

# Tax credits for disposal of non-performing loan portfolios and unlikely-to-pay exposures

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## Tax credits

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On 17 March 2020 the government published Decree-Law 18/2020 in the *Official Gazette* (the so-called 'Heal Italy' decree-law, which entered into force immediately). The decree-law, which is currently being examined by Parliament, must be converted into law by 16 May 2020 and is therefore still subject to modifications.

## Tax credits

Article 55 of the decree-law entitles companies (not only banks and financial institutions, but also industrial and commercial companies) willing to dispose of non-performing loan portfolios (NPLs) and unlikely-to-pay exposures (UTPs) by 31 December 2020 to claim a conversion of deferred tax assets (DTAs) into tax credits, thus increasing their cash flow during this period.

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

- tax losses carried forward;<sup>(1)</sup> and/or
- excess notional interest deduction carried forward (allowance for corporate equity (ACE) surplus).<sup>(2)</sup>

The above companies may opt for the transformation of DTAs connected to such elements into tax credits to be used (without any amount limitation) for the payment of taxes (eg, value added tax, IRAP (a regional production tax) or withholding taxes)<sup>(3)</sup> and social security contributions. The tax credits can also be transferred to third parties<sup>(4)</sup> or a refund can be requested.

For the time being, it is unclear whether the tax credits can be used in the financial year 2020 or the financial year 2021, although it should be already possible to use them in the financial year 2020 according to the purpose of the provision.

## Tax credit regime

The tax credit regime applies solely to transfers of credits made until 31 December 2020, the total nominal value of which does not exceed €2 billion, taking into account the transfers made by all companies belonging to the same group. For tax credit computation purposes, tax losses and/or ACE surplus carried forward must be calculated for an amount not exceeding 20% of the nominal value of the transferred credits. Therefore, the consideration paid on the transfer is not relevant for this purpose.

For example, if credits having a nominal value equal to €100 million are transferred, the 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 credits would be equal to €4.8 million.

DTAs relating to tax losses and/or ACE surplus carried forward can be transformed being irrelevant the amount reported in the balance sheet (eg, where a company fails to pass the probability test).

The transformation of DTAs into tax credits takes effect from the date of the credits disposal and is subject to the payment of the 1.5% DTA fee regime<sup>(5)</sup> introduced by Article 11(1) of Decree-Law 59/2016 – see the tax authority's Circular Letter 32/E of 22 July 2016. Therefore, based on Article

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11 of Decree-Law 59/2016, the fee should be due from fiscal year 2020 to fiscal year 2031.

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

### **Tax consolidation regime**

In the case of the tax consolidation regime (see Article 117 and following of Presidential Decree 917/1986), the right to transform DTAs relating to tax losses carried forward should be attributed to the consolidating entity, since it has the right to use the tax losses carried forward generated under this regime. In contrast, the consolidated companies should have the right to transform the DTAs relating to the ACE surplus carried forward considering that all maintain the right to use said surplus.

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### **Endnotes**

(1) Article 84 of Presidential Decree 917/1986.

(2) Article 1(4) of Decree-Law 201/2011, converted into Law 214/2011.

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

(4) Article 43*bis* or Article 43*ter* of Presidential Decree 602/1973.

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

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