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**ITALIAN TAX BENEFITS FOR COMPANIES
“INDUSTRIA 4.0”**

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Foreword

This brochure aims to illustrate Italian provision about tax benefits for companies, named “Industria 4.0” project.

In particular, the tax provision deriving from the Italian Government, will be helpful for a large numbers of national and international companies, in a particular way for start up companies and intangible assets.

This brochure, analyses in brief all different aspects of benefits in consideration to each type of companies and their different needs.

Should you require any further information, Legalitax would be pleased to answer all your questions on the several argument.

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The international context

In the last decade, the World, in particular in Europe has assisted to an industrial revolution. Indeed, the digital innovation in the European economy is quickly accelerating. Big data, cloud computing and data analytics, combined with enabling Internet of Things sensors, virtual reality, rapid prototyping and 3D printing, advanced and “collaborative” robotics, are transforming the way products are imagined, designed, made and sold. This spawns far-reaching repercussions in terms of mass customisation of products, zero-defects demand-driven production, shortened time-to-market, improved consumer choice and satisfaction. Business efficiency and productivity are thus likely to significantly improve, affecting the organisation of labour. Well-established business models and strategies will undergo change, innovation and even disruption.

On the other hand, several States as: Netherland, Belgium, Luxemburg, Spain, Hungary, UK and Portugal etc. had introduced several tax benefits to encourage the foreigner investors and to attract large sums of money in their States.

Indeed, the narrow approach group has a better policy to encourage investment in R&D and innovation activities, focusing especially on patents and intangible assets (and, generally, not IP acquired from third parties, but rather solely on that produced by the beneficiary of the preferential treatment). As there are development conditions under this approach, no potential measures confronting the “harmful tax competition” would thus be required. On the other hand, the potentially harmful approach group (which includes Cyprus, Hungary, Italy, Liechtenstein, Luxembourg) is indeed criticized on these grounds. More specifically, the policy of this group exclusively aims at attracting income derived from IP assets, without there being any requirement regarding the actual carrying out of the R&D activity by the beneficiaries. The regimes of these countries are mainly regarded as a means of attracting highly mobile capital and relocating corporate income, rather than promoting innovation. In general, trade intangibles, and possibly designs and models, are indeed regarded as having a stronger link to the substantial activity requirement, and are thus more in line with the goal to increase investment in the research sector. As will be seen in detail below, difficulties can still arise in connection with the establishment of the direct link between qualifying expenditures and qualifying income.

In this context, the Italian Government has identified a set of measures and initiatives aimed at supporting the development of the "Industria 4.0" National Plan (I4.0). The objective is that of reaping the full benefits of the new industrial paradigm while pushing for innovation and digitisation in industrial companies. I4.0 is based on a structured and comprehensive set of policies that merge existing investment plans in national digital infrastructures with actions and initiatives to be pursued together with key European and international partners. They leverage on European support measures and awareness raising campaigns.

Italian Government introduced several benefits object of this brochure, in particular, the following:

- Patent box;
- Tax credit for R&S;
- Start-up and innovation companies;
- Super amortization and hyper amortization.

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The Italian patent box

The Italian Finance Bill for 2015 has enhanced an important provision named "Patent Box", to facilitate and attract foreign taxpayers, improve the Research and Development in Italy and most important preserve the "i.e. Made in Italy".

This provision introduced in Italy is an optional tax regime, that allows reduced taxation for income arising from direct use or licensing of intellectual property assets by companies and commercial entities performing Research & Development activities.

These measures are provided by the Italian government, in particular to permit more assessments appealing tax regimes in order to attract foreign investments and relocate IP assets.

Italy's Patent box regime is applicable to specific entities, in particular to the following taxpayers: individuals business income holders, companies and institutions, partnerships, trusts and non-residents with a Permanent Establishment in Italy that carry out research and development activities aimed at the production, maintaining and enhancing certain intangible assets (i.e. qualifying Intellectual Properties). This regime is also available for (i) income earned from licensing qualifying Intellectual Properties to third parties and (ii) income attributable to direct use of qualifying Intellectual Properties by their owner.

In this way, the income attributable to direct use must be determined in agreement with the Italian Revenue Agency, through the international tax ruling procedure or without but with the possibility to be controlled by the Revenue Agency opting on the tax return.

The regime is excluded to some particular entities such as: self-employed, bankrupt companies and entities that use a non-analytic method to determinate the taxable income.

The tax benefit consists of an exclusion from the taxable base, included in corporation tax (i.e. IRES) and regional tax (i.e. IRAP), of a percentage of the income sourced from the exploitation of qualified intellectual property assets.

The percentage excluded of the taxable income is set at 50 per cent from the tax year 2017 onwards and once a taxpayer decides to opt into the regime, the election is irrevocable for a five-year period, which may be renewed. In particular, the incomes provided by the regime are the following: (i) Industrial patents that have been granted or that are in the process of being granted; (ii) Software protected by copyright; (iii) Models and designs capable of being legally protected; (iv) Business and technical-industrial know-how (in particular for Know-how its necessary a technical appraisal).

Unfortunately, before the Decree Law April 24, 2017 No.50 “trademarks” were included in the Patent box regime, but now, income arises from registered or unregistered trademarks that are excluded from the tax benefit if the application for the patent box regime is exercised from tax year 2017 (the tax benefit still applies to patent box procedures started in tax years 2015 and 2016).

The procedure to determine the benefit of the patent box regime consists in a particular evaluation based on the percentage of favour income.

The first part of the operative evaluation consists on the identification of the possible favour incomes, in particular the incomes deriving by the utilization direct or indirect of intangible assets and Intellectual Properties.

The second part, consists of the evaluation of the i.e. “nexus ratio” that is a principle, promoted by OECD, that provides the ratio between qualified costs and overall costs.

The third and last part to determine the favour income consists in the multiplication between the favour income identified as (first part) and the “nexus ratio” as the (second part).

In specific, for qualified costs it is intended for the Research and Development activities, fiscal pertinent, aimed at the production, maintaining and enhancing certain favour intangible assets, whereas, for overall costs it is intended that the costs, fiscal pertinent, are supported to make these assets.

Furthermore, Research and Development has to consist in different activities listed by the Tax Authorities, in particular the Italian Revenue Agency, as: (i) Basic Research; (ii) Applied Research; (iii) Design; (iv) Software Development; (v) Communication.

If the company has opted to the Patent box regime and the income produced by the intangible assets become negative, the positive effects could be used on the consecutive fiscal year, with the i.e. “recapture mechanism”.

In case of direct employment of intangible assets, in order to be able to use the benefits of the Patent box regime, it is necessary to exhibit an advance ruling to the Italian Revenue Agency or exhibit the Italian tax return with the confirmation that the documentation is available that could prove that the use of the regime is correct.

In particular, basing the ruling on the following conditions:

- the determination of the economic capacity to the production of corporation income or losses in case of direct use of intangibles assets;
- the determination of income deriving from the use of the intangibles assets;
- the determination of capital gain realized in operations with companies that control other companies or are under control.

The methods used to determine the economic capacity to the production is represented by the Comparable Uncontrolled Price Method (CUP) or the Profit Split Method.

The CUP method is applied referring to the “royalty” and is much more useful to quantify the favour income referred to the Intellectual Properties.

Moreover, it is considered to be a more appropriate aim to the “price comparison” of selling products and services.

Whereas, the Profit Split Method has the purpose to determine the proper allocation of income and deductions among parties to an intercompany transaction where one party is comprised of controlled taxpayers and another consists of uncontrolled taxpayers.

The profit split method is used to evaluate controlled transactions to determine if the allocation of profits and losses between the related parties were conducted at arm's length based on the relative value of their contributions to the profit or loss.

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Tax Credit for research and development

Companies who carry out investments in Research and Development could have the possibility to obtain a tax credit. In particular, the provision, introduced by the Italian Finance Bill for 2015 (hereinafter “Finance Bill”), is applicable to a large target of entities, without any kind of limit for legal form; production sector (including agriculture); size (eg. in terms of turnover) and Accounting regimes, moreover, are also included consortiums and networks of companies; non-commercial entities, universities or other research centres, such as resident commissioners to whom the non-resident contractor has commissioned research and development; permanent establishment in the territory of the State of non-resident companies.

The tax credit also applies to companies operating on national territory (resident or permanent establishment) on the basis of customer contracts with foreign companies, universities or any other localized research entity in other Member States of the European Union; States acceding to the Agreement on the European Economic Area (EU Member States, Norway, Iceland and Lichtenstein); in countries that allow adequate information exchange.

Instead, the tax credit could not be applied to the individuals with self-employment incomes; entities in bankrupt; third-party research firms commissioned by resident companies; non-commercial entities (for institutional activities).

The R&D investments object of the procedure are represented by experimental or theoretical work carried out with the aim of acquiring new knowledge on the foundations of phenomena and observable facts, without the application of direct applications or commercial use [i.e. "Fundamental research"]; planned research or critical inquiries aimed at acquiring new knowledge to be used to develop new products, processes or services or to allow an improvement in existing products, processes or services or the creation of complex system components necessary for industrial research, exclusion of prototypes [i.e. "Industrial research"]; acquisition, combination, structuring and utilization of existing scientific, technological and commercial knowledge and capabilities for the purpose of producing plans, projects or designs for new, modified or improved products, processes or services; may also be other activities designed for conceptual definition, planning and documentation relating to new products, processes and services; such activities may include the drawing up of plans, drawings, plans and other documentation, including feasibility studies, provided that they are not intended for commercial use; realization of prototypes usable for commercial purposes and pilot projects for technological or

commercial experiments, when the prototype is necessarily the final commercial product and its manufacturing cost is too high to be used only for demonstration and validation purposes [cd. "Experimental development"]; production and testing of products, processes and services, provided they are not used or processed for industrial or commercial purposes.

The provision is allowed until the year 2020, and is applicable to any kind of machinery, also if different from scientific devices. In this sense, the favoured provision recognize a deduction of 25 per cent of R&D costs and a rate of 50 per cent with exclusive reference to 1) expenses related to employees holding a subordinate employment relationship, even for a fixed term, directly employed in R&D activities; 2) the contracts stipulated with universities, research institutes and similar as well as with start-up resident companies and innovative companies, for the direct performance of R&D activities eligible for tax credit. These provisions are on the limit of a maximum of 10 Million Euro of R&D investments. For the purposes of calculating to the attributes of tax credit, only expenses incurred for R&D activities carried out in the territory of the Italian State are relevant.

The use of the tax credit is subject to compliance with specific certification obligations and to the preparation and preservation of a technical report illustrating the aims, contents and results of the R&D activities for each project.

Unlike the first version of the mentioned tax credit, the types of employees in R&D do not have to be "employees with high qualifications".

The principle aim expected by the tax credit is to acquire new knowledge and improve existing ones and also utilize knowledge for new applications in the industrial assets.

Furthermore, to determine the mentioned benefit is important that the tax credit will be recognized if the overall costs for investments in R&D carry out for every fiscal period exceed the average grade of the investments realized in the previous three fiscal period starting from the 31st of December 2015.

The mode of use is really easy because there is not a previous application, thanks to the possibility to the compensation that starts from the taxable period following the cost support period, whereas only for the credit corresponding to the accounting certification costs the use of compensation is allowed only from the day following the date of completion of the mentioned certification..

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Start-up and innovation companies

The concept of Innovative Start-up consists in companies, also not resident in Italy, which has formal and substantial requirements.

In particular, to be named as Innovative Start-up, the company has to assume the form of a capital company as: Ltd. (i.e. S.r.l.), Inc. (i.e. S.p.A.), Limited partnership (i.e. S.a.p.a.), or a cooperative company.

The Start-up could be considered as innovative it has to own particular features, as following: first, it has to own the exclusive or predominant social object of the development, production and marketing of innovative products or services of high

technological value; moreover has to own its head office in Italy or in an EU or EU country (European Economic Area) provided that it has a production site or a branch in Italy; has been constituted for no more than 60 months; the total value of the annual production of the company, starting from the second year, should not exceed 5 million euros; do not distribute profits for the entire duration of the scheme; do not arise from merging, splitting or divesting company / branch business.

The company, also, has to own at least one of the following features: it has to support R & D costs exceeding 15 percent of the higher value between cost and total value of production; it has to employ as employees or collaborators, by any means, alternatively: a person with a PhD degree or a PhD in a degree or more than 1/3 of his or her workforce, having a master's degree of at least 2/3 of its own strength work; it has to be an owner or custodian or licensor of at least one industrial property. The deed of incorporation for innovative start-ups may include the following features: the creation of categories of participation shares provided for specific rights, with the possibility of freely determining, within the limits imposed by law, the content of the different categories; the creation of lacking voting shares or voting rights which are not proportional to the share held by the shareholders or which confer voting rights limited to particular matters or subject to the occurrence of particular conditions; participation shares held in innovative start-ups in the form of limited liability companies may be the subject of public offering of financial products, including through fundraising portals (crowd-financing); innovative start-ups in the form of limited liability companies may, by way of derogation from the prohibition on carrying out their shareholdings, carry out operations in the form of incentive plans involving the allocation of allowances to employees, employees, directors and professionals; the memorandum of incorporation of innovative start-ups may include the issue of financial instruments of capital rights or of administrative rights with the exclusion of voting rights in respect of contributions made by members or third parties, whether or not services.

The measures described below are available to innovative start-up immediately after registration, for a maximum of 5 years since their date of incorporation.

The new procedure of incorporation presents several advantages. First of all, its usage is free-of-charge: no specific costs related to the establishment of the new enterprise are envisaged, implying a huge savings for innovative entrepreneurs as opposed to the standard procedure by notarial deed.

Unlike most companies, innovative start-ups and certified incubators are exempt from the payment of stamp duty and fees incurred due to the obligation of entering the Business Register, as well as from the payment of the annual fee usually owed to the Chambers of Commerce. In addition, as clarified in the Circular 16/E issued by the Italian Revenue Agency on 11 June 2014, the exemption from such fees could be interpreted as a general waiver, covering all the actions carried out by the innovative start-ups after the subscription to the company register, such as incentivized capital increases.

Another important benefit concerning the provision that innovative start-ups are not subjected to regulations concerning non-operational companies and companies registering systematic losses. Accordingly, in case they cannot get "appropriate" revenues, they are exempted from fiscal penalties applied to so-called "dummy companies", such as the computation of a minimum income and taxable base for corporate taxation purpose (IRAP).

In general, innovative start-ups comply with the regulations on fixed-term contracts as defined in Decree-Law 81/2015 (known as "Jobs Act"). Therefore, innovative start-

ups can hire a staffer on a fixed-term contract for a maximum of 36 months. However, in derogation to Jobs Act's provisions, innovative start-ups can hire personnel through fixed-term contracts of any duration, even very short, which can be renewed as many times as wished. After 36 months, the contract can be renewed only once, for 12 months maximum, leading to an overall employment duration of 48 months. By the end of this 4-year period, the fixed-term contract is automatically converted into an open-ended one. Moreover, in exception to general regulation, innovative start-ups with more than 5 employees are not required to maintain a statutory ratio between fixed-term and active open-ended contracts.

In particular, salaries due to workers employed in innovative start-ups can have a variable component linked to efficiency or profit-ability of the company, the productivity of the employee or the team of employees, or to other objectives and parameters for output and performance as agreed upon by the parties, including through stock options and work-for-equity schemes. The main benefit deriving by the investment in an innovative start-up is a tax deduction of personal income tax (i.e. IRPEF) for the individuals who want to invest in a start-up of 40 per cent until one million Euro, for legal entities the benefit consists in a fiscal deduction on the taxable income for company tax purposes (i.e. IRES) equal to 40% of the amount invested, up to a maximum of € 1.8 million. Furthermore, again limited to 2019, the deduction on the taxable income for company tax purposes (i.e. IRES) is raised up to 50% for subjects (other than innovative start-ups) who acquire the entire share capital of an innovative start-up, on condition that it is maintained for at least 3 years. In this sense, another benefit is: in case the losses exceeding 1/3 of the share capital, it is possible to return the loss within this limit within the second subsequent year (rather than within the following year); in the event of a reduction in share capital below the legal minimum, it is possible to wait until the end of the following year to resolve the reduction of the capital and the simultaneous increase of the same to a figure not less than the legal minimum.

A fundamental condition to be admitted to the mentioned benefits is to the inscription in a special section of the Business Register made by the Italian Chamber of Commerce.

At last, for entrepreneurs in case they open a new start-up during the 2019 they could pay a small percentage of personal income tax (i.e. IRPEF), indeed, the taxable income would be just the 5% for five years. The conditions to apply the provision are:

- the taxpayer has not exercised, in the three previous years, artistic activity, professional or business, also in an associated or family form;
- the activity to be carried out does not constitute, in any way, a mere continuation of another activity previously carried out in the form of employment or self-employment, excluding the where this activity constitutes a mandatory period of practice for the purpose of the exercise art / profession;
- if the activity is the continuation of an activity carried out by another person, the amount of revenue / compensation for the previous tax period is not greater to the revenue / compensation limits set for the flat rate scheme.

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Super amortization and hyper amortization

The provision of i.e. Super-Amortization has been introduced by the Italian Finance Bill for 2016 by the promoted model for industrial growth made by the Italian Government named “Industry 4.0” as a facilitation for companies and professionals that decide to carry out investments of new capital goods. In particular, the main benefit consist in an improvement of the purchase costs of the 40 per cent for the sole purpose to deduct higher amortization rates and higher lease fees.

The mentioned provision is up to investments made by the acquisition of property goods, and also not for goods utilized for operating lease or rent. The basic requirement is the new property goods.

The costs attributable to the investment sustained during the period of application of the facilitation, concern: the design investment; the materials purchased or those taken from the warehouse, when buying such materials have not been made specifically for the realization of the goods; direct work hand; amortization of assets instrumentalists employed in the realization of the good; the imputable industrial costs for example salaries of technicians, labor costs, energy electrical plant, material and expenses of maintenance, driving force, external machining, etc.).

The Italian Revenue Agency clarified that the requirement exists also in case of goods used for the exposure and also in case of complex assets.

The basic aim of the provision is to boost investments in new capital goods (except the motor vehicles with a different aim from the business activity), for this reason the mentioned provision has been extended until 31 December 2017 in any case and until 31 June 2018 if the order has been completed in a measure at least equal to the 20 per cent and from 01/04/2019 to 30/06/2020 the measure is up to the 30 per cent.

The super-amortization is usable for companies and professionals autonomously from the nature, the size and the economic sector of the company.

The investments that could be facilitate are capital goods acquired in property or through leasing.

The Government plan, however, has provided that are excluded the goods acquired through an operating leasing or rent, so the unique categories that can use the benefits are instrumental goods for the business activity that could be deduct of a amortization percentage in the tax return.

Indeed, the super-amortization does not matter for: intangibles goods; ware goods; consumer goods and consumer materials, moreover, are excluded goods acquired as buildings, building materials and instrumental materials. In the same way, are also excluded warehouse and buildings; the assets for which they are established in the Decree Law December 31, 1988 depreciation coefficients lower than 6,5 per cent; the pipelines used by the bottling industries of mineral waters, from the bathing establishments and thermal

baths and for production and natural gas distribution; rolling stock, railway and tramway; planes.

The Hyper Amortization, instead, is a benefit for amortization charges that are increased up to 170 per cent for investments until Euro 2.5 million; 100 per cent for investment between Euro 2.5 and 100 million, 50 per cent for investment between Euro 10 and 20 million which is allowed to benefit from specific digital and technological transformation processes under the “Industry 4.0”. In this way 20 million is the limit of total investments.

The Italian Tax Authority underlines that the investments "hyper-depreciable assets" are only those which, with legal requirements, have been carried out starting from January 1st 2017. It is clarified that, with reference to the “cost of acquisition”, the hyper-amortization regime it is solely for the purpose of determination of amortization amounts (or annual lease) deductible for tax purposes.

Relating with lease contracts the benefit is addressed only to the lessee and not to the lessor. The benefit is also applicable to the good that after the purchase is object of a contract of sale and lease back; in this event, the benefit is determined on the basis of the original cost of acquisition, following the temporal allocation previously determined, with no relevance to the lease contracts intervened later.

Capital goods acquired with operational lease contracts or rental contracts are still excluded from the benefit. Under the opinion of the Italian Revenue Agency the increase can be granted, if the specific requirements are met, to the lessor only in the event that the operating lease or rental activity constitutes the main object of the activity.

As already provided for the super-amortization regime, it reiterates that benefit applies, further to the purchase of capital goods from third parties, owned or leased, also with reference to goods realized internally or acquired by contract.

This benefit is applicable to purchases realized from 1 January 2017.

- Another additional 30 per cent Super–Amortization is also introduced for certain intangible assets such as software, IT systems and platforms related to the Government plan for industrial growth named “Industry 4.0 Plan”.

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THE FIRM

LEGALITAX is a firm with 90 lawyers and tax advisors, including 23 partners. The firm has offices in Milan, Rome, Padua and Verona and has legal and tax capabilities which are made available its clients in their cycles of life. The firm's clients are mostly Italian and foreign corporate entities with investments or operations in Italy.

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