

# Accounting Group Interprets Rules on Postmerger NOLs

by **Alessandro Adelchi Rossi**

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The *Associazione Italiana Dottori Commercialisti* (AIDC), an Italian accounting organization, recently issued Rule of Conduct No. 165 regarding the survival of net operating losses after a statutory merger.

In the business community, the carryover of tax attributes from one corporation to another can lead to reorganization transactions, including mergers and acquisitions, primarily because of those attributes. The most commonly sought attribute is an NOL carryover. Italy is no exception to that well-established practice, and its market of defunct corporations has always been very active.

Over the years, however, the Italian Parliament has provided the tax authorities with a variety of statutory weapons for attacking such transactions. In addition to the general carryover provisions of article 84, article 172(7) of the Italian income tax code also generally restricts the use of premerger NOLs when prescribed income, equity, payroll, and continuity-of-business standards are not satisfied.

However, simply falling within the definitions of article 172(7) may not be enough to preserve the use of the premerger losses, as one may argue that the antiavoidance provisions of article 37-*bis* of D.P.R. (Presidential Decree) No. 600/73 add a further requirement.

Article 37-*bis* applies to specific transactions, including mergers by operation of law, that lack economic substance or that are so interdependent that the legal relations created by one step would be fruitless without the completion of all the steps. Because of the unclear reach of article 37-*bis*, its relationship to article 172(7) has generated some uncertainty. The AIDC issued Rule of Conduct No. 165 to help provide guidance on the issue.

According to the AIDC, article 172(7) and article 37-*bis* do not overlap. Subject to the satisfaction of the income, equity, payroll, and continuity-of-business tests, article 172(7) takes precedence over article 37-*bis*. As a result, the NOLs can carry over to a successor corporation, and article 37-*bis* cannot be used to restrict the deduction for such losses to the same legal entity that incurred the loss, because in a statutory merger the corporate personality of the transferor is drowned in that of the transferee. U.S. readers will see the similarity of these issues to the “entity theory” and the approaches adopted by U.S. courts in *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934), and *Helvering v. Metropolitan Edison Co.*, 306 U.S. 522 (1939) — cases that occupied center stage in the U.S. carryover area from the 1930s until the early 1950s.

However, article 37-*bis* may be invoked in egregious cases of tax manipulation and abuse, when taxpayers intended to give the appearance that the requirements of article 172(7) have been met when in fact, they have not.

The value of the AIDC interpretation should be viewed against the backdrop of Italian administrative and judicial practice. Italian tax law does not have the detailed regulations, rulings, other published notices, and judicially developed antiavoidance doctrines that are found in the tax systems of other countries. It is therefore difficult to determine whether a particular transaction will run the risk of being attacked by the Italian tax authorities or will be safe from such scrutiny. In that context, rules of conduct set by an association such as the AIDC are a welcome addition. ♦

♦ *Alessandro Adelchi Rossi, Funaro & Co., P.C., New York*