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REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council = Approval

Italy's introduction of tax credit to the Budget law (IT022)

I. Background

Italy has notified a tax measure aimed at promoting research, development and innovation activities ("R&D&I") under the national 4.0 Industry project, and particularly of SMEs. The Commission Services draw hereafter a summary conclusion on the Italian measure.

II. Tax credit for investments under the 4.0 Industry Project

a) Description of the measure

The Italian Budget law for 2020 introduced a tax credit for qualifying investments in Research and Development, Green transition, 4.0 Digital Innovation and other similar innovation activities for the tax year 2020.

The tax credit is available to resident and non-resident taxpayers with domestically sourced business income who are not tax exempt, regardless of their actual size or business activity, provided that they carry on qualifying activities.

Qualifying activities are fundamental research, industrial research and experimental development, technological innovation for new or substantially improved products[1] or production processes, as well as innovative design and aesthetic design for new products and samples[2], particularly for businesses active in the textile, fashion, footwear, eyewear, gold, furniture and ceramics sectors.

Eligible expenses are the costs of personnel engaged in the qualifying activities, and in limited amount or percentage of the personnel costs, depreciation or leasing costs of instruments and equipment, costs for contractual research or consultancy services and other similar costs to the extent incurred for the research, development and innovation activities qualifying for the tax credit. Eligible expenses may include costs for intangible assets[3] such as patents, industrial property rights for industrial or biotechnological inventions, a topography of semiconductor products[4] or a new plant variety. The tax credit is also applicable for expenses incurred for third-party professionals who perform the qualifying R&D&I activities, provided the contract research company is resident in an EU Member State, or in an EEA country that allows an adequate exchange of information with Italy.

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[1] **Technological innovation for new or substantially improved products** includes, for instance, production of goods or services which differ from those already produced by an undertaking in terms of technical characteristics, components, materials, embedded software, user-friendliness, simplification of the use procedure, greater flexibility or other performance and functional elements. **Technological innovation for new or substantially improved production processes** includes, for example, processes or methods of production and distribution and logistics of goods or services involving significant changes in technologies, plant, machinery and equipment, software, resource-efficiency, reliability and safety for internal or external actors involved in business processes.

[2] **Innovative design and aesthetic design for new products and samples** include, for instance, work of design and aesthetic design aimed at significantly innovating the company's products in respect to their form and other non-technical or functional elements, e.g. with the characteristics of lines, contours, colors, texture, ornaments.

[3] The law explicitly excludes the possibility to exploit any of the eligible intangible assets for activities other than research and development. Therefore, the taxpayer cannot receive income, for example, by licensing them.

[4] A **topography of semiconductor products** is a series of fixed or encoded related images, representing the three-dimensional pattern of the layers of which a semiconductor product is composed. It represents at the same time the pattern of a surface of the semiconductor product at any stage of its manufacture and is the result of its creator's own intellectual effort and is not commonplace in the semiconductor industry.

The tax credit is available only in the form of an offset against other tax debts and social security contributions of the taxpayer. The amount is credited in three equal annual instalments, starting from the tax period following that of accrual, upon submission of a certification confirming that qualifying expenses have been actually incurred and properly registered in the business accounts of the taxpayer. The tax credit may however be limited due to an annual cap of 700,000 EUR that, under the Italian law, applies when offsetting taxes (such cap was increased to 1,000,000 EUR by decree in 2020, and further increased to 2,000,000 by decree in 2021, to preserve the liquidity of companies during the pandemic). The taxpayer is entitled to carry forward any excess tax credit to the following tax year.

The initial design of the tax credit was as follows:

R&D&I ACTIVITIES	**TAX CREDIT**	**MAXIMUM THRESHOLD FOR ELIGIBLE EXPENSES**
Fundamental, Industrial and Experimental Development Research	12%	3 Mio EUR
Technological Innovation	6%	1.5 Mio EUR
Technological Innovation for new products or processes	6%	1.5 Mio EUR
Innovative and aesthetic design	10%	1.5 Mio EUR

b) Changes to the tax credit in 2020

With the Italian Budget Law for 2021, the tax credit was increased for all qualifying activities as shown in bold in the table below, and its duration was extended by two additional tax years, i.e. 2021 and 2022.

R&D&I ACTIVITIES	TAX CREDIT	MAXIMUM THRESHOLD FOR ELIGIBLE EXPENSES
Fundamental, Industrial and Experimental Development research	**20%**	**4 Mio EUR**
Technological Innovation	**10%**	**2 Mio EUR**
Technological Innovation for new products or processes	**10% (or 15% if aimed at green transition or 4.0 digital innovation[5])**	**2 Mio EUR**
Innovative and aesthetic design	**10%**	**2 Mio EUR**

Taxpayers can benefit from the tax credit up to the maximum threshold set for the eligible expenses of each category of R&D&I if separate accounting is held per each R&D&I project and related eligible expenses. Taxpayers may claim the tax credit for one or more qualifying activities in the

[5] **Green transition** activities include, for instance, the design of sustainable products that last longer and are designed to be re-used, repaired or updated for the recovery of their functions or subject to high-quality recycling processes for the recovery of materials, so as to reduce the environmental impact of products throughout their life cycle (eco-design); or adoption of solutions and technologies to monitor the life cycle of the product and to enable the assessment of the status of the post-use product in order to facilitate its collection for the recovery of materials and functions.

4.0 digital innovation activities include example forms of integration, through the application of digital technologies, between the IT system and the stages of production processes of goods or services, or digitalisation of processes and products in the different areas of value creation(e.g., predictive maintenance of CNC machine tools, process/product traceability, logistics/warehouse/handling, quality control, automatic tracking of quality specifications of a product, raw materials, etc.).

same tax year up to the relevant thresholds. The tax credit is calculated net of other subsidies or contributions received for the same eligible expenses.

Example

A company undertook activities of industrial research and spent 100,000 EUR in 2020 for qualified and trained personnel, assets and research contracts with external laboratories. The same company also spent 200,000 EUR to promote innovation of its production processes for achieving more energy-saving and less polluting production performances.

In such case, the company may claim a tax credit of 20,000 EUR for eligible expenses of R&D activities and 30,000 EUR for eligible expenses incurred for green transition. The total tax credit allowed is 50,000 EUR. The company may offset 16,666 EUR against other tax debts or social contributions in 2021, 16,666 EUR in 2022 and 16,667 in 2023 (2023 is the last tax year available under the measure).

III. Summary conclusion

The tax credit is a 'front-end' incentive for R&D&I and its benefit depends on the amount of qualifying expenses actually incurred. It may take only the form of an offset against other tax debts or social contributions due by taxpayers, if all the conditions above are fulfilled. The measure falls within the scope of the Code of Conduct only insofar as the tax credit can be offset against debts arising from corporate income tax.

The Group has dealt in the past with 'front-end' tax incentives for R&D. Such 'front-end' tax incentives may operate as deductions from the tax to pay[6] or as deductions from the tax base[7]. The Italian measure is very similar to DE015 ("Regulation for the promotion of R&D"): both tax incentives reduce the tax to pay. Differently from DE015, the Italian measure also includes innovation activities in its scope.

[6] See Germany (DE015), (doc. 8374/20 Annex 2).

[7] See Poland (PL008), (doc. 9637/18 para. 18); Croatia (HR013), (doc. 9652/19 ADD 6 REV).

Based on the past practice of the Code, it appears that the COCG cleared all tax regimes under scrutiny which involved ‘front-end’ incentives although they led to lower taxation, as these were considered an economically sound and evidence-based method for encouraging R&D. Moreover, a similar provision is included in the Commission’s proposal for the CCTB and the Recovery and Resilience Facility encourages national measures aimed at digital and green transition.

Follow-up

In light of all considerations above, and the fact that it is limited in time (three years), the Commission Services are of the opinion that such measure does not appear to cause concerns under the Code of Conduct criteria and does not need to be assessed.

IV. Follow-up

The COCG agreed that IT022 measure does not need to be assessed.