

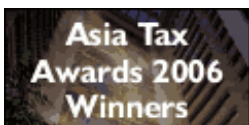
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Italy: Ruling on the tax treatment of the Italian branch of a UK Limited Liability Partnership reveals potential disputes

Gianni Origoni Grippo & Partners

Preliminary ruling no. 80/E, dated April 26 2007 (the ruling) has addressed the Italian tax treatment of the income produced by an Italian branch of a law firm organised as a UK Limited Liability Partnership (LLP). The ruling also looked at how income is attributed to the LLP's Italian partner is to be taxed.



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The ruling acknowledged that if the LLP is planning to open an Italian Branch to provide legal services therein, is treated as a transparent entity for UK tax purposes and the LLP's net income is attributed, irrespective of any distribution, as a flow-through to all its partners. Each partner would then pay UK taxes on the portion of the LLP's net income subject to UK taxes attributed to him/her.

The Italian Branch: Based on the ruling, the LLP shall be treated for Italian income tax purposes as an autonomous taxpayer and not as a transparent entity. The LLP would be subject to Italian tax on the income deriving from the legal activity carried out in Italy. The LLP would qualify as a foreign "non commercial entity" and the LLP's taxable net income would have to be determined by applying the rules established by Articles 53 and 54 of the Italian Tax Code for determining the professional services income (as if it were an Italian law firm but only with respect to the income originated from activities carried out in Italy). The net income would be subject to the 33% corporate income tax (IRES), and possibly the 4.25% regional tax (IRAP) as well. The above taxes would be non deductible costs for the LLP/Italian branch and it is not clear if, how and to what extent somebody (for example, the LLP itself or its non-Italian partners) would be entitled to claim a credit in respect of such taxes or whether withholding taxes would apply on payments made to the LLP/Italian Branch from its Italian corporate clients. The ruling addressed neither of these points.

The Italian Partners: Based on the ruling, the income derived by the Italian partners, even if treated as partnership income in the UK and subject to UK tax on a flow-through

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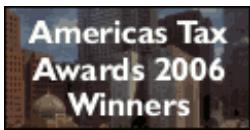
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basis, shall be treated as a dividend for Italian tax purposes.

To the extent an Italian partner would not be entitled to more than 20% of the voting rights in (or 25% of the capital of) the LLP, the dividend would be subject to Italian tax at the time it is effectively received and subject to an ad-hoc substitutive taxation (presently at a rate of 12.5%, expected to be increased to around 20% in the near future), on the gross amount therefore, including the portion of dividend utilised to pay the UK taxes due by the recipient. Because of the application of the ad-hoc substitutive taxation, no tax credit would be available to an Italian partners for the UK taxes paid by him/her or for any Italian taxes paid by the LLP/Italian branch.

An Italian Undertaking: It is important to note that both an Italian partnership and an Italian "company among lawyers" (each an Italian undertaking.) would be treated very differently. When compared to the LLP/Italian branch. Indeed an Italian undertaking could be treated as an autonomous taxpayer for IRAP purposes and would be a transparent entity for personal income tax purposes (IRE). A 20% advance withholding tax would apply on payments received from its Italian corporate clients. The Italian undertaking's net income would not be subject to 33% IRES and would count as a flow-through to all its partners. Each partner would be subject to IRE on his/her portion of such net income at progressive rates as high as 45.2% (including certain local surtaxes), although he/she would be entitled to a tax credit for his/her share of the advance withholding suffered as well as for the foreign taxes paid by him/her (with the ordinary limits set forth by Article 165 of the Italian Tax Code).

The above differences mainly derive from the hybrid qualification of the LLP (transparent, for the UK and opaque, for Italy) and from the lack of specific and detailed Italian tax rules addressing foreign undertakings carrying on professional services. However, since the above differences are based on the different nationality/residence of the relevant undertakings, the existing Italian rules appear incompatible with, EC treaty rules on freedom of establishment and/or the freedom of services.

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