



Italy: Recap of the Research & Development tax credit mechanism



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As already described in our previous Alert, dated [11 August 2015](#) a tax credit is granted to Italian companies and Italian PEs of foreign companies investing in R&D from the fiscal year following that in progress on 31 December 2014, up to that in progress on 31 December 2020. The benefit is available to any enterprise, irrespective of its legal form, size and business sector.

Eligible activities include fundamental research, industrial research and experimental development, while the costs of the following can be used to calculate the tax credit:

- personnel employed in R&D;
- depreciation charges on instruments and laboratory tools costing EUR 2,000 or more per unit (net of VAT), in relation to the extent and period of their use for R&D;
- research contracts signed with universities, research institutions and equivalent entities, and with other enterprises, including innovative start-ups;
- technical expertise, property rights over industrial or biotechnological inventions, semiconductor topography rights or plant variety rights, even if acquired from external sources.

The tax credit is capped at EUR 20 million per beneficiary and is granted on condition that the total investment in R&D in each fiscal year amounts to at least EUR 30,000.

The total R&D expenditure must exceed the average R&D investment made in the three fiscal years prior to that in progress on 31 December 2015. The tax credit is calculated as 50% of the increase in expenditure.

Key points for foreign investors

In the case of companies incorporated for less than three fiscal years, the average R&D investment to be considered in determining the total increase in expenditure is calculated over the periods since incorporation. In the case of a NewCo incorporated after 1 January 2015, the tax credit is calculated on 100% of the investments in R&D.

Following the amendments introduced by the 2017 Budget Law, Italian companies (or Italian PEs of foreign companies) which carry out R&D on behalf of a foreign company can benefit from the tax credit. However, the foreign company must be resident in other EU Member States, in EEA Member States (Norway, Lichtenstein or Iceland), or in countries that have signed an agreement on the exchange of information with Italy.

Recent clarifications

Ministry of Economic Development Circular no. 59990/2018 of 9 February 2018: clarifications on the application of the tax credit to investments in software

This Circular is important because it clarifies that the OECD Frascati Manual (the latest edition, published by the OECD on 8 October 2015) can, in principle, be used to interpret the Italian R&D tax credit rules.

Concerning the controversial point of the eligibility of investments in software development, the Circular clarifies that a software development project can be classified as an R&D investment if i) its implementation depends on scientific and/or technological progress, ii) the purpose of the project is the systematic solution of a scientific and/or technological issue.

Italian Tax Authority Circular no. 10/E/2018 of 16 May 2018: clarifications on the applicability of the R&D tax credit in the event of a business reorganization (transformation, merger, demerger, or transfer or contribution of business)

First of all, due to past uncertainty surrounding the matter, the Circular clarifies that the Italian tax authority will not impose penalties on companies that, in the absence of official clarifications, interpreted the rules using criteria different from those now published.

The Circular not only regulates the functioning of the tax credit in the event of an M&A operation but also lays down certain principles that will help to ensure a systematic approach to the tax credit system.

In particular, the Circular reiterates that the R&D tax credit mechanism and principles are distinct from the ordinary accounting and corporate tax rules. This means that, in general, the R&D measures should be interpreted according to the nature of the incentive and its purpose, which is to increase investments in R&D.

Italian Tax Authority Ruling no. 46/E/2018 of 22 June 2018: clarifications on the application of the R&D tax credit to investments in software

In this ruling, the Italian tax authority has denied a company's right to take the tax credit for the costs of reorganizing industrial processes that took the form of planning, programming and implementing software, web services, apps and technological systems.

The tax authority argued that the company had introduced certain technologies already available in all business sectors; therefore, they were not novel and the company had not taken on a risk. The ruling also cited Circular no. 59990/2018 and the OECD Frascati Manual, and explicitly listed cases that cannot be counted as eligible R&D activities:

- the development of business application software and information systems using known methods and existing software tools;
- the addition of user functionality to existing application programs (including basic data entry functionalities);
- the creation of websites or software using existing tools;
- the use of standard methods of encryption, security verification and data integrity testing;
- the customization of a product for a particular use, unless during this process knowledge is added that significantly improves the base program;
- routine debugging of existing systems and programs, unless this is done prior to the end of the experimental development process.

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