Italy: Budget Law 2019 - New IRES and IRAP measures for enterprises

Tax Alert

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The Budget Law 2019 (Law no. 145 of 30 December 2018) was published in Official Gazette no. 302 of 31 December 2018 and has been in force since 1 January 2019. Listed below are the most important direct tax measures introduced by article 1.

1. Extension of the 'hyper' depreciation of certain tangible/intangible assets
2. Amendments to the R&D tax credit
3. Repeal of the Notional Interest Deduction (NID)
4. Lower corporate income tax on profits reinvested in the acquisition of income-producing assets and/or in job creation
5. Registration tax - Retroactive nature of article 20 of the Registration Tax Act
6. Extension of the step-up regime for the cost of land and unlisted shares
7. Postponed deduction of write-downs of receivables and losses on receivables (paragraphs 1056 and 1065)
8. Deductibility of expected losses on customer receivables during the first-time adoption of IFRS 9 (paragraphs 1067-1069)

1. Extension of the 'hyper' depreciation of certain tangible/intangible assets (paragraphs 60-65 and 229)

'Hyper' depreciation

The Budget Law 2019 extends the 'hyper' depreciation regime (introduced by the Budget Law 2017) to investments made in 2019 in tangible assets used in the technological and digital development of enterprises covered by the Industry 4.0 Plan promoted by the Italian government.

As a general principle, all conditions and rules applicable to investments made in fiscal year 2018 will be applicable to investments made in fiscal year 2019. Moreover, the 'hyper' depreciation regime will also apply until 31 December 2020 provided that, by the end of 2019,

i. the seller has accepted the purchase order and,

ii. at least 20 percent of the purchase cost has been paid in advance.

Increase in the purchase cost of tangible assets - Three new rates

Previously, the purchase cost of eligible tangible assets could be increased by 150 percent.

Under the Budget Law 2019, this rule has been replaced by three different percentages:

— 170 percent for investments of up to EUR2.5 million

— 100 percent for investments ranging from EUR2.5 million to EUR10 million

— 50 percent for investments ranging from EUR10 million to EUR20 million.

Extra amortization of certain intangible assets for 'hyper' depreciation taxpayers

On the same terms as in the past, there is extra amortization of investments in intangible assets made by taxpayers that also use 'hyper' depreciation for tangible assets in 2019 (and in 2020 if the above two conditions are met). The purchase cost of the intangible assets can be increased by 40 percent.

The eligible costs now include fees paid to access intangibles through cloud computing systems. In this case the benefit can only be taken, on an accruals basis, in respect of the fees charged to the relevant year.

Limits and documentary evidence

For the 'hyper' depreciation regime, the Budget Law 2019 sets the same limits and documentary evidence requirements as previous budget laws.

2. Amendments to the R&D tax credit rules (paragraphs 70-72)

The Budget Law 2019 amends the rules on the computation of the R&D tax credit.

New tax credit measures

The tax credit percentage is modified for fiscal year 2019. A 25 percent tax credit generally applies, while a 50 percent tax credit applies to certain R&D costs only (mainly the cost of employees assigned to R&D, or costs arising from contracts with universities, research bodies, start-ups established in Italy, and innovative SMEs).

Maximum amount

The maximum annual R&D tax credit has been reduced from EUR20 million to EUR10 million for each recipient.

Expenditure on materials and supplies

The benefit applies to expenditure on materials, supplies and similar products used for R&D purposes and for the building of prototypes and pilot plants used in industrial research activities and experimental development activities.

New certification requirement: technical report

The R&D tax credit can be used only if specific formalities are complied with. The Budget Law 2019 adds a new obligation to the mandatory certification requirements: a detailed technical report describing the purposes and results of the R&D must be prepared and kept by the tax credit recipient.

Effective date

The amendments to the R&D tax credit rules will apply from the tax year following that in progress on 31 December 2018, i.e. from 2019 for calendar-year taxpayers.

However, the new technical report is required retroactively, from the tax year in progress on 31 December 2018.

Official interpretation of the law

For the computation of the R&D tax credit, the Budget Law 2019 officially clarifies that only R&D carried out directly in laboratories or facilities established in Italy qualifies.

3. Repeal of the Notional Interest Deduction (NID) (paragraph 1080)

The rule in place until 31 December 2018 was introduced by Law Decree no. 201/2011. It allowed a deduction from the total IRES base of an amount corresponding to notional interest on the increase in new equity since 31 December 2010. NID applied after computation of the total net income - already net of any tax losses - and, if the amount of notional interest exceeded the total net income, the surplus could be carried forward, in full and indefinitely, to subsequent fiscal years, to be deducted from the first available taxable income.

The Budget Law 2019 repeals NID from 1 January 2019. Thus, for calendar-year taxpayers, fiscal year 2018 will be the last year in which NID applies (at a rate of 1.5 percent).

Any notional interest exceeding the total net income of the fiscal year ended on 31 December 2018 may be carried forward to be deducted in subsequent fiscal years or converted (in whole or in part) into a tax credit, to be used - in five equal annual installments - exclusively to reduce IRAP payments.

4. Lower corporate income tax on profits reinvested in the acquisition of income-producing assets and/or in job creation (paragraphs 28-34)

The Budget Law 2019 introduces an incentive to encourage investment in new income-producing tangible assets and/or in job creation. Starting from the fiscal year following that in progress on 31 December 2018 (i.e. from 1 January 2019 for calendar-year taxpayers), it will be possible to apply a lower corporate income tax (IRES) rate of 15 percent, instead of the ordinary rate of 24 percent, to a portion of total net taxable income. That portion is determined by taking into account:

i. profits set aside to reserves

ii. depreciation of new investments, and

iii. labor costs.

Calculation of the incentive

The portion of the taxable income qualifying for the incentive corresponds to the lower of the following.

(1) The portion of the profits of the previous tax year that is set aside to freely disposable reserves.

(2) The sum of the (a) investments made in new income-producing tangible assets and (b) costs of employees hired under fixed-term or open-ended employment contracts.

Any difference between amounts (1) and (2) can be carried forward and added to the total net taxable income of the following year for the purpose of calculating the incentive.

If amounts (1) and (2) each exceed the total net taxable income of the year in which the incentive applies, the 15 percent tax rate will be levied on the full total net taxable income of the year, while surplus (1) and surplus (2) will both be carried forward.

The Budget Law details the criteria and method for calculating the amounts qualifying as investments in income-producing tangible assets and as employee costs. For instance, the income-producing tangible assets, and the production facilities to which the employees are assigned, must be located in Italy.

Investments in real estate, company cars and intangible assets are not eligible investments.

Use of the reduced rate by a tax group

If companies have opted for the domestic tax consolidation regime, the amount eligible for the reduced tax rate can be used by the parent of the tax group in the consolidated income tax return, up to an amount equal to the difference between the total income and the tax losses.

5. Registration tax - Retroactive nature of article 20 of the Registration Tax Act (paragraph 1084)

Article 1(87)(a) of the Budget Law 2018 amended the anti-avoidance rule set out in article 20 of the Italian Registration Tax Act (the 'IRTC'). The amended rule concerns the treatment of transactions for registration tax purposes.

Based on the amendment, tax offices should have imposed registration tax on each deed separately, without considering any other deeds executed immediately before or after the transaction. However, there was debate last year about whether and to what extent the new article 20 could apply retroactively to deeds executed and registered before 1 January 2018. For instance, the Italian Supreme Court and some lower tax courts ruled that the new version of the article did not apply to deeds executed and registered before 1 January 2018; whereas other lower tax courts defined the new article as a 'rule on how to interpret another rule' and concluded that it applied to disputes already pending before the tax courts.

Paragraph 1084 of the Budget Law 2019 puts an end to the debate by expressly defining article 1(87)(a) as a 'rule on how to interpret another rule'. This should override the interpretation given by the Supreme Court and allows the retroactive application of article 20 of the IRTC, as amended by the Budget Law 2018, to deeds executed and registered before 1 January 2018.

6. Extension of the step-up regime for the cost of land and unlisted shares (paragraphs 1053-1054)

The Budget Law 2019 extends the deadline for the optional step-up of the tax cost of land and qualifying or non-qualifying shares in unlisted entities, held on 1 January 2019 by resident individuals and by non-resident entities without a permanent establishment in Italy.

The step-up is subject to payment of a substitute tax on the cost, to be appraised by 1 July 2019 (as 30 June 2019 is a Sunday). The substitute tax must be paid by 1 July 2019 or in three equal annual installments.

The substitute tax on the cost is applied as follows:

— 11 percent in the case of qualifying shares

— 10 percent in the case of non-qualifying shares

— 10 percent in the case of land.

Qualifying shares are those that represent more than 20 percent of the voting rights or 25 percent of the stated capital of a resident unlisted company or more than two percent of the voting rights or five percent of the stated capital of a resident listed company.

This optional regime allows a tax saving if the asset is sold, as the higher cost reduces any taxable capital gain. However, the step-up is not recognized for the purpose of deducting capital losses, i.e. if the sale price is lower than the stepped-up cost, any capital loss will not be deductible.

This regime could be advantageous for non-residents (without a permanent establishment in Italy) who sell shares in unlisted Italian companies and cannot benefit from double tax treaty relief. To understand whether they would benefit from this rule, such taxpayers should compare:

i. the tax on capital gains from the sale of shares in unlisted Italian companies, i.e. 26 percent for gains realized in 2019 from the sale of qualifying shares, with,

ii. the 11 percent or 10 percent substitute tax on the cost emerging from an appraisal made by 30 June 2019.

7. Postponed deduction of write-downs of receivables and losses on receivables (paragraphs 1056 and 1065)

For both IRES and IRAP purposes, Law Decree no. 83/2015 introduced a special tax regime for financial institutions and insurance companies, allowing them to deduct, over FYs 2016-2025, a gradually increasing percentage of the write-downs of receivables and losses on receivables existing on 31 December 2015.

Paragraph 1056 amends this regime by postponing by eight years (to the fiscal year in progress on 31 December 2026) the deductibility, for both IRES and IRAP purposes, of the 10 percent of write-downs and losses that, under Law Decree no. 83/2015, were deductible in the fiscal year in progress on 31 December 2018.

This means that, in relation to FY 2018, financial institutions and insurance companies can only deduct the write-downs and losses of that fiscal year, and not those of previous fiscal years not yet deducted.

Paragraph 1065 specifies that paragraph 1056 does not have any effect on the computation of the advance payments of IRES and IRAP for FY 2018.

8. Deductibility of expected losses on customer receivables during the first-time adoption of IFRS 9 (paragraphs 1067-1069)

A rule was introduced last year[1] in relation to items deriving exclusively from the adoption of the IFRS 9 model for the recognition of expected credit losses, booked in financial statements at the date of first time adoption ('FTA') of IFRS 9. According to the new rule, which applies to financial institutions and insurance companies, such items are subject to the general tax rules on the adjustment of receivables, laid down in the Italian Income Tax Code[2]. Expected losses are thus fully deductible.

Paragraphs 1067-1069 of the Budget Law 2019 complete the picture by establishing that financial institutions and insurance companies can deduct expected losses on customer receivables, for IRES and IRAP purposes, as follows.

— Ten percent of the loss is deductible in the fiscal year of IFRS 9 FTA[3].

— Ninety percent of the loss is deductible in equal instalments over the next nine fiscal years[4].

In other words, expected losses on customer receivables, booked in financial statements at the date of IFRS 9 FTA, have to be deducted over ten fiscal years.

(1) Article 7(3) of the Ministry of Economy and Finance Decree of 10 January 2018, which lays down provisions on coordination between:

— the international accounting standard adopted by Commission Regulation (EU) 2016/2067 of 22 November 2016 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 9, and

— the domestic rules for computing taxable income for IRES and IRAP purposes, under article 4(7-*quater*) of Legislative Decree no. 38 of 28 February 2005.

(2) The relevant tax rules are those in force during the first fiscal year of IFRS 9 FTA.

(3) FY 2018 for calendar-year taxpayers.

(4) FYs 2019-2027 for calendar-year taxpayers.

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