The Italian Supreme Court endorses the Italian tax authorities' position on how statute of limitations applies to income components that are spread over multiple tax periods

The Joint Chambers of the Italian Supreme Court recently handed down a landmark decision (judgment No. 8500 of 25 March 2021) dealing with the statute of limitations applicable to the Italian tax authorities when they assess income components that are spread over multiple tax periods, such as, for instance, deductions deriving from tax depreciation of tangible assets.

The case decided by the Supreme Court concerned the Italian branch of a Dutch bank that had written down an account receivable in 2003 because the borrower (Parmalat) entered business distress proceedings. Under Italian tax law as applicable back then (Article 106(3) of Presidential Decree No. 917 of 22 December 1986), banks could deduct write-downs of their receivables only up to 0.6 percent of the overall book value of the receivables accounted in their financial statements.

Any excess over the 0.6 percent amount had to be carried forward and could be deducted in equal instalments in the following nine tax periods. In 2009, the Italian tax authorities served a notice of tax deficiency for corporate tax and regional tax purposes on the taxpayer denying the deduction of one of the instalments of the excess write-down in 2004 because they claimed that the original calculation of the write-down in 2003 was incorrect. In the tax authorities' view, the original write-down could not be fully allocated to the Italian branch as its free capital was not adequate and the loan was granted to the borrower drawing on the head office's resources. The taxpayer argued that the tax authorities' claim was inadmissible because they should have challenged the validity of the write-down in the year when it was accounted for the first time and partially deducted, i.e. in 2003, which was no longer open for assessment because the statute of limitations had run.

At that time indeed the statute of limitations expired at the end of the fourth fiscal year following the year in which the relevant tax return was filed; the tax return for 2003 had to be filed in 2004, and consequently the tax period 2003 could be assessed only until 31 December 2008. In other words, in the taxpayer's view, whether the deduction of the write-down was legitimate was an issue concerning only 2003, whilst the deferred deduction in nine tax periods of the portion of the write-down not immediately allowed in 2003 represented just an automatic application of the law. So, the tax authorities could not reconsider the validity of the deduction of the write-down in the following tax periods.

The Supreme Court sided with the Italian tax authorities, grounding its reasoning on the principle that, under Italian income tax law, taxpayers have an autonomous tax obligation for each single tax period, even if the calculation of the income of a given year may be affected by taxable events that took place years before. Therefore, in case of recurring income components that stem from a specific event in a tax period (e.g. acquisition of depreciable assets) but that affect also the following years (e.g. through depreciation), the statute of limitations for the tax authorities starts running only from the tax period in which each single income component actually impacts on the taxpayer's reportable income. And this is so regardless of whether the tax authorities are still allowed to review the taxpayer's position in the tax period in which the relevant tax event first took place.

The Court also held that its conclusions are not inconsistent with the principles laid down in a previous case decided by the Italian Constitutional Court in 2005 (judgment No. 280 of 2005), affirming that taxpayers cannot be indefinitely exposed to the tax authorities' assessment powers. Although the Supreme Court recognizes that its interpretation would allow the tax authorities to dispute the tax treatment of the event giving rise to the income components spread over several tax periods after the event took place, it ruled out that this effect may infringe the taxpayers' legitimate expectation.

This precedent will certainly have significant repercussions on tax assessments regarding tax depreciation and amortization. Because of the interpretation embraced by the Supreme Court, in all these cases taxpayers will have to keep the relevant documentary evidence (even for decades) until the statute of limitations expires with respect to the last tax period in which the recurring income components affect the taxpayers' income (e.g. the year when the statute of limitations in relation to the last depreciation allowance of the recovery period of equipment or machinery expires).

Even if the decision specifically focuses on income components that are spread over multiple tax periods, which were relevant for the Dutch bank in the case, the Supreme Court also briefly refers to carry-forward tax losses (NOLs) in the initial section of its opinion. It thus remains to be seen whether, and how, the legal reasoning and the holding of the Supreme Court may in practice be applied to cases of carry-forward NOLs and other tax attributes (e.g. interest expenses not deducted under the Italian interest-barrier rule) that are utilized when the tax period in which the NOLs (or other tax attribute) arose is no longer open for assessment.

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