18 March 2020

Global Tax Alert

Italian NPLs and UTPs: Conversion into tax credits of Deferred Tax Assets associated with tax losses carried forward and other deferred deductions

Executive summary

On 16 March 2020, the Italian Government, to counteract the current liquidity crisis following the spread of COVID-19, approved a Decree[1] that entitles companies (mainly banks and financial institutions) willing to dispose of NPLs[2] and UTPs[3] by 31 December 2020 to claim a partial conversion into a tax credit of the existing, although possibly unrecognized, Deferred Tax Assets (DTAs) associated with:

1) Tax losses carried forward (TLCF)

2) Excess notional interest deduction carried forward (NIDCF)[4]

Once converted into tax credits, the above DTAs will also be fully computed as part of the regulatory capital thus possibly improving the capital shortfall of Italian banks that is expected to increase due to the worldwide economic challenges following the spread of COVID-19.

The conversion of DTAs into tax credits is subject to an election for the option of the 1.5% DTAs guarantee fee regime.

Tax credits resulting from the above conversion (Converted Tax Credits or CTCs) can be: (i) offset without any limit against tax payables; (ii) assigned within the same group or to third parties; and (iii) reclaimed.

Building a better working world

This new measure represents an incentive that is intended to strengthen the Italian NPL and UTP markets creating an incentive for transactions to be executed before year end.

However, there are currently some uncertainties about the quantification of the above tax incentive and the relevant procedural steps.

Taxpayers should work with their local tax professionals to estimate the potential benefits associated with the disposal of NPLs and UTPs.

Detailed discussion

Conversion of DTAs on TCLF and NIDCF: the previous regime rejected by the European commission

In June 2019, the Italian Government introduced new rules[5] aimed at encouraging the consolidation among banks with their legal seat in the south of Italy.

The above rules contemplated the possibility to convert into tax credits DTAs on:

1) TLCF
2) NIDCF
3) Bad debt provisions made upon first time adoption of IFRS9

According to the above rule, each bank taking part in the consolidation could convert up to €500m of DTAs booked on the above components.

The conversion of DTAs into tax credits was subject to the election for the option of the 1.5% DTAs guarantee fee regime.

The applicability of the above tax incentive was subject to the approval of the European Commission.

In December 2019, the Italian Government was informed that the European Commission would not give its approval to the above tax incentive because allegedly it was in contrast with the European Union (EU) State aid policy.

Conversion of DTAs on TLCF and NIDCF: the new measure

Following the rejection by the European Commission of the previous regime and to counteract the global economic crisis expected from the spread of COVID-19, on 16 March 2020, the Italian Government approved a Decree which repeals the regime described in paragraph 1 and introduces a new and completely different regime for converting DTAs on TCLF and NIDCF into tax credits.

The new rule states that in the case of disposal by 31 December 2020 of loans granted to defaulting debtors,[6] the seller can partially convert into tax credit DTAs on TLCF and NIDCF.

The sum of the TLCF and NIDCF whose DTAs are eligible for conversion cannot be higher than 20% of the face value of the loans disposed. In addition, the conversion mechanism only applies with reference to the disposal of loans for a face value not exceeding €2b, computed taking into consideration all disposals made, before 31 December 2020, by all companies belonging to the same group.

The above conversion mechanism also applies to DTAs which had not been booked in the financial statements (e.g., the ones that did not pass the so-called "probability test").

The conversion of DTAs into tax credits takes effect from the date of the loan disposal and is subject to the election for the option of the 1.5% DTA guarantee fee regime.[7]

Starting from the date of the disposal of the loan, the seller can no longer carry forward tax losses and notional interest deductions whose DTAs have been converted into tax credit.

CTCs are interest free and are fully computable in the regulatory capital of banks. They can be used to offset tax payables without any limitation or to request refunds from the Italian tax authorities. They can also be sold within the group or, once the refund request has been filed, be disposed of to third parties.

CTCs does not give rise to any taxable income in the hands of the seller for corporate income tax (Ires and Irap) purposes.

The above described tax incentives do not apply to the sellers under insolvency proceedings.[8]

In addition, the above tax incentives do not apply to the disposals of loans between companies belonging to the same group.

Impact on businesses

The new tax incentive will boost the Italian NPL and UTP markets. It is expected that Italian banks and financial institutions will accelerate the NPLs/UTPs disposal plan in order to benefit from the above described tax advantage.

In addition, given the current economic crisis following the spread of COVID-19, it is likely that the European Commission will not raise any concern about the compatibility of the newly introduced measures with the State aid policy.

This said, the computation of TLCF and NIDCF that feed in the determination of the convertible amounts typically entails some degree of complexity that may require an in-depth review prior to considering potential transactions.

Accordingly, taxpayers should work with their local tax professionals to estimate the potential benefits associated with the disposal of NPLs and UTPs.

Endnotes

1. Decree 17 March 2020, no. 18 published in the Italian official journal on 17 March 2020 and effective from the same date.
2. Non-Performing Loans portfolios.
3. Unlikely to pay exposures.
4. NIDCF represents the notional interest deduction pertaining to previous fiscal years (FYs) exceeding the relevant taxable income. The notional interest deduction is a special off-balance deduction introduced by art. 1 of Decree no. 201/2011 with reference to capital injections and destination of profits to reserves available for distribution occurred starting from 2011.
5. See previous version of art. 44-bis, of Legislative Decree no. 34 of 30 April 2019.
6. Defaulting debtors are defined as debtors with more than 90 days of delay in paying amounts due.
7. The DTAs guarantee fee regime was introduced by art. 11, paragraph 1 of Legislative Decree no. 59/2016 to preserve the conversion of eligible DTAs into tax credits. The DTAs guarantee fee is computed as 1.5% of the positive difference between DTAs eligible for conversion accrued starting from FY2008 and taxes paid starting from FY2008. In case of negative difference the DTA guarantee fee is not due.
8. Reference is to be made to procedures under art. 17 of legislative decree no. 180/2015 and art. 5 of Decree no. 267/1942 or art. 2, paragraph 1, let. b) of Legislative Decree no. 14/2019.

For additional information with respect to this Alert, please contact the following:

Studio Legale Tributario, FSO Head of Tax, Milan
- Giuseppe Marco Ragusa marco.ragusa@it.ey.com

Studio Legale Tributario, FSO Global Compliance and Reporting, Milan
- Paolo Zucca paolo.zucca@it.ey.com

Studio Legale Tributario, FSO International Tax and Transaction Services, Milan
- Antonfortunato Corneli antonfortunato.corneli@it.ey.com
- Giancarlo Tardio giancarlo.tardio@it.ey.com

Studio Legale Tributario, FSO Indirect Tax, Milan
- Gabriella Cammarota gabriella.cammarota@it.ey.com

Studio Legale Tributario, FSO Tax Controversy, Milan
- Alberto Giorgi alberto.giorgi@it.ey.com

Ernst & Young LLP (United Kingdom), Italian Tax Desk, London
- Domenico Borzumato dborzumato@uk.ey.com

Ernst & Young LLP (United States), Italian Tax Desk, New York
- Emiliano Zanotti emiliano.zanotti2@ey.com
- Andrea Ajovalasit andrea.ajovalasit1@ey.com
- Luigi Caltagirone luigi.caltagirone1@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 001248-20Gbl

1508-1600216 NY
ED None

ey.com