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The new hyper-deduction regime for R&D costs

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Manager Bernoni Grant Thornton

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The Budget Law did not provide (nor could it, given the context in which it was approved) structural interventions with a strategic impact on the management of Italian companies.

In this issue, two of the most debated topics have been selected: the *Expert's Opinion* analyses the new Hyper-deduction regime for research and development costs introduced to replace the old Patent Box regime; the *Focus On* article analyses the restrictions implemented "on the run" and the tax revaluation of trademarks and goodwill, after many companies last year exercised the option offered by the previous legislation. While this introductory *Overview* outlines the economic context in which the Budget Law 2022 is inserted.

Such context is one oriented towards recovery and based on virtuous behaviours of companies, mainly middle ones, which characterize the Italian economic system, and on taxation for investors.

Non-repayable interventions are no more sufficient. Companies need to recovery the balances suspended due to the emergency period; it is necessary to move towards a system where the recovery is led by the State with structural aids that provide, for example, for access to capital on the condition that private investors enter under the same conditions.All this according to an industrial policy and no longer to simple disbursements of funds.

In fact, the time to repay the funds granted during the first emergency period has now come. The quantity of debts to be repaid as of 1 January 2022 is huge, given the termination of the moratorium periods established by the first Covid-19 emergency laws, was news (the data was reported in the specialized press based on information provided by the liquidity task force that highlighted the number of payments suspended at 31 December 2021, which is the termination date of the moratoriums supported by a public guarantee). The suspended loans of companies that had not made payments have been estimated as equal to approximately 36 billion; therefore, we can observe a scarce availability of effective tools to support companies that are unable to make payments.

On the one hand, this situation shows the risk for public accounts due to interventions resulting from the guarantee granted; on the other hand, it shows the risk for companies of not being able to meet the ordinary deadlines which, from a financial point of view, also affect the ordinary need to support working capital.

Now, speaking about the provisions contained in the Budget Law, we would like to summarize some general considerations that could be in line with this "recovery" path:

1. the reduced registration, mortgage and land registry taxes at a fixed rate for the transfers of instrumental properties within company transfer contracts (Article 1, para. 224 and subsequent of the Budget Law). This is an important benefit, at least with regard to its extent, since the payment of the proportional tax is not required as it generally happens. The reduction, however, is applied on the condition that the deeds of sale are stipulated as part of plans aimed at supporting employment levels and business continuity. The latter aspect has already been specified by the Revenue Agency in recent circular letter number 3 of 2022;
2. the confirmation and extension of the terms for the granting of tax credits against investments in so-called 4.0 tangible and intangible capital goods (art. 1, para. 44 et seq. Budget Law). The benefit is part of the investments aimed at the ecological transition, digital development and internationalization processes. The recent "Sostegni ter" law decree, by adding a new paragraph to the regulatory framework, selects, within eligible assets, a specific category for investments aimed at achieving ecological transition objectives by assigning new thresholds. These interventions are especially significant if we also consider the scope of digital innovation activities (which are required both due to entrepreneurial development needs and due to the scope of interventions included in the NRRP);
3. the extension of the tax incentive for business combinations (Article 1, para. 233 et seq. of the Budget Law). The extended incentive is that allowing the party resulting from the business combination (merged or acquiring company, beneficiary company or transferee company) to transform the deferred tax assets (so-called "DTA") referring to previous tax losses and unused ACE surpluses into immediately usable tax credit. In order to benefit from the incentive, the merger, demerger or company transfer operations must be approved by the competent corporate bodies between January 1, 2021 and June 30, 2022;
4. from a financial point of view, we remind the additional allocation of the Fund made available to companies targeting foreign markets. This is the so-called support for business internationalization. The measures concern three areas: (i) digital and ecological transition of SMEs with an international vocation, (ii) participation of national SMEs, also in Italy, in business missions and (iii) development of electronic commerce of SMEs in foreign countries. The aims of these interventions are also taken into consideration in the NRRP. The measures for businesses, managed by Simest, concern two areas: one dedicated to loans, the other one to non-refundable grants;

5. again, from a financial support point of view, new funds have been allocated for the so-called “Sabatini Law”. This law provides three different measures: (i) a loan disbursed before the investment is made, (ii) the free guarantee by Mediocreditocentrale for companies that have not exceeded the 5 million ceiling and (iii) a non-refundable contribution. This last one is provided directly by the Italian Ministry of Economic Development. The maximum amount of the subsidy is equal to the value of the interest calculated on a five-year loan for an amount equal to the investment made.

These are some of the support measures provided under the 2022 Budget Law. Thanks to them, economic operators can implement development projects and interventions to seize the recovery opportunities that may derive from a proactive management in this historical moment.

Obviously, these aids cannot represent the only tools to be used to plan relaunch and development actions, but must be integrated according to a “multidisciplinary” approach to a conscious management that need to be well studied and planned.

In this phase, therefore, it is necessary to take actions to support a conscious management and plan investments useful to recover, according to sustainable financial dynamics, seizing the opportunities that arise in this historical phase. This must be made based on an adequate risk management, including that concerning IT security and digital development.

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Expert's Opinion

The new hyper-deduction regime for R&D costs

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The Patent Box regime, initially conceived as a tax advantage of strategic importance for the purposes of Italy's economic policy, has undergone several changes during the course of its introduction by the 2015 Stability Law. of its validity. The real "turning point", however, was introduced by art. 6 of Law Decree dated 22 October 2021, n. 146, as amended by art. 1, para. 10 of Budget Law 2022, which abrogated the "old" Patent Box regime (aimed, as better explained below, at incentivizing entities able to express "extra profits" attributable to the development and use of certain intangibles) and replaced it, starting from 2021, with a 110% increase in the deduction for IRES and IRAP purposes of research and development (R&D) costs incurred for the creation and development of eligible intangible assets (i.e. software protected by copyright, industrial patents, designs and models).

This new Hyper-deduction regime of R&D costs - which is in line with the OECD recommendations contained in Action 5 "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance" of the BEPS Project - is applicable to all subjects receiving business income and is subject, like the old Patent Box regime, to the exercise of a five-year irrevocable and renewable option.

Pending the issuance of one or more implementing measures by the Director of the Revenue Agency for the purposes of the concrete application of the new regime in question, this article will only provide some reflections and comments on some fundamental features of this new tax advantage.

Preliminarily, as stated in the explanatory report to Law Decree no. 146/2021, the new regulation aims to simplify and speed up the use of the benefit by taxpayers.

In fact, unlike the previous regime, which rewarded the profitability of eligible intangibles through a complex analysis and calculation (sometimes also resorting to complex and expensive ruling procedures), the new subsidy regime exclusively rewards investment in R&D regardless of income earned from eligible intangible assets and allows taxpayers to

autonomously liquidate the benefit by means of a decreasing adjustment in the tax return, thus leaving the discussion with the tax authority to the possible subsequent audit phase.
What has been outlined so far probably suggests that, as it already happens with the tax credit for R&D activities pursuant to art. 1, paragraphs 198-206 of Law no. 160/2019, the attention of the Tax authority will no longer be on the allocation of costs and revenues in the virtual income statement that had to be drawn up to benefit from the old Patent Box, but on the admissibility and effectiveness of R&D expenses incurred, as well as on their relation to a specific eligible intangible. It will therefore be essential to create and maintain adequate accounting documentation to demonstrate the validity of the costs on the basis of which the 110% increase was determined. In this regard, it is important to mention the reward regime that the legislator has recognized to those taxpayers who will prepare suitable documentation as indicated in a future provision of the Revenue Agency and indicate the possession of such documentation in the tax return relating to the tax period in which the benefit is used.

In particular, as it was provided for the previous Patent Box regime through self-calculation, in the event of a correction of the costs subject to a 110% increase during the audit phase, the application of the fine for false declaration pursuant to art. 1, para. 2, of Legislative Decree no. 471/1997 (which ranges from 90 to 180 percent of the higher tax due or of the difference in the credit used) is excluded if the companies concerned provide the aforementioned documentation during the tax audit.

Furthermore, considered the confirmed possibility to combine the tax credit for R&D activities with the new regime under analysis, such non-application of the fine should nevertheless give greater appeal to the new hyper-deduction system of R&D costs rather than to the tax credit for R&D activities, also in consideration of the recent interpretative issues related to the qualification - in terms of "non-existent credit" or "undue credit" - of the tax credit for R&D activities that should prove to be totally or partially undue.

The introduction by 2022 Budget Law of the recapture mechanism was also extremely significant, allowing the recovery of the unused tax benefit in relation to R&D expenses incurred for the creation of the eligible intangibles during the eight tax periods prior to the one in which the qualification as industrial property was obtained. In this regard, however, it will be essential to wait for indications aimed at defining certain application aspects of the new regulation, such as, for example, the moment in which industrial property is deemed as "obtained" for the purposes of the regime in question.

If what has been observed so far could be welcomed by taxpayers, the fact that the repeal of the old Patent Box could significantly reduce our country's ability to attract investments in intangible assets and induce the relocation abroad of those assets cannot be ignored. intangible assets currently located in Italy.

This is due both to the structure of the new subsidy regime and to the relative narrow objective scope. With reference to the latter, in fact, with respect to the provisions of the Legislative Decree n. 146/2021, 2022 Budget Law has excluded trademarks and processes, formulas and information relating to experiences acquired in the industrial, commercial or scientific fields (know-how) from the list of eligible intangible assets. This exclusion, with particular regard to trademarks, undoubtedly represents a heavy penalty for taxpayers operating, for example, in the fashion industry, where brands allow companies to distinguish themselves from competitors and to convey their goods, services, values and experiences to customers.

But companies operating in the manufacturing sector are affected (negatively) by the changes introduced by 2022 Budget Law, too; in fact, these base their success on know-how, which, obviously for strategic and competitive reasons, is generally not patented.

In this regard, it should be noted that such exclusions were, however, predictable, taking into account, on the one hand, the OECD recommendations contained in Action 5 of the BEPS Project, and aimed at inviting Member states to exclude trademarks and know-how from their subsidy regimes, since they can give rise to distorted situations that could be interpreted as "harmful tax competition" and, on the other hand, of the fact that the Italian legislator had already intervened with art. 56 of law Decree no. 50/2017 to realign, though partially, the previous legislation to the aforementioned OECD recommendations, removing trademarks from the objective scope of the previous Patent Box regime.

On the other hand, it will instead be important to evaluate the expected benefit deriving from the application of the new Hyper-deduction regime for R&D expenses for those companies that do not currently have particular (eligible) intangible assets but intend to develop them through significant R&D investments, as well as for technological and pharmaceutical companies which incur significant R&D expenses on a recurring basis.

Focus on

Goodwill and trademarks: it's time to "recalculate"

Leonardo Fortunato
Manager Bernoni Grant Thornton

The revaluation regime of corporate assets, introduced by the so-called August Decree (Law Decree no. 104/2020, was certainly one of the most effective regulatory interventions - in the midst of a pandemic emergency – concerning capital strengthening for companies. There are several advantages characterizing this measure also and above all compared to similar past experiences, which were mostly characterized by non-particularly favourable access requirements. In fact, among the main "innovation" aspects, which has rendered this measure highly attractive to taxpayers, there are:

i) the possibility to recognize for tax purposes the so-called revaluation and realignment higher values through the payment of a 3% substitute tax;

ii) the possibility to opt (both for revaluation and for realignment purposes) for individual tangible and/or intangible assets (so-called cherry picking) without necessarily having to recognize higher values per homogeneous categories;

iii) the immediate tax recognition of the higher values for the sole purpose of amortization (e.g. 2021 for taxpayers whose fiscal year corresponds to the calendar year);

iv) the opportunity - regardless of accounting principles adopted (i.e. IAS / IFRS vs ITA GAAP) - to proceed with the realignment of the lower tax values to the higher statutory/accounting values of goodwill and other intangible assets for which this opportunity had always been denied.

In addition, it is necessary to highlight the favourable effects for equity related to the emergence of latent capital gains that would have - prospectively - counterbalanced and supported the covering of "announced" losses, due to the pandemic context. In this regard, it should be noted that the positive effects were not only due to the creation of a new equity reserve deriving from the step-up of the accounting value of the asset, but also to the positive effect on the result for the year, generated from the disposal of items attributable to deferred taxation, which, following the recognition of higher tax values, had lost their raison d'etre.

Therefore, it is easy to understand the reasons underlying the exercise of the option for the aforementioned regimes (revaluation and/or realignment) made in the last year by many taxpayers, who, on the one hand, closed and approved their financial statements affected by the aforementioned options and, on the other hand, where convenient, paid the substitute tax for the tax recognition of higher values.

In this scenario, Budget Law 2022, through an intervention that is not so "timely", introduces - with retroactive effect - significant changes aimed at clearly discouraging the option for the recognition of higher values tax with exclusive regard to goodwill and trademarks.

In particular, it provides that the higher tax values - deriving from the option for i) the revaluation of trademarks and/or ii) the realignment of the lower tax values to the higher accounting values of trademarks and goodwill - can be deducted for no more than one fiftieth, thus extending the tax recoverability period from 18 years (for these types of intangible assets) to 50 years. This measure which, as mentioned, has a retroactive effect - and therefore, has its effects starting from fiscal year 2021 (for the so-called "calendar year" subjects) - provides alternative tools in favour of taxpayers to correct any options already undertaken "in progress". Specifically, a double possibility is given: i) cancel the tax recognition of the higher values by means of a direct refund (or the recognition of a tax credit to be offset) of the sums already paid as substitute tax or, alternatively ii) proceed with the payment of an additional substitute tax (from 12% to 16%), net of the amounts already paid, in order to restore the status quo or proceed with the deduction of the higher values through an amortization plan in 18 years.

Nothing is provided with regard to the possible cancellation of the accounting effects in the financial statements.

Therefore, companies that in this period are closing their accounts with regard to the past financial year 2021 and opted for the tax recognition of the higher values in 2020, will have to carefully weigh the best solutions - tailored to their specific case - to unravel the impasse created by the aforementioned intervention of the Stability Law.

Although the options provided by the legislator are quite clear from a fiscal point of view, the accounting effects that each choice could determine are less clear and therefore worthy of further attention. Under this last aspect, the main points to be taken into consideration may be different and therefore it is not possible to offer and/or outline specific scenarios valid for all cases. On the contrary, we could highlight the main aspects that each choice must carefully evaluate.

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As an example: i) a subject who has revalued the trademark with simultaneous tax recognition of the higher values and who intends to continue with the new tax amortization plan will have to examine - with the approval of the supervisory board where present - the sustainability connected to the maintenance of deferred tax assets recognized in the financial statements on the basis of a rather long and doubtful period of recoverability (as mentioned, 50 years); ii) a subject who, on the contrary, wishes to cancel the tax recognition of the higher values even if not renouncing the statutory revaluation carried out will have to assess the impact of the deferred tax liability on the misalignment between accounting and fiscal values; iii) a subject could decide to evaluate the cancellation of both tax effects and accounting effects of the revaluation carried out. In this case, it is necessary to evaluate if and how this can be done or decide to proceed with a reapproval of the 2020 financial statements, or, rather, with a change in the valuation criteria to be implemented in the 2021 financial statements; iv) lastly, the possibility to pay the additional amount of substitute taxes - to restore a tax amortization plan over 18 years - could lead to a reduction in the reserves created following the revaluation itself.

Furthermore, in consideration of the significant modification of the longer amortization period, the legislator also introduces some precautionary provisions so that the rule in question is not avoided by means of extraordinary operations.

In particular, it is provided, on the one hand, that in the case of sale of the trademark or goodwill (usually falling within a much broader perimeter, e.g. company sale), assignment to shareholders or destination for purposes unrelated to the operation of the business or to the entrepreneur's personal or family use, or in the case of elimination from the production complex, any capital loss is deductible, up to the residual value of the greater value, on a straight-line basis for the residual amortization period (i.e. the residual "fiftieths"). On the other hand, moreover, it is established that for the assignee, the portion of the cost referable to the residual depreciable value of the higher value, net of any capital loss deducted by the assignor (as previously mentioned), is deducted on a straight-line basis for the residual depreciation period. This therefore requires the parties involved in the transfer of intangible assets to keep track of the fiscal nature of the aforementioned assets with adequate documentation.

It must also be pointed out that the revaluations and/or realignments carried out on assets other than trademarks and goodwill will continue to benefit from the subsidy regime established by the August Decree. It is also important to remember that the legislator has extended the possibility to revaluate corporate assets - with exclusively accounting purposes - also in the Financial Statements at 31 December 2021 (for the so-called "calendar year" subjects) with exclusive reference to assets that were not revalued in the previous financial statements.

In conclusion, the changes made by the Stability Law regarding the revaluation and realignment of trademarks and goodwill, impose the need to carefully assess not only the necessary tax consequences but above all the management of the accounting impacts that in some cases could have negative effects on the result for the year and on the stability of shareholders' equity.

All this in an economic context that has not yet found its way out of the pandemic emergency, although to date the expectations and prospects are strongly improving compared to the previous year.

The above assessments must necessarily involve, in addition to the main actors "naturally" involved (e.g. the control bodies) in the correct representation of economic events in the financial statements, also the strategies that the company intends to pursue in the medium-long term (e.g. the forecast of the sale of a business unit containing revalued and/or realigned goodwill and/or trademarks could lead - in some situations - to the abandonment of the previous tax options).

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