



Film Financing and Television programming

A Taxation Guide



Now in its eighth edition, KPMG LLP's ("KPMG") Film Financing and Television Programming: A Taxation Guide (the "Guide") is a fundamental resource for film and television producers, attorneys, tax executives, and finance executives involved with the commercial side of film and television production. The guide is recognized as a valued reference tool for motion picture and television industry professionals.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps producers and other industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including film and television development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in the financing of film and television productions, the Guide includes a robust discussion of relevant tax incentive programs in each country.

The primary focus of the Guide is on the tax and business needs of the film and television industry with information drawn from the knowledge of KPMG International's global network of member firm media and entertainment Tax professionals.

Each chapter focuses on a single country and provides a description of commonly used financing structures in film and television, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

Introduction

A thumbnail description of the country's film and television industry contacts, regulatory bodies, and financing developments and trends.

Key Tax Facts

At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

Financing Structures

Descriptions of commonly used financing structures in film and television production and distribution in the country and the potential commercial tax implications for the parties involved. The section covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

Tax and Financial Incentives

Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

Corporate Tax

Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

Personal Tax

Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

Digital Media

For the first time, we have included a discussion of digital media tax considerations recognizing its growing role in the distribution of film and television content.

KPMG and Member Firm Contacts

References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

Thank you and we look forward to helping you with any questions you may have.

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Introduction

Since the Italian government has been considering the film industry relevant, it has issued a series of incentives to promote the Italian production of films and their distribution both in Italy and abroad.

Therefore, the film industry has been expanding in Italy, and certain types of transactions are becoming more and more common. In any case, it is advisable for foreign investors to consider carefully the Italian fiscal implications before commencing business in this country.

Key Tax Facts

Corporate tax rate	24%
Highest personal income tax rate	43%
Regional tax on productive activities (IRAP)	3.9% (ordinary rate for FY 2018, which can be increased up to 0.92% by each region)
VAT rates	0%, 4%, 10%, 22%
Annual VAT registration threshold	None
<i>Normal non-treaty withholding tax rates:</i>	
Dividends	1.20%, 26%
Interest	12.5%, 26%
Royalties	22.5%, 30%
Tax year-end: Companies	As established by the bylaws
Tax year-end: Individuals	31 December

Film Financing

Financing Structures

Co-Production

An Italian investor may enter into an Italian-based co-production joint venture (JV) with a foreign investor to finance and produce a film in Italy. The rights of exploitation may be divided worldwide among the JV members, although the Italian company may retain exclusive media rights in Italy.

Note that the entity subject to taxation would be each investor in the JV, not the JV itself.

Provided that the exploitation can be kept effectively separate from the production, the foreign investor should not be subject to Italian tax on the income received from exploiting the film outside Italy, because the investors do not share overall revenues, but get various worldwide rights to exploit the film from their own home territory. As long as the foreign investor cannot be said to be carrying on a trade or business of film exploitation in Italy, Italian tax would be solely chargeable in respect of the Italian investor's activities and any other trade that the foreign investor may carry on in Italy.

The issue is complicated if the foreign investor produces the film in Italy under a production contract. In that case, he is likely to be taxed assuming that business profits are realized by the permanent establishment operating in Italy. This might provoke some discussions with the Italian tax authorities as to the proper level of profit that should be returned to Italy. It would be more sensible to create a separate Italian-incorporated special-purpose company in order to undertake the production and set an appropriate market rate for the production fee so that this risk could be decreased.

On the basis of the proposed structure, the Italian investor would be taxed on the full amount of its profits arising in respect of film production and exploitation. Unless the transaction was carefully structured, the foreign investor could be taxed on a similar full amount of profits and it would need to help ensure that its exploitation did not form an Italian trading activity.

The Italian company would be taxed on the profits arising from its exploitation of the film. The foreign investor would only be taxable if it produced the film, provided the correct corporate structure was in place.

If the foreign investor produces the film in Italy, he is likely to have a production office and hence a permanent establishment in Italy. As previously stated, its business profits arising from such permanent establishment would be taxed in Italy, and it would have to rely on the applicable treaty to obtain relief.

Examples of the relief available under such treaties are as follows:

U.S.	Italian tax on business profits creditable against U.S. tax (Article 23)
Netherlands	Business profits exempted from tax where already taxed in Italy (Article 24)
Australia	Italian tax on business profits creditable against Australian tax (Article 24)
Japan	Italian tax on business profits creditable against Japanese tax (Article 23)

As indicated above, the foreign investor should not undertake the film production through a permanent establishment in Italy but should create a special purpose company. Any exploitation arrangements should be structured in such a way as to help ensure that the foreign investor exploits the film within its home territory.

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Partnership

Occasionally financial investors¹ from several territories and film producers become limited and general partners respectively in an Italian partnership, all contributing funds. The partnership may receive royalties under distribution agreements from both treaty and nontreaty territories, proceeds from the sale of any rights remaining after exploitation, and a further payment from the distributors to recoup any shortfall in the limited partners' investment. Such proceeds may first be used to repay the limited partners (perhaps with a premium, such as a fixed percentage of the superprofits).

In such an event, an Italian-resident limited partner will have acquired an interest in the partnership. It will pay tax on its share of chargeable profits, including any "superprofits."

Investors would still need to pay tax on their share of profits and it would be necessary to rely on an applicable treaty to obtain relief. See above examples of the relief available under certain treaties.

A partner may be resident in Italy and the partnership's office may be located elsewhere. If the only activity that takes place in a territory is the production of the film, there would be two permanent establishments, one being the office located in the foreign territory and the other being the film production office in Italy. If one or more partners are resident in Italy, the Italian tax position would depend on where the partnership was controlled.

It could be that the partnership's business would be carried on partly in Italy and partly abroad. If the partnership was resident abroad, all the partners would be charged tax on the entire profits arising in Italy, while the Italian-resident partner would also pay tax on his or her share of the profits arising outside Italy. If the partnership was resident in Italy, all of the partners would be charged tax on the whole of the profits arising in, and from outside of, Italy, whether received or not.

Consequently, the tax position of an Italian-resident partner in the above circumstances is as follows when the partnership is located in the following territories:

U.S.	U.S. tax on business profits creditable against Italian tax (Article 23)
Netherlands	Dutch tax on business profits creditable against Italian tax (Article 24)
Australia	Australian tax on industrial or commercial profits creditable against Italian tax (Article 24)
Japan	Japanese tax on business profits creditable against Italian tax (Article 23)
Nontreaty country	The tax remains payable but is creditable in Italy as "unilateral" relief.

¹ According to the Reform of Corporate Law, in force from January 1, 2004, even limited companies can become partners of an Italian partnership.

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Equity Tracking Shares

These shares provide for dividend returns depending on the profitability of a film production company's business. Tracking shares have the same rights as the production company's ordinary shares, except that the dividends are linked to the profits of a particular business sector. In addition, the corporate bylaws could remark particular rights to such shares.

According to the Italian Corporate Law Reform, in force from January 1, 2004, it is possible for an Italian-resident stock company to issue tracking shares. In that case, the dividend arising from such shares issued by an Italian production company is subject to different taxation rules depending on the quality of the investor.

With respect to shares issued by a nonresident company and acquired by an Italian-resident company, according to the Italian Tax Law, the shares could be treated in Italy as giving rise to dividends, only if their payment is linked to the profits (or losses) of the company. Thus, tracking shares issued by a production company not resident in Italy normally yield dividends, which would be treated in the same way as dividends arising from ordinary shares.

As a result, dividends distributed to Italian-resident individuals are taxed on 26% of their amount.² Dividends distributed to Italian companies are taxed, if certain conditions are fulfilled, only on 5% of the total amount without regard to the shareholding.

Any tax withheld would be dealt with according to the dividend article of the appropriate double tax treaty.

Yield-Adjusted Debt

A film production company may issue a debt security to investors. Its yield may be linked to revenues from specific films. The principal would be repaid on maturity and there may be a low (or even nil) rate of interest stated on the debt instrument. However, at each interest payment date, a supplemental (and perhaps increasing) interest payment may be made where a predetermined target is reached or exceeded (such as revenues or net cash proceeds).

It is necessary to investigate the nature of the "debt security" in order to establish the treatment of the "interest" for the beneficiary and for the debtor. In fact, in certain cases, interest may be assimilated to the dividend.

If the debt security is fiscally considered as a debt, the interest payment is deductible,³ and it is subject to a withholding tax of 26% if paid to resident individuals and nonresident persons (both corporations and individuals).

² The substitute tax at 26% is applicable if the shareholding is lower than 20% of the share capital and if the shareholding is higher than 20% of the share capital and:

- (i) Dividends are accrued after January 1, 2018;
- (ii) Dividends are accrued up to December 31, 2017, but approved after December 31, 2022.

If the shareholding is higher than 20% and dividends are accrued since December 31, 2017 but approved in the period between January 1, 2018 and December 31, 2022, dividends are subject to personal income tax on:

- (i) 40% of the amount for those accrued since December 31, 2007;
- (ii) 49.72% of the amount for those accrued over the period between January 1, 2008 and December 31, 2016;
- (iii) 58.14% of the amount for those accrued over the period between January 1, 2017 and December 31, 2017.

³ In this case, corporations' interest payments are deductible up to 30% of the gross operating margin.

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An applicable tax treaty could provide for lower withholding tax rates on payments to nonresident persons.

Other Tax-Effective Structures

There are no other particular tax-effective structures in Italy.

Tax and Financial Incentives

Investors

The interest payable on loans and other forms of business debt can be deducted for tax purposes (but not for IRAP purposes). However, the loan principal can never be deducted when calculating taxable profits.

Other general tax incentives for investment include certain beneficial rates of tax depreciation (known as “Capital Allowances”) for plant and buildings and certain qualifying investments.

Producers

Producers are eligible for contributions for the production of “Italian film.”

A film is considered an “Italian film” if it meets a minimum score of 70/100 on the following requirements and at least 18 points under items 1, 2, 3, and 4 below.

- a) Italian or European nationality or, irrespective of their nationality, subject to taxation in Italy of:
 1. Director or the majority of the directors (10 points)
 2. Author of the subject matter or the majority of the authors (8 points)
 3. Author of the screenplay or the majority of the authors (10 points)
 4. Majority of principal actors (8 points)
 5. Three quarters of the secondary role actors (5 points)
 6. Photographic director (7 points)
 7. Assembly director (7 points)
 8. Composer of the music (7 points)
 9. Scenographer (6 points)
 10. Costume designer (6 points)
- b) The film is shot in Italy at least at 50% (10 points)
- c) The film is shot directly or mainly in the Italian language or in Italian dialect (5 points)
- d) At least 50% of the troupe must be subject to Italian taxation (5 points)
- e) Shooting carried out mainly in Italy (2 points)
- f) Use of Italian theaters (2 points)
- g) Post-production mainly carried out in Italy (2 points)

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In certain cases, the film may qualify as Italian even if some of the above requirements are not met or when produced under an international co-production treaty with foreign producers.

Distributors

The Italian government provides contributions to encourage the distribution of films in Italy and abroad. The condition to obtain the contribution is that the distributed film must be "Italian," as discussed above.

The tax treaties negotiated by Italy are generally favorable, with respect to payments of film copyright royalties, provided that they do not arise in the conduct of a business operated through a permanent establishment in Italy. In certain circumstances, a tax treaty may apply a reduced or nil withholding tax rate.

Actors and Artists

There are no tax or other incentives available for actors, or other artistic individuals, who are Italian residents for tax purposes.

Other Incentives

The following are the main incentives introduced by the Law 14/11/2016 n. 220 that apply to Italian companies or permanent establishments in Italy relating to cinematographic and audiovisual works qualified as "Italian":

1) Tax credits

Company not yet operating in the film industry

To incentivize investments in the film industry, limited and unlimited liability companies and individuals can receive a tax credit set at a 30% of the capital contributions for the production and distribution of cinematographic and audiovisual works in Italy and abroad. The tax credit can be raised up to 40% if the investment is made for the development and production of works that have received the selective contributions provided for by Law 220/2016.

Producers

Production companies can receive a tax credit of not less than 15% and not exceeding 30% of the overall production costs. The maximum amount of expenditure is € 2,500,000 per year.

Distributors

Distribution companies can receive a tax credit of not less than 15% and not exceeding 30% (or 40% certain specified cases) of the overall national and international distribution costs. The tax credit is also recognized for the overall costs of distribution of works in a language other than Italian, provided that the language belongs to a recognized linguistic minority.

Cinema operating companies

Cinema operating companies can receive a tax credit of not less than 20% and not exceeding 40% of the overall costs related to realization of new cinemas, reopening of inactive cinemas, restructuring and structural and technological adjustment of cinema screens, installation, restructuring, renewal of plant, equipment, furnishing and accessory services to screening theatres.

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Technical and post-production industries

Companies in the technical and post-production industries, including restoration laboratories, can receive a tax credit of not less than 20% and not exceeding 30% of costs borne for updating technology and structures of their businesses. In determining the percentage of the tax credit, it is considered, inter alia, the existence of the cinema screen prior to 1 January 1980.

Italian executive production and post-production industries

Italian executive production and post-production companies can receive a tax credit of not less than 25% and not exceeding 30% of the costs borne within Italy in relation to cinematographic and audio-visual works or part of the works realized within Italy at the commission of foreign production companies using Italian labor.

Enhancement of the film offer

To enhance the film offer and in particular to increase the presence of Italian cinematographic and audio-visual works in cinemas, a tax credit of 20% on the revenues deriving from the programming of audiovisual works, with particular references to Italian and European works, also with documentary features, carried out in the respective cinemas is granted.

The incentives provided refer to particular cinematographic works and in particular to small cinemas located in municipalities with a population of less than 15,000 inhabitants.

Taxable basis

The above tax credits:

- Are included in neither the Corporate income tax (IRES) nor the Regional Business tax (IRAP) base
- Are not relevant for the purpose of determining the deductible percentage of interest expenses and general expenses in accordance with articles 96 and 109 of the Italian income tax code
- May be used only to offset income/regional tax and social security contributions
- Are not subject to the limit of use in compensation (€ 250.000)
- Can be sold to bank or assurance enterprises.

The tax credit benefits are assigned within the amount of available funds.

Cultural and artistic industries

The Budget Law 2018 introduces a further benefit for cultural and creative enterprises which:

- Have as their exclusive or prevalent social purpose the conception of creation, production, development, dissemination, conservation, research, and enhancement or management of cultural products
- Carry out a stable and continuous activity, based in Italy or in one of the member states of the European Union or in one of the states that are members of the agreement on the European Economic Area

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— Are taxable subject/person in Italy.

For these entities, a tax credit equal to 30% of the costs incurred for development, production, and promotion of cultural and creative products and services is granted, within the spending limit of € 500.000,00 for the year 2018.

2) Automatic contributions

Automatic contribution are granted for development, production, and national and international distribution of cinematographic and audio-visual works already realized, according to the economic, cultural, and artistic results. These contributions are subject to be invested in the cinematographic and audio-visual sector.

3) Selective contributions

Selective contributions are granted for writing, development, production, and national and international distribution of cinematographic and audio-visual works. Cinematographic works by young authors or realized with modest financial resources or of particular artistic quality are favored to obtain the selective contributions as the start-up companies or companies in the film industry that meet the requirements of “*micro-imprese*” located in municipalities with a population of less than 15,000 inhabitants.

4) Other Financing Considerations

Tax Costs of Share or Bond Issues

The issue of new ordinary or preference shares/stock is subject to registration tax if a cash payment is made.

In case of transfer of shares, capital gains tax is applicable. The capital gain is computed as the difference between the selling price and the price or value upon acquisition.

The capital gain arising from the sale of shares within the sphere of an entrepreneurial activity is partially exempted from corporate taxes, if the following conditions are respected:

- The shares have been continuously held by the company for one year before the disposal
- The shares were registered as fixed assets in the first financial statements of the company
- The company held has not been resident in a tax haven for at least three fiscal years
- The company held has been carrying out a business activity for at least three fiscal years.

In that case, the percentage of exemption provided for the capital gain is 95%.

In case of sale of shares made by an individual, the capital gain, if realized before December 31, 2018 is subject to a rate of tax of 26% if the shareholding is lower or equal to 25% of the share capital. For other capital gains realized before December 31, 2018 and arising from shareholdings higher than 25% of the share capital, the ordinary rate of taxes is applied to a percentage of 58.14% of capital gain. Capital gains realized after January 1, 2019 will be subject to a rate of tax of 26% regardless the percentage of shareholding.

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Financial Transaction Tax

The transfer of ownership of shares and other participative financial instruments, issued by companies residing in Italy, as well as securities representing such instruments, regardless of the residence of the issuer, is subject to a tax on financial transactions with a rate of 0.2% on the value of the transaction. The tax rate is equal to 0.1% for transfers that take place as a result of transactions concluded on regulated markets and multilateral trading facilities.

No specific tax is levied on the reorganization of a company's shares. The tax applicable depends on the kind of operation, e.g., a merger, division, sale of the business activity, etc.

Corporate Taxation

Italian corporate income tax (IRES) is a flat tax rate of 24%. Among other features, IRES provides for dividends exemption and a partial capital gains exemption, the option for corporate taxpayers to file consolidated returns, the option for corporate taxpayers to elect to be taxed as partnerships, the thin capitalization rules, and a domestic definition of permanent establishment.

Please also consider the existence of the local tax; IRAP is a tax on production activities and essentially levies 3.9% of the taxable base that, broadly, is the gross operating margin excluding the deduction of certain costs.

Recognition of Income

Film Production Company – Production Fee Income

Italian-resident Company

If a special-purpose company is set up in Italy to produce a film without acquiring any rights therein, the tax authorities can query the level of income attributed if it is attributed by a nonresident company, belonging to the same group at a rate lower than arm's length. In Italy, there are no fixed parameters to determine the percentage of the total production budget that would be an acceptable level of attributed income. However, the lower the rate, the more likely that it would be required.

Note that it is possible, for companies belonging to the same group, to negotiate an acceptable level of income with the Italian tax authorities in advance. Such unilateral Advance Pricing Agreement (APA) exclusively binds the Italian company and the Italian tax authority for three years. Bilateral APAs are also available.

Non-Italian-resident Company

If a company is not resident in Italy, but it has a production office to administer location shooting, it may be subject to tax in Italy as having a permanent establishment. However, it is possible to obtain an opinion from the Italian Tax Authorities on the effective existence of a permanent establishment.

If no exemption can be obtained, the permanent establishment would be treated as a resident company. In this case, as discussed above, it is possible to negotiate a unilateral APA with the Italian tax authorities to determine an acceptable level of income.

It is unlikely that a production office would be regarded as causing a company to be resident in Italy, unless the company has its management headquarters or its principal activity in

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Italy. If a company is not resident in Italy and does not have a production office within its territory, but it undertakes location shooting, it is unlikely that it would have an Italian tax liability as it would not be regarded as having a permanent establishment in Italy.

For tax purposes, the Italian authorities would interpret the term “permanent establishment” by applying the appropriate article of the Italian tax law, which is up to the OCSE definition (i.e., locations such as a branch, office, factory, workshop, or similar site).

Film Production Company – Sale of Distribution Rights

If an Italian-resident production company sells the distribution rights of a movie to an unrelated distribution company, in consideration for a lump-sum payment in advance and subsequent periodic payments based on gross revenues, the sale proceeds would normally be treated as income arising in the trade of film rights’ exploitation. The same rules would apply without regard to the type of entity making the sale.

There are no special rules governing the transfer of intangible assets.

If intangible assets, such as distribution rights, are transferred from Italy to an entity in a foreign territory, it is better to help ensure that such a transfer is carried out as part of a commercially defensible transaction. The tax authorities could seek to attribute an arm’s length price if the transfer takes place between connected parties.

Film Distribution Company

If an Italian-resident distribution company acquires a complete or partial copyright ownership in a film from an unrelated production company, the payment for the acquisition of the rights is normally treated as an expense, in relation to the earning of profits and not as a royalty. The normal method of deducting such payments for tax purposes is by claiming a deduction on revenues through depreciation.

On the other hand, if the Italian-resident company, on the basis of a licensing agreement, has the right to exploit the copyright in Italy or worldwide, the payment made to the owner of the copyright has to be considered a royalty. The normal method of deducting such payments, for tax purposes, is by claiming a deduction on revenues through the accrual basis (and in case of a lump-sum payment, the deduction will be made through depreciation).

The income arising from exploiting such rights is normally recognized as trading income. The distribution company would be taxed on the income derived from the exploitation of any of its acquired films, wherever and however these are sublicensed, provided that the parties are not related. If the parties are related, the tax authorities might question the level of income returned to the licensor.

For Italian accounting purposes, income in this case is normally recognized in the year in which it arises, rather than on the date the deal is signed or payment is received. In other words, income is recognized in the specific period in which it is expected to be earned.

The tax treatment of a transaction usually follows accepted principles of commercial accounting, unless these give a completely misleading picture of the trading results.

Transfer of Film Rights between Related Parties

Where a worldwide group of companies holds rights to films and videos and grants sublicenses for exploitation of those rights to an Italian-resident company, care needs to be

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taken to help ensure that the level of profit can be justified. Any transactions within a worldwide group of companies are liable to be challenged by the Italian tax authorities since they would seek to apply an open-market third-party value to such transactions.

Indeed, if an Italian-resident company remits income to a low-tax territory by virtue of a sublicensing distribution agreement, the Italian tax authorities can be expected to question the level of such attributed income. In principle, the expenses arising from transactions between an Italian-resident company and a company resident in a tax haven are not fiscally deductible.

There is no specific level of income that the Italian tax authorities seek to apply. The authorities make comparisons with contracts concluded with other unrelated parties. It is always wise to obtain evidence at the time the contract is signed to verify that the rate agreed can be substantiated at a later date in case the tax authorities questioned the contract.

As discussed above, it is possible to obtain a unilateral APA from the Italian tax authorities giving formal clearance in advance on an agreed level of attributed income.

Amortization of Expenditure

Production Expenditure

According to Italian tax law, companies with rights in films are entitled to write off over a prescribed period the expenditures they incur on producing or acquiring those films.

Other Expenditure

Neither a film distribution company, nor a film production company, has any special status under Italian tax law. Consequently they are subject to the usual rules to which other companies are subject. For example, in calculating taxable trading profits, they may deduct most normal day-to-day business expenditures such as the cost of film rights (as detailed above), salaries, rents, advertising, travel expenses, and legal and professional costs normally relating to the business.

Certain other expenditures cannot be deducted, including some expenditures on capital accounts, such as the purchase of land and non-instrumental buildings. Neither can the acquisition of plant and machinery be deducted, although tax depreciation can be deducted at specific rates and in some circumstances these rates can be quite generous. Additionally, certain day-to-day expenditures are not allowable, such as entertainment expenses related to existing or prospective clients and any other expenditure, which is considered to be too remote from any business purpose.

Super depreciation

The super depreciation regime allows higher depreciation of investments made in certain new tangible assets in 2018 or—provided that, by the end of 2018, the order has been accepted by the seller and at least 20% of the purchase cost has been paid in advance—in the first six months of 2019 (up to 30 June).

Foreign Tax Relief

If an Italian-resident film distributor receives income from unrelated, nonresident companies, but suffers foreign withholding tax, it is normally able to rely on Italy's wide range of double tax treaties to obtain double tax relief for the tax suffered. If no such treaty exists with the other country concerned, the Italian distributor can expect to receive credit

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for the tax suffered on a “unilateral” basis. In this case, the relief for foreign tax suffered would be granted in the year in which the withholding tax was deducted.

Foreign taxes are creditable solely against the Italian tax that should have been paid if the foreign income had been produced in Italy; the credit cannot actually exceed the attributable Italian tax. It is important to note that the Italian tax to consider for the calculation of the foreign tax credit is the tax due on the aggregate income (net of the tax losses of the preceding years). That means that if the Italian tax due was equal to zero, because the company used tax losses from preceding years in order to reduce the aggregate income, the amount of credit for foreign taxes would be equal to zero. A particular procedure is provided in order to carry back and carry forward the amount of the foreign tax exceeding the creditable tax, as calculated above.

ACE (Support for Economic Growth – Italian Notional Interest Deduction)

Starting from the income tax return to be filed for 2011, Italian companies and Italian branches of nonresident companies are entitled to a deduction from taxable income, computed by applying a notional yield to the increase of the company’s net equity resulting from the annual statutory balance sheet as compared to the net equity from the financial statement as of 31 December 2010 (for company with fiscal year corresponding to the calendar year) net of the 2010 profits (Initial Net Equity). The ACE rate is set at 1.5%.

Specific computational rules apply and the amount of the notional yield that exceeds the net taxable income of the relevant year may be carried forward and used to offset the net taxable income of a subsequent tax period. Certain anti-avoidance rules also apply. The rules implementing the deduction are provided by a Decree issued by the Ministry of Economy and Finance and include specific anti-avoidance provisions to prevent the inappropriate duplication of the ACE relief.

ACE surpluses can be converted in a tax credit to reduce IRAP taxable base in five equal annual installments, within the limit of IRAP due in each year.

Earnings stripping rules

Under applicable earning stripping rules the deductibility of net interest costs is up to borrower’s 30% of the Earning Before Interest, Taxes, Depreciation and Amortization (i.e., EBITDA). The excess can be carried forward (subject to the above conditions) with no time limitation. Any excess of EBITDA capacity can be used to increase the EBITDA capacity of the future tax periods. Within a tax group the EBITDA of all members could be pooled for deduction purposes.

Royalties

The applicable withholding tax is generally 30%, which is applied to 75% of the gross amount of the payment (i.e., 22.5%). This rate may be reduced under the tax treaty provisions. An exemption applies under the provisions of the EU Interest and Royalties Directive 49/2003.

Indirect Taxation

Value Added Tax (VAT)

General

Italy charges VAT on the sale or supply of goods or services under the harmonized system of VAT applicable in the EU. As a “value added” system, there are certain restrictions that

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deny company's credit for tax suffered at an earlier stage in the manufacturing or service process. No credit is available in respect of incurring expenses and the purchase of other goods and services, not purchased for business purposes. Nevertheless, the purchase and maintenance of automobiles for business purposes is partially tax deductible.

Supply of a Completed Film

Any Italian-resident company that delivers a completed film to a company also resident in Italy has to charge VAT at the rate of 22% on this supply. Such a sale is regarded as a supply of rights and therefore as a supply of services.

Where an Italian-resident company delivers a completed film to a company not resident in Italy but resident in a Member State of the EU, the supply would be zero-rated for Italian VAT purposes (i.e., there would be no Italian VAT charged to the customer but the Italian supplier would be able to recover all the VAT that it had paid). An Italian company delivering the film would need to establish that the customer is receiving the supply in his or her business capacity, usually by showing the customer's own VAT registration number on the invoice. However, the customer in the Member State would have to pay the VAT applicable to the product in that particular country as a "reverse charge" and credit the sum against his or her own VAT liability.

An Italian-resident company that delivers a completed film to a company not resident in either Italy or the EU, would not charge VAT at all since such supply would be regarded as being "outside the scope of VAT," but it would be able to recover the VAT incurred in making the film. Such regime requires that the non-EU company will not make use of the film delivered in the Italian territory.

If an Italian company delivers a completed film, the related invoice can be issued within 15 days from the end of the month in which the supply was made. However, the company would account for any applicable VAT to the tax authorities within the month in which the delivery occurred. VAT accounting periods can cover one month or three months. The normal taxable event is the completion of the service. However, if a company receives a payment in advance of delivery of a completed film, or defers a payment to a date subsequent to delivery, the receipt of payment would create a taxable event, if earlier than the normal taxable event.

Presale of Distribution Rights

VAT is charged at the rate of 22% on a "presale" of distribution rights to an Italian resident. Generally, a presale to a business entity not resident in Italy but resident in the EU is zero-rated. If made to a person resident elsewhere in the EU, but not in business, the rate is 22%. On a presale to a person not resident either in Italy or in the EU, the supply is zero-rated.

Royalties

Where an Italian-resident company pays a royalty to another Italian-resident company, VAT would be charged at the rate of 22%. There are no special reporting requirements.

Where an Italian-resident company pays a royalty to a company not resident in Italy, but in a country that is a member of the EU, VAT is charged at the rate of 22%. The Italian company would be required to operate a "reverse charge" calculation in its own Italian VAT return and the supplier would effectively zero-rate the supply for the purposes of its home country VAT obligations.

Italy

If an Italian-resident company pays a royalty to a company not resident either in Italy or in the EU, VAT is charged at the rate of 22%. The Italian company is required to operate a reverse charge calculation.

Peripheral Goods and Merchandising

VAT on the sale of peripheral goods (such as books, magazines, and music publishing), connected with the distribution of a film, might be reduced if certain conditions are met. On the other hand, VAT on the sale of merchandising (such as the sale of clothes, toys, etc.) is normally charged at 22%.

Promotional Goods or Services

On the provision of promotional goods or services in Italy, VAT is charged at 22% in most cases. The free provision of promotional services is VAT-free, just like the provision of goods. However, in such cases, the company cannot deduct VAT charged on the purchase of the goods distributed for free.

Film Crews and Artists

If film crews and artists pay for the catering supplies on location while filming, VAT is payable at the rate of 10%. If no payment is made, the crew does not pay VAT. If catering is provided to "front of camera" artists who are not engaged as employees but are self-employed, the paying company may suffer a restriction on VAT recovery.

Imports of Goods

Where an Italian-resident company imports goods into Italy from outside the EU, VAT at 22% would almost certainly be payable in respect of the goods, as well as Customs duties (see below).

Customs Duties

If goods are temporarily imported into Italy, potentially no tax or Customs duty would be charged if they are subsequently re-exported without alteration, provided a Customs relief such as "Inward Processing Relief" or a duty suspension regime such as Customs warehousing is used.

Personal Taxation

Nonresident Artists (self-employed)

Income Tax Implications

Italy taxes the income arising to a nonresident artist from a performance in Italy independently of whether or not the individual receives such income outside Italy.

If a nonresident artist receives any payment arising from, or in consequence of, an Italian activity, the Italian payer is obliged to deduct withholding tax and account for this tax to the authorities. However, where a non-Italian payer makes a payment to the nonresident artist in respect of a performance made in Italy, the Italian withholding tax rules are not effective. Therefore, the nonresident artist should file an income tax return in Italy in order to pay the taxes related to the income produced in Italy. Such income would be equal to the difference between the compensation received and the expenses directly sustained by the artist in relation to the activity performed in Italy.

Italy

VAT Implications

The performance of a nonresident artist in Italy is considered as a taxable supply for Italian VAT purposes, and therefore, the individual is obliged to register for VAT purposes unless he or she does not habitually carry out his or her activity in Italy. However, when the nonresident artist renders his or her services to a VAT taxable entity in Italy, he or she is not obliged to register for VAT; thus the VAT taxable entity is required to account for Italian VAT under the reverse charge rule.

Resident Artists (self-employed)

Income Tax Implications

Resident artists are subject to tax on their worldwide income unless exempt under the provisions of a treaty against double taxation.

According to Italian domestic legislation, if a resident artist receives any payment for, or as a consequence of, a performance in Italy or abroad, the Italian payer is required to deduct withholding tax and account for this tax to the authorities. The applicable withholding tax rate is 20% on account of the tax due on the basis of the income tax return.

VAT Implications

The performance of a resident artist in Italy is considered a taxable supply for Italian VAT purposes. The applicable VAT rate is 22%.

Employees

Income Tax Implications

Employers resident in Italy are obliged to make regular, periodic payments to the Italian tax authorities in respect of employees' personal tax liabilities arising from salaries or wages paid to them. Deductions are made under the salary and wages withholding scheme.

Social Security Implications

Employees are liable for personal Social Security contributions in respect of payments of salaries or wages.

Italian-based employers are obliged to deduct from their employees' salaries or wages the employees' own personal Social Security contributions and account for them to the Social Security authorities. Employers are also liable to make their own "employer" contributions in respect of emoluments paid to their employees.

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