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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 amendments to the existing Notional Interest Deduction regime to apply the interest rate of 15% to increase of equity in 2021 (IT024)

1. Background

Italy has notified some amendments to the existing Italian Notional Interest Deduction ("NID") regime under the Standstill and Rollback notifications for the year ending on 31 December 2021. The Commission services draw hereafter a summary conclusion on the Italian measure as amended.

The Italian NID regime was assessed by the Code of Conduct Group for the first time in 2018 and the regime was deemed not harmful (doc. 14364/18 ADD 4). Subsequently, Italy abolished its NID regime by the Budget Law for 2019 (Law no. 145 of 30 December 2018) but introduced it again by the Budget Law for 2020, with a seamless application (i.e. the provisions of the Budget Law for 2020 were applied retroactively, from 1 January 2019). The Code of Conduct Group found the reintroduced NID regime not harmful on the same basis as the assessment by the Group in 2018 (doc. 8374/20 ANNEX 4).

2. **Relevant legal framework and design of the measure as amended**

Under Article 19, paragraph 2, of Law-Decree 25 May 2021 no. 73, as converted into Law 23 July 2021 no. 106), Italy introduced the following amendments to the existing NID regime, that apply only in tax year 2021:

- 15% interest rate;
- A monetary cap of 5,000,000 EUR per company up to which the 15% interest rate applies to determine the amount of notional interest to deduct (i.e. the tax benefit[1]);
- A recapture mechanism will apply if the 15% NID qualifying equity decreases within the following two tax years (2022 and 2023) for reasons other than statutory loss coverage. This is the case for dividend distributions or returns of capital before January 2024 that may cause a recapture of the 2021 tax benefit to the extent such distribution brings the company's equity below the portion of the 2021 amount that benefitted from the 15% NID.

All the other existing provisions of the NID regime stay unchanged[2].

Under the amended NID regime, a net increase of equity in 2021 up to 5,000,000 EUR is subject to the higher 15% interest rate, whilst a net increase of equity in the same tax year exceeding 5,000,000 EUR, if any, is subject to the ordinary rate (1.3%).

The strengthened NID regime will apply only in tax year 2021 as exceptional response to the economic crisis caused by the pandemic. The net increase of equity in 2021 is calculated as usual by comparing the amount of equity in tax year 2020 with the amount of equity in tax year 2021, starting from 1 January 2021 (the so called incremental-based approach).

3. **Assessment**

As noted, the Code of Conduct Group already assessed the Italian NID regime and found it not harmful in the past.

The two amendments recently introduced by Italy, the higher NID rate and the monetary cap are substantive changes compared to the NID regime previously in force.

[1] The tax benefit would therefore result in a maximum NID of €750,000 with a cash corporate income tax (CIT) savings of €180,000 per company (24% CIT rate).
[2] In this regard, it is to be noted that the 2021 Law Decree also provides that, as an alternative to a CIT deduction of 15%, companies may choose to convert the total or part of the 2021 NID in tax credits (i.e., maximum €180,000). This tax credit can be used against any type of tax even during 2021, i.e., CIT, local tax (IRAP), VAT, payroll taxes, social security contributions, or even be available for refund or sold to third parties, to maximise its potential use by companies, especially those in a CIT loss position. This is however an administrative change of the Italian NID regime that appears to be immaterial for the present assessment by the Code of Conduct

While the application of a monetary cap can be considered positively as it is essential purpose is to limit the tax benefit of notional interest deduction up to a certain predetermined amount of net increase of equity for the tax year in question, the substantial increase of the interest rate to 15% deserves further consideration in light of the Guidance on NID regimes of the Code of Conduct.

Under p. 4.2 of the Guidance, the Code of Conduct Group acknowledges that NID regimes may differ significantly depending on whether they are stock-based or incremental-based, or depending on the level of interest rate applied. In general, it can be said that the greater the tax incentive, the greater the risk for tax planning. For a well-designed regime, a NID should encompass appropriate limitations of scope and anti-abuse measures to reduce opportunities for tax abuse.

From this perspective, it is worth noting first that the Italian NID regime is an incremental regime, meaning a tax regime whose calculation base is represented only by the yearly increase of net equity and, hence, the windfall effect associated with a regime based on the stock of equity is not at stake.

Second, as Italy confirmed that all the other conditions of the previous NID regime remained unchanged, the regime is limited in its scope and assisted by the same anti-abuse provisions (both targeted and general), especially for intra-group transactions, that led the Code of Conduct Group to find the tax measure not harmful in 2018 (doc. 14364/18 ADD 4).

Furthermore, an additional anti-abuse measure or safeguard is provided for by the recently amended NID regime. Accordingly, taxpayers are required to pay back the 2021 tax benefit where, and to the extent, non-statutory loss coverage such as forms of distributions would bring the company's equity below the portion of the 2021 amount that benefitted from the 15% NID.

Last but not least, the amended NID is limited in time for one year and consists in an exceptional response to the pandemic and its economic consequences. While noting in fact that the level of NID rate is unusually high, Italy introduced it as a 1-year measure to further encourage taxpayers to increasing their own capital rather than resorting to debt financing in these particularly difficult times.

4. Conclusion

In light of the aforementioned, it is the Commission services' view that the amended NID does not alter the assessment made by the Code of Conduct Group in the past and, hence, the measure does not need to be re-assessed.

5. Follow-up

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