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Italian Revenue Agency comments on the Patent Box regime



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Patent Box is the optional tax regime⁽¹⁾ (see our Tax Alerts of [2 December 2014](#) and [2 February 2015](#)) that provides relief on income arising from the exploitation of qualifying intangible assets. Certain clarifications were contained in the Implementation Decree (approved on 30 July 2015 by the Ministry of Economic Development together with the Ministry of Economy and Finance – see our [Tax Alert of 3 November 2015](#)). The Italian Revenue Agency, in Circular no. 36/E of 1 December 2015 ('Circular 36/E'), has now published its initial comments on the regime, which are summarized below.

The incentive in brief

Under the Patent Box regime, a certain percentage⁽²⁾ of income attributable to the 'use' of qualifying intangible assets or IP (i.e. software protected by copyright, patents, registered or pending trademarks, designs and models, processes, secret formulas, and industrial, commercial or scientific knowledge) is excluded from the tax base. Resident entrepreneurs and non-resident companies/entities⁽³⁾ are eligible for the incentive. The benefit is available for income arising from the tax year following that in progress on 31 December 2014 (i.e. 2015 for calendar-year taxpayers). The election lasts for 5 years and cannot be revoked.

Following the principles of the OECD and the example of other EU Member States, the regime rewards enterprises which undertake and bear the costs of R&D that may increase the value of an intangible asset located in Italy.

1. How the election must be made and what its effects are

From tax year 2017 (for calendar-year taxpayers), the election must be made in the income tax return and the 5-year regime will run from the year of the tax return⁽⁴⁾.

⁽¹⁾ Introduced by the 2015 Budget Law (article 1 [paragraphs 37-45] of Law no. 190/2014) and amended by article 5 of the 'Investment Compact' Decree (Decree no. 3/2015, converted into Law no. 33 of 24 March 2015).

⁽²⁾ For calendar-year taxpayers: 30 percent in 2015, 40 percent in 2016 and 50 percent from 2017

⁽³⁾ Provided that they (i) are resident in a treaty country allowing an effective exchange of information with Italy, and (ii) have a permanent establishment in Italy to which the intangible assets are 'attributable'.

⁽⁴⁾ Usually, this is the year preceding that in which the return is filed

The report accompanying the Implementation Decree clarifies that the election can be made for one or more intangible assets, and not necessarily for all the intangibles held by the same beneficiary.

For 2015 and 2016 (for calendar-year taxpayers), the Implementation Decree⁽⁵⁾ clarified that the election must be made and notified to the Italian Revenue Agency in the ways established by its director, and that the regime will last for the year of the notification and the following four. The notification process was clarified in Regulation no.144042 of 10 November 2015, which was issued by the Italian Revenue Agency's director and which contained the form and instructions to be used to elect the Patent Box regime for 2015 and 2016. Taxpayers who intend to apply for the regime from tax year 2015 must submit the form electronically by 31 December 2015.

The form is quite simple. The basic details of the beneficiary and its legal representative must be given, as well as the start date and end date of the year of election. The purpose of the form is to allow all entrepreneurs to apply, even if they cannot evaluate, at the date of election, whether they fulfil the conditions for the regime, or whether the regime is actually advantageous for them. Circular 36/E clarifies that there should be no adverse consequences if, after election, the entrepreneur decides not to pursue the benefit, because he is ineligible or because the regime is not actually advantageous.

2. Patent Box losses

The law does not establish what to do when the Patent Box mechanism results in a loss. This may occur especially in the early stages of development, when the qualifying R&D costs usually more than offset the income earned from the use of the intangible.

The Circular clarifies that such losses will be recovered in the year when the intangible asset begins to generate income: losses accrued in previous years will offset this income. In other words the benefit offered by the regime (a decrease in the IRES and IRAP tax base) will only materialize in the year when the intangible asset generates income net of any past-year losses.

The following examples are given in Circular 36/E)⁽⁶⁾.

Example 1

Year	IP loss	IP income	Qualifying IP income	Patent Box benefit (decrease in taxable income)
1	200	-	-	-
2		500	300	150=(300x50%)

⁽⁵⁾ Article 4 (2) of the Decree of 30 July 2015

⁽⁶⁾ These examples assume, for the sake of simplicity, that the ratio of R&D expenditure to overall expenditure is 1:1 and therefore the qualifying income is simply given by the income earned from the intangible net of R&D expenditures

Example 2

Year	IP loss	IP income	Qualifying IP income	Patent Box benefit (exclusion from taxable income)	Loss to be carried forward
1	100	-	-	-	100
2	200	-	-	-	300
3	200	-	-	-	500
4	300	-	-	-	800
5	200	-	-	-	1000
6		500	0=(500-1000)	-	500
7	900=400+500	-	-	-	-
8		1500	600=(1500-900)	300=(600x50%)	-

3. Business reorganizations

In a merger, demerger or contribution of a business concern, the effects of an elected Patent Box regime will pass to the transferee⁽⁷⁾.

The Circular⁽⁸⁾ clarifies that such transactions should not be abusive if the transferee actually engages in R&D (what the Circular describes as a 'substantial activity'). This is true even when, as a result of the business reorganization, the intangible asset is no longer directly used and a ruling application is therefore no longer mandatory⁽⁹⁾ (for instance, when Company A legally demerges or contributes certain assets, including R&D activities, to Company B and then B licenses the resulting IP back to Company A).

4. Ruling procedure

A ruling is mandatory for the determination of the income attributable to an intangible asset that is used directly by an entrepreneur. It is optional for the determination of (i) the income attributable to an intangible asset that is used indirectly (e.g. licensed), and (ii) the gain made from an intercompany sale of an intangible⁽¹⁰⁾.

Moreover⁽¹¹⁾, if a tax ruling is requested, the election is effective from the tax year in which the application is filed (and not, as normally happens, from the year in which an agreement is reached). Therefore, any entrepreneur wishing to benefit from the regime from tax year 2015 must submit – by 31 December 2015 – not only the election form indicated in section 1 above but also a ruling application. Supporting documentation must be filed within the following 120 days.

A recent regulation⁽¹²⁾ describes the ways in which a ruling application must be filed. These are the main indications, summarized by Circular 36/E.

⁽⁷⁾ Article 5 of the Implementation Decree

⁽⁸⁾ Section 3 of Circular 36/E of 1 December 2015

⁽⁹⁾ Income attributable to direct use must be determined, for each intangible asset, in agreement with the Italian Revenue Agency, through a ruling procedure

⁽¹⁰⁾ The capital gain may, under certain conditions, be exempt from income taxes

⁽¹¹⁾ Under article 4(3) of the Implementation Decree

⁽¹²⁾ Regulation no. 2015/154278, issued by the Italian Revenue Agency's director on 1 December 2015

- The application can be delivered personally or sent by recorded delivery post (raccomandata) to the following Italian Revenue Agency office in Rome: Accordi preventivi del Settore Internazionale della Direzione Centrale Accertamento.

- The information to be given is basic and varies according to the subject matter and purpose of the application: the minimum required details are the beneficiary, the eligible intangibles and the R&D costs borne by the applicant.

- The application must be signed by the applicant's legal representative.

- The supporting documentation should provide full details of the intangibles that qualify for the regime and the relevant R&D activities undertaken by the applicant. It should also give a detailed description of:

i. depending on the type of ruling, the methodologies used to compute: a) the economic contribution of the intangibles to the overall income produced by the applicant, in the case of direct use; b) the royalty income from the licensing of the intangible; c) the capital gains from disposal of the intangible to related parties;

ii. the reasons why such methodologies are adopted.

- Simplified procedures are available for application for rulings submitted before 31 December 2015 and small and medium-sized enterprises (for example, for SMEs, the content of the application and supporting evidence are simplified in the case of direct use of an intangible).

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