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DISPOSAL OF NPLS AND UTPS – CONVERSION INTO TAX CREDIT, NEW DECREE "HEAL ITALY" (ART. 55, LAW DECREE 17 MARCH 2020, NO. 18)

On 17 March 2020, the Italian Government published in the Italian official journal the Law Decree no. 18 of 17 March 2020 (so called "Heal Italy", the "Decree"), which entered into force immediately.

The Decree introduces urgent economic measures to counteract the current liquidity crisis following the spread of COVID-19 as well as provides for stronger public guarantees for the bank system. The Decree, currently under the examination of the Italian Parliament, must be converted into law within the next 16 May 2020 and therefore it is still subject to modifications.

Article 55 of the Decree entitles companies (not only banks and financial institutions but also industrial and commercial companies) willing to dispose of some Non-performing loans portfolios ("NPLs") and Unlikely to pay exposure ("UTPs") by 31 December 2020 to claim a conversion into a tax credit of some Deferred Tax Assets ("DTAs"), increasing their cash flow situation in this period.

The new provision applies to companies which sell to third parties both financial and commercial credits against non-complying debtors (i.e. NPLs/UTPs and, in general, any credit with more than 90 days of delay in paying amounts due) by 31 December 2020 and which have:

(i) tax losses carried forward[1]; and/or
(ii) excess notional interest deduction carried forward ("ACE surplus")[2].

The above companies may opt for the transformation of the DTAs connected to such elements into tax credit to be used for the payment of taxes (e.g. VAT, IRAP, withholding taxes, etc.)[3] and social security contributions. For the time being, it is not clear if the tax

[1] According to article 84 of the Presidential Decree no. 917 of 22 December 1986, n. 917 ("ITC").

[2] According to article 1, paragraph 4 of the Law Decree no. 201 of 6 December 2011, converted into the Law no. 214 of 22 December 2011.

[3] Once converted into tax credits, the DTAs will also be fully computed as part of the regulatory capital thus possibly improving the capital shortfall of Italian banks that is expected to increase due to the worldwide economic challenges following the spread of COVID-19.

ASSOCIAZIONE PROFESSIONALE
Corso Europa n. 2 - 20122 Milano
Tel. +39 02 7636931
Fax +39 02 76369345 / +39 02 76015178
nome.cognome@slta.it
www.sbnp.it
C.F. e P. IVA 12607090151

credit can be used in the FY2020 or in the FY2021 even if it should be already possible to use it in the FY2020 according to the purpose of the provision.

The new regulation does not affect:

- the sellers under insolvency proceedings[4], and
- the disposals of credits between companies belonging to the same group[5].

The regime applies solely to transfers of credits made until 31 December 2020 the total nominal value of which does not exceed EUR 2 Billions, taking into account also the transfers made by all companies belonging to the same group.

For tax credit computation purposes, the tax losses and/or ACE surplus carried forward have to be calculated for an amount not exceeding 20% of the nominal value of the transferred credits. Therefore, the consideration paid upon the transfer is not relevant for this purpose.

For example, if credits having a nominal value equal to EUR 100 million are transferred, an amount of tax losses and/or ACE surplus carried forward equal to 20 million (maximum) could be computed for the transformation. In such case, considering the 24% corporate income tax (27,5% for banks and financial institutions), the DTAs to be transformed into tax credit would be equal to EUR 4,8 million.

DTAs related to tax losses/ACE surplus carried forward can be transformed being irrelevant the amount of which is reported in the balance sheet (e.g., since the company failed to pass the probability test, i.e. the capacity in the next future to generate a taxable income to be used to compensate the tax losses and/or the ACE surplus carried forward).

The tax credit resulting from the new regime can also be transferred to third parties[6] other than be used for tax compensation purposes without any amount limitation (generally 700.000 EUR) for payment of taxes and social security contributions. Companies may also submit a refund request.

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[4] According to article 17 of the Legislative Decree no. 180 of 16 November 2015, article 5 of the Royal Decree no. 267 of 16 March 1942 and article 2, paragraph 1, b), of the Legislative Decree no. 14 of 12 January 2019.

[5] Pursuant to article 2359 of the Italian Civil Code.

[6] According to article 43-*bis* or article 43-*ter* of the Presidential Decree no. 602 of 29 September 1973.

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The transformation of DTAs into tax credit takes effect from the date of the credits disposal and it is subject to the election for the option of the 1.5% DTAs fee[7] regime (introduced by article 11, paragraph 1, of the Law Decree n. 59 of 3 May 2016. See circular letter of the Italian tax authorities no. 32/E of 22 July 2016). Therefore, on the base of the article 11 of the Law Decree no. 59, the fee should be due from FY2020 to FY 2031.

The tax credit does not give rise to any taxable income in the hands of the seller for both corporate income tax (IRES) and regional production tax (IRAP) purposes.

Starting from the date of the disposal of the credits, the seller can no longer carry forward tax losses and ACE surplus whose DTAs have been converted into tax credit.

In case of tax consolidation regime (see article 117 and subsequent of the Presidential Decree no. 917 of 22 December 1986) the right to transform the DTAs related to the tax losses carried forward is attributed to the consolidating entity since it has the right to use the tax losses carried forward generated under this regime. In a different way the consolidated companies have the right to transform the DTAs related to the ACE surplus carried forward considering that all maintain the right to use the ACE surplus.

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[7] The 1.5% fee can be deducted both for income corporate tax (IRES) and regional production tax (IRAP) purposes.

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