August 19 2022

Supreme Court rules on use of tax losses to offset minimum income of shell company in tax consolidation regime

Studio Legale e Tributario Biscozzi Nobili Piazza | **Corporate Tax - Italy**

ANDREA SPINZI

FEDERICA CIONI

According to article 30 of Law No. 724/1994, a company is qualified as a "shell company" in a fiscal year if its average revenues in the same fiscal year and the prior two fiscal years are lower than the amount resulting by applying certain "deemed return" percentages to the average value[(1)] of specific assets[(2)] in this three-year period.

Facts

If a company is deemed to be a "shell company", it is assessed as having a minimum taxable income for both corporate income tax (IRES) and regional production tax (IRAP) purposes, in addition to other issues such as the IRES standard rate increasing by 10.5%, and therefore equalling 34.5%, and limitations on the use of the yearly value-added tax credit.

In particular, for IRES purposes, the taxable income of a non-operative entity in the fiscal year under analysis is determined as the sum of values emerging from the application of specific percentages to the values[(3)] of the assets[(4)] held during such fiscal year.

Moreover, according to article 2 paragraph 36-*decies* and 36-*undecies* of Law Decree No. 138/2011, a company is also identified as a "shell company" when it is established that:

- there were tax losses during five previous periods; or
- in the last five income tax returns, the company had four fiscal years with tax losses and during one fiscal year an income lower than the minimum income threshold, as defined by article 30 paragraph 3 of Law No. 724/1994 (so-called "systematic loss-making companies").

In this case, the company is qualified as a "shell company" from the following fiscal year, (ie, from the sixth fiscal year).

However, according to article 9 of Law Decree No. 73/2022 (which has not yet been passed into law), shell companies will no longer be applicable to "systematic loss-making companies" starting from the current year on 31 December 2022.

Further, the shell company regime may not be totally or partially applicable if certain exclusion criteria or disapplication causes occur (according to the provisions of the director of the Italian Revenue Agency No. 2008/23681 and No. 2012/87956). In addition, it is possible to submit an advance ruling to the Tax Authority in order to assess the specific and objective circumstances that prevent the company from earning the minimum amount of income.

Decision

According to Supreme Court Decision No. 13123 of 27 April 2022, if a taxpayer elects to apply the "fiscal unit" regime as a consolidating entity and it is considered a "shell company" under the above criteria, the losses of consolidated companies may not be used to reduce the entity's income below the minimum deemed return.

The issue under analysis concerned a group of companies that had elected to use the fiscal unit regime provided by article 117 and the following articles of the Income Tax Code, which allows group taxable income to be determined as the sum of all the incomes and losses of the consolidated companies, as a result of choosing to apply the "fiscal unit" regime.

In this context, the consolidating company was a shell company that had reported the minimum deemed income (according to the provisions under article 30 paragraph 3 of Law No. 724/1994) in its tax return. After having reported this, the consolidating company applied the criteria of tax consolidation regime by offsetting its own income (ie, minimum deemed income) against the operating losses of the other consolidated companies, so that it did not result in any groupwide taxable amounts for the fiscal years under dispute.

The Tax Authority questioned the offsetting of the consolidating company's minimum income against the tax losses of the other companies within the scope of the fiscal unit regime and when assessing a tax base equal to such minimum income, which would require the payment of the related taxes, in addition to interest and penalties.

The Supreme Court confirmed the Tax Authority's position and denied the group's behavior, stating that it was not consistent with the rationale of the provisions regarding "shell companies". In particular, the Court argued that under no circumstances the non-operative entity can tax an amount that is lower than the minimum income threshold. In other words, a "shell company" can only use the tax losses of the other consolidated companies to offset the income that exceeds this threshold.

Comment

In this regard, while article 30 paragraph 3 of Law No. 724/1994 does not allow a shell company to use its previous years' losses to offset its minimum income, there is no specific provision that prevents a non-operative consolidating company from using losses incurred in the same fiscal year by other companies that participate in the fiscal unit regime in order to reduce or nullify the overall taxable income.

For further information on this topic please contact Andrea Spinzi or Federica Cioni at Studio Legale Tributario Biscozzi Nobili Piazza by telephone (+39 02 763 6931) or email (andrea.spinzi@sbnp.it or federica.cioni@sbnp.it). The Studio Legale Tributario Biscozzi Nobili

Piazza website can be accessed at www.sbnp.it.

Endnotes

(1) According to the article 110 paragraph 1 of the Income Tax Code.

(2) A 2% rate for shareholdings, financial instruments or financial receivables, from a 1% to 6% rate depending on different categories of owned or leased real estate properties or certain vessels, and a 15% rate for other owned or leased tangible and intangible assets.

(3) Please see endnote (1).

(4) A 1.5% rate for shareholdings, financial instruments or financial receivables, from a 0.9% to 4.75% rate depending on different categories of owned or leased real estate properties or certain vessels, and a 12% rate for other owned or leased tangible and intangible assets.