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Covid-19 – New incentive to boost the Italian NPL/UTP Market in 2020

On 29 April 2020 the Italian Parliament converted into law the Italian Law Decree no. 18 of 2020, commonly known as the Cura Italia Decree (the "**Decree**"), provisionally enacted by the Italian Government in March 2020.

The Decree (as converted into law by the Italian Parliament) provides for some measures aimed at mitigating the economic consequences of the Covid-19 outbreak. In this context, we would like to bring to your attention the provision set forth by Article 55 of the Decree, which could have a positive impact on the Italian NPL/UTP market.

In particular, Article 55 provides that companies that transfer for consideration "impaired" monetary receivables (the "**Impaired Receivables**") by the end of 2020 are entitled to claim the conversion of certain existing deferred tax assets ("**DTAs**") into tax credits (the "**Tax Credits**"). Given the novelty of the Decree, a few aspects of the relevant provisions are unclear and guidelines from the tax authorities are awaited. Therefore, the below high-level summary only reflects our interpretation and understanding of the matter to date.

1. The notion of eligible transferors under Article 55

An eligible transferor under Article 55 (the "**Transferor**") can in principle be any company. Article 55 is applicable not only to banks and financial intermediaries, but also to industrial companies, as confirmed by the technical report (the "**Report**") to the Decree.

Having said that, under Article 55 a Transferor cannot be:

(i) a failing, or likely to fail, bank pursuant to article 17 of Legislative Decree 16 November 2015 n. 180 and Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms;

(ii) an insolvent business pursuant to article 5 of Royal Decree 16 March 1942, n. 267 (the Italian Bankruptcy Law); or

(iii) an insolvent debtor pursuant to article 2(1)(b) of Legislative Decree 12 January 2019 n. 19 (the law that governs insolvency of debtors other than businesses).

2. The notion of eligible transferee under Article 55

There is not a specific notion of transferee under Article 55. A transferee could therefore be, for instance, a company, an investment fund or a securitization vehicle.

However, Article 55 is not applicable if the Transferor controls the transferee pursuant to Article 2359 of the Italian civil code, or vice versa or both entities are under common control by another company. In other words, only transactions between "unrelated" parties could qualify for the tax incentive under Article 55.

The notion of control under Article 55 is broad and encompasses:

(i) the availability of the majority of voting rights in the shareholder meetings of a company, or
(ii) the availability of sufficient voting rights to exercise a dominant influence, or
(iii) the possibility to exercise a dominant influence on the basis of contractual relationships.

3. The notion of Impaired Receivables under Article 55

The notion of Impaired Receivables is broad and includes both financial and trade receivables. Such receivables qualify as "impaired" for the purposes of Article 55 if the relevant debtor has been in default on its payment obligations for more than 90 days from the relevant due date.

4. The features and timing of an eligible transfer

The transfer of the Impaired Receivables must be made for consideration (i.e. the transfer cannot be for free or by way of security) and must take place on or before 31 December 2020 in order to allow the Transferor to then convert its DTAs in Tax Credits.

5. The DTAs eligible for conversion into Tax Credits

The DTAs that are eligible for conversion into Tax Credits under Article 55 are not those arising from the potential losses connected to the transfer of the Impaired Receivables. Rather, the convertible DTAs are those already existing and available for use as of the date of transfer.

More in detail, the DTAs that are in principle convertible into Tax Credits are those potentially generated by the following tax attributes:

(i) unused tax losses carried forward pursuant to Article 84 of the Italian Presidential Decree No. 917 dated 22 December 1986 (the "**CFTL**"); and,
(ii) unused stock of notional return on equity pursuant to article 1(4) of Law Decree 6 December 2011 n. 201 (the "**ACE**", together are the "**Tax Reliefs**").

Eligible for conversion are not only the DTAs reported in financial statements, but also the DTAs which are have not been reported in financial statements on the basis of the relevant accounting principles (since there were/are no reliable indication of future use of the relevant Tax Reliefs as per the applicable accounting rules). In the latter case, the Tax Reliefs shown in the relevant tax return can be the basis for the conversion into Tax Credits under Article 55. As the Tax Reliefs are available to off-set the taxable income subject to Italian corporate income tax purposes (the "IRES") only, such reliefs could generate potential DTAs on the basis of the IRES tax rate only.

As the transfer of the Impaired Receivable must take place by 31 December 2020 and the DTAs or Tax Relief must exist and be unused upon transfer date, the relevant Tax Reliefs should generally be those existing as of 31 December 2019 ([1]). This is however a point to be checked on a case-by-case basis depending upon the timing of the specific transaction.

6. The limitations applicable to the conversion of DTAs

The amount of the DTAs that can qualify for the conversion depends *inter alia* upon the amount of the Impaired Receivables transferred. As follows:

(i) the Tax Reliefs eligible for conversion into Tax Credits cannot exceed 20% of the nominal value of the Impaired Receivables transferred subject to a cap;

([1]) We note that Article 106 of the Decree allows companies to postpone by 60 days the approval of their financial statements for the financial year 2019, while the IRES tax returns for the year 2019 are due by the end of November 2020.

(ii) the conversion mechanism is capped to a maximum nominal amount of Impaired Receivables transferred of € 2 billion. This cap is determined taking into consideration all transfers made within 31 December 2020 by the Transferor, by companies controlled by the Transferor or that control the Transferor and also by companies that are under common control. The notion of "control" is defined pursuant to Article 2359 of the Italian civil code;

(iii) after having applied the rules *sub* (i) and (ii), the Tax Reliefs could be then converted into Tax Credit by applying the relevant IRES tax rate (i.e. 27.5% for banks and financial intermediaries, 24% for industrial and commercial companies).

The above mechanism implies that the maximum amount of Tax Reliefs convertible into Tax Credit is equal to € 400 (i.e. 20% x € 2 bln), which corresponds to:

(i) a maximum Tax Credit of € 110 mln (€ 400 mln x 27.5%) for banks and financial intermediaries; and

(ii) a maximum Tax Credit of € 96 mln (€ 400 mln x 24%) for industrial or commercial companies.

7. The timing of the conversion

The conversion of DTAs into Tax Credits takes effect from the date of the transfer of the Impaired Receivables. Starting from such date, the Transferor will generate a Tax Credit and will no longer be able to use the Tax Reliefs converted into credits. Our considerations as to the timing for the use of the Tax Credits, our remarks are *sub* section 10. below.

8. Certain other features of the Tax Credit

The Tax Credit is non-interest bearing.

Where the company has not booked any DTAs under the applicable accounting principles, to the extent it converts its Tax Reliefs into Tax Credits pursuant to Article 55, it will book a gain in the profit and loss account, and such gain will not be taxable for IRES or IRAP purposes.

9. The conversion option and the annual fee due for the conversion

In order to convert the DTAs into Tax Credits under Article 55, the Transferor must exercise the option set forth under Article 11(1) of Italian Law Decree No. 59 dated 3 May 2016 (the "**Option**"). The Option must be exercised by 31 December 2020, unless the same option has already been exercised in the past.

The regime set forth by Article 11(1) mentioned provides that the conversion of deferred tax assets into tax credits is available and compliant with the EU laws if an annual fee is paid until the tax year 2030. The annual fee payable with respect to a given tax year falls due when the payment of the IRES balance of that year falls due (generally by the end of June). The annual fee is determined by multiplying the rate of 1.5% by an amount (the "**Basis**") which is to be determined annually on a case-by-case basis under certain detailed rules and in light of the specific tax position of the company. If the Basis resulting from the application of the mentioned rules is negative, then no such fee is payable. The fee due, if any, is deductible for the purposes of IRES and IRAP in the tax years in which it is paid. The Option is exercised through the payment of the annual fee to the Italian Treasury, or by notifying the relevant tax authority to their registered email address, if the Basis is negative and no fee is due in the relevant tax year.

There are several uncertainties regarding the interplay between the tax incentive under Article 55 discussed herein and the exercise of the Option under Article 11(1) mentioned. In particular, the are uncertainties in relation to the payment of the annual fee and the determination of the Basis for

the purposes of the tax incentive under Article 55. Guidelines from the tax authorities on this aspect are required.

10. The timing for the use of the Tax Credits

According to Article 55, the Option becomes effective in the tax year following the one in which it is exercised. According to one interpretation, the implication of this rule is that the Tax Credits can be used only starting from, generally, 1 January 2021. According to another line of reasoning, the Tax Credits can be utilised as soon as the transfer of the Impaired Receivables is effective. Guidelines from the tax authorities on this aspect are required.

11. The utilisation of the Tax Credits

The Transferor may utilise the converted Tax Credits according to one or more of the following options:

(i) offset its own tax and social security liabilities, without the application of the annual limit of € 700,000;
(ii) claim, in full or in part, the Tax Credits for refund from the tax authority;
(iii) transfer the Tax Credits to group companies which can use the Tax Credits to offset tax and social security liabilities within the annual limit of € 700,000 (unless the transferee offsets its own IRES liabilities in which case no limit should be applicable); or
(iv) claim the Tax Credits for refund, and the transfer them to third-parties.

Article 55 does not clarify whether the Tax Credits can be transferred to group companies or other third parties for a price equal to the nominal value or at any other price.

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As you may appreciate, the above are our high level and preliminary considerations on a new tax measure, which has just been enacted and in respect of which no official guidelines have been issued to date. Therefore, the above summary only reflects our interpretation and understanding of the matter to date. We are monitoring the possible issuance of official guidelines by the tax authority and will provide further updates in that respect.