directors must present to shareholders their report on the company's operations for the year, together with the board of statutory auditors' report and the independent auditor's report, 15 days before the shareholders' annual meeting, which is usually held within four months after the company's balance sheet date. Public companies must file six-months' financial information with the Statutory Board report and, generally, the review report. Public companies must also prepare a quarterly report containing unaudited quarterly condensed financial information. This report must be filed with the company's head office and stock exchange management companies. The filing of this report must be disclosed in the press.

Filing Requirements

Within one month after approval by the shareholders, the financial statements for the year and the statutory auditors' report, together with the independent auditors' report for a listed company, must be filed with the Register of Enterprises.

Audit Requirements

Following to the modification made in 2004 to the Civil Code, with respect to the rules related to corporate governance and financial statements, limited liability companies are now required to appoint an independent auditor

- to audit their separate (and consolidated if any) financial statements and
- to monitor the correctness of the company's books and accounts on a quarterly basis.

The independent auditor is appointed by the company and could be an individual or an auditing firm or, under certain conditions (e.g. the company is not required to issue a consolidated financial statements), the statutory auditors (Collegio sindacale; see below for further details).

In any case, the individual, the auditing firm or the majority of the board of statutory auditors should be registered in a special register of approved auditors.

No standard form of audit report is required by the Civil Code.

Board of statutory Auditor

In addition to the above auditor, the companies are requested to appoint a further governance body, named the board of statutory auditors (Collegio sindacale): under the Civil Code, limited liability companies that have capital with a nominal value of €120,000 or more must have a board of statutory auditors (the so called "Collegio Sindacale"). Regardless of the amount of capital, a board of statutory auditors is required if, for two consecutive years, two of the following parameters are exceeded:

- Total assets of €3.125 million;
- Turnover of €6.250 million; and
- An average labor force of 50 employees.

The board of statutory auditors consists of three or five members and two substitute members. The members of the board of statutory auditors, who must be individuals, are appointed by the company's shareholders for a term of three years. They must perform the following activities:

- Determine whether the provisions of Italian laws and the company's articles of association are being observed.
- Exercise monitoring activities on the correctness of the principles based on which the business is managed, in particular with respect to the adequacy of the design and operation of the company's procedures from an organizational and accounting perspectives.

In addition, only under certain condition, the board of statutory auditors could be appointed to perform the audit of the financial statements and to monitor the correctness of the company's books and accounts on a quarterly basis.

Registered Auditing Firms

The accounts of listed companies, state-controlled companies, municipality - controlled companies, large consortia, insurance companies, brokers (securities traders) and publishing companies must be examined by auditing firms registered with CONSOB (see Section A.4). The auditing firm, chosen from a special CONSOB roll, is appointed by the shareholders for three years and may be reappointed for two successive three-year terms.

The report must express the opinion that the balance sheet and the income statement (consolidated as the case may be) are prepared clearly and give a true and fair view. The conformity is determined in accordance with the law applicable to financial statements. If the auditing firm determines that it cannot give such an opinion either because it is unable to do so or because it has substantial disagreements with the financial statements, it must explain the reasons in its report and inform CONSOB immediately.

The auditing firm must be independent of the company it audits. The firm's auditors must carry out all work that they consider necessary to enable them to fulfill their duties; they may not accept any restrictions relating to the work.

Following to the recent improvement of the law occurred in 2004, also nonpublic companies are required to have their financial statements examined by an external auditor and, under the rules described in the previous paragraph, could choose to appoint as external auditor their board of auditors, a certified auditor or an auditing firm. The non-public companies who appoint an auditing firm, however, could choose between both auditing firms registered or not registered with CONSOB. In case an auditing firm has been appointed, the report and independence rules are similar to the ones described above for public companies.

D. Individuals

D.1 Income Tax

Who Is Liable

Residents are subject to personal income tax (IRE) on worldwide income. Nonresidents are taxable on Italian-source income or on income earned in connection with activities performed in Italy.

Individuals are considered resident for income tax purposes if, for the greater part of the tax period, any of the following applies: their habitual abode is in Italy, the center of their vital interests is in Italy or if they are registered with the Records of the Resident Population in Italy.

Italian citizens who move their residence for tax purposes to countries included in a “black list” are deemed to be tax resident in Italy in any case, unless they provide specific evidence of their non resident status.

Income Subject to Tax

Taxable income for personal income tax purposes consists of income from the following categories:

- Income from employment;
- Income from self-employment;
- Income from real estate;
- Income from capital;
- Business income; and
- Miscellaneous income, including capital gains.

Each category is defined by law. If income falls under a category not specifically mentioned in the law, further investigation is needed to determine the tax treatment. The uncategorized income may not be automatically aggregated with miscellaneous income.

For a table outlining the taxability of income items, see Appendix 1.

Employment Income

Employment income is income derived from work performed for an employer. It includes any compensation, either in cash or in kind, received during a tax period in connection with employment, including any payments received as shares of profits, from acts of generosity or as reimbursement for expenses incurred in the production of the income. Benefits in kind are valued for tax purposes at the arm’s-length value, calculated in accordance with specific regulations. Any compensation received in connection with employment is considered employment income, even if the compensation is paid by a third party (for example, the legal employer’s parent company).

Employment income also includes income known as “income deriving from a collaboration”.

The so-called “Biagi Reform”, approved by the Italian Government on July 31, 2003, has consistently modified the panorama of para- *subordinate* collaborators. In particular, the job relationship has to be connected to a specific project, a work program or phase of a program - i.e. so-called “*lavoro a progetto*”-. Otherwise, the relationship will automatically be considered as a subordinate employment relationship, with all implications in the field of social security and other labor related obligations.

Said income includes fees for consulting and directors’ services. As a result of this change, the payer of the income must withhold income taxes on a monthly basis from the gross income and apply social security contributions based on the amount of the income. The recipients of the income are also required to make social security contributions on the income, which are withheld at source. These rules do not apply to income from a collaboration earned by a professional individual who is registered in one of the “Professional Register” (e.g. lawyers, engineers, etc.).

The following items are not included in taxable employment income:

- Mandatory contributions paid by an employer and by an employee for social security as provided by law
- Contributions, up to a ceiling of €3,615.20, paid by an employer or an employee to entities or funds for the sole purpose of medical assistance in accordance with collective labor contracts or company agreements and regulations;
- Voluntary social security contributions to qualified and individual pension funds and life insurance premiums, which are deductible from gross income in an amount not to exceed 12% of gross income up to a ceiling of €5,164.57;
- Stock options and share purchase plans granted under certain conditions; and

- Business trip indemnity, up to a maximum of €46.48 for trips within Italy and up to €77.47 for trips abroad if the employer reimburses only the travel expenses.

In addition, certain benefits in kind, including meals in factory cafeterias and transportation services provided to a majority of employees, up to certain amounts and under specified conditions, are not included in taxable employment income.

Nonresidents are subject to tax on income from employment derived from services performed in Italy and pensions paid by the state or by Italian residents.

A more favorable regime is applicable to those individuals who meet the following conditions:

- the individual is tax resident of Italy;
- the employment activity is rendered wholly and continuously abroad for more than 183 days in a 12 months period and;
- the employee's assignment abroad is regulated by the employment contract or by other written agreement signed by the parties.

According to the above regime, the compensation to be considered as taxable in Italy is a "notional remuneration" stated by the Italian Ministry of Finance.

Self-Employment Income

Self-employment income consists of income from a profession, including accounting, law and medicine. Effective from 2001 tax year, income deriving from a collaboration is treated as employment income (*see Employment Income*, above). Residents are subject to tax on worldwide self-employment income at the rates described in *Rates*; a 20% withholding tax applies to income derived from Italian sources. Nonresidents are subject to tax on income from self-employment derived from services performed in Italy. Nonresidents are subject to a final withholding tax of 30% on self-employment income and need not to file a tax return.

For professionals, taxable self-employment income consists of the differences between compensation received during a tax period and related expenses incurred during the same period. In particular, the following rules apply:

- Hotel and restaurant expenses may be deducted, up to 2% of compensation received in the period.
- Entertainment expenses may be deducted, up to 1% of compensation received in the period.
- Depreciation on fixed assets used for a business may be claimed at rates fixed by the Ministry of Finance. Accelerated depreciation is not allowed. If the fixed assets are also used personally, only 50% of ordinary depreciation may be claimed.
- Leasing contract fees may be deducted if the life of the contract exceeds half the ordinary depreciable life of the leased asset.

Professional income is subject to value-added tax (VAT) and bookkeeping is required. In addition, professional income is subject to a regional tax, or IRAP, at a rate of 4.25% (*see Business Income*).

Business Income

Business income consists of income derived from the commercial or industrial activities (entrepreneurial activities) described in the Civil Code.

Taxable business income consists of profits disclosed in the financial statements, adjusted for exemptions, disallowed expenses, special deductions and losses carried forward.

Taxable business income is subject to personal income tax at the rates described in *Rates*. In addition, business income is subject to a regional tax on productive activities called IRAP. IRAP is levied at a rate of

4.25% on the amount of net production income derived from activities carried out in Italy. This amount is calculated by adding to financial income certain costs that are not deductible for IRAP purposes (for example, salaries paid to employees and interest expense).

Nonresidents are subject to tax on business income from a permanent establishment in Italy.

Directors' Fees

Directors' fees are taxed in the same manner as employment income (see *Employment Income*). The company must withhold income taxes at the marginal income tax rate on a monthly basis. However, this tax treatment does not apply if the services are performed by a professional individual who is registered for VAT purposes (see *Self-Employment Income*).

Investment Income

Dividends: 40% of dividends received is taxed as ordinary income (see *Rates*) if the individual has a qualified participation, or they are subject to a separate final withholding tax of 12.5% if the recipient individual has a nonqualified participation (for listed companies, a nonqualified participation is a participation with no more than 2% of the voting rights in the ordinary shareholders' meeting or with no more than 5% of the issued capital. For unlisted companies, a nonqualified participation is a participation with no more than 20% of the voting rights in the ordinary shareholders' meeting or with no more than 25% of the issued capital). 100% of dividends received by an individual from a company resident in a "tax haven" (as defined by Italian authorities) is included in ordinary income.

Dividends paid to nonresidents are subject to withholding tax at a rate of 27% if deriving from ordinary shares and of 12.50% if related to saving shares; tax treaties may provide for a lower tax rate. In addition, nonresidents may claim reimbursement of foreign tax paid (with reference only to ordinary shares) up to four-ninths of dividend withholding on dividend income paid by an Italian company, that is also taxed in their country of residence (this rule is not applicable if the tax treaties is applied).

Interest: Italian-source interest is usually subject to withholding tax at a rate of 12.5% or 27%; therefore, such interest is not aggregated with other taxable income. Foreign-source interest may be either included with other income and taxed at the rates described in *Rates* or taxed separately at a rate of 12.5% or 27%.

Interest paid to nonresidents is subject to a final withholding tax of 12.5% or 27%; tax treaties may provide for a lower tax rate.

Interest paid to nonresidents derived from a bank and postal accounts and from bonds issued by banks, listed companies and other particular entities if the foreign recipient is resident in a white list country (as defined by Italian authorities) is exempt from tax.

Royalty: Royalties derived from patents, trademarks and know-how are taxable at the rates set forth in *Rates on 75% of amount*. Nonresidents are subject to final withholding tax at a rate of 30% on 75% of the amount of royalties received.

Rental income: Rental income derived from real property is taxed as ordinary income (see *Rates*). If the rent shown in a rental agreement, less a reduction of 15%, exceeds the cadastral income, the amount taxable is deemed to be equal to the rental income less the reduction. Real property is also subject to a local municipal tax (ICI) levied at rates ranging from 0.4% to 0.7% of the property's legal value (cadastral value).

Capital Gains and Losses

Capital gains from the sale of securities (including stock, shares representing capital and other similar interests, convertible obligations, stock options and similar rights), not realized from business activities, are subject to the following rules:

- Substitutive tax at the rate of 12.5% on the gain if the transaction does not involve a qualified percentage of the company stock (a qualified stake is a sale of more than 2% of the voting rights, or more than 5% of the issued shares, in case of a company listed on a regulated stock market, or a sale of more than 20% of the voting rights, or more than 25% of the shares, in case of an unlisted company); or

- Ordinary rates on 40% of the gain if the transaction involves a qualified percentage of the company stock; or
- Ordinary rates on 100% of the gain derived from qualified sales of shares in companies residing in a “tax haven” (as defined by the Italian authorities).

The tax is applied on the taxpayer’s net capital gain for the tax year (i.e., total capital gains less capital losses for the same period) as indicated in the annual income tax return. Generally speaking, the capital gain or loss is equal to the sales proceeds reduced by the purchase cost and reduced by the value that has already been taxed. If the taxpayer’s losses exceed gains, the difference may be carried forward up to a maximum of four years against future capital gains. The capital gains tax must be paid by the same date as the balance tax payment due according to the taxpayer’s annual income tax return. If the security is held with an Italian resident intermediary (e.g., Italian agent bank, etc.) and the transaction does not involve a qualified percentage of the company stock, an election may be made under which the tax due is withheld at source by the Italian resident intermediary and the transaction does not need to be reported in the taxpayer’s annual income tax return.

Deductions

Deductible Expenses

No expenses are specifically deductible from taxable income. However, mandatory social security contributions paid by an employee may be deducted from gross income derived from all sources in determining taxable income.

Personal Deductions, Tax Credits and Allowances

No expenses are specifically deductible from taxable income. However, alimony paid to a spouse from whom the taxpayer is legally separated or divorced may be deducted from gross income derived from all sources in determining taxable income.

A tax credit of up to 19% of the following expenses is granted:

- Interest paid to European entities on mortgage loans for real estate located in Italy that is used as a principal abode, up to a maximum amount of €3,615.20;
- Medical expenses, including specialized medical treatment, surgical expenses and prostheses, for the taxpayer or dependants if the expenses exceed €129.11;
- Life and health insurance premiums, up to a maximum amount of €1,291.14 (applies only in certain circumstances);
- University tuition expenses, not exceeding tuition charged at state universities; and
- Funeral expenses, up to a maximum amount of €1,549.37.

The following deductions may be claimed by resident taxpayers, regardless of the category of income earned.

<i>Type of Allowance</i>	<i>Amount</i>
Dependent spouse (a)	€3,200 depending on the amount of income of the taxpayer
Each dependent child (a)	€2,900 (b) (c) (d), depending on the amount of income of the taxpayer.

(a) A taxpayer’s spouse or child is considered a dependent if he or she earns less than €2,841.

(b) For each dependent child under three years of age, the amount is increased by €50.

(c) For the first child the allowance is increased up to €3,200 in three different cases:

1) the taxpayer is not married and the spouse is absent or has not recognized his natural children;

2) the taxpayer is married but he has subsequently divorced;

3) the children have been adopted only by the taxpayer either if he is married or he is divorced.

(d) For each child with handicap the amount is increased by €800.

Foreign taxes paid by resident taxpayers on foreign-source income may be credited against the personal income tax. The maximum amount of foreign tax that may be credited is the full amount of Italian taxes attributable to the foreign-source income, based on the proportion of the foreign-source income to the aggregate income.

Business Deductions

In addition to deductible expenses specifically allowed, other expenses may be deducted from aggregate income for personal tax as described above. The allowances for a dependent spouse and children also apply.

Rates

The following tax rates apply for personal income tax (IRE) in 2005:

<i>Taxable Income</i>		<i>Tax on Lower</i>	<i>Rate on</i>
<i>Exceeding</i>	<i>Not Exceeding</i>	<i>Amount</i>	<i>Excess</i>
€	€	%	%
0	26,000	23	
26,000	33,500	23	33
33,500	100,000	33	39
Over 100,000	-	33	39+4