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**REPORT**

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

**Italy's option for an increased deduction of R&D costs relating to certain IP assets (IT023)**

### 1. Background

1. The Italian authorities notified the tax measure – option for an increased deduction of R&D costs relating to certain IP assets (a front-end tax incentive) - under the 2021 standstill exercise (IT023).

### 2. Relevant legal framework

2. Law Decree no. 146 of 21 October 2021, converted into law on 17 December 2021, introduced first the front-end tax incentive allowing for a 90% extra deduction of R&D eligible expenses and repealed at the same time the old patent box regime. The Budget Law for 2022 increased then this extra deduction from 90% to 110% of R&D eligible expenses.

3. The above measure entered into force on 21 October 2021.

4. The Italian tax authorities already adopted, by means of the "*Provvedimento del Direttore dell'Agenzia delle entrate*" no. 48243/2022 of 15 February 2022, implementing rules detailing how to exercise the option for the tax incentive and submit the supporting documentation.

### 3. Purpose of the measure

5. Italy has introduced the measure to promote further investments in certain IP assets by allowing for an additional tax deduction of the R&D eligible costs from the tax base of both Corporate Income Tax (IRES) and the regional tax on production activities ("*Imposta Regionale sulle Attivitá Produttive*" or IRAP), thus supporting business growth and competitiveness.



### 4. Design of the measure

#### *4.1.Beneficiaries*

6. Taxpayers conducting business activities are entitled to a 110% extra deduction of R&D eligible costs from the tax base at the end of the tax year.

7. The extra deduction is available to resident and non-resident taxpayers, regardless of their legal form, size or type of business activity. Businesses in voluntary or involuntary liquidation, bankruptcy or in other insolvency proceedings are excluded.

#### *4.2. Qualifying IP assets*

8. The tax measure applies to the R&D eligible costs incurred for developing, maintaining, legally protecting and exploiting the following IP assets:

a) Copyrighted software;
b) Industrial patents;
c) Legally protected design and models.

9. R&D expenses for trademarks and know-how are excluded from scope of the tax measure.

#### *4.3.Qualifying R&D activities and eligible costs*

10. Under the tax measure, qualifying activities are fundamental research, industrial research and experimental development, technological innovation, innovative design and aesthetic design[1], as well as legal protection of relevant Intellectual Property Rights.

11. Eligible costs are the costs of personnel engaged in the qualifying activities, depreciation or leasing costs of instruments and equipment, costs for contractual research[2] or consultancy services, and other similar costs to the extent incurred for the qualifying activities. The tax measure also covers costs of legal protection of rights over qualifying IP assets, including costs for the prevention of counterfeiting.

[1] The Ministerial Decree of the Ministry of Economic Development of 6 October 2021 clearly defines all qualifying activities falling within scope of fundamental research, industrial research and experimental development in Article 2, of technological innovation in Article 3, and of innovative design and aesthetic design in Article 4 of the same Decree. The details of such qualifying activities are included in the Commission's proposal "not to assess" the IT022 measure that the Code Group approved in 2021 as part of the 2020 standstill process.

[2] The tax measure also covers expenses incurred by third-party professionals who perform the qualifying R&D activities, provided that 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.

*4.4.Tax advantage*

12. The tax advantage consists in a 110% extra deduction of the eligible costs from the tax base at the end of the tax year in question.

13. It is to be noted that, if R&D eligible costs are incurred prior to the creation of a qualifying IP asset, the 110% extra deduction applies from the tax year in which the relevant IP is granted legal protection. The 110% extra deduction would include R&D eligible costs incurred up to the 8th tax year before the IP legal protection is granted in such case.

*4.5.Amount of the tax advantage*

14. As mentioned, the tax measure is a front-end incentive for R&D and innovation investments made by taxpayers and its benefit depends on the types of qualifying activities carried out and amount of R&D eligible costs actually incurred.

15. Based on the information provided by Italy, the national law does not seem to provide for any cap on the amount of the R&D eligible costs.

16. More in concrete, assuming for instance R&D eligible costs of 1.000.000 EUR in a given tax year, the extra deduction would amount to 1.100.000 EUR (110% of the eligible costs). The overall deduction would amount to 2.100.000 EUR (210% of the eligible costs).

*4.6. Duration and exercise of the optional tax incentive*

17. The option for the extra deduction can be exercised as of the 2021 tax year and is available for 5 years. Once a taxpayer has made the option, it cannot revoke its request but it can opt for its renewal.

18. As noted in p. 12, taxpayers that have incurred R&D eligible expenses prior to, and connected with, the creation of a qualifying IP asset are entitled to benefit from the 110% extra deduction from the tax year in which the relevant IP is granted legal protection up to the 8th tax year preceding its legal protection.

19. The option for the new tax incentive is also available to taxpayers who are still waiting for the conclusion of an old patent box[3] ruling (including renewals of prior agreements). These taxpayers may renounce the old patent box and opt for the new tax incentive. However, such alternative is not available in situations where an old patent box ruling (including renewals of prior agreements) is already concluded.

[3] Old patent boxes are to be understood as those falling within scope of the previous IP regime, that Law Decree no. 146 of 21 October 20211, converted into law on 17 December 2021, has recently repealed.

## 5. Conclusion

20. It is the Commission Services' opinion that the measure does not need to be assessed for the following reasons:

    i. The new tax incentive is a front-end (or cost-based) incentive replacing the old patent box regime operating on IP income, that is no longer in force from as specified above;
    ii. As such, the front-end incentive consists in a tax relief of real R&D and innovation costs incurred by businesses;
    iii. The tax relief can only be used against an amount of income generated by the taxpayer in a given tax year.
    iv. If the tax relief cannot be used fully in a given year, it cannot be carried forward.

21. Furthermore, the Code of Conduct Group has already cleared a number of front-end incentives[4] for R&D in the past as this kind of tax incentives is considered an economically sound and evidenced based method for encouraging R&D and innovation activities.
22. More generally, promoting research, development and innovation is an important Union objective laid down in Article 179 of the TFEU and a front-end R&D tax incentive is also suggested in the draft CCTB.

## 6. Follow-up

23. In light of the foregoing, the COCG agreed that the measure does not need to be assessed.

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[4] Such 'front-end' tax incentives may operate as deductions from the tax to pay or as deductions from the tax base like the present tax measure. For example, the Italian case (IT022) in 2021 or the German case (DE015) in 2020, or the Croatian case (HR013) in 2019.