Italy issues draft 2014 Budget Law

On 15 October 2013, the Italian Government approved, as part of its 2014 budget package, a Draft Law (the Draft) regarding the so called “Law of Stability” for 2014. The Draft will be discussed by the Parliament for amendments and final approval.

The Draft contains some changes to the Italian tax rules that may be of immediate interest to multinationals with Italian operations. These include:

- Introduction of a one-off asset step up
- Increase of the notional interest deduction for 2014 through 2016
- Re-introduction of the participation step up
- Deduction of new employees cost for IRAP purposes
- Special provisions for banks and insurance companies

This Alert provides some highlights based on an unofficial version of the Draft.

Introduction of a one-off asset step up

The Draft introduces a one-off opportunity for Italian companies to step up business assets for accounting and tax purposes for the period in course on 31 December 2013. To a certain extent, this rule revamps the same mechanics provided under other step up laws introduced from time to time as of 2000 (e.g., Law n. 342/2000) while it differentiates from the existing asset step up rules as it does not require a corporate reorganization (e.g., merger, contribution of assets) as a prerequisite for the step up election.

The election may apply to tangible and intangible assets (except for immovable properties held by real estate companies) as well as to qualifying shareholdings, provided that the mentioned assets are included in the balance sheet related to the period in course on 31 December 2012.
Under the proposed regime, companies can pick and choose the category of assets to be stepped-up through the payment of a substitute tax amounting to 16% for amortizable/depreciable assets and 12% for non-amortizable/depreciable assets. The payment of the substitute tax results in a higher tax base allowing depreciation/amortization at a 31.4% rate or a lower taxable gain in case of disposal of the assets.

Tax recognition of the new values for depreciation and amortization purposes occurs starting from the third fiscal year following the one in which the step up was made (e.g., from 1 January 2016 for calendar year companies). Tax recognition for capital gain purposes occurs starting from the fourth year following the one in which the step up was made (e.g., from 1 January 2017 for calendar year companies).

The equity reserve created as a consequence of the accounting step up can be freely distributed provided that a 10% substitute tax is paid. The substitute tax is due in three annual installments. The first payment is due within the deadline for the payment of the corporate income tax balance related to fiscal year 2013 (e.g., by 16 June 2014 for calendar year companies). No interest is due on the second and third installments.

Increase of the notional interest deduction for 2014 through 2016

The Draft sets out the notional interest deduction (NID) rates for 2014, 2015 and 2016 at 4%, 4.5% and 4.75% respectively. The NID allows Italian companies and Italian branches of foreign companies an income tax deduction computed as a percentage of the qualifying equity formed after 2010.\(^1\)

For the fiscal periods 2011, 2012 and 2013, the deduction was fixed at 3%. For subsequent years the percentage is to be determined annually by the Ministry of Finance, on the basis of the average return on Italian public debt securities, possibly increased by an additional 3% to remunerate a higher business risk.

As a deviation from the original rule, the NID rates for fiscal periods 2014, 2015 and 2016 are directly amended by the Draft rather than determined by the Ministry of Finance. Specifically, the Draft increases the current 3% deduction to 4% for 2014, 4.5% for 2015 and 4.75% for 2016. The NID rate for the subsequent years should be periodically reviewed by the Ministry of Finance under the aforementioned criteria.\(^2\)

Re-introduction of the participation step up

The Draft re-vamps a special rule which allows Italian companies to step up certain values related to controlled companies. The regime is reintroduced and made permanent as it can be applied with reference to participations acquired in the fiscal period 2012 and onwards. The regime was previously made available in two different stages for acquisitions occurred up to 2011 only.\(^3\)

The election implies the upfront payment of a 16% substitute tax in order to benefit from tax amortization at a higher rate of at least 31.4% with respect to the hidden intangibles owned by the acquired controlled company (i.e., not shown in the latter’s balance sheet or, in any case, with no tax relevance) and reflected in the value of the participation as shown in the consolidated statutory balance sheet.

The 16% tax is due within the deadline provided for the payment of the corporate income tax balance related to the fiscal period during which the relevant participation was acquired (i.e., generally by 16 June of the year following the year of the acquisition for calendar year companies). However, for transactions that occurred in 2012, the 16% tax is due by the deadline provided for the 2013 balance payment.

The higher tax amortization can be deducted starting from the second year following the payment of the 16% tax. If the relevant participation or the underlying assets are transferred prior to the fourth fiscal year following the one in which the substitute tax was paid, then the higher tax value would not be considered in the determination of the taxable capital gain.

The Draft provides that this option should not be available in case the taxpayer elected for another type of step-up regime and vice versa.

Specific implementing instructions will be issued by the Italian Revenue Agency.
Deduction of new employees cost for IRAP\(^4\) purposes

Starting from fiscal year 2014, additional deductions are provided for employees hired under contracts with no expiration date. Companies will be able to benefit from a maximum of €15,000 deduction for each of the new employees within the limit of the annual increase for the overall labor cost. The deduction will apply for the year of the hiring and the following two.

Special provisions for banks and insurance companies

The Draft introduces significant amendments for banks and insurance companies by providing that any bad debt write-downs will be deducted in a five year period for both IRES (corporate income tax, generally levied at 27.5%) and IRAP purposes. It is also provided that bad debt losses arising from the transfer of receivables will be immediately deductible for IRES purposes.

The proposed amendment represents a major change since current rules provide that banks and insurance companies may deduct the write-down of receivables only for IRES purposes (not for IRAP) and only for an amount exceeding the 0.30% of the total receivables booked in the balance sheet with the allowed deduction occurring over 18 years.

This new rule should already apply for fiscal year 2013.

Endnotes

1. A NID system for corporate income tax purposes (IRES) was introduced in the Italian tax legislation with Law Decree n. 201 on 6 December 2011 then converted into Law n. 214 of 22 December 2011.

2. For additional details on the NID system, see EY International Tax Alert, *Italian government issues draft regulations on notional interest deduction regime*, dated 16 March 2012.

3. For more information on this regime, see EY International Tax Alert, *Italy issues regulations on tax step-up election on participations*, dated 29 November 2011.

4. Italy’s regional tax on productive activities, generally levied at 3.9%.
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