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Law Expands Banks' Bad Debt Deduction

The Italian Parliament on June 27 introduced Law Decree No. 83/2015, which amended tax code article 106(3) to introduce a book conformity requirement for the deduction of bad debts. The move was intended to help lenders clean up their balance sheets and ease the credit crunch.

Generally, under article 101(1) of Italy's tax code, if a debt is collected in part and the taxpayer cancels the balance, the unpaid amount is deductible as a capital loss. Tax code article 101(5) effectively allows a deduction for any debt that becomes worthless within a tax year.

For tax years up to and including December 31, 2013, tax code article 106(3) previously allowed banks -- instead of deducting specific debts as partially or wholly worthless -- to deduct a reserve for debts in the year in which it was provided, and apportioned over each of the four succeeding tax years.

Under the new statute, in lieu of the deduction over five years, for tax years up to and including December 31, 2015, bad debt losses are deducted in the tax year in which they are recognized for financial accounting purposes.

By contrast, in the U.S., the IRS had been taking the position that a charge-off for financial accounting or regulatory purposes does not necessarily substantiate that the debt is worthless under IRC section 166. This placed significant burdens on banks, since they needed to make a factual determination on a loan-by-loan basis.

To provide relief to banks in these situations, the IRS in late 2014 issued a directive generally providing that examiners should not challenge a bank's bad debt deduction to the extent that it corresponds to credit-related charge-offs taken for book purposes.

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