Maria Silvia Avi

TRUTHFULNESS OR TRIB-TRUTHFULNESS OF FINANCIAL REPORTING?

A historical analysis

II. Analysis of the historical evolution from the Visentini reform to today

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1. TAX INTERFERENCES IN FINANCIAL REPORTING AS A MEANS OF DEDUCTING ECONOMICALLY NON-EXISTENT AMOUNTS OR AVOIDING ADMINISTRATIVE WORK: TWO OBJECTIVES COMPARED

1.1. Brief considerations on the reasons for the presence of tax interferences in financial reporting and reference to Vol. I

The concept of tax interference has already been discussed in detail in Volume I of this series. We, therefore, refer the reader to what has already been indicated on this topic in the previous text.

In order to complete what has already been illustrated and to underline some peculiarities of the phenomenon of tax pollution of financial reporting, we report below some observations that may help to understand better the reasons of tax interferences in profit and loss statement, balance sheet and notes as well as in the cash flow statement.

As already pointed out and as it will be demonstrated in Vol. III of this booklet, in many entrepreneurial realities of our country, it can identity financial reports, frequently, characterized by a trib-veridicality, fiscal evaluations by a "truthfulness" influence that. As can be easily understood, the values recorded in such a document do not identify "economically truthful" data but rather represent values relevant in different areas (in this specific case, tax) from the one we are interested in.

In addressing the issue of tax interferences and the identifiable relationship between general accounting/financial reporting and taxable income, we intend to focus our attention on possible interrelationships/interconnections of data deriving from the application of economic/business/civil law valuation principles and values quantified based on rules dictated to determine taxable income.

Considering the consequences deriving from incorrect objective values in the accounts as the result of "pure and simple" tax evasion is of little relevance to our analysis. It is evident that, in the presence of non-accounting of revenues

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and recognition of non-existent costs, to address the possibility that the output of the general accounting can be considered a reasonable basis of information for management purposes is an activity devoid of relevance and logic.

In fact, in such a situation, the mere hypothesis of basing the decision-making/management process on accounting data tainted by the performance of an illegal accounting activity as it is carried out to reduce the taxable income appears so unrealistic that it can be considered absurd and, consequently, extraneous to our research objective. Therefore, we will not consider the hypothesis of implementation of tax evasion following the detection of incorrect objective values, and we will instead focus our attention on the possibility that the company implements, consciously or unconsciously, the so-called "tax interferences", meaning, by this expression, the application of a policy of real osmosis between the valuation rules imposed by the tax legislator and the principles that, on the contrary, must, or rather should be applied for assessing the subjective accounting items.

Whoever implements the so-called tax interferences in accounting and financial reporting identifies subjective accounting values (e.g. depreciation, closing inventories, provisions for expenses and risks, etc.) by inappropriately applying valuation criteria dictated by tax regulations instead of the principles illustrated by statutory provisions and, indirectly, by national and/or international accounting standards. In such a case, the accounting system, and therefore the basin from which every information system draws its lifeblood, is tainted by tax pollution of accounting data carried out with a method "more refined than simple evasion", implemented through the application of tax valuation criteria instead of the economic principles imposed by the Civil Code.

It should be noted that this problem arises from the divergence of objectives that the two legislators, civil and tax, set themselves through the provisions concerning, respectively, financial reporting and taxable income.[1].

[1] "To better understand the terms of the problem, it is necessary to carry out a brief preliminary reflection and to distinguish those differences between statutory and tax regulations that do not or at least should not pollute financial reporting, from those that do alter, sometimes seriously, the results. The former is to be considered entirely physiological, being the natural consequence of the logic underlying the fiscal, regulatory system and the Civil Code. The objective of the tax legislator is, at least primarily, to create a basis of "certainty" for the calculation of taxable income to be able to realise the flow of tax revenues deemed necessary. For this reason, he is forced, at times, to 'reduce' those spaces of evaluative discretion that the civil legislator, on the other hand, grants, since he has the objective of providing, through financial reporting, clear and economically correct information on the equity, financial and economic results of companies. The different objective to be achieved explains the presence of different and sometimes decidedly contrasting valuation solutions in the Civil Code and in the T.U.I.R. However, this does not create any overlapping or con-fusion of regulatory

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Financial reporting "is [.... In financial reporting "the concept, originally Anglo-Saxon, of true and fair representation of the company's economic, asset and financial situation is sanctioned, aimed not only at preventing the company from appearing to third parties to be more solvent than it is, but also at providing third parties (including the financial markets) with good information support for a more precise understanding of the company's economic situation: prudence in the valuation of the elements that make up the company's assets remains a drafting principle, but it is nevertheless subordinate to the clause generated by the drafting of financial reporting oriented towards a representation, as already mentioned, more in line with the actual company situation.

The different function of tax regulations is instead to manage a monetary levy necessary to cover public expenditure, aimed at satisfying the objectives of economic policy identified by the government; for this reason, the assessments in the tax area are often oriented to rules of "minimal character", concerning a guarantee of minimum determination of taxable income, beyond which the behaviour is normally legitimate, leading however to an increase in taxable material. Tax provisions are usually more analytical to favour certainty in their application, thus decreasing the degrees of freedom (discretion in assessments) available to the taxpayer (discretionary powers) available to directors"[2]

Concerning financial reporting , if such a document can be defined as untrue due to the inclusion of tax accounting entries without any economic content, there are consequences, not only "ethical/social" but also purely

sources, since financial reporting must comply with the business principles established by the Italian Civil Code. In contrast, tax provisions, which have as their object the tax return and not financial reporting, have no citizenship in the latter document. A connection between the two regulations is made through the provisions of Article 52 of the T.U.I.R. which, establishing the principle of the dependence of taxable income on statutory income, provides that the former is achieved by making 'increases and decreases' to the result that emerges from the profit and loss statement, thus reflecting, when determining the taxable income, the effects of the different provisions of the two regulations. It must be noted, however, that if we abandon the theoretical aspects and move on to the examination of concrete applications, we find that not everything has been carried out with the clarity and simplicity that seem to emerge from a reading of Article 52 and that the reconciliation between the two configurations of income (statutory and fiscal), through the statement of changes contained in the tax return, has often been neither easy nor clear for companies". Magistro, Le interferenze fiscali nel disegno di legge delega per la riforma del diritto societario, in Rivista italiana di ragioneria e di economia aziendale, no. 2, 2000.

[2] Piccinelli, *Il bilancio d'esercizio e le imposte dirette: norme civilistiche, regole IAS e disposizioni tributarie nelle loro mutue relazioni, in bilancio d'esercizio e imposizione tributaria: le regole per le società di capitali*, a cura di Camodeca, Cedam, Padova, 2014, p. 3.

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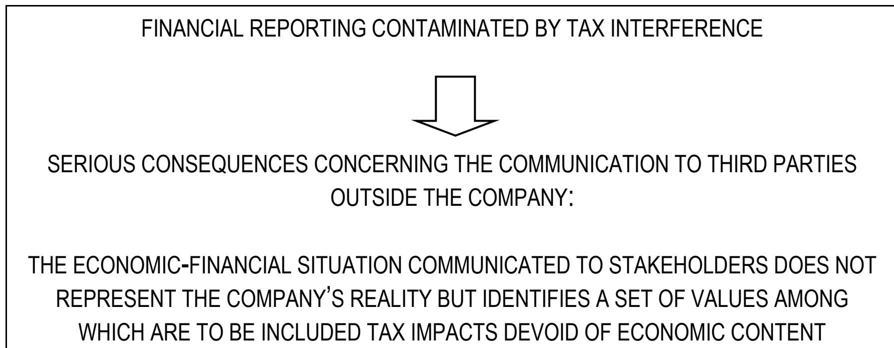
legal. Firstly, suppose the financial reporting is drawn up based on 'subjective' tax values (rather than economically and civilly correct). In that case, the document filed with the Chamber of Commerce does not reflect the company's economic, financial, and asset reality[3].

Therefore, communication to the outside world is distorted with the consequence that users (e.g. social creditors, shareholders, workers, lenders, etc.), for whom financial reporting is the only element from which to draw economic information concerning the company, have at their disposal data that fail to illustrate the situation in which the economic entity to which they refer operates.

As a result, decisions are taken on the basis of values that do not reflect the income, financial and asset reality that these external users are interested in.



Secondly, one cannot overlook the consequences of a legal nature connected to the inclusion in financial reporting of values without economic content. Such a policy entails the non-observance of the truthfulness postulate imposed by Article 2423 of the Italian Civil Code. Untruthful financial reporting is unlawful financial reporting or, to be more precise, the resolution

[3] Savioli refers to the "considerable violence" that the statutory financial statements have caused. "s affected by the confluence of tax provisions' with, in his view, 'conflicting or at least in many cases incompatible interests'. Savioli, *Il bilancio d'esercizio, strumento di informazione esterna dell'impresa in funzionamento*, Giappichelli, Torino, 1998, p. 72. In this regard, it was pointed out that "there are certainly tax rules that cause a mixture of values of a fiscal nature (concerning the "declaration") and values of an economic-legal nature (concerning the "financial statements so"), but this demonstrates the tendency to want to transplant provisions of a tax content into the fabric of civil law rules. This phenomenon of legislative brandishing must be promptly circumscribed and eliminated if we do not want to run the risk of being subjected to a hybrid discipline, devoid of foundation in the theory of law and irrational in the economic theory of business". Mazza, *Il bilancio d'esercizio e la dichiarazione dei redditi*, da AA.VV., *Il bilancio d'esercizio. Problemi attuali*, Giuffrè, Milano, p. 294 ss.

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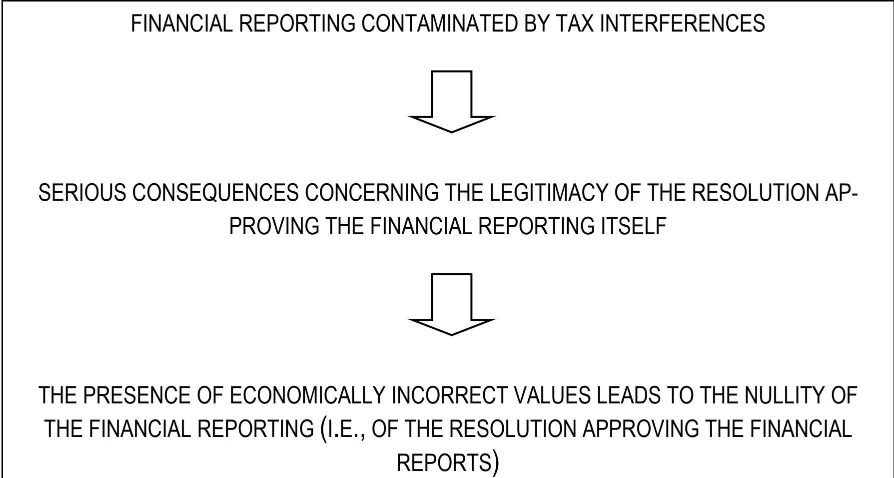
approving the financial reporting is invalid. Article 2434 bis govern this invalidity, the first paragraph of which states that cannot bring actions requesting the nullity and cancellation of the shareholders' meeting resolution after the approval of the financial reporting for the financial year following the year in question. The prevailing doctrine and jurisprudence agree on the circumstance that the interest in the dissemination of economic and financial information to be implemented through financial reporting identifies, without a shadow of a doubt, not a particular but a general interest. Almost all scholars and all judges, therefore, believe that a resolution approving untruthful, incorrect or unclear financial reporting must be considered radically null and void and, as such, may be challenged ex officio or by a third party who, according to Article 100 of the Code of Civil Procedure, demonstrates an interest in bringing proceedings. This issue will discuss in greater detail in Vol III of this series.



Finally, it is necessary to understand, in all its aspects, the impact of the presence of tax interferences in accounting data on decision-making. It is clear that the use of negative and/or positive income components determined for tax purposes and, therefore, without an economically correct meaning, prevents the quantification of costs and revenues that allow the determination of "valid" values to improve the decision-making process of the company and, consequently, the maximization of effectiveness and management efficiency. In other words, if it is undoubtedly true that the inclusion of tax values, which are not economically correct, causes consequences at a legal level (invalidity of financial reporting, etc.), we must ask ourselves whether

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such accounting behaviour can also influence the management of the company. In this respect, it should be pointed out that, in most cases, the general accounting data are the information pool from which the values used for management control and cost analysis are drawn directly.

As can be easily understood, from such accounting behaviour, the main "victims" are precisely the managers of the company, who determine aggregate or compartmentalized values (e.g. operating income, company operating income, product cost, product returns, etc.) based on economically incorrect values and, therefore, devoid of any income and/or financial meaning. The consequences, also in this field, can be harmful since deciding based on economically incorrect values means taking as reference points data that are partially or incorrect and therefore misleading.

As an example, let us consider the depreciation of a plant specifically dedicated to producing a good. Let us assume that the manager's objective is to determine a full product cost, i.e., the asset's cost, including negative fixed and indirect income components. The depreciation of the plant, if we want to quantify the full product cost, is a value that, necessarily, must be included in the database for calculation purposes.

Let's assume that the tax depreciation is 100, and the economically correct value is 80. For tax reasons, a value of 100, i.e. the maximum tax-deductible limit, is recognized in the accounting and financial reporting. In this case, since the amount recognized in the general ledger exceeds the correct amount, it is clear that the full cost determined based on this value is overstated. The cost is untrue because it can not correct the decisions made on this quantitative data. It is evident that, in the opposite hypothesis, the consequences could be even more severe. Suppose the economically correct depreciation is, for example, 150. In that case, the full cost determined based on an underestimated value will identify an underestimated figure with the easily foreseeable consequences for decision-making.

It should be noted that both of the above hypotheses (economic depreciation higher or lower than the fiscal depreciation erroneously entered in the general accounting and, therefore, in financial reporting so) often occur in the entrepreneurial reality of many companies as the double calculation of depreciation (civil and fiscal) causes a sort of duplication of administrative work with a simultaneous increase in the complexity of the measures to determine the taxable income and the statutory income.

Despite the apparent consideration, the import of tax values into general accounting and financial reporting is widespread.

If therefore, despite the highlighting of the inappropriateness of such accounting entries, the so-called "tax interferences" are carried out in the

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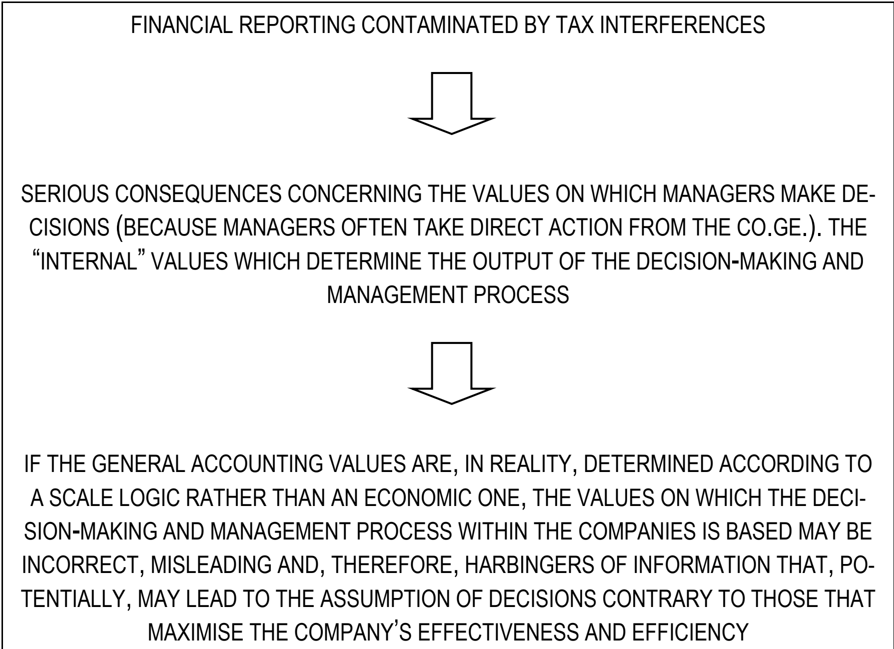
company, it appears extremely important that, at least during the internal interpretation of the data deriving from taxation, it should be borne in mind how the values thus determined are affected by elements lacking any economic/income meaning and therefore identify potentially misleading values.



Summarising the reasons that lead companies to carry out tax interferences in the financial reporting even though they are aware of drawing up an incorrect document and therefore, potentially, imputable and void for lack of truthfulness, we can state that this contamination is due, essentially, to two reasons:

1) Firstly, indeed, the recognition of a tax cost without economic content in the financial reporting is due to the desire to enjoy the tax deductibility of an amount that, if absent in the profit and loss statement, could not be included among the negative values relevant to tax. In reality, this is not a matter of tax evasion but of 'postponing' the payment of taxes. It should note that tax interference occurs mainly, or rather exclusively, concerning subjective valuation items, i.e., non-objective values requiring a specific assessment by the financial reporting manager. The recognition of a portion of cost or, even, of an entire negative component of income (think of the case in which there are no doubtful receivables and the company still

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records the provision for bad debts) without economic content reduces the period interested in the deductibility of the cost because, by increasing the amount recorded in the profit and loss statement, the end of the tax deductibility of the entire cost is reached first (think, for example, of depreciation). The higher the amount of depreciation recognised in the financial reportings, the lower the number of years concerned by the deductibility of the total cost.

The achievement of the total cost deductible for tax purposes over the years causes the impossibility of further tax deductions concerning that negative income component. Therefore, at the end of the above-mentioned period, the taxes will be higher than those that would have been allocated to the state if, over time, had calculated a correct economic cost lower than the tax deductible.

Thus, the taxation of financial reporting does not lead to tax evasion but instead postpones tax payments. This is a circumstance that is particularly welcome by the financial management for companies that are increasingly lacking in liquidity due to the ongoing economic crisis.

2) The second reason for the fiscal contamination of financial reporting, to which we have already alluded, is related to the administrative work that would inevitably create if the statutory regulations were to be followed strictly and correctly. The accounting behaviour imposed by the code provides for calculating the costs subject to subjective assessment of the economically correct and true value, resulting from applying the valuation criteria provided for by Article 2426 of the Civil Code and the OIC accounting standards. The person who follows the provisions of the Civil Code must, therefore, in practice, calculate two values:
   a) the first one, economically correct, to be charged to the profit and loss statement;
   b) the second to be used for the calculation of income tax.

If there is no tax interference, it is not relevant whether one of the two values is higher or lower than the other. In any case, the value determined according to correct economic-business logic will be entered in financial reporting, while in tax calculation, it will consider the relevant tax value. This may lead to the loss of a part of the tax deductibility of the cost (when the economically correct value entered in the financial reporting is lower than the value potentially deductible in the tax return) or to a tax recovery of the amount not deductible for tax purposes because it exceeds the maximum limit provided by tax regulations. There is no need to go into further detail on this issue to understand how this double calculation is a source of considerable administrative work that turns into additional labour costs for

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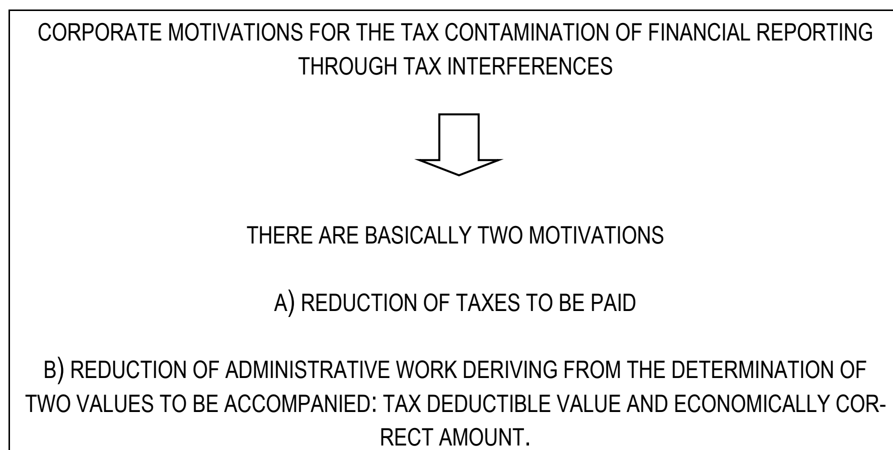
companies. In addition, the double calculation is seen as a potential source of errors, especially in the determinations following the identification of tax recovery.

Inexorably, all this leads companies to simplify internal work through the inclusion, in financial reporting, of items immediately deductible at tax level that, at the same time, do not make them lose opportunities to reduce taxable income. This attitude inevitably leads to the fiscal contamination of financial reporting.



In the following pages, an analysis will be made of the historical evolution of the civil and tax regulations, which, directly or indirectly, have been the reason for the fiscal contamination of financial reporting by companies. As it will be seen, in specific periods, the interferences have even been "legalised". In contrast, in subsequent periods, the legislative rules, at least at a theoretical level, prevented, as they still do, from giving an acceptable legal form to the tax law interferences in the preparation of the profit and loss statement, the balance sheet, the notes to the financial statements (and, today, following the enactment of Legislative Decree 138/15 of the cash flow statement).

The reader is referred to the following pages to analyse this historical evolution from the Visentini reform to the present day. For a complete analysis of the concept of tax interference, the reader is referred to Vol. I of this series.

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2. THE TRUTHFULNESS OF FINANCIAL REPORTING VS. THE UNRELIABILITY OF FINANCIAL REPORTING DATA DUE TO THE PRESENCE OF "TAX INTERFERENCES" FROM THE VISENTINI REFORM TO THE 2003 REFORM

2.1. Law 216/74 and the Visentini reform: turning points in the relationship between general accounting and taxes

The Vanoni reform of the 1950s accelerated the problem of the need for the tax system to be adapted to the changed general economic conditions of our country. The Vanoni reform, however, began to show its limits about 10 years after it came into force. From the beginning of the 1960s, the need for a systemic intervention in the Italian tax system was perceived. In 1962, a study commission was set up with the objective of identifying a tax reform that would overcome the limits of the Vanoni Law and, at the same time, be able to understand the structural changes of an economic nature that had taken place in our economy in that decade. An extremely important point of reference for the tax reform that took place in 1973-75, known as the 'Visentini reform', was Law No 685 of 27 July 1967, which approved the national economic programme for the five-year period 1966-1970. All scholars agree that the precursors of the Visentini reform can be found in the above-mentioned Law No 685. In this law, in fact, there are references to the delegated law on the basis of which the Visentini reform was implemented about four years later.

The law with which the national economic programme was approved identified a series of objectives to be achieved over the next five years in the following areas:

- reform of the Public Administration;
- regional and territorial organisation, social security and public
- public finance
- and, last but not least, fiscal order.

Regarding the latter objective, Article 35 of Annex 1 to the law stated:

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"In this area, too, the conditions and guidelines for a reform of the tax system, inspired by the requirements of greater fairness and efficiency, and greater functionality with respect to the aims of economic policy, have long since matured as a result of studies carried out by the competent authorities. Chapter XXIII sets out the general criteria for this reform and the measures that the Government intends to implement in the next five years. In particular, the following initiatives are envisaged: a) reorganisation of the tax administration; b) reform of direct taxes, so as to simplify the taxation system, which shall be more tolerable for the taxpayer and more rigorous as regards assessment; c) reform of indirect taxes, also in order to harmonise with the directives of the European Economic Community, as they are approved; d) reorganisation of local finance; e) broadening of the tax base, through a reduction in exemptions and a better equipped repression of tax evasion"[1].

Furthermore, Article 237 of Schedule No 3 to Law 685/67 states: "The new tax system, which shall be more in line with the systems in force in the other countries of the European Economic Community, shall meet certain well-defined requirements. a) First, the tax system shall ensure the Constitution's progressiveness prescribed by Article 53. b) Second, the system shall be manoeuvrable so that it can be adapted, as necessary, to the fundamental needs and purposes of economic policy. Therefore, the tax system must aim at an articulation based on a few fundamental taxes and relatively moderate rates but to be applied to as large a taxable mass as possible. To this end, it is necessary: the elimination of all those taxes that create distortions in the economical use of resources and lead to unnecessary cost increases; their replacement by efficient contributions not only from the fiscal point of view but also from that of economic policy; the revision and rationalisation of exemptions. c) Thirdly, the tax system must be clear so that the taxpayer can easily realise the burden imposed on him. The taxpayer has the right to demand that taxes are transparent. No financial illusion processes are created by leaving standard tax rates low but increasing them – often to a considerable extent – with a series of surcharges. To this end, it is necessary to incorporate, in principle, all taxes, surcharges and surcharges, for whatever reason and regardless of the body to which they are due, in a single tax. This means the abolition of all non-State taxes and incorporating the various rates into a single rate of State tax. d) Fourthly, the structure of the finances of the smaller territorial entities must be coordinated with that of the State finances, to avoid conflicts in the financial and economic policies pursued".

[1] Art. 35, notes attach 1, legge 27 luglio 1967, n. 685.

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These indications laid the Visentini reform implemented between 1973 and 1975.

This reform can be identified as the first real tri-budgetary reform implemented. This reform had its origins in Law No. 825 of 9 October 1971, containing 'legislative delegation to the Government of the Republic for tax reform'.

The delegation provided for the simplification of the system, with a consequent reduction in the number of taxes; the application of pro-rata and personal taxation that would take into account the situation of each individual taxpayer distinguished by his or her own ability to pay; and finally, the implementation of a system of fiscal controls and new techniques for assessing and collecting taxes that could limit tax evasion.

In extremely concise terms, the Visentini reform was structured on the basis of the following provisions:

- Presidential Decree No. 633 of 26 October 1972, establishing the Value Added Tax;
- Presidential Decree no. 597 of 29 September 1973, establishing the Income Tax for Individuals;
- Presidential Decree no. 598 of 29 September 1973, instituting the Income Tax for Legal Persons,
- Presidential Decree n. 599 of 29 September 1973, instituting the Local Income Tax;
- Law no. 823 of 19 December 1973 (the so-called Law on tax amnesty);
- Law 576 of 2 December 1975 (the so-called "mini-reform Visentini"), which introduced the principle of cumulation of income between spouses who were not legally and effectively separated, if the total income exceeded seven million, imposing on them, in any case, the obligation to draw up and sign a single declaration. These provisions were challenged, and the Constitutional Court ruled against the law on cumulation. Law No 576 of 2 December 1975 also established the system of self-assessment. This mechanism was envisaged to make the collection of tax credits by the State easier, faster and more secure.

It should note that, with the Visentini reform, the following were imposed:

1) the extension of the obligation of declaration to all taxpayers;
2) the identification of a single analytical-accounting system for the determination of the income of self-employment and business;
3) and finally, the elimination of flat-rate and transactional systems of income determination, such as the concordant.

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Concerning the problem of tax interferences in financial reporting, the reform mentioned above introduced two fundamental principles, namely that, firstly, the determination of business income should take place according to the results deriving from the application of the accrual basis of accounting and, secondly, that the quantification of taxable income should be determined based on the values of financial reporting or accounting (n. . (n.a. in the context of the law, the term "statement" does not refer to financial reporting at all but to an obsolete definition of balance sheet and financial reporting consisting of profit and loss statement and balance sheet.

Article 52 of Presidential Decree No. 597/73 concerning the determination of business income indicated that the financial reporting values should be subject to the variations arising from the criteria established by the provisions of the title in which Article 52 (business income) was inserted.

Article 74 of Presidential Decree No. 597/73 also provided that revenues, income, costs and expenses were to be included in business income in the year of their accrual unless their existence was not yet certain or their amount could not yet be objectively determined, in which case they were to be included in the income of the tax period in which those conditions occurred. (Costs and expenses are deductible to the extent that they relate to activities from which revenues or income are derived and contribute to the enterprise's income; if they cannot be specifically attributed, they are deducted in the proportion established by the first paragraph of Article 58).

Costs and expenses were not deductible if they were not charged to the profit and loss account attached to the declaration. However, costs and charges were deductible to the profit and loss account of a previous taxable period if and to the extent that deferred deduction under the preceding Articles. Costs and expenses required to be recorded in proper books for income tax purposes were not allowed as deductions if they had been omitted or improperly recorded, except in the case of purely formal irregularities.

From the above, it can be understood how the Visentini reform provided a derivation from the net income of the statutory financial reporting. It should note that the fundamental principles of the IRPEG disciplined by Presidential Decree 598/73 made direct reference to the rules contained in Presidential Decree 597/73 relating to business income. A series of limitations and variations governed by Presidential Decree 597/73 and 598/73 (for legal persons) had to be applied.

Therefore, the taxation principle could be summarised as follows: the taxable income was determined based on the pre-tax net statutory income to which the variations provided for by the two Presidential Decrees mentioned above had to be applied.

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In substance, the taxable income was directly derived from the values recorded in the statutory financial reporting.

In this regard, it should note that the Visentini reform concerning IRPEF and IRPEG came into force on 1 January 1974. In the same year, there was also a significant reform at the civil law level without which, probably, the legislation's impact on reorganising the tax system would have been less critical and, undoubtedly, less efficient and effective.

This is not the place to illustrate the historical significance of the external communication caused by Law 216 of 7 June 1974. For the first time, this law regulated the public control of companies through Consob, indicating its structural characteristics and tasks. Law 216/74, in addition to regulating general control of companies, made various amendments to the Civil Code. In this context, the aim of which is to examine whether, after the Visentini reform and the promulgation of Law 216/73, tax interference in financial reporting could be hypothesised, it is essential to underline that, according to Article 12, for the first time in Italy the rules to be followed for the compilation of the directors' report were established, a document illustrating the company's situation which is of primary importance in the context of the economic-financial communication of companies[2] intended for third parties outside the company.

In addition to this provision, the law mentioned above brought a historical addition to financial reporting (i.e. the profit and loss account and balance sheet).

[2] Article 12 Law 216 of 7 June 1974: "The following Article shall add after Article 2429 of the Civil Code: "Article 2429-bis. – Directors' report. – The directors' report required by the third paragraph of Article 2423 shall illustrate the performance of operations in the various sectors in which the company has operated, including through other companies controlled by it, with particular regard to investments, costs and prices. It shall also indicate significant events occurring after the financial year. The report shall, in any event, indicate: 1) the criteria used in the valuation of the various categories of assets and any changes concerning the financial statements of the previous year; 2) the criteria used for depreciation and provisions and any changes concerning the financial statements of the previous year; 3) changes in the consistency of assets and liabilities; 4) data on employees and provisions for seniority indemnity and retirement benefits; 5) interest expense, broken down between long-term and medium-term loans and short-term loans, with a separate indication of those included in the asset items; 6) study, research and planning expenses, advertising and propaganda expenses and start-up expenses for plant or production, recorded in the assets of the financial statements, with a separate indication of the relative amount; 7) relations with parent, subsidiary and associated companies and changes in equity investments and receivables and payables. Within three months from the end of the first half of the financial year, the directors of companies with shares listed on a stock exchange must provide the board of auditors with a report on management trends regarding production, sales, and services placed expenses and revenues. The report shall be kept on deposit at the company's registered office for three months; the shareholders may inspect it".

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For the first time, the legislator indicated the minimum mandatory content of the profit and loss account. Article 11 of Law No 216 of 7 June 1974 provided that: "after Article 2425 of the Civil Code the following is added: "Article 2425-bis. – Contents of the profit and loss account. – Without prejudice to the provisions of special laws for companies engaged in particular activities, the profit and loss account must show the revenues and costs attributed to the financial year, indicating separately in their total amount: in the profits: 1) revenues from sales and services grouped by homogeneous categories; 2) income from real estate investments; 3) dividends from investments in subsidiaries and associated companies; 4) dividends from investments in other companies; 5) interest on fixed-income securities; 6) interest on loans to banks; 7) interest on loans to subsidiaries and associated companies; 8) interest on loans to customers; 9) interest on other loans; 10) gains on the sale of assets that cannot be included among the revenues referred to in number 1); 11) increases in plant and other assets for internal work; 12) income and revenues other than those indicated in the previous numbers and contingent assets; 13) closing inventories of raw materials, semi-finished and finished products and goods; in losses: 1) opening inventories of raw materials, semi-finished and finished products and goods; 2) costs for purchases of raw materials, semi-finished and finished products and goods; 3) costs for employee services and related contributions; 4) costs for services; 5) taxes and duties, with separate indication of those relating to previous years; 6) interest and other charges on debenture loans; 7) interest on payables to subsidiaries and associates; 8) interest on bank loans; 9) interest on other payables; 10) discounts and other financial charges; 11) depreciation for homogeneous groups of assets; 12) provisions for liquidation or pension funds; 13) provisions to cover the risk of impairment of securities, receivables and other categories of assets; 14) provisions for tax and other specific charges; 15) losses resulting from financial reporting valuations relating to the various categories of assets; 16) expenses and losses other than those indicated in the previous numbers and contingent liabilities. Matching fees are prohibited".

There is no need to delve further into the subject matter to understand the scope of this provision, especially if it is set in the context of the period in which the restructuring of the tax system through the Visentini reform was enacted.

After the entry into force of Law 216/74, the doctrine began a heated debate about the interrelationship between civil financial reporting and "tax financial reporting" rectus document to identify taxable income. Synthesising the various positions in a few lines is arduous if not impossible.

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At a synthetic level, we can point out that, at the time, there were authors, among whom we can mention, for example, Moroni[3], Nava[4] e Mazza[5] who considered the double reform of civil law and tax law to be the reason for implementing the so-called double track. The existence of Article 74 of Presidential Decree No. 597/73, which provided, as has already been pointed out, "that costs and charges are not deductible if they are not charged to the profit and loss account attached to the declaration. However, costs and expenses charged to the profit and loss account of a previous tax period are deductible if and to the extent that the deduction has been deferred following the preceding articles" these experts replied that the account attached to the return was not the statutory profit and loss account but that document to which the increases or decreases had already been made so that all the amounts entered could be considered tax-deductible. According to this doctrine, it was possible to make increases and decreases in statutory income based on the possibility of the various items being considered tax-deductible.

This interpretation did not find many followers since, also based on a cardinal principle of the legal system, "when the tax rules refer to institutions and terms of private law without giving a specific different definition, reference must be made to the provisions by which the institution or concept referred to is defined in the ordinary law, and it is not possible to create a different law from the ordinary one just because one is dealing with the application of taxes"[6].

Based on this basic principle, which has also been endorsed by the Supreme Court, the profit and loss account mentioned in Article 74 of Presidential Decree 597/73 undoubtedly identified the document accompanying the statutory balance sheet, without any change due to the application of the changes provided for by the tax law.

From the letter of Art. 74 of Presidential Decree 597/73, interpreted in the light of Art. 52 of the same decree, it could therefore say that the legislator was firm in considering civil financial reporting to be a document deriving from the application of the principles of valuation contained in Art. 2425 of the Civil Code. It also inferred from the set of rules that any tax adjustments

[3] Moroni, "Il bilancio d'esercizio e il bilancio d'esercizio fiscale", *Consulenza*, n. 13, 1980.
[4] Nava, "Avremo un nuovo tipo di politica fiscale nella formazione dei bilancio d'esercizio s delle società di capitale?", *Riv. Dott. Comm.*, n. 6, 1974.
[5] Mazza, "Interrelazioni e interferenze fra il bilancio d'esercizio e le dichiarazioni fiscali", *Giornale dei dottori commercialisti*, n. 10, 1974. This author provides a restrictive interpretation of the above, considering that Article 74 of Presidential Decree 597/73 refers only to objective values and not to estimated and conjectured data.
[6] Cassation Court 28 maggio 1941, n. 1586.

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provided for by the tax law could only be deducted if the statutory cost exceeded the maximum limit provided for by the tax provision.

Therefore, in the years following the Visentini reform and the reform produced by the enactment of Law 216/74, tax interferences were not legally permissible. However, this is, unfortunately, the only theory. In practice, to avoid losing a tax deduction, companies enter values in the profit and loss account that were higher than the economically correct ones so that these amounts reach the maximum tax-deductible limit.

It should also be pointed out that, to avoid double work, companies did not "waste time" calculating "economically correct" values in addition to the tax-deductible amounts and entered the tax values in financial reporting. As we will see in the following pages and in the research that will illustrate in volume III, such behaviour is still rampant today.

In the post-Visentini reform years, some authors, while criticising such behaviour, "justified" it under a corporate interest in not paying more tax than necessary. As we will illustrate in the following pages and volume III, such behaviour, however, although understandable from a company management point of view, caused and still causes today, the drafting of financial reports that are null and void as they were drawn up disregarding the postulates of truthfulness and correctness (truth and accuracy, using the terms found in Article 2423 of the Italian Civil Code in force in the 1970s).

This position is well highlighted by Loero who, in 1975, pointed out that" [...] large shareholding companies found themselves, in practice, (due to the lack of legislative recognition of the double track, faced with an unpleasant alternative: to comply with the civil-statutory rules that imposed the "truth" of financial reporting and therefore voluntarily submit to heavy taxation or to continue, as in the past, to compile financial reporting as a function of the tax declaration (i.e. in practice to obtain the highest possible tax savings), running the risk of seeing themselves annulled (n. d. declare null and void). n. to declare null and void the resolutions approving the financial reporting by the judiciary"[7].

This behaviour is evident from the companies' financial reporting of that period. Not a few companies even considered it correct to specify that the valuations applied to costs constituted the implementation of the tax rules of the tax decrees 597/73 and 598/73.

In the years following the Visentini reform and the promulgation of Law 216/74, tax interferences were, therefore, the norm for the majority of the

[7] Loero, Se sia possibile iscrivere nel bilancio d'esercizio fiscale delle società di capitali componenti negati di reddito non iscritti nel bilancio d'esercizio civile (c.d. tesi del doppio binario), in Le imposte dirette erariali e l'iva, fascicolo settembre-ottobre, 1975, p. 116.

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financial reporting s for the year, even if we cannot overlook the attitude of part of the judiciary, especially the Court of Milan, which has always been against this accounting procedure. The position of this Court was so focused on the integrity of the financial reporting that, voluntarily or involuntarily, it created a case. The tax reform provided accelerated depreciation, i.e. depreciation with no economic content and intended only to facilitate business. Theoretically, it should not include the item in financial reporting as it was not 'economic'. Still, failure to include it in the profit and loss account would have meant that it could not grant the relief. All companies, of course, included accelerated depreciation in their financial reporting, but the Court of Milan declared financial reporting marked by this item to be null and void. However, the legal alternative involved the loss of a tax benefit provided explicitly by the legislator to favour companies and help economic growth.

The situation, as you can well understand, was somewhat chaotic until respectively, in 1991 (with the transposition of the IV EEC Directive) and in 1986 (with the tax reform related to the issuance of Decree 917/1986) the legislator modified, on the one hand, the civil-law financial reporting and, on the other hand, the tax regulations, by creating a situation which should have facilitated the drafting of financial reporting in which, in reality, the tax interferences did not disappear but were highlighted in specific items to make the financial reporting valid and the cost without an economic content deductible.

The reader is referred to the following paragraph to analyse this twofold reform.

2.2. The relationship between financial reporting and tax provisions in the period 1991-1993 and the tax appendix

Concerning the relationship between financial reporting and tax regulations, the period 1991-1993 was characterised by the coexistence of the tribenefit provisions of Presidential Decree no. 917 of 22 December 1986, i.e. the new Consolidated Income Tax Law (TUIR) and the civil law provisions deriving from the implementation of the IV EEC Directive. This directive was introduced into Italian law by Legislative Decree No. 127 on 9 April 1991.

Concerning the implementation of the IV EEC Directive, it should be noted that, in the 1970s, the intensification of commercial and financial relations between economic entities belonging to different countries; the development, in the financial and stock markets, of the trading of securities relating to foreign companies and, finally, the now generalised need for financial

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reporting to be correctly interpreted by anyone (including residents in foreign countries) had "made the need for accounting information [...] to be as accurate as possible.] to be as uniform as possible across countries [...] so that those interested in learning about companies could clearly understand the balance of the companies themselves, even if they were operating in different countries"[8].

The formal and substantial differences in the financial reporting of companies belonging to different countries constituted a negative factor both because it prevented, or at least made it difficult, to compare the financial reporting of companies of different nationalities and because the existence of such differences could lead to errors of interpretation by the analyst due to the lack of knowledge of the financial reporting structures adopted in foreign countries. The achievement of a formal and substantial unity of financial reporting (which, however, at the same time took into account the differences that distinguished the companies and the economic structures of the various countries involved) was, therefore, could achieve an objective quickly. The need for such harmonisation led to numerous associations, the most important of which, at the European level, was the IASC, whose aim was to issue accounting standards and promote their international acceptance.

Also, the EEC, primarily because of the multiplication of economic relations within the EU, intervened in this issue by issuing a Directive, the IV, containing the principles for the coordination of national provisions on financial reporting of corporations within the various Member States.

Following the implementation of this Directive by all Member States, the structural, terminological and content differences that distinguished the financial reporting systems of the various countries of the European Community should have been eliminated or at least reduced.

The IV EEC Directive was issued in 1979, but the Italian State only implemented it in 1991 through the Legislative Decree 127/91.

In the following, the articles of this decree related to the issue of tax interferences will be reported. On the other hand, no consideration will be given to the other changes introduced to financial reporting by this Directive compared to the situation before 1991. For a similar in-depth analysis, the reader is referred to specific texts on this subject.

The legal provisions deriving from the combined civil and fiscal conditions provided a practical and operational justification for the inclusion of tax rules in the financial reporting, violating the postulates of truthfulness

[8] Cassandro, "Sull'armonizzazazione internazionale dell'informativa contabile", *Riv. It. Di Rag. e di Ec. Az.le*, settembre-ottobre, 1984, p. 382.

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and fairness imposed in the writer's opinion by Article 2423 of the Civil Code.

This legal legitimacy of fiscal contamination found, in the period 1991-1993, its origin in the set of articles 75 and 52 of the new TUIR (Presidential Decree no. 917/1986) and Article 2425 of the Civil Code introduced after the implementation of the IV EEC Directive.

Before considering the combined provisions of Articles 52 and 75 of the Consolidated Income Tax Law and Article 2425 of the Italian Civil Code, it is appropriate to indicate the content of such rules.

Art. 7 of Legislative Decree No. 127 of 9 April 1991 required the profit and loss statement to be prepared following the following structure and content:

Art. 2425 (Content of the profit and loss statement). – The profit and loss statement should be prepared following the following format:

A) Production value:
1) revenues from sales and services;
2) changes in inventories of work in progress, semi-finished and finished goods;
3) changes in contract work in progress;
4) increases in fixed assets for internal work;
5) other revenues and income, with contributions in contractual income shown separately.

Total.

B) Costs of production:
6) for raw materials, ancillary materials, consumables and goods;
7) for services;
8) for the use of third party assets;
9) for personnel:
   (a) wages and salaries;
   (b) social security charges;
   (c) severance pay;
   (d) pensions and similar obligations;
   (e) other costs;
10) amortisation, depreciation and write-downs:
   (a) amortisation of intangible fixed assets;
   (b) depreciation of tangible fixed assets;
   (c) other write-downs of fixed assets;
   (d) write-downs of receivables included in current assets and of liquid assets;
11) changes in inventories of raw, ancillary and consumable materials and goods for resale

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12) provisions for risks
13) other provisions;
14) other operating expenses.
Total.
Difference between value and cost of production (AXXB).

C) Financial income and expenses:
15) Income from equity investments, with separate disclosure of income from subsidiaries and associates;
16) other financial income:
    (a) from receivables included in fixed assets, with a separate indication of those from subsidiary and associated companies and those from parent companies;
    (b) from securities included in fixed assets that do not constitute participation;
    (c) from securities included in current assets that do not constitute participation;
    (d) income other than the above, with separate disclosure of income from subsidiaries and associates and parent companies;
17) interest and other financial charges, with separate disclosure from subsidiaries and associates and parent companies.
((Total (15+16-17))).

D) Value adjustments on financial assets:
18) Revaluations
    (a) of equity investments;
    (b) of financial fixed assets that are not equity investments;
    (c) of securities shown under current assets that are not participating interests:
19) write-downs:
    (a) of equity investments;
    (b) of financial fixed assets which are not equity investments;
    (c) of securities shown under current assets that are not equity investments.
Total adjustments (18-19).

E) Extraordinary income and expenses
20) income, with a separate indication of capital gains on disposals, the income from which cannot be entered under No. 5);
21) Expenses, with separate disclosure of capital losses on disposals, the effects of which cannot be reported under 14), and taxes relating to prior years.
Total extraordinary items (20-21).
Result before taxes (AXXB+XXC+XXD+XXE);

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22) Income tax for the year; 23) result for the year;
24) Value adjustments made exclusively for tax purposes;
25) Provisions made exclusively for tax purposes;
26) Profit (loss) for the year.

The profit and loss statement structure referred to above is derived from the provisions of Articles 23, 28 and 30 of the IV EEC Directive.

As regards the content of Articles 52 and 75 TUIR, the paragraphs that are of interest in this context are the following:

Article 52 TUIR

Paragraph I: Business income [...] is determined by adding to the net profit and loss account for the financial year ending in the tax period the increases or decreases resulting from applying the criteria set out in the subsequent provisions of this ChapterChapter.

Article 75 TUIR

Paragraph IV: Expenses and other negative components may not be deducted if and to the extent that they are not charged to the profit and loss account relating to the financial year closing. However, expenses and other negative components are deductible even if they are not attributable to the profit and loss account but are deductible by law and those attributed to the profit and loss account of a previous year if the deduction has been deferred following the previous rules of this ChapterChapter that provide or allow the deferral. Expenses and charges explicitly relating to income and other revenues that, although not charged to the profit and loss account, contribute to income formation shall be allowed as deductions if and to the extent that they result from specific and distinct elements.

Briefly, from a tax point of view, in 1986, recalling two provisions contained in the previous tax legislation of the decrees 597 and 598 of 1973, it was established that the necessary condition for the tax-deductibility of negative income components was represented almost exclusively by their allocation to the profit and loss statement, except in certain borderline cases.

Based on the mechanism created by Articles 52 and 75 of the Consolidated Income Tax Act, what some scholars have interpreted as a logical contradiction was made. On the one hand, the derivation of taxable income for tax purposes was required from statutory income, to which a series of changes provided for by the Consolidated Income Tax Act had to be made, and, on the other hand, the compulsory recognition in financial reporting of valuations useful to benefit from tax deductibility was required[9].

[9] See, among many others, the considerations of Savioli, *Verità e falsità nel bilancio d'esercizio*, Giappichelli, Torino, 1998, p. 121, quelle di Monti, *Reddito civile e reddito fiscale. Gli effetti fiscali dell'attuazione della IV Direttiva in materia di bilancio d'esercizio*, Cedam,

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This was also established by the tax legislation prior to the promulgation of the new TUIR of 1986.

The big news in 1991 was the transposition of the Fourth Directive 10 through Legislative Decree 127/91. This decree made profound changes to the civil law on financial reporting. With specific regard to tax interferences in financial reporting, the most significant change was the provision of items 24 and 25 of the profit and loss statement, which provided for the inclusion in financial reporting of items deriving from value adjustments and provisions made exclusively to implement tax regulations.11.

We had already highlighted this choice in the delegated law to the decree implementing the IV EEC Directive: Article 1, letter d, of Law Decree no. 69/1990 stated that the Legislative Decree to be issued based on the Directive should "ensure, to the extent compatible with the laws in force on tax matters, the autonomy from the tax provisions of those dictated by the implementation of the Directive, in any event providing that the tax provisions of the Directive shall be included in the legislative decree. Art. 1, letter d, of DL n. 69/1990 stated that the Legislative Decree to be issued based on the Directive should "ensure, to the extent compatible with the laws in force on tax matters, the autonomy from tax provisions of those dictated in implementation of the Directive, in any event providing that the profit and loss account should indicate the extent to which the application of the tri-budgetary legislation has influenced the valuation of individual items".

For this reason, the final version of Article 2425 of the Italian Civil Code indicated items 24 and 25 at the end of the profit and loss statement.

Padova, 1994, p. 12 according to which the legal provision was 'literally antinomian', or those di Mazza, già nel 1978, *Il bilancio d'esercizio e la dichiarazione dei redditi*, AA.VV., *Il bilancio d'esercizio. Problemi attuali*, Giuffrè, Milano, p. 280 ss., ed in "La cronica discrasia tra reddito di bilancio d'esercizio e reddito imponibile", *Il fisco*, n. 25/1994, p. 6091, where the author reflects: "one has to wonder what sense can be made of a rule that states to start from X, add Y and remove Z, provided that X contains R, S or T as corrective values. But then we are no longer starting from X, but from "non-X": which confirms the contradiction in terminus". Per Tabet e Minervini, *Utile civilistico e reddito d'impresa*, *Il reddito d'impresa*. Volume I – Saggi a cura di Tabet, Cedam, Padova, 1997, p. 45 Article 75 seemed to be inspired by a "different type of connection between the two orders of discipline" than that provided for in Article 52.

[10] On this point see Avi, *Il bilancio d'esercizio come strumento di informazione verso l'esterno*, cap. IV, Cedam, Padova.

[11] Piazza identifies this situation as "a compromise solution". Piazza, *Il raccordo tra reddito d'esercizio e reddito fiscale. Gli effetti fiscali della nuova disciplina sul bilancio d'esercizio*, *Il bilancio d'esercizio*, a cura di A. Palma, Giuffrè, Milano, 1992, p. 259.

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In this way, the legislator introduced in the civil financial reporting the "legalised" fiscal interference, even if highlighted transparently through the entry of two specific items of financial reporting[12].

In pratica, nel legislatore, prevedendo le poste 24 e 25 del profit and loss statement, "ammise l'esistenza di un problema connesso all'contamination del financial reporting da parte della normativa tributaria"[13 14].

In substance, therefore, "[...] the tax appendix was intended to ensure, to the extent compatible with the laws in force on tax matters, the autonomy of tax provisions from civil law provisions and to allow companies to draw up a profit and loss statement that is correct from a civil law perspective without preventing them from taking advantage of the opportunities granted by tax legislation"[15].

The provision of the so-called 'fiscal appendix' represented the acceptance of a now evident situation[16]: all financial reporting s, due to the tax rules set out in the TUIR, were constantly polluted by tax valuations devoid of economic content and, therefore, it would have been impossible by now to ignore such a situation[17 18.] Therefore, "noting the substantial impossibility of freeing financial

15 On the point see Nasini, "L'eliminazione delle interferenze fiscali e la rilevazione delle imposte sul reddito nella redazione del bilancio d'esercizio – le novità della legge di riforma delle società di capitali", *Rivista italiana di ragioneria e di economia aziendale*, marzo aprile 1994, p. 198.

[13] Avi, *Il bilancio d'esercizio come strumento di informazione verso l'esterno*, Cedam, Padova, 1990, p. 66.

[14] Colombo speaks of the 'insurmountable obstinacy of the tax legislator', which led to the 'subordinate solution of tolerating deviations from civil law rules, imposing the best possible information on them and their consequences'. Colombo, *Relazione di sintesi*, *Il progetto italiano di attuazione della IV Direttiva CEE*, a cura di Jorio, Giuffré, Milano, 1988, p. 158.

[15] Spoletti, "L'eliminazione delle interferenze fiscali e la rilevazione delle imposte sul reddito nella redazione del bilancio d'esercizio – le novità della legge di riforma delle società di capitali", *Rivista italiana di ragioneria ed economia aziendale*, n. 1, 1994, p. 74 ss.

[16] "There is no doubt that reference must be made in that regard to that particular type of adjustment aimed at obtaining tax relief, even if the benefit is limited in time. In this regard, the Directive requires that the notes to the accounts provide information on the effects of the derogation not only in the year in which it is applied, but also in the year in which it is reabsorbed, to show, on the one hand, the extent to which the "undervaluation" has led to an understatement of the statutory result, and, on the other hand (in the year of recovery) the extent to which the statutory result has been positively affected only because of the previous derogation". Feliziani, "Appendice fiscale al bilancio d'esercizio so. Problemi applicativi e soluzioni operative", *Il Fisco*, n. 12, 1994, p. 3165 ss.

[17] On this subject, see Picolli's considerations in "I principi contabili internazionali e la disciplina italiana in materia di bilancio d'esercizio alla luce della attuazione della IV e VII Direttiva CEE", *Rivista dei dottori commercialisti*, n. 6/1991 e di T. Di Tanno, "Brevi note a favore del 'doppio binario' nella determinazione del reddito d'impresa", *Rivista di diritto tributario*, n. 4, 2000.

[18] See on this subject, Falsitta, *I rapporti tra bilancio d'esercizio civile e bilancio d'esercizio fiscale alla luce della IV Direttiva*, *Il progetto italiano di attuazione della IV Direttiva CEE*, a cura di Jorio, Giuffrè, Milano, 1988, p. 102, The European directive "has demonstrated a

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reporting from the most varied tax implications[19] an attempt was made to create a profit and loss statement architecture whereby value adjustments and provisions of an exclusively tax-related nature were allocated at the end of the document (hence the term 'tax appendix')"[20].

Regarding items 24 and 25 of the profit and loss statement[21], it must remember that Article 2427 of the Italian Civil Code, introduced following the implementation of the IV EEC Directive, also provided, in point 14, for the illustration of the composition of items 24 and 25 together with the obligation to indicate the reasons for the choice made.

Thus, tax interference in financial reporting was legalised[22], "softened" on the one hand, by the explicit highlighting of tax items without economic content and, on the other, by the obligation to explain, in the notes to the financial statements in point 14, the range of the items themselves accom-

lively sense of practicality and the ability to avoid vague and extremist attitudes". Falsitta has dealt with this issue on several occasions and more recently, after the 2003 reform, which we will discuss in the following pages, he pointed out that the pragmatic attitude would have been in some way borrowed from the German legislator, who had already previously "taken note of the phenomenon and provided for regulating it in the share law". Falsitta, "Il problema dei rapporti tra bilancio d'esercizio civile e bilancio d'esercizio fiscale nel progetto di riforma della imposta sulle società (IRES)", *Rivista di diritto tributario*, 2003, I, p. 926.

[19] Not all authors were critical of including these tax items in the profit and loss statement. Tedeschi, for example, points out that "the rationale for these two items, 24 and 25, to supplement the profit and loss statement, was to meet the requirements that "the financial statements must be prepared with understandability and must give a true and fair view of the financial position for the year", Tedeschi, *L'attuazione della IV Direttiva CEE. Aspetti fiscali e civilistici nel bilancio d'esercizio*, Giuffrè, Milano, 1992, p. 160.

[20] Di Siena speaks of an 'experiment' inspired by the pragmatic indications of the Community legislator. Di Siena, "Bilancio d'esercizio e disciplina tributaria: evoluzione dei rapporti", *Contabilità finanza e controllo*, n. 1, 2005, p. 15.

[21] "Since it was not possible to eliminate tax interferences in the determination of the correct result for the financial year, it was deemed necessary to give them at least independent evidence so that the user of the financial statements could separate the economically correct result from the result determined by the influences of tax legislation". Savioli, *Verità e falsità nel bilancio d'esercizio*, Giappichelli, Torino, 1998, p. 123.

[22] "The proposed solution of highlighting, within the profit and loss statement, the interferences deriving from the application of tax regulations while having the merit of isolating them and bringing them to light, has sanctioned the subordination of the principles of preparation of the financial statements to the requirements of the tax legislator, launching legislation on the subject towards a single financial statement in which the interferences of a regulatory system completely unrelated to the purposes of the correct determination of the economic result and correct external information have full legitimacy. In other words, a derogation from the general clause of true and fair representation has been established by law". Savioli, in last work cited, p. 123 e ss.

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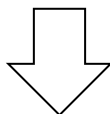
panied by an explanation of the reasons that had led to such financial reporting entries[23].

TRANSPOSITION OF THE IV CEE DIRECTIVE: D. legislative decree 127/91

MAIN CHANGES RELATED TO THE ISSUE OF TAX INTERFERENCES IN FINANCIAL REPORTING



1) ADDITION, IN THE PROFIT AND LOSS STATEMENT, OF ITEMS 24 (VALUE ADJUSTMENTS MADE EXCLUSIVELY IN APPLICATION OF THREE-YEAR RULES) AND 25 (PROVISIONS MADE EXCLUSIVELY IN APPLICATION OF TAX RULES)

2) ADDITION OF POINT 14 TO THE NOTES TO THE FINANCIAL STATEMENTS, REQUESTING AN EXPLANATION OF THE COMPOSITION OF ITEMS 24 AND 25 AND AN INDICATION OF THE REASONS FOR THE CHOICE MADE

ART. 52 AND 75 TUIR: DEPENDENCE OF TAXABLE INCOME ON THE RESULTS OF FINANCIAL REPORTING SO

THE SO-CALLED DEPENDENCE OF TAXABLE INCOME ON THE RESULTS OF FINANCIAL REPORTING IS REITERATED, WHICH, AT TIMES, WAS “REVERSED” IN SUCH A WAY THAT TAXABLE INCOME DID NOT DERIVE FROM FINANCIAL REPORTING, BUT RATHER THAT FINANCIAL REPORTING DERIVED FROM THE CONTENT OF THE TAX RULES TO EXPLOIT TAX DEDUCTIBILITY FULLY.

[23] This rule was imposed by the Fourth EEC Directive, which, in Article 43, point 10, required that in the notes to the annual accounts, the proportion in which a valuation of the assets influenced the calculation of the profit or loss carried out, by way of derogation from the principles of Article 31, which regulated the valuation criteria to be adopted within the framework of the annual accounts, and from Articles 34 to 42, which dealt with the problem of the so-called “fair value”, should be indicated. In Articles 35 to 42, the Directive dealt with the issue of fair value during the financial year or a previous financial year to obtain tax relief. Articles 35(1) and 39(1) of the Directive provided that, where such a valuation had an appreciable effect on the future tax liability, information should be provided, together with an explanation of the reasons for including such values in the annual accounts.

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Art. 52 TUIR
Paragraph I: Business income [...] is determined by adding to the net result of the profit and loss account for the financial year ending in the tax period the increases or decreases resulting from applying the criteria established in the subsequent provisions of this Chapter.

Article 75 TUIR
Paragraph IV: Expenses and other negative components may not be deducted if and to the extent that they are not charged to the profit and loss account for the financial year closing. However, expenses and other negative components are deductible even if they are not attributable to the profit and loss account but are deductible according to the law and those attributed to the profit and loss account of a previous financial year if the deduction has been deferred following the provisions of this Chapter providing for or permitting the deferral. Expenses and charges explicitly relating to income and other revenues which, although not included in the profit and loss account, contribute to the formation of income, shall be allowed as deductions if, and to the extent that, they result from elements which are sure and precise.

The provision of a tax appendix, according to various authors, was within the mandate contained in the Fourth EEC Directive. According to Colombo, the imposition of "more evident information, through specific items in the accounting document, was entirely consistent with the intention of the Community legislator", since he had imposed "at least one item of information at the level of the notes to the accounts""[24]. In this regard, one must bear in mind the powers given to national legislators by the EU Directive, through Articles 35.1.d and 39.1. These articles explicitly provided, both for fixed assets and current assets, for a rule allowing to "indicate the amount, duly justified, of the adjustments made solely because of the application of tax rules, in the notes to the accounts" (i.e. in the notes to the accounts). Article 6 of the Directive also provided that the Member States may permit or require the amendment of the balance sheet and profit and loss statement to show the allocation of profits and losses.

Despite the articles mentioned above of the EEC Directive, part of the doctrine was strongly criticised, including the fiscal appendix in the profit and loss statement because items 24 and 25 raised considerable problems of interpretation.

[24] Colombo, *Bilancio d'esercizio e consolidato. Trattato delle società per azioni* – vol. VII, diretto dallo stesso e da Portale, Utet, Torino, 1995, p. 215 ss.

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In this regard, two issues can be mentioned which, between 1991 and 1993, were the subject of fierce debate in the doctrine.

Firstly, problems immediately arose with interpreting the concepts referred to in items 24 and 25 of the profit and loss statement: adjustments and provisions[25].

The provisions under item no. 25 did not give rise to any particular interpretation as all authors agreed that the related double-entry item could only give rise to a profit reserve. There were no particular doctrinal diatribes on this issue[26].

Post 24, on the other hand, gave rise to considerable problems of interpretation. The concept of value adjustments was unclear, so much so that while some authors interpreted these adjustments as write-downs[27], others considered them to be connected with the part of the tax-deductible costs that have no economic content. The doctrinal positions on this item never converged towards a unanimously shared interpretation.

Those who believed that item 24) could include parts of tax-deductible costs that could not be recognised in the profit and loss statement items under item 23 due to the inexistence of an economic content believed that, given the prohibition to recognise among liabilities the adjustment funds of asset items, these items must necessarily be deducted, directly, from the asset item

[25] To understand the non-understandability of items 24 and 25 of the profit and loss statement, it may be recalled that, at the time, ASSONIME and CONSOB indicated that accelerated depreciation without economic content could be recognised under item 24 by increasing the depreciation provision and, therefore indirectly adjusting the value of the tangible assets, or under item 25, creating an equity reserve, without, however, making the recognition of deferred taxes mandatory.

[26] "There is no doubt that the rules of tax law which, for example, allow for accelerated depreciation or the deferral of the fiscal effects of capital gains resulting from the sale of depreciable assets, or even the recording of a special fund for "contingent assets" constituted by contributions or donations, are aimed at promoting the development of productive activities, as they either alleviate the tax burden resulting from the purchase of new capital goods (accelerated depreciation) or they encourage the permanence in the company of the proceeds from the disposal of capital goods or extraordinary income". Monti, *Reddito civile e reddito fiscale. Gli effetti fiscale dell'attuazione della IV Direttiva in materia di bilancio d'esercizio*, Cedam, Padova, 1994, p. 65. Buffelli, Piazza, Rizzardi, *Il nuovo bilancio d'esercizio nella normava fiscale: problemi di coordinamento fra il TUIR e i decreti legislativi 127)1 e 87/92*, Giuffrè, Milano, 1992, p. 26 ss.

[27] Gaetano points out, for example, that his observations on this item are not merely lexical but are "aimed, in fact, at preventing someone, misinterpreting the law, from using the item 'value adjustments' to include, for example, in the profit and loss statement the inventories of invoices for amounts more significant than those required, just because the tax legislator sets the 'minimum' value of such stocks at higher levels". Gaetano, "Considerazioni sull''appendice fiscale' al profit and loss statement previsto dallo Schema di Legge Delegata per l'attuazione della IV direttiva CEE", *Rivista italiana di ragioneria e di economia aziendale*, n. 9-10, 1990, p. 391 ss.

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to which they referred. For example, making write-downs greater than those that could be expected for the sole purpose of pursuing tax advantages reduced the value of the assets and, consequently, of the company's capital. This generated hidden reserves as they were "ca-muffled" by adjustment funds. This type of recognition caused considerable damage to external communications, as the greater the value of the assets, the greater the amounts entered in item 24[28].

Part of the doctrine considered that the choice between one or the other accounting entry was, in fact, indifferent, provided that it adequately explained the options made in the notes.

However, not all authors were of this opinion. In particular, a part of the doctrine did not consider the two methods of recording the value connected with the item to be analogous. Even if there was a specific illustration in the notes to the financial statements, the informative effects were different. These authors hoped for a regulatory intervention to clarify the method of recognising the value opposite to that recorded in the profit and loss statement. They also hoped for a doctrinal convergence towards a particular recognition method[29].

Items 24 and 25 of the profit and loss statement also gave rise to another interpretation problem regarding their content.

"It is in this period that the doctrine coined the terms of tax value subsidy as opposed to that of a structural nature" where, according to Falsitta, the former can be entrusted with "tasks that concern the pursuit of interests of a fiscal nature (i.e. values that are exclusively relevant to the dimension of tax legislation and its conformation) such as the interest in the certainty and simplicity of tax relations and the interest in avoiding evasion or avoidance" while the latter is given "tasks that concern the satisfaction of interests of an extra-fiscal nature (such as the interest in strengthening the productive apparatus or possibly other constitutionally protected interests other than those explicitly relating to tax legislation)"[30] [31].

[28] On this subject, see the comments of Gaetano, "L'"appendice fiscale" al profit and loss statement nello schema di legge delegata per l'attuazione della IV direttiva CEE", *Giurisprudenza commerciale*, 1991, I, fasc. 2, p. 275 ss.
[29] On this issue see Buffelli, Piazza, Rizzardi, last work cited.
[30] Avi, last work cited, p. 67.
[31] "Subsidised income components are those harmful components that the tax legislation allows to be deducted not as expressions of cost elements calculated according to correct principles of economic competence, but as instruments of facilitation and incentives to achieve objectives of efficiency, strengthening and realisation of the production apparatus. Albertinazzi, "Attuazione della IV Direttiva Cee, le voci n°24 e 25 del C.E.", *Rivista dei Dottori commercialisti*, n. 1, 1992, p. 85.

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By way of example, structural costs could refer to tax deductions in the strict sense, i.e., costs that could also have an economic content but which did not find a place in the items before item 24 because they were characterised only by tax relevance related to deductibility. Structural costs were, therefore, in substance, costs whose valuation was subject to fiscal ceilings considered permissible in terms of deductibility. Examples of this are percentages for the depreciation of receivables, depreciation, etc. On the other hand, the structural costs relate to costs whose valuation is subject to a maximum limit of the amount deductible.

On the other hand, subsidised values refer to items provided by tax legislation to facilitate the taxpayer to achieve greater self-financing or strengthen the production plant of a specific industrial, geographical or financial sector[32]. These included capital gains, which are attributable to one year but may be spread over several years, and accelerated depreciation, which was eliminated by the tax reforms that followed the one in 1986.

The doctrine never reached a consensus on the actual content of items 24 and 25 of the profit and loss statement. The divergent opinions of Quatraro and Spoletti are given as examples.

According to Quatraro[33], Entries 24 and 25 referred exclusively to items of a supra-ventional nature. By way of example, the author listed the following items:

Item 24 should have included, for example: Accelerated depreciation (Art. 67 T.U.).

- the provision for credit risks for interest on arrears;
- lump-sum adjustments to inventories of work in progress;
- the write-down of participations due to deterioration of assets.

Item 25, on the other hand, was to be entered under item 25:

- operating grants;
- gains on disposal[34].

[32] On this subject, see the comments of Falsitta, *La dichiarazione tributaria e il bilancio d'esercizio. Trattato di diritto tributario*, Padova, 1994, distingue le due norme – sovvenzionali e strutturali – p. 53 ss.

[33] Quatraro, "Il bilancio d'esercizio civile e le interferenze tributarie le voci 24 e 25 del nuovo profit and loss statement", *Rivista dei Dottori commercialisti*, 1992, n. 4, p. 565 ss.

[34] Colucci took a similar position. Riccomagno pointed out that "in lines, no. 24 and no. 25 of the profit and loss statement the items that originate a difference between the statutory result and the taxable income should not find a place, but only those items that, even if in contrast with the civil law, should be recorded in the statutory profit and loss statement to take advantage of tax benefits otherwise not obtainable", where the "otherwise not obtainable" should be highlighted". Colucci, Riccomagno, *Il bilancio d'esercizio e il bilancio d'esercizio consolidato dopo l'attuazione delle direttive comunitarie. Analisi, commenti e soluzioni tecniche*, Cedam, Padova, 1992, p. 72 ss.

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According to Spoletti[35] On the other hand, the items could also be structural. According to this author, the following accounting items, by way of example, could pass through the tax appendix:

- Art. 55, paragraph 3 of the T.U.I.R. (Income Tax Consolidation Act). Allocation to a reserve, within the limit of 50%, of the contingent assets that the company has charged to the profit and loss statement, but which it intends to keep in suspension of taxation;
- Art. 60 paragraph 3 of the T.U.I.R. (Income Tax Consolidation Act). Impairment due to contractual risk in the valuation of works, supplies and services with a duration of more than one year, when the tax law allows the impairment to be determined at a higher level than that justified in the statutory accounts;
- Art. 66(3) T.U.I.R. (Income Tax Consolidation Act) losses on receivables relating to persons subject to bankruptcy proceedings;
- Art. 67 paragraph 3 of T.U.I.R., accelerated depreciation;
- Art. 67, paragraph 6 of T.U.I.R., full depreciation of assets with a unit value not exceeding 1 million lire; in this case, it is necessary to specify that only the excess (e.g. 80%) over the statutory amount (20%) allocated in the profit and loss statement should be indicated in the tax appendix;
- Art. 68, paragraph 1 of T.U.I.R. depreciation of intangible assets granted by the tax authorities in excess of the amount deemed correct in the statutory accounts;
- Art. 69 T.U.I.R. financial depreciation for the part that exceeds the economic-technical depreciation;
- Art. 71 1° paragraph of T.U.I.R. provisions for credit risks allowed by tax legislation to an extent more significant than that provided for by civil law;
- Art. 71, paragraph 3 of the T.U.I.R. Provisions for credit risks for interest on arrears, if, regardless of the delay, it can fundamentally assume that the debtor willfully discharges his obligations.
- Art. 72 1st paragraph of the T.U.I.R. Provisions for exchange rate risks: when the methods provided for by the tax rule lead to a negative result more significant than that considered civilly appropriate;
- Art. 73 T.U.I.R. other provisions to miscellaneous funds: for expenses for cyclical works for the maintenance of ships and aircraft for the construction and operation of free devolved public works; for charges

[35] Spoletti, "Nuovo conto economico tra normativa civilistica e tributaria. Ultime considerazioni sull'appendice fiscale", *Rivista dei Dottori commercialisti*, n. 4, 1994, p. 502 ss.

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deriving from operations and prize competitions, etc. when the percentages allowed by the tax law are higher than those considered appropriate by the directors.

Scholars who disagreed with this last doctrinal position pointed out that such an entry would lead to the misapplication of Article 52 of the TUIR. For many authors, the recognition in the tax appendix of the profit and loss statement of higher costs resulting from the difference between the correct values from a statutory point of view and the maximum amounts identified by the tax regulations, not related to the application of subsidies and therefore merely facilitative and without economic content, would have led to an incorrect application of the principle indicated in Article 52 of the TUIR. In other words, such an entry would have prevented the achievement of the specific objective of Article 52 TUIR, which is the dependence of taxable income on the result of financial reporting taken as a parameter expressing the company's ability to pay, determined by the algebraic sum of negative and positive income components which are economically correct and, therefore, actually realised. The hypothesis of including in the items 24 and 25 non-subsidised values but structural values to an extent more significant than the eco-nomically correct value would have had as its only motivation the accounting deduction of again provided for by the tax regulations without economic content since already recorder the economically right item in the items of the profit and loss statement before item 22 of the profit and loss statement[36].

As already noted, the doctrine never reached a convergence of opinions and, consequently, the practice adopted different recognition methods. This situation of accounting chaos was one of the reasons why the tax appendix was eliminated in 1994.

[36] In this regard, Albertinazzi points out that such a survey would have led to applying the so-called double-track system, on which the reader is referred to Chapter 1 of this text. Albertinazzi points out that the double-track system, in which 'the tax rules determine the taxable income and the civil rules autonomously determine the balance sheet profit for the financial year so, without these having any relevance for tax purposes. However, the author emphasises that such an interpretation would have led to recognising a system not provided for in our legislation. The author affirms that "the civil legislator, [...] in regulating the financial statements for publication, can do no more than taking note of the option that may exist in the tax system for the "single track" and introduce all the corrective measures to reduce the pollution that may result. A different option for the 'double track', although desirable, can only be carried out by the tax legislator as part of a more general change in the system for determining business income. To do otherwise would result in an unforeseen upheaval of the existing tax legislation, the effects of which would certainly not benefit legal certainty and the possibility of arriving at systematically consistent interpretations of the individual tax rules, thus depriving them of one of the cardinal principles on which they are currently based".. Albertinazzi, Prime considerazioni sull'abrogazione dell'appendice fiscale del conto economico, Rivista dei dottori commercialisti, n. 1, 1995, p. 136 e ss.

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It should also be noted that the introduction of items 24 and 25 was not followed by any indication as to the value to be recorded in double-entry bookkeeping in the section opposite to that of the value recognised in profit and loss statement[37]. In fact, there was no provision explaining what should be the accounting counterpart of the entry leading to the recognition in the profit and loss statement of value adjustments and/or provisions made only for tax purposes[38] [39]. And this

[37] "… therefore, it did not immediately give the progressive effect on equity of the adjustments due importance. Moreover, 'the limited nature of the solution was even more serious if one considers that the financial year's financial statements were not yet characterised by the recognition of deferred and prepaid taxes, which generally accompany tax interferences". Fusa, "Disinquinamneto del bilancio d'esercizio so. Vantaggi e svantaggi", *Il fisco*, n. 14/2005, p. 2068. "The application of items 24 and 25 of the profit and loss account introduced by Legislative Decree No 127 of 9 April 1991 was made difficult above all for technical reasons, which often made it necessary for the preparer of the financial statements to adopt conceptually unacceptable accounting procedures. It had provided no accounting counterpart for items 24 and 25, so the only solution was to include them in the equity reserves. The result of this solution was, of course, to increase shareholders' equity through a tax provision. Accounting nonsense!". Bianchi, "Fisco e bilancio d'esercizio. Nella nota integrativa una possibile soluzione alle interferenze tributarie", *Il Fisco*, n. 32, 2002, p. 5107. On this poin see also Avi, "Bilancio d'esercizio fra norme civiliste e disposizioni tributarie", *La settimana fiscale*, n. 39, 1999, p. 21. The absence of regulatory provisions on the impact of items 24 and 25 on the balance sheet "meant that, although the information related to specific components (of a purely fiscal nature) of the profit and loss statement was disclosed annually, the 'memory' of the fiscal or, better still, purely fiscal components of the balance sheet was lost over time". Pontani, *La clausola generale ed i principi di redazione del bilancio d'esercizio*, Cedam, Padova, 2005, p. 385. On the contrary, we disagree with what was stated by Feliziani, who highlighted the following reasoning: "[...] first of all, the law, after reiterating that the delegated taxation must be aimed at safeguarding the autonomy of the civil law rules concerning the tax law rules, acknowledges that there are (or may be) tax interferences in the preparation of the financial statements and that the forthcoming delegated law cannot eliminate such interferences. Consequently, the law requires that the profit and loss statement shows, in the hypothesis of deviation from the valuation criteria dictated by the Italian Civil Code, the extent of the influence exercised on the statutory result by the application of the tax law". He proceeds and argues that "it is only worth noting how the provision, in providing for the obligation to indicate the tax effects on the statutory result, explicitly mentions only the profit and loss statement, thus suggesting that no trace of the "derogation" valuations should be found in the balance sheet (except, of course, in compliance with the accounting procedures, or rather the equity counterparts, imposed by the tax provisions)". Feliziani, ult op. cit., p. 3166.

[38] Legislative Decree published in the Official Gazette no. 90 of 17 April 1991, in the ordinary supplement.

[39] Falsitta, concerning the content of the Fourth EEC Directive on tax issues, states that "to avoid the defect of excess of delegation (under the profile that the delegate would have arrogated to himself the power to alter the characteristics of the profit of the financial statements) it is necessary, therefore, to interpret and apply the tax rules that accrue benefits and determine a deviation of taxable income from the correct accounting principles in such a way that they do not alter or affect the fundamental principles of accounting discipline. In other words, and the statement does not sound paradoxical, it is necessary to find solutions of accounting techniques that allow - within the framework of the single financial statements - to operate as if the double-track were in force and to highlight separately the differences or deviations that

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shortcoming led to the development of diverse practices that certainly did not help to improve corporate financial reporting[40] [41].

In conclusion of this summary of the situation between 1991 and 1993, it can be stated that tax interferences were "legalised" by the legislator in this period for the first time. Despite this, although legally legitimate, it undoubtedly polluted the values of financial reporting, especially since, as already mentioned, in the absence of a doctrinal convergence on the various interpretative problems raised by the items 24 and 25 of the profit and loss statement, it adopted different accounting methods that made the financial reporting difficult to understand from the outside.

In this regard, however, it should note that the inclusion in the tax appendix of the profit and loss statement of only the subsidy items was prevalent on an operational level. This could lead to the assumption that companies adhered more to a specific doctrinal trend for correct interpretation of the regulations in force.

But the reality was different. At an operational level, in many financial reporting companies, subjective items deriving from valuations (e.g. amortisation and depreciation, provisions for bad debts, etc.) continued to be recognised in the same way as before Legislative Decree 127/91 came into force. This meant that, in reality, the items from 1 to item 22 of the profit and loss statement, continued to be determined according to the logic applied before the introduction of the fiscal appendix. Such behaviour showed, in reality, how the accounting items recorded before the tax appendix were often, in fact, polluted by the tax legislation as there was a tendency to record costs equal to the maximum value deductible for tax purposes.

Therefore, the tax contamination was "double": explicit in the appendix consisting of items 24 and 25, implicit and not evident in items 1 to 22.

The tax interferences continued to inquinate the financial reporting precisely as they happened in the previous period. As we will see in the following pages, it will also occur after 1993.

the application of tax legislation has caused on the profit, strictly understood. Falsitta, *Il bilancio d'esercizio delle imprese. Interrelazioni tra diritto civile e tributario*, Giuffrè, Milano, 1985, p. 100 ss.

[40] See note n. 21. CONSOB E ASSONIME.

[41] "[...] From the government report (accompanying Legislative Decree no. 127/1991, n.d.a.), it would seem to be taken for granted [...] that also value adjustments of a fiscal nature must be deducted - in the balance sheet - from the value of the items to which they refer". However, the same author noted that "the prevailing doctrine has been of a contrary opinion". Piazza, *Il raccordo tra reddito d'esercizio e reddito fiscale. Gli effetti fiscali della nuova disciplina sul bilancio d'esercizio. Il bilancio d'esercizio*, a cura di Palma, Giuffrè, Milano, 1992, p. 305 ss.

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2.3. The mini-reform of financial reporting in 1994: abolition of the tax appendix, legitimisation of tax interference and information capacity of financial reporting

In 1994, faced with the problems of interpretation posed by the combination of Article 2425 of the Italian Civil Code, which included items 24 and 25, and Articles 52 and 75 of the Consolidated Income Tax Act, the legislator intervened with a mini-reform of the civil law rules concerning the financial reporting tax provisions.

In particular, Article 2-bis of Legislative Decree no. 416 of 29 June 1994, converted into Law no. 503 of 8 August 1994 and published in the Official Gazette no. 193 of 19 August 1994, abolished items 24 and 25 of the profit and loss statement, with the consequent elimination of item no. 23.

In addition, Article 2 bis mentioned above attempted to solve the problems connected with the deductibility of costs subject to subjective evaluation without economic content by adding a paragraph to Article 2426 of the Italian Civil Code. This provision established that it was "permitted to make value adjustments and provisions exclusively in applying tax regulations". It should emphasise that the legislator had assumed only a mere option to use the provision and not a legal obligation to apply it. It was, therefore, within the companies' disponibility to take advantage of or not to apply the provisions of Article 2426 of the Italian Civil Code[42].

In addition, Art. 2 bis modified the notes to the accounts by introducing, in point 14, a legal obligation. In particular, the legislator stipulated in Article 2427, point 14 of the Civil Code that the notes to the accounts should indicate, in addition to what is laid down in other provisions: "the reasons for value adjustments and provisions made exclusively in compliance with tax regulations and the amounts thereof, specifically highlighted concerning the total amount of the adjustments and provisions resulting from the appropriate items of the profit and loss statement".

About the content of point 14 of the notes to the financial statements, it should be noted that, with Law Decree no. 1 of January 7 1995, this point was extended by imposing the need for information and justification also concerning the total amount of the adjustments and provisions resulting from the relevant items of the balance sheet and especially about latent taxation. Subsequently, Law Decree 1/95 was replaced by Law Decree no. 64 of

[42] "The real turning point, be it evolution or involution, is provided for in paragraph 2 of Article 2426, according to which: "Value adjustments and provisions may only be made in the application of tax legislation". Bianchi, "Fisco e bilancio d'esercizio. Nella nota integrativa una possibile soluzione alle interferenze tributarie", *Il Fisco*, n. 32, 2002, p. 1983 ss.

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March 9, 1995, which did not provide for such integration, with the result that it restored the situation before the issue of Law Decree 1/95.

To precisely understand the situation created following the 1994 reform, it is necessary to examine two essential concepts to understand the actual scope of the rules introduced by Article 2 bis of the Law Decree of June 29 1994, converted into Law no. 503 of August 8 1994. For this reason, it is essential to examine in-depth;

a) the issue concerning the components of the financial reporting,
b) and the meaning of the postulates of truthfulness and fairness.

a) The components of financial reporting

First of all, it must remember that the implementation of the IV EEC Directive through the issuance of Legislative Decree 127/91 brought about a significant change in terms of the composition of financial reporting. In fact, in the period before 1991, financial reporting meant the balance sheet and profit and loss account as a whole. The directors' report had to be drawn up but was not considered part of financial reporting. Article 2423 of the Italian Civil Code was amended by Legislative Decree 127/91. Implementing the IV EEC Directive established that financial reporting consisted of the profit and loss statement, the balance sheet, and the notes to the financial statements. The explanatory notes, i.e. the directors' report of the previous legislation, became an element constituting financial reporting[43].

The fact that the notes to the financial statements were, for all legal purposes, part of the statutory financial reporting led to an abnormal situation, which will discuss in the following pages.

b) Meaning of the postulates of truthfulness and fairness.

The second concept that must be borne in mind to understand the situation created by the implementation of Article 2bis of Law Decree no. 416 of 29 June 1994 converted into Law no. 503 of 8 August 1994, concerns the real meaning of the postulates of truthfulness and fairness.

As is well known concerning financial reporting, the term "truth" can never be used – which would imply the existence of absolute truth – but it is necessary to refer to a concept of truthfulness, understood in the sense of

[43] In this regard, it should be noted that, following the transposition of EU Directive 36/2013, through the promulgation of Legislative Decree 139/2015, the financial statements consist of four elements. In addition to the three documents mentioned above, the cash flow statement has been added, which, consequently, also becomes a constituent element of the financial statements on a par with the balance sheet, the profit and loss statement and the notes to the financial statements.

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reliability. This is due to the circumstance that in financial reporting, in addition to objective values (and therefore true in the absolute sense), must also record subjective items, which identify conjectures and estimates, respectively.

Subjective values identify estimated quantities if the determinations are approximations to the truth, while they are guesses if they represent "subjective representations of the truth"[44] [45].

Financial reporting, therefore, is more or less reliable depending on whether the approximations to the "truth" are made in a manner consistent with the reality to be shown in the balance sheet and profit and loss statement.

For this reason, concerning subjective quantities, it is possible to speak not of truth but a "greater or lesser degree of approximation to the truth"[46].

The true and fair value of subjective items should be interpreted as an amount that reflects the economic content of the item in question. It, therefore, measure the truthfulness and fairness of financial reporting items in terms of the truthfulness and economic fairness of items that identify negative or positive components of income or assets of the company[47].

In this regard, Giunta-Pisani points out that "in any case, estimates and conjectures should not be the result of the arbitrariness of the financial reporting editor. That is, they must not express an absolute subjectivity and, as such, in-comprehensible and unquestionable. On the contrary, they must express a rational subjectivity, i.e. they must be the result of an ordinary and rigorous "logic-application" process. This process presupposes:

- the definition of appropriate premises, feasible hypotheses and precise cognitive objectives concerning the quantities to be assessed;
- the awareness that the quantities to be measured are expressed not by a number but by a range of numbers. Among these, it must choose a

[44] Ferrero, *La valutazione del cap. di bilancio d'esercizio so*, p. 29. "Not infrequently in determinations the estimate provides an obvious basis for conjecture". Masini, *I bil. d'impresa*, p. 64.

[45] Examples of subjective measurements include depreciation, the determination of the closing value of inventories, the identification of the exchange value based on which to recognise a liability or receivable denominated in a foreign currency in the financial statements, the title of potentially uncollectible receivables, the determination of the year-end valuation of securities, equity investments and derivative financial instruments, etc.

[46] Onida, *Ec. d'az*., p. 558.

[47] "It is not correct to speak of truth in the matter of financial statements, but it is appropriate to speak of the reliability of which what we have called truthfulness is only a particular moment. The values that make up the financial statements are only in the part objective, capable of expressing the truth in an absolute sense. In most cases, however, they are subjective values, for which any claim to accuracy is unreasonable". Brusa, *Veridicità attendibilità e chiarezza del bilancio d'esercizio d'es*., p. 26.

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value in the light of the premises and hypotheses formulated, using a specific criterion or method. In other words, it is a question of establishing a precise evaluation criterion, i.e., processing the previously defined assumptions and conditions and translating them into financial reporting values using a specific method;
- the constant verification of consistency and compatibility between the assumptions, criteria and conclusions reached at the end of the estimative reasoning.

Truth, in a subjective sense, is, therefore, to be understood as the rationality of the evaluation process followed by the financial reporting editor and the consequent credibility of the results obtained".

As Colombo points out, therefore, "no one can guarantee (except specific values) the absolute accuracy of the judgement"[48] [49].

It should note that, while for approximate and estimated quantities, an ex-post accuracy "check" is conceivable, for conjectures, this is technically impossible because representing values "which are attributed to different objects as a division of unique values common to these objects of imputation. "[50] cannot be confirmed by subsequent verification.

Concerning the concept of truthfulness and its interconnection with the postulate of clarity, the position taken in the past by Superti Furga is peculiar, who pointed out that, in his opinion, "the three requirements of clarity, truthfulness and correctness of financial reporting tend to be linked to the more general and meaningful concept of intelligibility, which is the real purpose

[48] Colombo, *La clausola gen*. AA.VV. *Il bil. d'esercizio*, a cura di Palma, p. 29.
[49] At the end of these brief considerations regarding the interesting postulate, the concerns set out in Assonime circular No 70 of 1986 appear: "in the context of the project rules intended to implement the fundamental Article 2 (of the Fourth EEC Directive, n.d.a.) it is appropriate to point out that the formula proposed to transpose into Italian law the well-known notion of "true and fair view" adopted by the Directive is logically flawed and, in any case, likely to give rise to misunderstandings. The draft refers to true representation, which presupposes the concept of "truthfulness" of the company's assets and liabilities, financial position and economic results. However, it is universally acknowledged that the concept of truthfulness applies only to a part of the values recorded in the annual accounts, those for which an objective verification is possible, and that for other values, one can only require estimates, forecasts and conjectures based on which they are determined and executed in a fair and technically correct manner. Therefore, the formula under consideration may be misleading because it promises more than the financial statements can deliver. It may also cause serious discomfort for the auditors who will be asked to provide certification, which is impossible, that the financial statements are a true representation [...] It is not clear (however) why the law should not state this concept and should refer to the concept of truth, with the mental reservation that this truth is a non-objective truth: a concept that is deeply contradictory because there is no such thing as a non-objective truth, truth being, by definition, objective".
[50] Superti Furga, *Le valutazioni di bilancio*, p. 30 ss.

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of financial reporting. The term clarity is impracticable by default regarding its possible use in the drafting of financial reporting since it is impossible to establish either naturally or conventionally precise rules to be followed. The reference to truthfulness is also [...] scarcely usable, but in this case by excess, since (it) [...] constitutes a limiting concept or regulatory idea, which financial reporting must strive for without ever being able to fully achieve it. The reference to fairness must then be understood in a strictly economic sense, with all the margins of discretion that any economic evaluation necessarily entails. [...] Consequently, it seems that it is possible to attribute a relative homogeneity of meaning to these three concepts only by considering them as three different specifications of the broader notion of intelligibility (of financial reporting)"[51]. From what has been said by this author, it is therefore understandable how, in the past, it was possible to identify a doctrinal current according to which the postulates of clarity, truthfulness and correctness, in addition to being logically interrelated, had such a connection as to deny the existence of a substantial diversity between the three principles mentioned. Therefore, according to Superti Furga, the three postulates imposed by Article 2423 integrated the so-called intelligibility of financial reporting. Due to the liason that links them indissolubly, they identified "only" three different specifications of this concept.

Also, for the post-1994 period, the civil law legislation disciplated the problem of the valuation of accounting items of a "subjective" nature through the indications contained in Article 2426 of the Civil Code, which contained and still contains a series of basic valuation principles that the preparer of the financial reporting was and still is obliged to follow, except for applying the fundamental principle indicated in Article 2423, paragraph 4, according to which if, in exceptional cases, the application of a provision of the following articles is incompatible with the true and fair representation, the provision must not be applied. The notes to the financial statements shall state the reasons for the exemption and indicate its effect on the presentation of the financial position and results of operations. Any profits arising from this exemption shall be set aside in a reserve that may not be distributed except to the extent of the recovered value.

From the content of this rule, it is possible to understand the overriding value compared to any other provision of the first paragraph of Article 2423 of the Italian Civil Code. The postulates of truthfulness and correctness

[51] Superti Furga, *Il bil. di es. secondo la normativa europea*, p. 45 ss.

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should have been and must still be applied even if this entails non-compliance with the specific rules indicated by the Code in Art. 2424 et seq.

This means that to safeguard the truthfulness of the data shown in financial reporting, the legislator allowed and still allows the non-application of provisions issued to illustrate the framework principles of valuation. The observance of the postulates of truthfulness, fairness, and understandability represented and still represents, therefore, the ultimate goal that the financial reporting manager must set himself. Any other rule identifies a sub-ordinate provision and thus represents only a legislative attempt to provide functional elements to achieve this priority objective, the importance of which is such that the same legislation allows, without making further specifications, to derogate from any provision if, in exceptional cases, this does not permit compliance with the postulates considered herein.

Civil law regulations on financial reporting valuations, apart from the provisions of Article 2426 of the Italian Civil Code, could not and still cannot, by its very nature, discipline, in an analytical and specific manner, every economic and business argument connected to subjective valuations present in financial reporting.

The task of the legislation is "only" to dictate the "framework principles" to which the entities that draw up the financial reporting must refer. It is not conceivable that legal regulations should illustrate, in a detailed and specific manner, the procedures and valuation principles to be followed so that financial reporting can be said to be economically truthful, i.e. truthful and correct from an economic-business point of view. In other words, the economic truthfulness, i.e. the determination of the "real" intrinsic value of the financial reporting items, cannot be entirely based on civil law.

The circumstance that the law never regulates in a specific and analytical way every subject concerning financial reporting and, in particular, every evaluation criterion related to the conjectures and estimates present in the balance sheet and the profit and loss statement, must be judged positively because certain flexibility and adaptability must characterise this material to the changes that occur both in the external world and within each company that, necessarily, the legal regulations cannot have. Flexibility which, by definition, cannot be possessed by a lawful provision whose characteristic, in general, lies in its immutability for a generally rather long period.

Based on these considerations, it is easy to understand how in the articles of the code relating to economically correct valuations, such as Article 2426 of the Italian Civil Code, one can only find the reference framework to which the preparer, in evaluating estimates and conjectures, must conform.

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However, the careful reading of the articles of the Italian Civil Code makes us understand how these reference principles, although essential and relevant, require further indications of an economic-business nature. To affirm that depreciation, to be economically correct, must be systematic and calculated based on the possibility of residual use of the asset, or to know that inventories, by law, must be valued at the lower of cost and realisable value inferable from the market trend, or to be aware of having to record receivables at their presumed possible value, helps the preparer to understand the basic principle applies in the determination of the single item, but does not provide the latter with pragmatic and theoretical elements useful for the quantitative and operational determination of the amount to be recognised in financial reporting.

In this regard, Giunta Pisani[52] have pointed out that subjective values are not precise numbers but rather identify an area in which it is necessary to opt for the value that the preparer believes comes closest to the reality he wants to represent in financial reporting. Therefore, truth in a subjective sense is to be understood as the rationality of the valuation process followed by the financial reporting editor and as the consequent credibility of the results obtained...estimates and conjectures must express a rational subjectivity; they must be the result of a rigorous and or-dined "logical-applicative" process"[53].

In the civil code, the operating principles applicable in the drafting of financial reporting can only find the reference framework but, precisely for this reason, need a source, analytical and structured, external to the legislation.

The hypothetical source from which to draw valuable ideas for the correct assessment of the financial reporting items conjectured and estimated could, in theory, be represented by the economic and business doctrine that, daily, deals with these issues. However, it is easy to understand how the deepening of the doctrinal thought of the various authors, although indeed very interesting, would be, in good substance, impractical for the editors of the financial reporting. This would mean studying and analysing hundreds of books continuously written on the subject of our interest. This is why, for several decades,

[52] Giunta Pisani, Last work cited p. 36 e ss.

[53] Giunta Pisani, *Il bilancio d'esercizio so*, p. 37. "[...] it is evident that different authors of financial statements can... come to different conclusions, so that a range of values is created concerning the generation of a minimum, neutral information for all stakeholders, which is considered, in the circumstances, an expression of values that are all equally correct. This means, in essence, making information derived from subjective assessments objective. Within the hypothesised range of values, each value can therefore be considered correct (even if, n.d.a.) one must ask oneself the problem of what conditions can make the estimated and conjectured values correct in the context of the reasonableness of the processes of their determination". Pontani, last work cited p. 276.

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the need has been felt for the issuance of correct accounting principles, regularly formalised, which represent the summary of the best doctrine and practice of the issuance sector. Principles which, by their very nature, are not immutable in time, but take into account the changing situation and, for this reason, identify the instrument which, due to its completeness and flexibility, succeeds in integrating and completing the legislative "gaps" which, necessarily, characterise all legal regulations governing financial reporting.

The instruments to fill this gap, which was necessary for the code in the post-1994 period and characterise today's situation, were the generally accepted accounting principles. It should be noted that, while today, these documents are complete and have legal significance, in 1994, such guides were almost in their infancy.

The evolution of these principles in Italy has been instead tormented. As early as the 1940s, the need to fill the gap caused by the absence of uniform accounting principles was already being felt: this is why in 1942, the Uniconti Commission was created, which, having as its aim the unification of accounting standards, should have allowed, at least in part, to overcome this situation.

However, this body failed to achieve the purpose for which it had set it up because the practical application of the accounting unification proposed by the commission mentioned above was essentially nil.

After the unsuccessful experience of the Uniconti Commission, it did not consider the issue of accounting unification in Italy for some time.

In the 1960s, the subject began to be addressed again following the imposition of a compulsory financial reporting structure on electricity companies. In this decade, the lack of "correct accounting principles" to which they could refer began to be perceived by an increasing number of academics and practitioners.

The issuance of accounting standards was a need that could no longer postpone.

Moreover, the lack of 'generally accepted accounting principles' was destined to become a real 'history anachronism' since, following the legislative evolution in our country during the 1970s, the legal regulations themselves presupposed the existence of a series of correct accounting principles.

In 1975, in fact, with Decree No 136, the Italian legislator made, for the first time, an explicit reference to the criteria as mentioned above, stating that "auditing companies, if the financial reporting and the profit and loss account correspond to the results of the accounting records and the assessments made and complied with the rules for the preparation of the financial reporting of the

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profit and loss account and if the operating events are accurately reflected in the records following accounting principles, shall issue a certification [...]".

At the time of the issuance of this legislation, however, despite the explicit reference, no national body had yet prepared to issue those criteria that, from the letter of the law, seemed to have become Italian cultural heritage.

Finally, in 1975, the Order of Certified Public Accountants undertook to form a commission whose task was precisely that of formulating, similarly to what had been happening for over 40 years in the United States, the so-called "generally accepted correct accounting principles".

In 1982, Consob, with its resolution No. 1079 of 8 April, considered that "the series of accounting principles prepared by the National Council of Chartered Accountants for industrial and commercial companies, should be considered as a reference point for both companies with listed shares and auditing firms, respectively, for the preparation and certification of financial reporting.

At a regulatory level, the introduction of the explicit reference to accounting standards was characterised by considerable variability in time.

While on the one hand, the law repeatedly made explicit reference to such standards, on the other hand, it subsequently, and in some cases, deleted all reference to such standards.

This is not the place to illustrate this development. In this context, it is essential to note that, already in 1994, the concept of economic truthfulness, i.e. the truthfulness of the accounting values contradicted by economic-corporate correctness, was already present. As already pointed out, in 1994, the so-called generally accepted accounting principles, issued by the National Commission for the issuance of accounting principles of Certified Public Accountants, were at their inception but, both at a doctrinal and operational level, the principle that the eco-nomically correct determination of a financial reporting item derived from the application of Article 2426 of the Italian Civil Code, except for the application of the Italian Civil Code, as well present. (except for that provision), and from the principles set out by the economic-business doctrine and accounting principles available at that time.

To conclude this brief examination of the truthfulness postulate, it is appropriate to underline that, although the concept of truthful representation implies a concept of "flexibility" and "relativity" of the result, this does not mean that it refers to subjective behaviours that cannot be monitored by the person drawing up the financial reporting. Colombo, with regard to this issue, pointed out that it should be "stressed that the general clause in question not only imposed a certain behaviour on the preparers of financial reports (objective re-search of the components that contribute to the determination

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of the cost, conscientious and diligent investigation of relevant market data, acknowledgement of the most probable hypotheses for the future use of the asset, and finally faithful representation of the results arrived at based on those data and hypotheses) but also aimed at ensuring that the financial reporting representation arrived at results as close as possible to reality. Of course, "true representation" does not exclude the relativity of the result [...] but this relativity is limited by the duty of diligence, accurate and neutral search for the value that is most consistent with the purpose of financial reporting and with the legally imposed criteria, so that, when objectively one goes beyond the limits of what is consistent with those purposes and those criteria, one will no longer give a true representation, regardless of the subjective conviction of the financial reporting manager[54].

Based on the above considerations, it can be stated, with Jaeger, that "in no case, can financial reporting have the characteristics of a photograph of corporate assets. It is still a representation bound by its stylistic canon. To put it bluntly: the editor must comply with criteria chosen by the legislator to resolve conflicts between the various interests at stake and not to represent a single 'objective reality. In this sense, it should note that financial reporting has always offered a conventional image of the company's economic and financial situation"[55].

In conclusion, it should be pointed out that, obviously, the truthfulness or rather, in this specific case, the truthfulness of financial reporting requires that the objective values are absolutely true.

With reference to such data, the concept of truth assumes a different meaning from that of reliability related to estimates and conjectures. In fact, objective data can be considered true and, if they are not marked by this peculiarity, it is possible to speak of falsity of fi nancial reporting.

By way of example, such falsity may occur if:

1) the financial reporting values do not correspond to the data entered in the general accounts o the objective items indicated in the balance sheet and profit and loss statement are, in reality, non-existent or exist for a value that is different from the one recognised in the financial reporting;
2) errors are made in the allocation to financial reporting, such as compromising the correct determination of income and capital (e.g. the allocation of deferred costs to the profit and loss statement or the recognition of operating costs in the balance sheet).

[54] Colombo, *La clausola generale. Il bilancio di esercizio*, a cura di Palma, p. 30.
[55] Jaeger Denozza, *Appunti di diritto commerciale*, p. 467.

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On the other hand, as regards the postulate of correctness, expressly provided for by Article 2423 of the Italian Civil Code, it can be stated that, by the majority of the economic-business doctrine, this principle identified and still identifies a concept that, although different from that of truthfulness, has ineliminable connections with the latter[56].

Santesso Sostero considered that "the two concepts (fairness and truthfulness) were closely linked, so that it is difficult to imagine that financial reporting could be truthful without being fair at the same time. ... Indeed, fairness could be interpreted in two ways: technically, as the obligation to refer to technically correct criteria in the determination of values, and behaviourally, as the obligation to comply fully and fairly with the rules, communicating information correctly, in particular in the discursive parts of financial reporting (notes to the accounts). In the first sense, fairness was intended to emphasise an aspect already included in "true and fair view", since technically correct criteria in determining values was an essential prerequisite for truthfulness. [...] In this second sense, correctness took on a deontological dimension, i.e. loyal conduct, in good faith, in the communication of information and was linked to the principle of under-standability. In other words, the financial reporting editor had to apply the rules by striving to interpret their true spirit, avoiding taking refuge in literal or convenient interpretations to formulate reticent or deviant communications"[57].

In short, it can be said that, for some scholars, both in the past and in recent years, the postulate of fairness "integrates [...] the principle of truthfulness and is, in a sense, upstream of it, since the representation, albeit faithful, of valuation results which the preparer of the financial reporting has arrived at based on incorrect initial data or incorrect valuation criteria cannot be defined as "true and fair""[58].

After having highlighted the meaning of the postulates of truthfulness and correctness and after having pointed out that, since 1991, the financial reporting consisted, by law, of profit and loss statement, balance sheet and

[56] Quagli, on this issue, identifies such an interconnection between truthfulness and fairness that the author states that '[...] fairness must be interpreted as honesty, neutrality, i.e. as the will to draw up a balance sheet that does not favour any particular centre of interest in terms of form and content". Quagli, *Bilancio d'esercizio e principi contabili*, p. 25.

[57] Santesso Sostero, *I principi contabili per il bilancio d'esercizio*, p. 19. A similar definition of fairness is given by Giunta Pisani, Last work cited, p. 39. Sull'argomento, Superti Furga, *Il bilancio d'esercizio di es. it. nella normativa europea*, p. 10 ss.; Matacena, *Il bilancio d'esercizio di eser.*, p. 24 ss.; Carattozzolo, *Il bil. d'es.*, p. 23 ss.; Colombo, *Il bil. d'es e cons.*, a cura di Palma, p. 40 ss.

[58] Colombo, *La clausola generale*. AA.VV. (a cura di Palma), *Il bilancio d'esercizio*, p. 30 ss.

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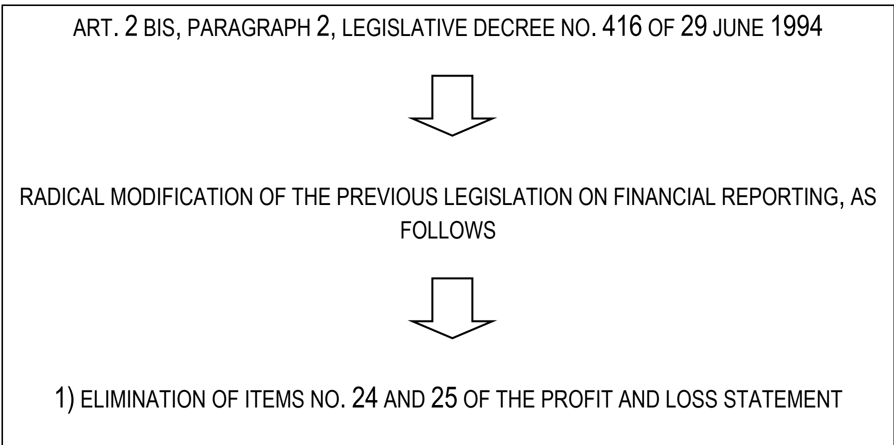
notes, it is possible to fully understand the situation concerning the fiscal interferences deriving from the mini-reform of 1994.

Summarising the changes introduced by Art. 2 bis, paragraph 2, Law Decree no. 416 of 29 June 1994, it should note that:

1) Items 24 and 25 of the profit and loss statement were eliminated (together with item 23, which no longer had any reason to exist);
2) it introduces a paragraph in Article 2426 of the Italian Civil Code according to which it was possible to carry out valuations of a fiscal nature only;
3) point 14 was introduced in the notes to the financial statements, requiring the preparer of the financial report who had carried out purely fiscal evaluations to "explain the reasons for the value adjustments and provisions made exclusively for tax purposes and the relevant amounts, specifically highlighted concerning the total amount of the adjustments and provisions resulting from the relevant items of the profit and loss statement".

The insertion, legitimated by the civil law legislator, of pre-tax values in the balance sheet and the profit and loss statement provoked the legitimation of tax interferences, which were already present before 1994 due to items 24 and 25 profit and loss statement.

In the case analysed here, the undue interference was implemented by the tax legislation, which, in an "improper" and "inappropriate" way, influenced the drafting of a document – the financial reporting – whose objective was not and is not to identify the taxable income, but was and still is identified in highlighting, in a correct, truthful and understandable way, the economic, financial and equity situation of the companies.



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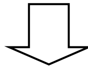
2) INTRODUCTION OF PARAGRAPH 2 OF ARTICLE 2426 WITH THE POSSIBILITY OF CARRYING OUT VALUATIONS EXCLUSIVELY OF A FISCAL NATURE

3) INTRODUCTION OF POINT NO. 14 OF THE EXPLANATORY NOTES IN WHICH THE "REASONS FOR VALUE ADJUSTMENTS AND PROVISIONS MADE EXCLUSIVELY IN APPLICATION OF TAX REGULATIONS AND THE RELATIVE AMOUNTS, SPECIFICALLY HIGHLIGHTED CONCERNING THE TOTAL AMOUNT OF THE ADJUSTMENTS AND PROVISIONS RESULTING FROM THE SPECIFIC ITEMS OF THE PROFIT AND LOSS STATEMENT", HAD TO BE ILLUSTRATED

Also in the post-1994 period, as in the previous years, the implementation of tax interferences in financial reporting was motivated by the presence, in the tax field, of Articles 52 and 75 of the TUIR, which, respectively, as already pointed out, created the conditions of a dependence on financial reporting which, due to Article 75 became, substantially, a "reverse dependence""[59] [60].

DUE TO ART. 75 TUIR, THE DEPENDENCE OF TAXABLE INCOME ON THE RESULTS OF FINANCIAL REPORTING IS TRANSFORMED INTO A DERIVATION OF FINANCIAL REPORTING FROM TAX PROVISIONS



THE ROOTED DEPENDENCE IS LEGALLY REALISED

[59] "[…] instead of breaking the forced coexistence in the same document (i.e. in the body of the financial statements) between the requirements of understandability, truthfulness and correctness of civil law and those of certainty of tax law, [the 1994 mini-reform] has sanctified this difficult marriage [...]". Di Siena, "Bilancio d'esercizio e disciplina tributaria: evoluzione dei rapporti", *Contabilità finanza e controllo*, n. 1/2005, p. 15.

[60] The issue of the interference between the rules of commercial law and those of tax law in the rules governing the preparation of financial statements has long been the subject of discussion among scholars and, in recent years, has given rise to a heated debate that has seen the emergence of opposing positions. Often, some tax rules condition the preparer of the financial statements, becoming essential points of reference for the drafting of the same and putting in second place the legal and economic-business principles at the basis of the summary statements. A problem of hierarchy is then generated, and often a link, which jurists define as one of inverted dependence, between the rules of commercial law and those of tax law, creating," recourse to the latter, a sort of substitute function in the face of the lack of civil law rules, or a real "contamination" of civil law provisions by tax law". Cardillo, "La relazione di dipendenza rovesciata nel reddito d'impresa", *Diritto e pratica Tributaria*, n .1, 2003, p. 85 ss.

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The subordination of the tax-deductibility of negative income components to the recognition of the same in the profit and loss statement on an accrual basis imposed by Article 75 of the Consolidated Income Tax Act meant that the award of a cost in financial reporting was an essential condition for the cost to be relevant from a tax point of view.

The recognition in the profit and loss statement of an amount lower than the maximum amount deductible for tax purposes, entailed, automatically and without any possibility of proof to the contrary, the loss of tax deductibility, in the year of accrual, of the portion not recognised in the statutory financial reporting.

Hence, there was a need to allow companies not to lose any tax advantages arising from tax legislation. It accepts this need for companies to legitimise fiscal interference implemented by introducing the second paragraph of Article 2426 of the Italian Civil Code.

In the presence of this rule, therefore, quite legitimately, the balance sheet and the profit and loss statement inevitably lost the characteristic of correctness and truthfulness[61].

Despite the presence of this regulation, the correctness and truthfulness of financial reporting were, however, guaranteed by the existence of point No. 14 of Article 2427 of the Italian Civil Code, which regulates the explanatory notes, a document which we would like to reiterate, according to Article 2423 of the Italian Civil Code, identifies the third part of financial reporting.

Point No. 14 of Article 2427 required the preparer of the financial reporting to indicate the reasons for value adjustments and provisions made exclusively in the application of tax regulations and the relative amounts, highlighted explicitly concerning the total amount of the adjustments and requirements resulting from the specific items of the profit and loss statement.

This rule, therefore, provided that, in the face of the entry in the balance sheet and profit and loss statement of values without economic content and marked only by the need for accounting recognition due to tax reasons, an illustration should be provided of the identifiable discrepancies between the tax amounts recorded in the two documents mentioned above and the

[61] According to Pontani, such legislation reduced 'what little transparency had been achieved by Legislative Decree 127/1991". Pontani, *La clausola generale ed i principi di redazione del bilancio d'esercizio*, Cedam, Padova, 2005. For Savioli, the legitimacy imposed by the 1994 mini-reform leading to "deprecated behaviour aimed at preparing financial statements subject to the logic of another regulatory system" was "clear and unequivocal". Savioli, *Verità e falsità nel bilancio d'esercizio*, Giappichelli, Torino, 1998, p. 124.

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economically true amounts, determined, of course, according to correct accounting principles.

Since the notes to the financial statements were (and still are) part of the financial reporting, the truthfulness of the same was guaranteed by the whole of the second paragraph of Article 2426 of the Italian Civil Code and point no. 14 of Article 2427.

Therefore, in the post-1994 period, financial reporting could be considered legitimate and, consequently, correct and true according to art. 2423 of the Italian Civil Code, even in the presence of an explanatory note explaining the reasons why the income shown in the profit and loss statement and the assets shown in the balance sheet were not economically "true" and, therefore, did not correspond, respectively, to the wealth "really" produced/destroyed by the company and to the capital existing at the time of closing the accounts[62].

In the period before 31 December 2003, the situation, therefore, saw the coexistence of two rules: one, which was superordinate concerning any other provision concerning financial reporting, which imposed the postulates of understandability, correctness and truthfulness (art. 2423 of the Italian Civil Code), and the other, which legitimised the making of value adjustments and provisions of an exclusive tax nature (art. 2426 of the Italian Civil Code), which could only use for tax purposes. 2423 of the Italian Civil Code), and

[62] "The change of presentation venue does not in itself lead to radical conversions of the meaning of the deductions, but it is significant [...] under the reflection of the understandability of reading the items in the annual report.) under the reflection of the understandability of reading the items of the financial statements, understandable as it is that giving a double result, in the civil law outcome of the financial statements and the outcome influenced by the tax rules, separately, puts the reader of the financial statements in a position to decipher the balance sheet and the profit and loss statement based on the technical discipline that the Civil Code provides with the principles and criteria that support it. On the contrary, it is much more difficult and problematic to search for the tax effects by removing them from the context of the costs separately shown in the Profit and Loss Statement; at least, it is a confusing presentation that does not benefit the true and correct representation from the point of view of a clear and intelligible interpretation of the technical and economic data of the financial statements. Suppose the issue is investigated in the terms illustrated above. In that case, it is easy to infer the illogicality of the modification (abolition of the tax appendix) of a discipline that should not have been introduced in the first place and, if anything, it is legitimate to wonder why the legislator had this regurgitation of regulatory ethics after the fact; Moreover, it should be added that the autonomous enucleation of the fiscal results of the financial statements resulting from the application of facilitating and more permissive rules than the statutory ones, even if not slavishly aligned with the statutory rules, would certainly have benefited the separation of the disciplines by giving the structure of the financial statements the dignity that is implicit in the deep and substantial reconsideration of the regulatory framework pursued with Legislative Decree no. 127/1991". 127/1991". Gatto, "L'appendice fiscale non serve più", *Il fisco*, n. 3/1995, p. 466.

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the other, which legitimised the making of value adjustments and provisions of an exclusively fiscal nature (Article 2426 of the Italian Civil Code), which, according to Article 2427, point 14), had to be adequately illustrated in the explanatory notes.

The contrast between Articles 2423 and 2426 of the Italian Civil Code would have been evident if, to the postulates of truthfulness and correctness of financial reporting, imposed by Article 2423, it had attributed the meaning of "truthfulness and economical correctness" of the values recorded in the balance sheet and in the profit and loss statement (i.e. it believed that a financial reporting could be considered true only if "economically truthful" values are recorded in the balance sheet and the profit and loss statement).

The possibility of legitimately recognising in financial reporting costs of a purely fiscal nature with no economic content (according to Article 2426 of the Italian Civil Code), prevented the full recognition of costs of an economic nature. The possibility of legitimately recording costs of a purely fiscal nature with no economic content (under Article 2426 of the Italian Civil Code) prevented the principle of "economic truthfulness" of the data contained in the summary accounting documents constituting financial reporting (i.e. balance sheet and profit and loss statement) from being considered fully respected. Still, in the explanatory notes, the rule that imposed the highlighting of discrepancies identifiable between economically correct values and tax amounts recorded in the balance sheet and profit and loss statement allowed the postulates of truthfulness and correctness imposed by Article 2423 of the Italian Civil Code to be considered respected[63].

In the preparation of legally legitimate financial reporting, therefore, required, on the one hand, an understanding of the real meaning of the principle indicated in Article 2426 of the Italian Civil Code and, on the other hand, an in-depth examination of the civil law postulate of "truthfulness of financial reporting so".

This interpretation of Article 2426 of the Italian Civil Code led to the belief that the concept of "economic" truthfulness did not coincide with the principle of "legal" truthfulness of the profit and loss statement and the balance sheet considered individually.

[63] "The contamination effects expressed their pernicious effects in a widespread manner throughout the document [...] with the only palliative represented by the mandatory disclosure of such effects in the descriptive part of the same. [...] In this situation, the possibility of polluting the financial statements with items of exclusive tax relevance has been the rule until the recent review of company law and corporate taxation". Di Siena, last work cited, p. 15.

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Highlighting this discrepancy did not represent a mere doctrinal exercise. On the contrary, it laid the groundwork for civil law financial reporting to be considered valid and legitimate.

The contextual interpretation of articles 2426 u.c. and 2427 point no. 14 did not allow to share the opinion of those who affirmed that, given the legal provisions, it could carry out the statutory valuation of the income items through the mere application of the tax regulations.

The Civil Code itself by requiring that the notes to the financial statements adequately illustrate[64] the reasons for adjustments and provisions made exclusively for tax purposes and the amounts involved obliged the taxpayer to carry out a double valuation of the financial reporting components: the determination of the tax value had to be accompanied by the identification of the economically correct value. Only in this way could the effects on income resulting from applying show tax provisions favourable to the taxpayer in the notes to the accounts.

In the context of the problems concerning the so-called tax interferences, the "economically" correct valuation criteria - governed by Article 2426 of the Civil Code, whose "necessary gaps" had to be filled, as highlighted above, by national and international accounting standards - continued to play a role of primary importance.

If the negative income values had been determined exclusively by the uncritical and automatic application of tax rates, there would have been no "economic" element with which to compare the "tax cost". In this case, the obligation imposed by Article 2427 point 14 could not have been observed due to the lack of economic data for comparison.

In the absence of an economic analysis of the "tax" costs recorded in the accounting records, the financial reporting would have been invalid due to the lack of the requirements imposed by Articles 2423 et seq. of the Italian Civil Code.

This entailed a further significant strengthening of the importance of economically correct valuation criteria.

[64] "This was a correction that shifted the transparency of the taxation of financial statements from the profit and loss statement to the notes to the financial statements". However, the author points out that the legislation did not clarify "whether the adjustments and provisions mentioned had to be written in the profit and loss statement indiscriminately, together with the other income components, in the items already present in the scheme or had to appear in analytical sub-items of existing items or, again, whether other ad hoc items had to be created" and also did not clarify "which counterparts had to be concerned at balance sheet level (a problem which, as before, remained without a clear solution)". Patroni Negri, "Interferenze fiscali sul bilancio d'esercizio e imposte latenti", *Contabilità finanza e controllo*, n. 4/1995, p. 321 ss.

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From the analysis of the financial reportings published by companies in the years before 2003, it could be noted that, frequently, the notes to the financial statements represented the "weak element" of financial reporting. Often, reading this document did not allow the economically correct data to be traced. It was therefore difficult for third parties to reconstruct the "real" situation of the company.

The vagueness of the information on tax interferences contained in the notes to the accounts made it impossible, in many cases, to quantitatively determine the impact, on the income for the year, of the adjustments and provisions made exclusively for tax reasons. Companies should have adequately assessed this circumstance given the danger that it could challenge the financial reporting and, consequently, could be considered, by the courts, radically null and void for lack of the requirements imposed by Article 2423 et seq. of the Civil Code.

Even in the post-1994 period, therefore, any determination of financial reporting valuations carried out employing a mere translation into civil law of the tax rules identified, therefore, an illegitimate behaviour attributable, exclusively, to the financial reporting preparer, since the regulatory framework allowed, albeit in a criticisable way, to draw up a true and correct financial reporting (intended as a whole).

The above considerations did not prevent, of course, to consider that the economically correct cost, i.e. the value that identifies "the quantitative-monetary expression of an input factor", could coincide with the amount deductible for tax purposes.

In the 1980s, about depreciation, for example, it was held by the courts that "the mere reference to the tax rules is not sufficient to clarify the criteria followed for depreciation. Consequently, 'the entry of depreciation does not satisfy the criterion of reasonableness and reliability (if it has been) calculated by applying the rates recognised for tax purposes and laid down for the sector'. Therefore, if one wishes to refer in financial reporting to the depreciation criteria prescribed by tax law, it is necessary at the same time to provide adequate clarification as to the relationship between those criteria and the extent of depreciation and consumption of the assets corresponding to the financial year in question"[65]. Based on these considerations, the judiciary also interpreted as 'unlawful the omitted indication of the criteria followed in the depreciation and provisions' and pointed out at the same time that it

[65] Court Milano, 19 maggio 1983, *Le società* 1983 p. 1384.

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was not 'sufficient that the directors merely justified the formation of these items by fiscal requirements for the sector'"[66].

This position was also reiterated at the end of the 1990s. It is "legitimate to depreciate, for example, fixed assets following the maximum tax rate allowed, if, in reality, this value corresponds to the residual possibility of use of the asset as per Article 2426 of the Civil Code and this correspondence is adequately and clearly explained in the notes to the financial statements"[67]. In any other case, it would have been necessary, therefore, to adequately illustrate in the notes to the financial statements the income impact of tax values without economic content.

In any other case, it would have been necessary to adequately illustrate the income impact of the fiscal values without economic content in the notes to the financial statements. From the above considerations, it is also clear that the possibility of recording in the financial reporting a "fiscal" value different from the economic cost was granted by Article 2426 of the Italian Civil Code only in the hypothesis in which the fiscal cost admitted in deduction identified an amount higher than the amount of the production factor consumed by the company. On the contrary, in the opposite case (economic value higher than the fiscal value), the writer of the financial reporting had to record the economically correct cost obligatorily. If the actual economic cost had exceeded the tax cost, the recognition of the deductible value for tax purposes would have led to an illegal overvaluation of the income for the year, which would have been "inflated" by the recognition in financial reporting of values lower than those corresponding to the actual consumption of the factor. For example, if a company had used an asset over several years to an extent significantly higher than the average for the sector as determined by tax rates. If it had determined the depreciation uncritically based on the percentages set by the Ministry of Finance, without carrying out a contextual economic analysis, this would have led to the drafting of an illegitimate financial reporting as it lacks the requirements of fairness and truthfulness imposed by Article 2423 of the Italian Civil Code.

The economically correct determination of the individual costs should therefore be considered as a necessary step for the preparation of financial reporting that is valid for statutory purposes, not only because any negative differences (tax value higher than economic value) should be adequately explained – according to Article 2426 of the Civil Code – in the notes to the

[66] Court of S. Maria Capua Vetere, 21 novembre 1987, *Le società*, 1988 p. 1033.
[67] Court Como 26 marzo 1997, *Le società*, 1997, n. 9, p. 1074.

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financial statements, but also because they should disclose them in the financial statements. – The reason for this is not only that any negative differences (fiscal value higher than the economic value) had to be adequately explained in the notes to the financial statements, but also that such an analysis could lead to the knowledge that the economic value was higher than the tax deductible value.

In this case, for the financial reporting to be legitimate, it triggered the obligation to indicate the actual cost in the profit and loss statement. Subsequently, it had to be followed by a tax recovery when drawing up the tax return.

When the financial reporting preparer verified the existence of a temporary difference between the value deducted for tax purposes and the economically correct value, the obligation to recognise in the financial reporting the taxes related to the non-permanent discrepancies identified between the civil income and the taxable income arose automatically.

The accrual principle set out in Article 2423 bis required the recognition in financial reporting of both deferred tax assets and liabilities, except in cases where there was no reasonable certainty of the future recovery of deferred tax assets or, for deferred tax liabilities, there was little likelihood that such liability would arise (OIC Accounting Principle 25 on the accounting treatment of income taxes).

The above considerations make us understand how the existence of a discrepancy between the values deductible for tax purposes and the amounts determined in an economically correct manner caused consequences on the preparation of financial reporting, which, inevitably, led to an increase in the complexity of the work of drawing up the document governed by Article 2423 of the Italian Civil Code; this latter circumstance certainly acted as a further deterrent to the determination of economically correct values.

In summary, the situation in the post-1994 period (until the reform came into force on 1 January 2004) was as follows:

BALANCE SHEET	
Situation after 1994 and before 31/12/2003	* the balance sheet could be characterised by the presence of items that were incorrect and untrue from an economic point of view, as the entry of purely fiscal values was permitted * the balance sheet could be incorrect and not true from an economic point of view

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PROFIT AND LOSS STATEMENT	
Situation after 1994 and before 31/12/2003	the profit and loss statement could be characterised by the presence of items that were not correct and true from an economic point of view, since the recognition of purely fiscal values was allowed; * the profit and loss statement could be incorrect and not true from an economic point of view

NOTES TO THE ACCOUNTS	
Situation after 1994 and before 31/12/2003	* in the event of the application of tax interference, the reasons for the interference and the amounts involved must be indicated, according to point 14 of Article 2427.

FINANCIAL REPORTING	
Situation after 1994 and before 31/12/2003	If the standard set out in paragraph 14 of the notes to the financial statements was met, the financial reporting could be considered true, fair and understandable although the profit and loss statement and balance sheet, individually considered, could be economically untrue and incorrect.

In conclusion, it can therefore be stated that, firstly, it is necessary to underline that the information required by point 14) of Article 2427 implies a quantitative analysis, particularly in-depth and precise, of each value recognised in the accounts for the sole purpose of enjoying a tax benefit. This circumstance was very often absent in the notes to the accounts. The indication, in the notes to the accounts, of generic observations concerning tax interferences, not integrated by quantitative-monetary elements that allow the precise measurement, in income terms, of the impact of the above mentioned interferences, does not correspond to the requirements of Article 2427 of the Italian Civil Code. For this reason, it can be said that the legitimacy of the notes to the accounts is subject to the accuracy with which the information regarding the economic impact of the tax interferences in the financial reporting is disclosed. Financial reporting could therefore be regarded as legitimate if third parties had been able to determine the quantitatively correct income employing the information deducible from the notes to the accounts. The lack of communicative efficacy of the message contained in financial reporting is based on the fact that companies could quite legitimately draw up a report (in this case, the explanatory note) that explicitly denied the economic truthfulness of the data set out in the summary accounting documents

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which substantiate the information message intended for the outside world. In the post-1994 period, therefore, perhaps also due to the operational behaviour of the companies that did not apply the civil law correctly, a situation was created in which external communication, through financial reporting, underwent an apparent regression.

Even though from a regulatory point of view, companies had all the elements necessary to draw up correct and truthful financial reporting, even in the presence of an untruthful profit and loss statement and balance sheet, external communication of the company's economic-financial situation suffered a collapse. There are two reasons for this:

1) the behaviour of companies that tended to import, directly, in profit and loss statement fiscal values to avoid double valuations (fiscal and economic) prevented the realisation of effective and truthful communication;

2) even in the presence of correct business behaviour, the circumstance of having to interpret and read an incorrect and untrue profit and loss statement and balance sheet and then determine the economic content of each item through calculations determined by the information in point 14 of the notes, certainly did not help to create the conditions so that the communication intended for the outside world could be considered practical and easily understandable.

This situation persisted until 31 December 2003, when the legislator changed the rules concerning the relationship between financial reporting and tax provisions in a major civil and tax reform.

The reader is referred to the next paragraph to explain this reform and the consequences of these new rules in terms of tax interferences.

2.4. The 2003 corporate and tax reform: profit and loss statement, EC framework and off-balance sheet deductions

In 2003, two Legislative Decrees were issued, which reformed company law and tax law in a very profound and radical way.

The company law reform was introduced by Legislative Decree No. 6 of January 17 2003 and concerned the civil law regulation of corporations and cooperatives. This decree was complemented by the issuance of Legislative Decree no. 5 of January 17 2003, concerning the definition of proceedings in banking and credit matters, company law and financial intermediation.

The tax reform with which IRES was established, was enacted by Legislative Decree No. 344 of December 12 2003.

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Both reforms modified the basic structure of company law and tax law, respectively, in part concerning income taxes. In addition, both the corporate and tax reforms concerned fundamental aspects of financial reporting, particularly the relationship between financial reporting and taxable income.

To implement the corporate reform, on July 24, 1998, the "Mirone Commission" was established, in an agreement between the Ministry of Justice and the Ministry of Treasury, Financial Reporting and Economic Planning, whose objective was to formulate a composite proposal of the problems related to the organic reformulation of a part of the corporate and banking law.

The Commission's work resulted in the delegation of powers under Law No. 366 of October 3 2001 (entitled "Delegation to the Government for the reform of company law" and published in the Official Gazette No. 234 of October 8 2003), which led to the enactment of Legislative Decrees 5/2003 and 6/2003. We shall focus our attention here on Legislative Decree 6/2003 since the issues relating to banks and financial institutions are outside the scope of our study.

To implement the delegated act, another study commission was set up on October 10 2001, by decree of the Ministry of Justice, in agreement with the Ministry of the Economy and Finance and the Ministry of Productive Activities, "for the implementation of the delegated act on the organic reform of company law": the so-called "Vietti Commission""[68]. It was the latter commission that prepared the legislative decree on company reform No. 6/2003, a reform that, due to its breadth, was called a 'Copernican revolution in company law'"[69].

[68] Concerning the enactment of Legislative Decrees, 5 and 6 of 2003, Portale pointed out that "Legislative Decrees 6/2003 and 5/2003, both implementing the delegated law of 3 October 2001 no. 366, complete, but not definitively (see the provision of art. 1, para. 5, L. 366/2001, which authorises the Government to issue corrective and supplementary provisions within one year, may prove providential due to the haste of the preparatory work and the apparent will of the reforming legislator - or rather of the so-called Vietti Commission - to disregard the need to take into account the specificities of the law. The reform of our law on capital companies, which had begun, on the wave of the "Americanisation" of company law and the consequent tendencies towards governance reform, with the Consolidated Law on Financial Intermediation (Legislative Decree 24 February 1998, no. 58 of the Italian Republic), may prove providential due to the hastiness of the preparatory work and the ostentatious will of the reforming legislator - or rather of the so-called Vietti Commission - to disregard, except for marginal profiles, the suggestions and proposals coming both from academic circles and from qualified associations of operators, and officially, allowed a few weeks before the expiry of the delegation, with the circulation of the "project" approved by the Government on 30 September 2002. 24 February 1998, no. 59[...]". Portale, "Riforma delle società di capitali e limiti di effettivi del diritto nazionale", *Le Società*, n. 2 bis, 2003, p. 261.

[69] "(The reform was) a Copernican revolution in company law, in which the autonomy of private individuals and the contract between shareholders came into the limelight. The

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The delegated law 366/2001, in Article 2, set out the primary objectives of the reform and, in particular, stressed that the reform of the system of joint-stock companies referred to in Chapters V, VI, VII, VIII and IX of Title V of Book V of the Civil Code and related regulations should be inspired by the following general principles:

a) to pursue the priority objective of encouraging the birth, growth and competitiveness of enterprises, also through their access to domestic and international capital markets
b) enhancing the entrepreneurial character of companies and defining with understandability and precision the tasks and responsibilities of corporate bodies;
c) simplify company law, taking into account the needs of companies and the competitive market;
d) broaden the scope of statutory autonomy, taking into account the need to protect the various interests involved;
e) adapting the rules of corporate models to the needs of companies, also in consideration of the composition of the company and how it is financed while excluding the introduction of automatic constraints on the adoption of a specific corporate model;
f) in compliance with the principles of freedom of economic initiative and the free choice of business organisational forms, provide for two company models, one referring to the limited liability company and the other to the joint-stock company, including the limited partnership limited by shares, to which the provisions on joint-stock companies shall be applicable, insofar as they are compatible;
g) regulate forms of participation of companies in different types of association, taking into account the need to protect members, creditors and third parties;
h) regulating groups of companies following the principles of transparency and balancing the interests involved.

Since our interest is focused only on the tax interferences in financial reporting, in very concise terms, we can state that Legislative Decree 6/2003, which implemented the delegation mentioned above, addressed the following issues:

- the creation of new S.p.A.'s;
- the shareholders' meeting of the S.p.A.;

previous codictic approach, based on a strong presence of public and judicial controls on the economy, which stemmed from the public interest in the proper functioning of commercial and corporate relations, disappears". Bauer, *Gli effetti della riforma sul bilancio d'esercizio e governo d'impresa. Novità, modifiche e prospettive*, 2003, p. 3.

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- directors in S.p.A.;
- governance in S.p.A.;
- control bodies in S.p.A.;
- bonds in S.p.A.;
- Company books;
- financial reporting in S.p.A.;
- amendments to articles of association in S.p.A.;
- assets and financing intended for a specific business in S.p.A.;
- an amendment of various rules concerning S.A.p.A.;
- the creation of S.R.L.;
- directors and control in S.R.L.;
- extraordinary operations;
- management and coordination of companies;
- amendments to the rules on cooperatives.

With specific regard to tax interferences, it must point out that the delegated law L. 366/2001, with Article 6, had highlighted that the delegated legislator also had to deal with the modification of the regulation of the financial reporting of capital companies. In particular, Article 6 stipulated that the following principles and guiding criteria should inspire the revision of the rules on financial reporting:

a) eliminate the interference produced in financial reporting by the tax regulations on corporate income, also through the amendment of the relative rules and establish the modalities by which, in compliance with the accrual principle, it should take the effects of deferred fiat into account;
b) provide for a regulation of the items of the net equity that ensures a clear and precise discipline as to their formation and their use;
c) lay down specific rules for the treatment of transactions denominated in foreign currency, derivative financial instruments, repurchase agreements, finance leases and other financial transactions;
d) establish the conditions under which companies, in consideration of their international vocation and financial character, may use internationally recognised accounting principles for consolidated financial reporting;
e) extending the cases in which the use of an abridged financial reporting format and the preparation of a simplified profit and loss statement is allowed;
f) harmonise the corporate income tax rules with the innovations referred to in the preceding paragraphs and lay down appropriate transitional

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provisions for the treatment of transactions in progress at the date of entry into force of such innovations.

As we have already pointed out several times, we will focus our attention exclusively on the provisions concerning tax interference. Concerning this issue, the delegated decree no. 6/2003 implemented the indications of the delegation by issuing limited but radical changes. In particular, it abolished the second paragraph of Article 2426, which provided for the right to 'make value adjustments and provisions exclusively in the application of tax regulations, and adjusted point 14 of the notes to the accounts for the sake of consistency. While in the period before the 2003 reform, in this point the notes to the financial statements required the explanation of the reasons why the value adjustments and provisions were made and the quantification of their amounts, with the Legislative Decree 6/2003, point 14 was modified with the requirement to prepare a statement capable of explaining and justifying the recognition of deferred tax assets and liabilities, resulting from temporary differences arising between financial reporting values and values relevant for tax purposes[70].

We will return later to what was established by the legislative decree on tax interferences in financial reporting.

To understand the issue at hand, it is necessary to analyse, at the same time, the tax reform, which also took place in 2003.

Concerning this reform, it can recall that reformed the tax system through the provisions of the delegated Law no. 80 of 7 April 2003, concerning "Delegation to the Government for the reform of the State tax system" and published in the Official Gazette no. 91 of 18 April 2003 (the so-called "Tremonti delegation"). This delegation aimed to change almost all aspects of taxation radically.

The work carried out by the Gallo Commission, which was set up in 2002, led to the issuing of Legislative Decree no. 344 of 12 December 2003 on the "Reformation of corporate income taxation, according to Article 4 of Law no. 80 of 7 April 2003", published in ordinary supplement no. 190 of Official Gazette no. 291 of 16 December 2003 (the so-called "IRES Decree", insofar as it established the new corporate income tax).

The enabling act no. 80/2003 provided, expressly, in articles 1 and 2 for the following general objectives:

[70] On this point see Moretti, "Esposizione in bilancio d'esercizio dell'eliminazione delle interferenze fiscali", *Corriere Tributario*, n. 31, 2004, p. 2423.

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ART. 1.

(*Proxy for the reform of the state tax system*).

1. The Government is delegated to adopt legislative decrees to reform the state tax system. The new system is based on five taxes arranged in a single code: income tax, corporate income tax, value-added tax, service tax, excise duty.

ART. 2.

(*Codification).*

1. The Code is divided into a general and a particular part. The general part shall organise the tax system based on the following principles
   (a) the Law shall regulate the essential elements of taxation, respecting the principles of legality, contributory capacity and equality;
   (b) tax rules shall comply with the fundamental principles of Community law and shall not prejudice the application of international conventions in force in Italy;
   (c) the tax rules, consistently with the provisions contained in Law No 212 of 27 July 2000, including requirements on the status of the rights of the taxpayer, shall be based on the principles of understandability, simplicity, effective knowability, non-retroactivity;
   (d) double legal taxation shall be prohibited;
   (e) the analogical application of tax rules determining the premise and the person liable to tax, exemptions and reductions shall be prohibited;
   (f) it shall ensure the protection of trust and good faith in the relationship between taxpayer and tax authorities;
   (g) uniform rules are introduced for all taxes on the taxable person, the tax liability, the penalties and the process, providing, for the latter, for the inclusion of labour consultants and auditors among the persons qualified to provide general technical assistance. The regulation of tax liability provides for principles and rules, common to all taxes, on declaration, assessment and collection;
   (h) the limit for offsetting tax credits is progressively raised; and
   (i) the regulation of tax liability minimises the sacrifice of the taxpayer in fulfilling its tax obligations; and
   (l) the administrative tax sanction focuses on the person who has benefited from the infringement
   (m) the criminal tax penalty is only applied in cases of fraud and actual and significant damage to the Treasury;

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(n) provision is made to introduce rules ordering and regulating legal tax institutions for ethical and social solidarity purposes.

2. The particular part of the Code contains the provisions concerning the individual taxes referred to in this Law.
3. The Code may be derogated from or amended only expressly.

As can be seen by analysing both the enabling act and the Legislative Decree no. 344 of 12 December 2003, which implemented the enabling act, the tax reform was comprehensive and structured.

As has already been pointed out, we shall analyse here only the rules relating to the issue of tax interferences.

Concerning the taxation of financial reporting by tax provisions, Article 4 of the enabling act 80/2003 stipulated that the delegated decrees should provide for:

i) the deductibility of the negative income components determined on a lump-sum basis, such as asset adjustments and provisions, independently from the transitory nature of the profit and loss statement, to allow the deferral of taxation even if calculated at the time of de-taxation of the profit; in the event of the inability of the taxable income of the company to which they refer, provision for the deductibility of the aforementioned negative income components at the time of allocation of the profit of another company included in the same group taxation; provision of the necessary mechanisms for the recovery of deferred taxes.

Legislative Decree No. 344 of 12 December 2003 translated the will expressed in the enabling act to make negative income components deductible in-dependently of the transit in profit and loss statement (see letter i of Article 4 of the enabling act 80/2003 mentioned above) with the enactment of Article 109, which took the place of the now-repealed Article 75 in force before the 2003 reform.

Article 109 of the new TUIR came into force on 1 January 2004, as did the company reform, and established the following principles:

"ART. 109 of the new TUIR entered into force 1/1/2004
General rules on the components of business income

1. Revenues, expenses and other positive and negative components, for which the preceding provisions of this Section do not provide otherwise, contribute towards forming income in the year in which they accrue; however, revenues, expenses and other components whose existence is not yet certain or their amount cannot be objectively determined in the year in which they accrue contribute towards forming income in the year in which those conditions are fulfilled.

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2. to determine the chargeable period

(a) the consideration for the supply of goods shall be deemed to be received. The cost of acquiring goods shall be considered to be paid, at the date of delivery or dispatch in the case of movable property and the date of the conclusion of the deed in the case of immovable property and businesses or, if different and later, at the date on which the transferor constitutive effect of the ownership or other right in rem occurs. It shall not take retention of title clauses shall into account. A lease with a transfer of ownership clause binding on both parties shall be treated as a conditional sale;

(b) the consideration for the rendering of services shall be deemed to be received, and the costs of acquiring services shall be deemed to be incurred, on the date on which the services are completed or, in the case of services dependent upon a lease, loan, insurance or other contracts from which periodic payments are derived, on the date on which the payments become due;

(c) in the case of companies and bodies which have issued bonds or similar securities, the difference between the sums due on maturity and the sums received in respect of the issue shall be deductible in each tax period to an extent determined following the amortisation schedule of the loan.

3. Revenues, other income of any kind and inventories shall be included in income even if they are not included in the profit and loss account.

4. Expenses and other negative items are not deductible, so they are not included in the profit and loss statement for the period they relate. However, they are deductible:

(a) those included in the profit and loss statement of a prior period, if the deduction has been deferred following the preceding rules of this section that provide or permit deferral;

Expenses and charges explicitly relating to income and other revenues, which, although not included in the profit and loss statement, contribute to the formation of income, maybe deducted if and to the extent that they result from elements that are certain and precise. (b) Although not included in the profit and loss statement, those that are deductible by operation of law. Depreciation of tangible and intangible assets, other value adjustments, and provisions are deductible if the total amount thereof, the civil and fiscal values of the assets, and the provisions' values are disclosed in the statement of income. In the event of distribution, equity reserves and profits for the year, even if earned after the tax period to which the deduction refers, contribute towards forming the income if and to the extent that the amount of the remaining equity reserves, other than the legal reserve, and the remaining retained earnings are less than the excess of depreciation, value adjustments and provisions deducted concerning those charged to the profit and loss

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statement, net of the deferred tax provision related to the amounts deducted. The excess amount is reduced by depreciation, gains or losses, value adjustments relating to the same assets and provisions, and equity reserves and distributed profit for the year, contributing to the formation of income. certain and precise elements

5. Expenses and other negative components other than interest expense, except charges relating to taxes, social security contributions and social benefits, are deductible to the extent that they relate to activities or assets generating income or other revenues which contribute to the formation of income or which do not contribute to income because they are excluded. Suppose they refer indiscriminately to activities or assets generating computable income and to activities or assets generating income which cannot be included in the calculation of income because they are exempt. In that case, they are deductible for the part corresponding to the ratio referred to in paragraphs 1, 2 and 3 of Article 96. Capital gains referred to in Article 87 shall not be taken into account for the preceding period.

6. If during the financial year the interest and income referred to in paragraph 3 of Article 1996 have been earned more than the amount of interest expense, up to that exceeds the expenses and other negative components referred to in the second sentence of the preceding paragraph shall not be deductible and, for the ratio referred to in the Article described above 96, an amount corresponding to that which has not been deducted shall not be taken into account.

7. it shall include notwithstanding paragraph 1 interest on arrears in income in the year it is received or paid.

8. By way of derogation from paragraph 5, the cost sustained for acquiring the right of usufruct or another similar right relating to a shareholding from which profits excluded under Article 89 are derived shall not be deductible.

9. Any kind of remuneration due is not deductible:

a) on securities, financial instruments however denominated, as referred to in Article 44, for the portion thereof which directly or indirectly

(a) on securities, financial instruments, however, denominated, as referred to in Article 44, to the extent to which it directly or indirectly entails a share in the results of the issuing company or of other companies belonging to the same group or of the business in connection with which the securities have been issued;

b) about contracts of joint ventures and those referred to in Article 2554 of the Civil Code, where a contribution other than that of works and services is envisaged”.

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Concerning the fiscal contamination of financial reporting, of particular interest is point 4, according to which depreciation of tangible and intangible assets, other value adjustments and provisions are deductible if the total amount, the civil and fiscal values of the assets and those of the provisions are indicated in a special statement in the income declaration.

In summary, 'the reform introduced numerous changes in financial reporting. First of all, the elimination of interferences produced by tax regulations, the correlated provision of the obligation to take into account deferred taxation and the integration of balance sheet items and profit and loss statements to highlight, among other things, tax credits and deferred tax assets. In compliance with the so-called dual-track between civil and tax financial reporting

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In compliance with the so-called dual-track between civil and tax financial reporting"[71].

The instrument through which the tax legislator established the deductibility of depreciation and other value adjustments, as well as of accruals was, therefore, a schedule linking financial reporting and the income tax return, which was intended to accommodate the recognition of the components mentioned in non-accounting deductions, without the need to go through financial reporting so. This schedule took the name "Schedule EC" and could be found in the "Modello Unico" (i.e. the tax return), of which it was an integral part.

The EC schedule consisted of four horizontal sections:

- Section I – Depreciation (of tangible assets, plant and machinery, capital buildings, intangible assets, research and development expenses and goodwill);
- Section II – Other adjustments (works and services over one year, bonds and similar instruments, fixed and current investments);
- Section III – Provisions (provision for risks and bad debts, provision for cyclical work, provision for restoration and replacement costs, provision for operations and competitions, provision for deductible taxes and provision for pensions);
- Section IV – Aggregate totals, deferred taxes and reserves

There were five columns in the EC schedule:

- Column 1: prior decontamination or pre-tax surpluses, in this column should be entered the higher tax deductions concerning the statutory values entered in the profit and loss statement, from which one benefited in previous tax periods.
- Column 2: Disallowances at regime or period surpluses, in this column should be entered the higher tax deductions for the economic values entered in the profit and loss statement, from which one benefited in the last tax period.
- Column 3: decreases, this column should show the excess amounts deducted in prior years and reabsorb due to their transfer to the profit and loss statement and their subsequent re-taxation.
- Column 4: the civil values of the assets were to be recorded.
- Column 5: The tax values of the assets were to be recorded.

The following comparison proved the correctness of the calculations related to the above sections and columns: the sum of the surplus of the period and the surplus of the past, net of decreases, had, necessarily, to coincide with the difference between the statutory value and the tax value of the asset.

[71] Ianniello, *La riforma del diritto societario*, Ipsoa, 2003, Milano, p. 117.

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This difference showed, in fact, the value that would have been recognised in the profit and loss statement in subsequent years and that, therefore, would have been subject to tax recovery, as already deducted in previous years.

Analysing the civil and fiscal legislation introduced by the double company and tax reform and the EC framework of Unico, period 2004-2008, it can be stated that, from a legislative point of view, in the period of validity of such provisions (until the new reform of 2008) anyone who had the absolute will to draw up a financial reporting in civil law economically truthful and correct in all its parts and a tax-exempt tax return, had all the legal instruments to do so.

All scholars hailed the elimination of tax interferences as a move towards the primary objective of true and fair disclosure of the company's situation.

The elimination of the last paragraph of Article 2426, by preventing the inclusion of tax items in financial reporting, obliged companies, at least apparently, to draw up financial reporting characterised by items of an exclusively economic nature.

Based on these considerations, it can therefore be stated that, since the entry into force of the corporate reform, both the financial reporting as a whole, as well as the balance sheet and the profit and loss statement individually considered – unlike in the pre-reform period – had to be characterised by understandability, correctness and truthfulness.

The prohibition to proceed, at the civil level, to valuations of purely fiscal nature, should have allowed stating that, at the first of January 2004, all the year-end valuations present in financial reporting had, necessarily, to be determined based on civil law and, by implicit reference, of the correct national and, as far as compatible, international accounting principles, i.e. both principles that, at least in theory, represent the sum of the proper economic-corporate knowledge on the subject of financial reporting valuations.

The tax law reform was an indispensable condition for the elimination of tax interferences, as envisaged by the company law reform, to be implemented in practice.

A comparison of the pre-and post-reform situation shows that the main differences between financial reportings can be summarised as follows:

BALANCE SHEET	
Situation before 31/12/2003	* the balance sheet could be characterised by incorrect and untrue economic statements, as it could recognise purely fiscal items. * the balance sheet could be marked by incorrect and true

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Situation after 1/1/2004	* Must be characterised by the presence of correct and true items from an economic point of view; * the recognition of purely tax-related values is no longer permitted

PROFIT AND LOSS STATEMENT	
Situation before 31/12/2003	* the profit and loss statement could be marked by the presence of items that were not correct and true from an economic point of view; * the profit and loss statement could be incorrect and untrue
Situation after 1/1/2004	* the profit and loss statement must be characterised by the presence of correct and truthful items from an economic point of view; * the recognition of purely tax-related values in the context of the profit and loss statement is no longer permitted

NOTES TO ACCOUNTS	
Situation before 31/12/2003	* in the event of the application of tax interference, the reasons for the interference and the amounts involved must be indicated, pursuant to point 14 of Article 2427.
Situation after 1/1/2004	* there is no longer any reference to any differences between economically correct values and tax-deductible amounts since, due to the elimination of tax interferences, the values recognised in the profit and loss statement in the balance sheet must necessarily be economically correct

FINANCIAL REPORTING	
Situation after 1994 and before 31/12/2003	Se rispettata la norma prevista dal punto n. 14 della nota integrativa, il financial reporting poteva essere considerato veritiero, corretto e understandable seppure il profit and loss statement e lo balance sheet, singolarmente considerati, potessero essere non veritieri economicamente e non corretti.
Situation after 1/1/2004	If it respected the rules imposed by the dual corporate and tax reform of 2003, the financial reporting was true, fair and understandable in its entirety and each of its cost-intensive parts (profit and loss statement, balance sheet and notes to the financial statements).).

From the brief considerations outlined above, it is clear that financial reporting, intended as a complex document made up of a balance sheet, profit and loss statement and notes, has undergone, at least apparently, a profound substantial change with the reforms of the company law and tax law.

As noted in the previous paragraph, in the period before 1 January 2004, due to the legitimacy of tax interference, it was possible to draw up, at the

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same time, an economically correct and truthful financial reporting and economically untruthful/correct balance sheet and an untruthful/correct profit and loss statement. This was possible due to the notes to the financial statements of information regarding the tax interferences detected in the accounting, which allowed to 'indirectly adjust' the values indicated in the two accounting documents constituting the financial reporting. Therefore, the integrity of financial reporting depended on the correct preparation of the notes to the accounts, which had to indicate, qualitatively and quantitatively, the impact of the tax interferences implemented in the accounts.

Following the entry into force of the company and tax law reforms, financial reporting could only be considered true and correct if the profit and loss statement and the balance sheet were also true and correct. Therefore, the correctness and truthfulness of financial reporting were guaranteed by the correctness and truthfulness of the individual documents making up financial reporting. All this, as illustrated in the previous pages, could only be developed following the tax reform passed in the same year as the company reform, which allowed non-accounting deductions (by entering in the EC panel of Unico) of tax-deductible values but without the economic content that would have allowed their recognition in financial reporting.

It should note that, in addition to establishing the critical innovation of the tax deductibility of a higher amount than that recorded in the statutory financial reporting, Article 109 of the Consolidated Income Tax Law (TUIR) provided for a further innovation compared to the situation before 2004. In the fourth paragraph, letter b), art. 109 of the reform established that "in the event of distribution, the equity reserves other than the general reserve and the profits for the year, even if achieved after the tax period to which the deduction refers, contribute to the formation of income if and to the extent that the amount of the remaining shareholders' equity reserves and retained earnings is less than the excess of depreciation, value adjustments and provisions deducted concerning those charged to the profit and loss statement, net of the deferred tax provision related to the deducted amounts". The rationale for this provision was based on the desire of the tax legislator to ensure that temporarily untaxed profits were retained in the company and were not subject to distribution in the form of dividends or reserves. The rule provided that it would trigger the recovery taxation if the distribution of profits or funds would affect its capital to cover the tax benefits. It had not yet fulfilled the obligation to pay tax, all net of the deferred tax provision to the amounts deducted. This rule did not guarantee the payment of taxes on charges deducted for tax purposes. Still, it was not yet recognised in the statutory financial reporting, as this obligation was already substantially covered

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by the mandatory creation of the deferred tax provision. The rule outlined in Article 109 TUIR had a different purpose. The condition ensured that the company's equity was not affected by the distribution of dividends or reserves for amounts related to values deducted for tax purposes but economically not yet accrued.

From the brief considerations above, the purpose of the provision indicated in point b), the fourth paragraph of Article 122 was, therefore, the guarantee of capital soundness provided to shareholders and third parties.

On a substantial level, it was therefore sufficient to indicate in the reconciliation statement between the income statement and financial reporting intended for publication the difference between the economic value recorded in the statutory financial reporting and the amount deductible for tax purposes to obtain the full deductibility for tax purposes of the entire value relevant for tax purposes.

Summarising the steps provided by the reform for the tax deduction of costs and expenses, it is possible to state that, since the entry into force of the tax law reform (1.1.2004), the preparers of financial reporting had to perform the following steps:

1) to disclose in the statutory profit and loss statement and balance sheet only amounts with true economic content. This value does not necessarily have to correspond to the value deductible for tax purposes since the economic truthfulness of the costs and revenues relevant for tax purposes is not one of the objectives of the tax legislator. On the contrary, it is possible to state that, precisely because of the there-rigidity of the tax regulations, the probability that the two amounts present discrepancies, negative and positive, is exceptionally high;
2) indicate in the statement of reconciliation between civil financial reporting and income tax return (EC panel) the difference (positive or negative) between the tax-deductible value and the economically correct and true amount;
3) store, outside the accounting records, the amounts deducted for tax purposes and not recorded in the civil profit and loss statement and balance sheet because they have no economic content;
4) determine the balance of surpluses deducted for tax purposes following recognition in the reconciliation statement and not recognised in the financial reporting so;
5) comparing the balance of excesses deducted for tax purposes following recognition in the reconciliation statement and not recognised in the statutory financial statements with unrestricted reserves and unrestricted net income to check that such available net assets exceed the

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excess of the amounts of value adjustments and provisions deducted over those recognised in the profit and loss statement, net of the deferred tax provision related to the quantities deducted;

6) recapture for taxation any excesses not co-executed from free reserves and freely distributable profits[72].

In order to illustrate in detail how to use the EC-Schedule[73], in 2005, the Agenzia delle Entrare issued no. 27/E of 31 May 2005[74]. In explaining the (reasoned) configuration of Schedule EC analytically, the Revenue Agency specified that "it was not allowed to take into account, to calculate the excess, any negative misalignment (civil values of the assets lower than the fiscal ones) which could be determined in the hypothesis that, as for goodwill, the amortisation attributable to profit and loss statement was higher than the one deductible for tax purposes". This was because "the damaging misalignment was irrelevant for the application of Article 109, paragraph 4, letter b, TUIR, as – unlike the positive misalignment – it did not configure the possibility of distributing dividends that had not been taxed in the hands of the distributing company.

Higher than the profit resulting from financial reporting, due to increases made exclusively for tax reasons, for example, as was the case for goodwill[75]. These increases, made to recover the higher depreciation for statutory purposes, could not therefore be used to reduce the total amount of negative components deducted ex-accounting and indicated in the EC schedule"[76].

To fully understand how Schedule Ec is used, it should note that the off-balance sheet deduction in Unico was allowed not only if the aforesaid negative components were charged to the profit and loss statement in an amount

[72] For a more in-depth discussion of this issue, see Avi, "Il bilancio d'esercizio fra veridicità economica e tribveridicità", *Il foro padano*, n. 1, 2008.

[73] This subject explained how Schedule EC could be used in a particularly analytical way in "standard of conduct" No. 159 of the Milan Association of Chartered Accountants. To further discuss this issue, the reader refers to the rule mentioned above of conduct No. 159.

[74] "Circulars IRES/8. Legislative Decree no. 344 of 12 December 2003. Article 109, paragraph 4, letter b, of the TUIR. Elimination of fiscal interference in the financial statements and off-balance sheet deduction of depreciation, other value adjustments and provisions', Circular 27E of 31 May 2005".

[75] Incidentally, it should note that the Italian Revenue Agency takes it for granted that the economically correct amortisation of goodwill is always more significant than the amount allowed as a deduction for tax purposes. This observation will come in handy later on when it is shown that companies often overlap these values in practice, and there are reservations about this accounting approach. We will not fail to go into the relevant question in greater detail.

[76] In practice, we are faced with a particular veto on the offsetting of offsetting non-accounting items relating to two different sections of the tax return, Schedule RF and Schedule EC.

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lower than that permitted by the tax regulations, but also if the cost did not appear at all in the profit and loss statement.

The above mechanism, of course, applied not only to goodwill but to all negative income components.

Obviously, in the years following the year in which the total amount of the negative income components listed in the EC schedule reached the maximum tax-deductible cost, additional negative income components were no longer deductible from a tax point of view. For these values, a corresponding taxable income adjustment had to be made in the tax return[77].

It should also note that the reform and the introduction of the EC framework addressed an issue that, in the previous period, was marked by a regulatory vacuum, namely that of deferred taxation. "According to the solution indicated by the legislator, the financial reporting and the tax return are to be two autonomous documents, synthetically linked to each other by the effect of the recognition, in the statutory document, of the deferred taxation. Tax evaluations and benefits will necessarily have to refer to parameters and results that can find in the statement reported in the tax return, and not in the statutory one, to avoid the current phenomena of interdependence that distort both the mechanisms of correct taxation and the mechanisms of benefits"[78].

In the opinion of P. Pisoni, F. Bava and D. Busso "the conceptual assumption of deferred taxation is based on the acceptance of the thesis according to which income taxes are assimilable to other costs that the company incurs for the production of income and, as such, must be accounted for following the principles of accrual and prudence"[79].

This obligation was established by the Fourth EEC Directive of 1978. Article 43, paragraph 1, no. 11, of the said Directive, provided that the "notes" (in the reform defined as explanatory notes) should contain "the difference between the tax charge attributed to the financial year and to previous

[77] However, Moretti points out that "[...] it is not clear from the new statutory Schedule what accounting treatment should be given to the residual "tax values" resulting from the application of the previous rules, since these, based on the general principles for the preparation of financial statements and the underlying purposes of the reform, can no longer be found in the new statutory financial statements". Moretti, *Le interferenze fiscali nel bilancio d'esercizio*, 2004, p. 22.

[78] Di Pace, in La riforma del diritto societario. L'eliminazione delle interferenze fiscali nella redazione del bilancio d'esercizio so, Impresa commerciale industriale, n. 3/2003, p. 432. On this point see also Capodaglio, "Le imposte anticipate e differite nel bilancio d'esercizio. Situazione attuale e prospettive future", *Rivista Italiana di Ragioneria e di Economia Aziendale*, n. 5-6/2004, p. 259.

[79] Pisoni, Bava, Busso, "La 'mappa' delle differenze temporanee e permanenti tra risultato ante imposte ed imponibile fiscale ed il ruolo del prospetto di riconciliazione", *Il fisco*, n. 1, 2005, p. 44.

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financial years and the tax charge already paid or to be paid for those years, to the extent that the difference is appreciable concerning the future tax charge". Furthermore, the Community text provided that this amount could "also be indicated in an accumulated manner in the balance sheet, in a specific item with the corresponding title".

It should note that this accounting entry, although not reflected in our legislation until the entry into force of the corporate reform of 2003, was, for a long time, the subject of study by the doctrine which pointed out that the absence of deferred and prepaid taxes distorted communication about the weight of taxes in financial reporting so. Despite scholars' suggestions, until 2003, the legislator did not consider it appropriate to impose any obligation on this issue.

To fully understand the reasons that led the legislator to impose the use of the EC panel and the recognition of deferred and advance taxation, it is interesting to read what is contained in the report accompanying the enabling act concerning the company reform: "[...] Often the taxable income differs from the result for the year due to the choices of the tax legislator, which mean that a specific component may have a tax relevance different from the statutory one, with the result of deriving a taxable income for the period different from the financial reporting profit or loss. Such other tax relevance may then, in turn - but only in some cases - give rise to further consequences to prepare the financial reporting since it may be costed by permanent or temporal adjustments. The first category ("permanent" differences) includes those adjustments originated by the intention of the tax legislator to disregard, for reasons mainly – but not exclusively – of an anti-avoidance nature, items of the profit and loss statement specifically identified defined as not relevant for tax purposes. On the other hand, the second category ("temporal" differences) includes those adjustments originated by the intention of the tax legislator to set a limit – quantitative or temporal – to certain income components: and this is not to highlight their absolute irrelevance, but rather to make them contribute to the formation of taxable income in a manner more in keeping with the purposes of the tax system. Such are, for example, the limits placed on the amount of deductible depreciation or provisions, in which the three-year legislator is not concerned with the actual deterioration and consumption of a particular capital asset (to size its depreciation for the period) or the real risk existing in a specific loan (to size the provision for risks), but rather to limit the impact on the taxable income for the period (and, therefore, on the revenue for the financial year) of the financial reporting policy followed by its authors.

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Also included in the hypothesis of "temporal" differences are those cases in which the tax legislator has allowed the deferral, in whole or in part, of the taxation of a phenomenon which undoubtedly occurred in a specific period, but which, for mere facilitation purposes, is taken into account at a time different from the realisation. This is the case of certain capital gains which may be taxed, on a straight-line basis, in five tax periods instead of only at the time of realisation. In addition, tax losses that can be carried forward and offset against the taxable income of the following five tax periods should be considered for the purposes in question, with all the necessary caveats [...]. While "permanent" differences are limited to producing a more significant increase in tax costs for the period compared to those that could be deduced from the results of financial reporting so far, "temporal" differences also have their effects on the results of future financial reporting: hence the opportunity to make explicit the consent of the system to greater transparency of financial reporting by making the most appropriate additions to the rules of the code that refer to the fulfilment (early or late) of the tax burden. This is to ensure full compliance with the principles of accrual and prudence also concerning income taxes, in complete agreement with the positions expressed by the best national (see accounting principle no. 25) and international (see document IAS 12) accounting practices, which have also recently had the opportunity to express themselves on the subject, recommending the recognition in financial reporting of the so-called deferred taxation"[80].

The obligation to recognise deferred taxation (as well as advance taxation) was considered by academics to be a step forward in external reporting. Almost all scholars, therefore, welcomed it.

In this regard, it should be recalled that, with the company reform, paragraph 22 of the profit and loss statement, which already contained the wording "income taxes", was supplemented by the specification "current, deferred and prepaid taxes"[81]. In addition, an analytical explanation was required in the notes to the financial statements, following the provisions of Article

[80] Accompanying report to the enabling act for company reform 366/2001, paragraph 3.1, Article 6.

[81] Since the reform came into force, current taxes, deferred taxes, and deferred tax assets have been recommended to be shown separately. In practice, deferred taxes are integrated and still integrate the amount of current taxes, and prepaid taxes are adjusted and still adjust. According to art, this tripartition of the value of taxes guarantees proper communication to the outside world that can be defined as clear. 2423 of the Civil Code. In this regard, also Nocera, Patimo, "Riforma diritto societario e principi contabili. Schedule di sintesi", *Il fisco*, n. 45/2004, p. 7582; Facchinetti, "Contabilizzazione della fiscalità differita. La rappresentazione in nota integrativa", "I quaderni" di *Contabilità finanza e controllo*, marzo 2005, p. 52; Quagli, *Bilancio d'esercizio e principi contabili*, 3ª ed., Giappichelli, Torino, 2004, p. 299.

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2427, no. 14 of the Italian Civil Code, which involves the presentation of a specific statement containing:

- the description of the temporary differences that led to the recognition of deferred tax assets and liabilities, specifying the rate applied and the changes compared to the previous year, the amounts credited or debited to the profit and loss statement or equity[82], the items excluded from the calculation and the reasons therefor" (Art. 2427(14)(a));
- "the amount of deferred tax assets recognised in financial reporting relating to losses for the year or previous years and the reasons for such recognition, the amount not yet recognised and the reasons for non-recognition" (Art. 2427, no. 14, point b).

The entry into force of the two reforms (company law and tax law) allowed, therefore, those who drew up the financial reporting for the year, to be able to count on a series of legal and accounting "tools", which allowed the preparation of an understandable financial reporting, correct and truthful in all its parts, calculating, at the same time, the taxes taking advantage of all the tax benefits provided by tax law.

Based on these substantive considerations, most scholars interpreted the elimination of tax interference and the subsequent reform of tax law, not so much as a simple evocation of the legal framework of financial reporting but as a real revolution in the legislative framework governing the preparation of the balance sheet, the profit and loss statement and the notes.

At this point, the question arises as to whether the objective pursued by the twofold reform has been fully or partially achieved as we will be able to deepen in vol. III of this series, the entry into force of the new legislation coincided with a substantial involution in the truthfulness and correctness of the accounting data that had to be disclosed according to Articles 2423 et seq. of the Civil Code. This slight involution was not connected to the legislative discipline in force in the post-2003 period. The civil and fiscal legislator, for the first time, had, in fact, legally guaranteed the preparation of a true financial reporting, consisting of a balance sheet and a profit and loss statement correct even if considered individually.

[82] Deferred taxes charged directly to equity are an exceptional case involving the revaluation of assets shown in the financial statements due to specific laws. Typically, laws requiring or permitting revaluations provide that, in return for the revaluation of assets, a reserve is recorded in equity that is not subject to taxation, except in the event of liquidation of the company or distribution of the reserve. In this case, the formation of taxable income occurs without the transit of any profit and loss statement. However, it is beyond the scope of this paper to go into this in-depth (however, in our country these situations are very rare).

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This situation can indeed not be interpreted as a setback, but, on the contrary, it must be considered as a considerable step forward towards the communication of accounting data to third parties outside the companies to publicise the actual economic, patrimonial and financial situation of the companies.

Therefore, the potential involution is to be found not in the legislation which, with the elimination of fiscal interference, had led to a significant improvement, but in the potential and undesirable behaviour of the parties responsible for drawing up the financial reports. The abolition of the possibility of indicating, in the balance sheet and the statutory profit and loss statement, values without a substantial economic nature could improve the communication of the financial and economic data of the companies only on the condition that those who drew up the financial reporting so, adopted an economically and legally correct behaviour. This circumstance, however, appeared to be more of a wish than a statement of what was happening at the time. This consideration derives from the analysis of the situation found in the preparation of financial reportings during the period before the reform and from the study of various financial reportings drawn up after 1 January 2004[83].

Even before 1/1/2004, even if the rules were completely different from those that have recently come into force, the financial reporting editor, at a legal level, possessed, albeit with some objective limits, all the instruments to ensure that it could draft the statutory financial reporting according to the postulates of understandability, truthfulness and correctness. If the preparer of the financial report had prepared the balance sheet, the profit and loss statement and the notes following the provisions of the Italian Civil Code, all three documents, even if marked by some gaps, would have provided a true picture of the company's situation. The obligation to explain the difference between the economically true values and the financial reporting amounts in qualitative and quantitative terms to obtain tax benefits ensured the disclosure of information which, at least in part, should have allowed third parties to reconstruct the economically correct values. Therefore, the regulations in force until 31 December 2003 already provided operators with the technical tools to draw up economically accurate financial reporting.

A sine qua non for this was the simultaneous determination of the values calculated according to economically correct criteria on the one hand and according to the limits set by tax legislation on the other. The contraposition of these values determined the amount to be recorded on the balance sheet and in the profit and loss statement. If the economically correct cost was

[83] For an in-depth analysis of the field research carried out in the period under consideration and in the years following the 2008 reform, the reader is referred to Volume III of this series.

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lower than the one deductible for tax purposes, the last paragraph of Art. 2426 allowed the recognition of the tax value, imposing at the same time the obligation to illustrate the reasons for the difference and the quantitative amount of the discrepancy of the two amounts in No. 14), Art. 2427 (notes to the financial statements). If, on the other hand, the economically correct value was higher than the amount deductible for tax purposes, the regulations required that the economically correct value be recorded on the balance sheet and in the statutory profit and loss account. As can be understood, the preparation of a legitimate financial reporting, in the presence of the possibility of "polluting" with tax values the public financial reporting, presupposed the identification of the cost determined according to correct accounting principles or rather the charge that reflects the real consumption of the productive factor within the company's production process.

With the reform of company law and the elimination of tax interference, there should theoretically have been no significant changes in the accounting procedures for companies. As has already been pointed out, the reform of company law, combined with the changes introduced by tax legislation, implicitly imposed the determination of the economically correct value and the identification of the tax-deductible value.

The significant difference introduced by the double reform, civil and fiscal, was the circumstance that the taxable value no longer had any civil value but, on the contrary, had to be considered, exclusively, when determining income taxes. The comparison between the eco-nomically correct value, recorded in the financial reporting so, and the tax value had to be verified only when it prepared the income tax return and the supplementary reconciliation statement (or EC panel of Unico), which was the link between the preparation of financial reporting and the determination of taxes.

From these considerations, it is clear that, at least in theory, the procedure for determining the economically correct values and the amounts deductible for tax purposes, following the double reform, should not have undergone significant differences.

If from a theoretical point of view, these considerations reflected what should have occurred, from a practical and operational point of view, it was often possible to identify anomalous situations, coinciding with much of the existing operational reality in the pre-reform period, which, in reality, led to the preparation of illegitimate financial reporting.

The analysis of the pre-reform situation shows a peculiarity that may, justifiably, lead to the conclusion that many financial reporting s prepared up to

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31 December 2003 were, in fact, illegitimate. From a study[84] conducted on several dozen financial reportings, it found that a decidedly peculiar circumstance characterised more than 90% of the documents: in fact, most of the financial reportings indicated tax-deductible values in the balance sheet and the profit and loss statement without referring, in the notes to the financial statements, to the implementation of tax interferences. This analysis, although not carried out according to strict statistical criteria, clearly shows how widespread was among companies the practice of indicating in the financial reporting the values deductible for tax purposes and to consider, at the same time, these amounts "economically correct" to avoid any extra-accounting calculation, indispensable for tax purposes, which would inevitably make the operators' activities more complex. The lack of determination of the economically correct value implied, even before the entry into force of the company law reform, two possible causes of the illegality of financial reporting:

1) if the economically correct value was lower than the value that could be deducted for tax purposes, according to the provisions of Article 2427, no. 14), the discrepancy between the two amounts had to be explained with qualitative and quantitative indications of the differences found. It is evident that the failure to identify the economically correct value did not permit the contrast between the two values and, consequently, does not permit the application of Article 2427, no. 14);
2) if the economically correct value was higher than the tax-deductible value, it was mandatory to enter the value resulting from applying the correct accounting principles. Also, in this case, the failure to identify the economically correct value did not allow the preparation of legitimate financial reporting. It prevented the determination of the value that, according to civil law, should have been written in the balance sheet and the profit and loss statement.

These considerations highlighted how the determination of the economically correct value on the one hand and the identification of the tax-deductible value on the other represented two indispensable steps so that, both with the post-2004 legislation and under the pre-reform legislation, it could draft financial reporting in a legally legitimate manner.

The "operating procedure" of the determination of the amounts, with the entry into force of the reforms, should not have undergone substantial changes because, both before and after the 2003 reform, the correct accounting of the values in financial reporting and the tax return presupposed that, separately, it determined two values:

[84] See previoues footnote.

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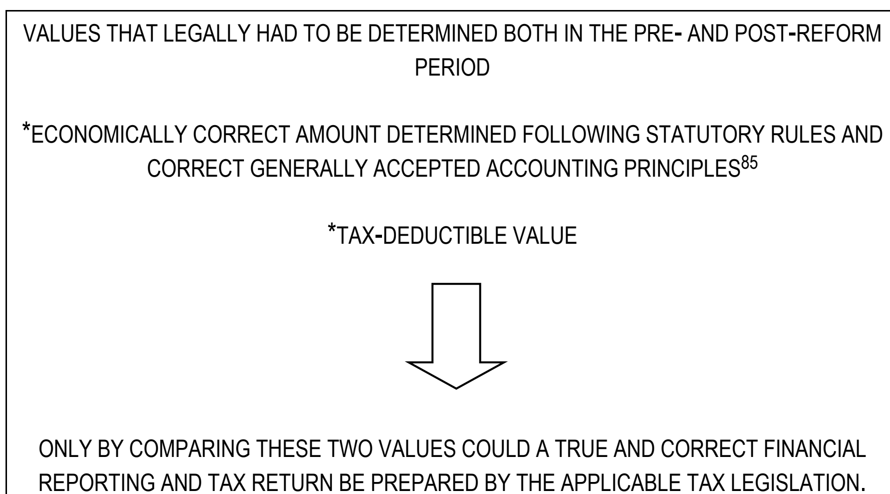
1) the economically correct amount, i.e. the cost and revenue determined following the provisions of the Civil Code and according to correct accounting principles;
   Vs.
2) tax-deductible value.



The objects of the profound change that took place with the entry into force of the company law reform and the differences inherent in the tax reform were the amounts to be recorded in financial reporting and the accounting treatment of tax-deductible values. However, this meant that the two values had to be determined separately and compared, as was the case under the legislation in force until 31 December 2003.

From the analysis of the financial reportings prepared before the entry into force of the two reforms, it can be seen that, in reality, the values recorded were almost always the costs relevant for tax purposes, even if, in the notes to the financial statements, no discrepancy was highlighted between the accounting cost and the value recorded in the financial reportings.

From the analysis of financial reportings prepared after 1 January 2004[86] it could see that the situation described above was prevalent and inevitably

[85] The phrase 'generally accepted' dates back to the 1980s, a period when the problem of tax interference had already been present in financial statements for almost a century. In this regard, the reader is referred to the preceding pages and Vol I of this series.
[86] In the period immediately following the entry into force of the corporate and tax reforms, the legislator intervened again in the field of corporate and tax issues to make some changes. In this regard, Procopio states: "It has already been pointed out that, concerning the decon-

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raised some doubts about the actual truthfulness of the financial reporting data.

Suppose for some values; such a coincidence was ordinary. In that case, it appears at least strange that, in almost all the financial reporting s and for nearly all the conjectures and estimates, there was perfect equality between

tamination of the annual accounts, Legislative Decree No 247 of 18 November 2005 made changes to the rules on profits and reserves in the annual accounts and to the mechanism for recovering the taxation of surpluses deducted off the books in cases where the distribution of profits or reserves reduces the coverage required by Law. This intervention deserves some brief reflections.
A first amendment concerns the provision contained in the third sentence of Article 109, paragraph 4, letter b), of the T.U.I.R., which, before the aforesaid amendments, provided for a restriction on profits and reserves in the financial statements for the year equal to the deductions made off the books and (unreasonably) excluded the legal reserve under Article 2430 of the Italian Civil Code from those which could be subject to such a restriction. This meant that, even in the presence of legal reserves capable of "covering" the amount of costs deducted off the books, companies distributing profits were subject, up to the amount of such deductions, to the recovery of taxation if they had no other reserves to bind. This provision was irrational and therefore penalised companies. The tax legislator had not taken into account the apparent consideration that, even if it is a non-disposable reserve, the legal reserve constitutes, to all intents and purposes, a profit reserve utterly distinct from the company's capital. The reason for this was therefore not understood (15). Thus, legislative Decree No 247/2005 has limited this unjustified exclusion provision, with effect from 1 January 2005. It follows, in short, that it must also take the legal reserve into account the amount of the capital reserves "bound" for the purposes mentioned above.
The second amendment introduced by the Law as mentioned above No. 247/2005 concerns the "mechanism" for recovering the taxation of the surpluses deducted out of taxable income if the distribution of profits or reserves should reduce the "coverage" required by the tax legislator. As is well known, the provision in Article 109(4)(b) of the T.U.I.R. (Income Tax Consolidation Act) provides that "in the event of distribution, the distribution of profits or reserves may not be made following the tax law". As you know, Art. 109, paragraph 4, letter b) of the T.U.I.R. states that "in the event of distribution, equity reserves and profits, even if achieved after the tax period to which the deduction refers, contribute towards forming the income if and to the extent that the amount of the remaining equity reserves and retained earnings is less than the excess of depreciation, value adjustments and provisions deducted concerning those charged to the profit and loss statement, net of the deferred tax provision related to the amounts deducted". Now, given the legal constraint referred to in the provision as mentioned above, a similar treatment must be reserved in the case of recovery for taxation of off-balance sheet deductions due to the distribution of the aforementioned profits and reserves that reduce the coverage itself; in this sense, the amount to be recovered for taxation must be calculated on the amount of distributed profits and reserves that affect the coverage in question, increased by the relative deferred taxes. It is precise with this in mind that Legislative Decree no. 247/2005 added a new sentence to letter b) of paragraph 4 of Article 109 of the T.U.I.R., providing that 'the part of the distributed reserves and profits that contributes to forming the income according to the preceding sentence shall be increased by the corresponding deferred taxes'. As it is easy to observe, this is a legislative provision of an interpretative nature; it follows, therefore, that the effect of this new provision takes effect from 1 January 2004".". Procopio, "Disinquinamento fiscale: ammortamenti e deduzioni extracontabili", *Corriere tributario*, n. 14, 2006, p. 1085 e ss.

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the tax-deductible cost and the value that, theoretically, according to the provisions of Article 2426 of the Italian Civil Code, should have been determined according to correctness and truthfulness.

This analysis leads to believe that, in financial reporting so, it ofted indicate "trib-economic" valuations, or rather, both items that, in substantial terms, in theory, should have reflected the economic correctness of the cost but that, in reality, were nothing more than the "old" and illegitimate tax valuations.

Therefore, the "trib-economic" valuations represented values de-terminated according to strict fiscal criteria permeated by a potential economic content deduced from the law in force in the period considered here. The legislative imposition of the inclusion in financial reporting of economically truthful items could not be considered evidence of economic correctness and, consequently, the legal legality of the accounting items recorded in the balance sheet and the profit and loss statement. The almost perfect coincidence of the tax values (relevant to the determination of taxable income) and the 'economically correct' values (or rather, considered as such only insofar as they are included in the civil financial reporting) undermined any certainty regarding the truthfulness and economical correctness of the items themselves.

Therefore, the "tributary" valuations were nothing more than unlawful valuations that, consequently, also rendered invalid the financial reporting that contained them.

As long as companies continued, almost systematically, to match tax values with the amounts recorded in financial reporting, claiming a hypothetical perfect coincidence between tax value and economic value, financial reporting could certainly not be considered, from a legal point of view, legitimate and, consequently, showed the characteristics of documents whose approval resolution could be challenged by shareholders and third parties. These documents could not even be considered valid communication instruments to the outside world since, in the event of such a situation, the truthfulness and correctness highlighted the non-application of the postulates imposed by Article 2423 of the Civil Code.

Therefore, based on the above considerations, it was possible to express a doubt as to the actual revolution resulting from the elimination of tax interferences. Since the implementation of such a circumstance was not related to a legislative loophole but resulted from the misbehaviour of the preparers of financial re-porting s, the improvement of the situation could only derive from a change of financial reporting culture in the business environment or a series of repressive actions by the judiciary. The shift in mentality re-

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garding the disclosure of company data to third parties outside the companies was a much-desired element for those who were convinced that the disclosure of true and correct data represented a legal obligation on companies and a strategic opportunity provided by the latter. The complete, true and correct disclosure of accounting data is still a real strategic weapon that, wisely used, not only does not harm companies but can lead them to achieve remarkable economic results in the medium and long term. This is also demonstrated by the fact that more and more companies communicate environmental and social data to the outside world. As everyone knows, the drafting of social, financial reporting and environmental impact reports is not legally binding in Italy.

More and more private companies and public bodies perceive the need to communicate to external parties qualitative and quantitative data on the social impact caused by the company. Even though it is not compulsory to publish such data, the number of companies drawing up such documents grows exponentially. In the absence of a legal obligation to do so, it is clear that companies are publicising this data to implement a communication strategy that not only does not harm them but also benefits them. In the absence of a legal obligation to do so, it is clear that companies publish such data to implement a communication strategy that not only does not harm them but also favours them. We do not intend to refer here to companies in which social communication could be considered almost a characteristic element of the company. Let's think, for example, of social co-operatives. External transmission of social data and environmental impact should be practically a structural element of the co-operative itself. From an analysis of the companies that have published social and environmental impact reports in recent years, it can seem that such data is not restricted to social enterprises but involves private companies whose primary objective is to maximise their operating income in the medium to long term. This shows beyond any doubt that the publication of company data is not a "burden" for these companies, from which they cannot be exempted, but a real strategic opportunity which, if adequately exploited, allows the company to achieve the economic and financial objectives that the economic subject considers to be primary.

For the reasons mentioned above, even in the period following the 2003 corporate and tax reform, it considered that the disclosure of data concerning the company's economic and financial situation was one of the strategic opportunities that a company had to exploit, not to publish confidential data of undivided interest to the economic entity, but with a view to proactivity with parties outside the company. Proactivity which not only was not and still is not an obstacle to achieving excellent economic and financial results but

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which, on the contrary, represented and identifies even today, a fundamental tool, nowadays almost necessary, for these objectives to be achieved.

From the analysis of what occurred at the operational level in the period after the 2003 corporate and tax reform, it seemed more likely that a substantial improvement in corporate communication could derive, rather than from a 'positive' attitude on the part of companies, from a 'guaranteeing' stance of the judiciary which, however, should not have given in to the temptation to implement a policy aimed at rendering potentially null and void financial reporting with minimal distortions, whether voluntary or involuntary, of the accounting data, potentially null and void, financial reporting with minimal distortions, whether voluntary or involuntary, of accounting data, but should have set itself the objective of striking the incorrect and untruthful communication if, this circumstance would significantly distort the economic, equity and financial situation communicated to third parties by a financial reporting containing accounting entries without economic content.

From this point of view, it is clear that it would have been, and still is, highly objectionable for the courts to take a stance on even the smallest unclear or incorrect elements. Such a situation would, in fact, recreate what occurred at the end of the 1960s after the relevant judgment of the Court of Milan in 1968 concerning the mandatory nature of the principles of precision and understandability cited in the Civil Code of 1942. The analysis of the judgments immediately following that date clarifies that, for a period, even minimal distortions of the principles of understandability and correctness were considered by the judiciary as causes of radical nullity of financial reporting. If, on the one hand, it is believed that the intervention of the judiciary can, in some way, "direct" and "influence" the culture of financial reporting and external communication of companies, on the other hand, one must deny the opportunity of the beginning of a historical period marked by the possibility of making financial reporting null and void which, insofar as limited inconsistencies, as a whole mark them, do not invalidate the external communication of the equity, financial and income situation in which the company operates.

Therefore, the transition from "trib-economic" to "economically correct" valuations in substantive terms is the indispensable element for financial reporting to perform its work as an information tool to the outside world. As long as the values recorded in the balance sheet and the profit and loss statement represent mere entries of fiscal nature, this tool will certainly not be able to guarantee third parties the communication of essential data on which

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to base their financial and investment actions[87]. This was the case in the period before and after the corporate and tax reform of 2003 and in the years following the 2008 reform, which, as we will see in the following pages, eliminated the EC Schedule, intended as a tool to deduct items not recognised in financial reporting and imposed the tax deduction only to the economically correct costs relevant in profit and loss statements. The reader is referred to the next chapter for a more in-depth analysis of this amendment to the Consolidated Income Tax Act, with the consequent analysis of the consequences of such a change in the issue of tax interferences in financial reporting.

[87] Zizzo appears very critical of the results of the 2003 reform: 'A quick review of the decade is necessary at the end of this analysis. If the goodness of a reform is measured by its ability to give stability and coherence to the regulatory Schedule, experience in the field of derivation certainly does not allow for a positive evaluation of the 2003 reform.
After only a few years, the model of the derivation-oriented model, accepted by the latter, was supplanted by the opposite model of single-track oriented derivation.
The latter, in turn, after a few years required the preparation of countermeasures, re-proposing the original model'. Zizzo, The principle of derivation 10 years after the introduction of IRES, *Rassegna tributaria*, n. 6, 2014, p. 1314.

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3. THE 2008 REFORM: ANALYSIS OF THE POST-REFORM SITUATION REGARDING THE RELATIONSHIP BETWEEN CIVIL LAW RULES AND PROVISIONS. THE ENHANCED DERIVATION IMPOSED IN 2017

3.1. The 2008 reform. Revolution, evolution or involution? Statutory income and taxable income post elimination of Schedule EC: the prohibition of deductions of non-accounting components

The 2008 Finance Act, Law No. 244 of 24 December 2007, entitled "Provisions for the preparation of the annual and multi-year financial reporting of the State", published in the Official Gazette No. 300 of 28 December 2007, has been in force since 1 January 2008, reformed, once again, the financial reporting tax provisions, entirely and subverting what had been established by the previous double reform of 2003.

As noted above, the 2008 reform involved several issues that we will not consider here.

In the following pages, we will focus our attention only on the provisions that, directly or indirectly, caused a radical modification of the issue of tax interferences by changing, in a tangible way, rules concerning the financial reporting - tax return relationship.

To understand the scope of the 2008 reform, it is necessary to carefully analyse two articles of the TUIR, which, following the Finance mentioned above Act, were amended with the consequence of recreating the situation regarding the interconnection between financial reporting and Unico before the 1990s.

The two articles to which it should draw our attention are Articles 83 and 109 of the Consolidated Income Tax Law, reproduced below for the reader's convenience[1]:

[1] Points of interest are highlighted in bold. It should be noted that in 2016 (with Article 13-bis, paragraph 2, letter a), no. 1, of Law Decree no. 244 of 30.12.2016, converted, with

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"Article 83 – Determination of comprehensive income shall determine total income by adding to the profit or loss shown in the profit and loss statement for the fiscal year ending in the taxable period, the increases or decreases resulting from the application of the criteria.

Outlined in the following provisions of this section. In the case of activities benefiting from partial or full income tax relief, the related tax losses shall be considered to the same extent as positive results. For entities that prepare their financial reports following the international accounting standards set out in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002, including in the formulation resulting from the procedure set out in Article 4, paragraph 7-ter, of Legislative Decree No. 38 of 28 February 2005, and for entities, other than those that prepare their financial reports by the international accounting standards set out in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002, including in the formulation resulting from the procedure set out in Article 4, paragraph 7-ter, of Legislative Decree No. 38 of 28 February 2005. (121) (133) ((182))

1-bis. For paragraph 1, the provisions issued in implementation of Article 1 (60) of Law No. 244 of 24 December 2007 and Article 4 (7-quater) of Legislative Decree No. 38 of 28 February 2005 shall apply, mutatis mutandis, to entities, other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which draw up their financial reports following the provisions of the Civil Code. ((182))

------------- UPDATE (121) Legislative Decree No. 38 of 28 February 2005 has provided (by Article 13, Paragraph 1) that "The provisions of Articles 83 and 109, Paragraph 4, of the Consolidated Law on Income Taxes, approved by Presidential Decree No. 917 of 22 December 1986, as amended by Article 11 of this Decree, shall also apply to components charged directly to equity in the first year of application of international accounting standards".

------------- UPDATE (133) Article 1, paragraph 34 of Law 244 of 24 December 2007 provides that these amendments shall apply from the tax period beginning on 31 December 2007.

amendments, by Law no. 19 of 27.2.2017), these articles were amended and, as a result of this change, the enhanced derivation, previously applicable only to IAS adopting companies, became a reference point also for companies that prepare their financial statements according to the rules of the code and the national OIC standards. The reader is referred to the following paragraph for further details on this issue.

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------------- UPDATE (182) Decree-Law No. 244 of 30 December 2016, converted with amendments by Law No. 19 of 27 February 2017, provided (by Article 13-bis, paragraph 5) that "The provisions of the preceding paragraphs shall be effective concerning income and balance sheet items recognised in financial reporting starting from the financial year following the one in progress at 31 December 2015. The income statement and balance sheet affect the financial reporting of the year mentioned above and of subsequent years of transactions that are differently qualified, classified, valued and temporarily charged for tax purposes concerning the qualifications, classifications, valuations and temporal charges resulting from the financial reporting of the year in progress as of 31 December 2015 continue to be subject to the previous tax regulations". It also provided (by Article 13-bis, paragraph 8) that "The provisions of paragraphs 5 to 7 shall also apply in the event of changes in accounting standards according to paragraph 3 of Article 12 of Legislative Decree No. 139 of 18 August 2015, and in the event of changes in financial reporting requirements resulting from changes in the size of the company".

"Article 109 – General rules on components of business income

1. Revenues, expenses and other positive and negative components, for which the preceding rules of this Section do not provide otherwise, shall contribute towards forming income in the year in which they accrue; however, revenues, expenses and other components whose existence is not yet particular or their amount cannot be objectively determined in the year in which they accrue shall contribute towards forming income in the year in which those conditions are fulfilled.

2. to determine the chargeable period

(a) the consideration for the supply of goods shall be deemed to be received. The cost of acquiring goods shall be considered to be paid at the date of delivery or dispatch in the case of movable property and the date of the conclusion of the deed in the case of immovable property and businesses or, if different and later, at the date on which the transferor constitutive effect of the ownership or other right in rem occurs. Retention of title clauses shall not be taken into account. A lease with a transfer of ownership clause binding on both parties shall be treated as a conditional sale;

(b) the consideration for the rendering of services shall be deemed to have been received, and the costs of acquiring services shall be deemed to have been incurred on the date when the services are completed or, in the case of services dependent on a lease, loan, insurance or other contract from which

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periodic payments are derived, on the date on which the payments become due;

(c) in the case of companies and bodies which have issued bonds or similar securities, the difference between the sums due on maturity and the sums received in respect of the issue shall be deductible in each tax period to an extent determined following the amortisation schedule of the loan.

3. Revenues, other income of any kind and inventories contribute towards forming the income even if they are not charged to the profit and loss account.

3-bis. Capital losses realised by Article 101 on shares, units and financial instruments similar to shares that do not meet the requirements of Article 87 are not taken into account up to the amount of the non-taxable amount of dividends, or interim dividends received in the thirty-six months preceding the realisation. This provision also applies to negative differences between the revenues of the assets referred to in Article 85 (1) (c) and (d) and their costs. (122)

3-ter. The provisions of paragraph 3-bis shall apply with reference to shares, units and financial instruments similar to shares acquired in the thirty-six months prior to realisation, provided that they satisfy the requirements for exemption under letters c) and d) of paragraph 1 of Article 87. (122)

3-quater. The application of Article 37-bis of Presidential Decree No. 600 of 29 September 1973 shall remain unaffected, also concerning negative differentials of a financial nature arising from transactions initiated in the tax period or in the preceding one on shares, units and financial instruments similar to shares referred to in paragraph 3-bis. (122) 3-quinquies. Paragraphs 3-bis, 3-ter and 3-quater shall not apply to persons drawing up their financial reports under the international accounting standards referred to in Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002. 3-sexies. To disapply the provisions referred to in paragraphs 3-bis and 3-ter, the taxpayer shall apply to the authorities pursuant to Article 11 (2) of Law No 212 of 27 July 2000 on the taxpayer's rights.

4. Expenses and other negative components shall not be deducted if and to the extent that they are not charged to the profit and loss statement for the year in question. The following shall be considered as charged to the profit and loss statement: components charged directly to equity due to the accounting principles adopted by the undertaking. However, the following are deductible: ((182)) a) those charged to the profit and loss statement of a prior period, if the deduction has been deferred following the preceding rules of this Section that provide or permit deferral; b) those that, although not

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chargeable to the profit and loss statement, is deductible by law PERIOD DELETED BY LAW NO 244 OF 24 DECEMBER 2007.

Expenses and charges specifically relating to revenues and other income which, although not included in the profit and loss statement, contribute towards forming income, may be deducted if and to the extent that they result from certain and precise elements. (121) (123) (126) (133)

5. Expenses and other negative components other than interest expense, except for charges relating to taxes, social security contributions and charitable contributions, shall be deductible to the extent that they relate to activities or assets from which income or other revenues are derived and which are included in income or are excluded from income. Suppose they refer indiscriminately to activities or assets generating computable income and to activities or assets generating income that cannot be included in the calculation of income because they are exempt. In that case, they are deductible for the part corresponding to the ratio between the amount of the revenues and other income that contribute towards forming the business income or that do not contribute towards it because they are excluded and the total amount of all revenues and income. The capital gains referred to in Article 87 shall not be taken into account for the preceding period. Without prejudice to the provisions of the preceding periods, expenses relating to hotel services and the serving of food and beverages, other than those referred to in Article 95 (3), shall be deductible to the extent of 75%. (133) (136)

6. PARAGRAPH REPEALED BY LAW NO 244 OF 24 DECEMBER 2007. (133)

7. By way of derogation from paragraph 1, it shall include interest on late payments in income in the year it is received or paid.

8. By way of derogation from paragraph 5, the cost sustained for acquiring the right of usufruct or another similar right relating to a shareholding from which profits excluded under Article 89 are derived shall not be deductible.

9. Any kind of remuneration due is not deductible:

a) on securities, financial instruments however denominated, as referred to in Article 44, for the part of it that directly or indirectly involves participation in the economic results of the issuing company or of other companies belonging to the same group or of the business in connection with which the financial instruments have been issued;

b) in respect of joint ventures contracts and those referred to in Article 2554 of the Civil Code where provision is made for a contribution other than works and services.

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--------------- UPDATE (121) Legislative Decree No 38 of February 28 2005 has provided (by Article 13 (1)) that "The provisions of Articles 83 and 109 (4) of the Consolidated Income Tax Law, approved by Presidential Decree No 917 of December 22 1986, as amended by Article 11 of this Decree, shall also apply to the components charged directly to equity in the first year of application of international accounting standards".

--------------- UPDATE (123) Legislative Decree No 247 of November 18 2005 provided (by Article 6(13)) that "The provisions of Articles 86(5-bis), 87(3), first sentence, (6) and (7), 88(4), 89(2) and (3), first sentence, 95, 98, 101 and 109(4)(b), fourth sentence, of the Consolidated Act, as amended by this Article, shall apply to tax periods beginning on or after January 1 2004. The provisions of Articles 87(1-bis), 93(7), 109(4)(b), third sentence, 111 and 114 of the Consolidated Law, as amended by this Article, shall have effect for tax periods beginning on or after January 1 2005. The provisions of Articles 87 (3), last sentence, and 89 (3), last sentence, as amended by this Article, shall have effect for tax periods starting from January 1 2006".

--------------- UPDATE (122) Decree-Law no. 203 of September 30 2005, converted with amendments by Law no. 248 of December 2 2005, provided (by Article 5-quinquies, Paragraph 2) that "The provisions of Paragraph 1 shall apply to capital losses and negative differences realised as from January 1 2006".

-------------- UPDATE (126) The Decree-Law no. 223 of July 4, 2006, converted into law with amendments by the Law no. 248 of August 4, 2006, provided (by Article 37, Paragraph 48) that "The provisions of Paragraph 47 shall apply to expenses relating to studies and development research incurred starting from the tax period following the date of entry into force of the present Decree".

--------------- UPDATE (133) Law No. 244 of December 24, 2007 has provided (by Article 1, Paragraph 34) that "The provisions of Paragraph 33, letters a), b), c), d), e), g), number 2), l), m), o), p), q), nu-meri 2) and 3), u) and aa), shall apply as from the tax period following the one in the course on December 31, 2007. [...] The provision referred to in paragraph 33 (q) (1) shall apply from the tax period following that in the course on December 31 2007, without prejudice to the transitional application of the provisions of Article 109 (4) (b), third, fourth and fifth sentence, of the aforesaid Consolidated Act referred to in Presidential Decree no. 917 of 1986, in the version provided for by article 109 (4) (b) of the aforesaid Consolidated Act. 917 of 1986, in the text preceding the amendments made by the present law, for the recovery of the surpluses resulting at the end of the tax period under way on December 31 2007".

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--------------- UPDATE (136) The D.L. June 25, 2008, n. 112 converted with amendments by the L. August 6, 2008, n. 133 has said (with art. 83, paragraph 28-quinquies) that "The provisions of paragraph 28-quater come into force starting from the tax period following the one in progress on December 31, 2008.

------------- UPDATE (182) Decree-Law No. 244 of 30 December 2016, converted with amendments by Law No. 19 of 27 February 2017, provided: - (through Article 13-bis, paragraph 5) that "The provisions outlined in the preceding paragraphs shall be effective concerning income and equity components recognised in financial reporting starting from the financial year following the one in progress at 31 December 2015. The income and balance sheet effects on the financial reporting of the aforesaid year and of subsequent years of transactions that are differently qualified, classified, valued and temporally charged for tax purposes with respect to the qualifications, classifications, valuations and temporal charges resulting from the financial reporting of the year in progress as of 31 December 2015 shall continue to be subject to the previous tax regulations"; – (by Article 13-bis, paragraph 7, letter b) of the Consolidated Law on Finance). 38 of 28 February 2005, updated pursuant to paragraph 3 of Article 12 of Legislative Decree No. 139 of 18 August 2015: a) the provisions of Article 109, paragraph 4, of the Consolidated Act referred to in Presidential Decree No. 917 of 22 December 1986 shall also apply to the components charged directly to equity"; - (by Art. 13-bis, paragraph 8) that "The provisions of paragraphs 5 to 7 shall also apply in the event of changes that occur in the accounting standards pursuant to paragraph 3 of Article 12 of Legislative Decree No. 139 of 18 August 2015, and in the event of changes in the financial reporting disclosure requirements resulting from changes in the size of the company".

Given the relevance of a provision and some deletions verified with the entry into force of Law 24 December 2007, no. 244, we have highlighted, in a relevant way, the points of our interest.

First of all, the 2008 reform reiterated the prior recognition of components in the profit and loss statement for their tax deduction. It is clear from reading Article 83 that, since 2008, negative income components are only deductible for tax purposes if they are recognised in the profit and loss statement for the financial year, with certain exceptions highlighted directly by Article 83.

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However, the central element of the reform is the deletions, highlighted in point No. 4 of Article 109, which were made following the entry into force of Law No. 244/2007.

The deleted points stipulated that:

"point no. 4

b) [...]. Depreciation and amortization of tangible and intangible assets, other value adjustments and provisions are deductible if the total amount, the civil and fiscal values of the assets and those of the provisions are indicated in a separate statement in the income tax return. In the event of distribution, equity reserves and retained earnings, even if earned after the tax period to which the deduction relates, contribute towards forming income if and to the extent that the amount of the remaining equity reserves, other than the legal reserve, and retained earnings are less than the exception of Depreciation and amortization, value adjustments and additions deducted concerning those charged to the profit and loss statement, net of the deferred tax provision related to the deducted amounts. The amount of excess is reduced by Depreciation, gains or losses, value adjustments relating to the same assets and provisions, and equity reserves and distributed profit for the year, contributing to income formation.

The report accompanying the draft of Law 244/2007 highlighted:

"On the other hand, it should be noted first of all that in many cases, and even when they deviate, the operational measures take their cue from the work of the Study Commission on IRES reform chaired by Prof. Biasco.

In this general perspective of system evolution, the main change concerns the rationalisation of the discipline of non-accounting deductions: that is to say, of the premises for depreciation and other costs that can make in the income tax return over and above the amount charged to the profit and loss statement. This phenomenon has now reached a level that is no longer in keeping with the function that non-accounting deductions were intended to fulfil. Suffice it to say that the amount of off-balance sheet deductions in the 2004 and 2005 tax returns reached more than 10 billion lire (and rising).

It should remember that this discipline was one of the most important innovations introduced by the previous 2003 reform. The decision to allow the off-balance-sheet deduction of specific estimated components (amortisation, depreciation, write-downs and provisions) stemmed from the decision made in the context of the reform of company law to eliminate the phenomenon of the so-called fiscal contamination of financial reporting, which is the result of the need to reduce the tax burden on financial assets. The possibility

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caused this – previously expressly provided for by the Italian Civil Code and other special laws – to include in the result adjustments and provisions for risks and charges made for exclusively fiscal reasons, but without, in whole or in part, justification according to correct accounting principles. In implementing the discipline of off-balance-sheet deductions of costs, Legislative Decree 344 of 2003 substantially followed the solutions indicated by the special study commission to coordinate the reform of company law with tax regulations. In particular, the commission made two basic choices and then implemented in the reform. The first choice was to keep the same tax opportunities previously available in the new system as well: therefore, no distinction was made between subsidised rules (such as, for example, those concerning accelerated depreciation) and rules that provided for flat-rate criteria for determining the maximum limits of deduction of negative components of an estimated nature (and of tax forfeits). The second choice was that of subordinating the tax suspension to a corresponding amount of equity: in short, while not requiring, as previously, the creation of specific reserves in the suspension of taxation, the rules require that the level of equity does not fall below the total amount of value adjustments and provisions deducted off the books, net of deferred taxes related to the anticipated deduction of such components. The application of these rules, as is well known, has revealed many problems of interpretation and a certain complexity of the mechanism. Above all, however, the scale of the deductions in question has highlighted the appropriateness of a reorganisation. It does not seem reasonable for the tax authorities to allow unlimited generalised deduction of costs without economic justification. Henceforth, it will pursue incentive policies to reward virtuous business behaviour, preferably through tax credits and without interfering with income determination rules. In this context, and line to lower the level of taxation, a radical rethink of the matter has been carried out.

As a result of the amendments made to the Consolidated Income Tax Act by letter o) of paragraph 1 of Article 3 in question, starting from the tax period following the one in course on 31 December 2007, non-accounting deductions for depreciation, other value adjustments and provisions will no longer be allowed, without prejudice to the deductibility of costs charged to the profit and loss statement, albeit always within the maximum limits allowed by the tax law”[2].

[2] Accompanying report on Bill 244/2007.

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It should note that Law 244/2007 was based on a study carried out by the Biasco Commission whose report, although not adopted in all its points, formed the basis of the reform passed in 2008.

In the Biasco report, it made the following observations concerning non-accounting deductions:

"Non-accounting deductions and the restriction on reserves.

Regarding business income, one of the most important innovations introduced by the 2003 reform concerns the off-balance-sheet deduction of specific negative components of an estimated nature of certain negative elements of an estimative nature (depreciation, devaluations, provisions).

The innovation is consistent with the decision, made in the context of the reform of company law, to eliminate the phenomenon of the so-called "fiscal contamination of financial reporting so" caused by the possibility, previously granted by the Civil Code and special laws, to contribute to the result for the year adjustments of values or provisions for risks and charges made for exclusively fiscal purposes but without, partially or totally, justification according to the correct accounting principles.

The choices made by Legislative Decree No. 344 of 2003, while maintaining the same tax opportunities previously used (without distinguishing between subsidies and rules concerning the possibility of adopting flat-rate criteria for the determination of maximum limits of deductibility of estimated components), have however made the deductibility of these negative items not recorded in the profit and loss statement subject to the attachment of a tax suspension restriction on a corresponding amount of shareholders' equity.

While not requiring, as previously, the creation of specific tax-suspension reserves, the regulations provide, more simply, that the level of profit and loss reserves should not fall below the total amount of adjustments and additions deducted off-balance sheet, net of deferred taxes related to the anticipated deduction of such components.

Compared to the previous system, which limited the creation of reserves only for the recognition of negative components induced by facilitating purposes, the interventions result in a uniformity of application, which, however, gives rise to many problems.

It has been observed that the extension of the fiscal constraint on the profits in question and the consequent need to keep them with the company that made them constitutes an obstacle to the optimal reallocation of resources, according to the needs of efficiency and competitiveness, especially in the context of corporate groups and competitiveness, especially in the context of corporate groups.

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From a management point of view, there is unanimous criticism of the complexity of the resulting mechanism, which requires complex monitoring of misalignments between statutory and fiscal values of assets subject to off-balance sheet deduction. This is due both to the possible occurrence of differentiated misalignments, in the case of deductions relevant only for income tax, but not for IRAP, and to the operational difficulties related to the realignment of values (which the administrative instructions provided so far provide that it should be implemented for all assets and funds for which there is a misalignment and in proportion to the existing misalignment), complexity exacerbated by the need to link with the adoption of international accounting standards.

Although the function of the safeguard clause mentioned above is obvious: it aims to keep the benefit of the off-balance-sheet deduction in the company's economy, preventing it from being transferred to shareholders through the distribution of profits or reserves, the Commission considers that the widespread call for the repeal of the clause can be considered. Indeed, the enabling act does not lay down strict conditions in this respect (Article 4(1)(i) of Law No 80 of 2003), so that

2003), so that a simplification of the system might be preferred, considering that, ultimately, the benefit in question is still a deferment of taxation over time, which would be reabsorbed upon completion of the process of depreciation of the assets or their realisation; moreover, any discrimination that might arise between undertakings depending on the accounting system adopted would be eliminated (the restriction for simplified accountants being inoperative).

The hearings have underlined the institute's low use both for the indicated application complexity and for the entity of the values at stake, the recovery of which could be considered sufficiently protected by the allocation of deferred taxes that decrease the distributable profit. [...]"[3].

From reading the Biasco report, it is clear that the outlines of the 2008 reform had been outlined by the Study Commission chaired by Prof. Biasco. Consequently, it had already identified the changes introduced in the financial reporting and tax return in that report.

[3] Report of the Study Commission chaired by Prof. Biasco on the taxation of companies, Final Report, p. 91.

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From the above, it is clear that, following the reform, it is no longer possible to deduct negative income components through the Schedule EC mechanism, i.e. by highlighting, in a special statement included in the Unico, the difference between the economic value recorded in financial reporting and the maximum limit deductible for tax purposes.

This means that if the economically correct value, i.e. determined following the provisions of the Italian Civil Code as supplemented by the OIC accounting principles, is lower than the maximum value deductible for tax purposes, then it must show the value of the asset in the income statement. [4] Suppose the difference between the value of the asset and the value of the liability charged to the profit and loss statement is lower than the maximum limit deductible for tax purposes. In that case, the reporting company loses the possibility of deducting the difference that, potentially, the tax authorities have considered as hypothetically deductible if it had passed through the financial reporting system.

The 2003 reform was hailed as a step forward in the area of the problem of tax interferences as, in the presence of a willingness of the company to determine the two values that should always be compared (economically correct value and tax-deductible amount), it was possible to draw up a true and correct financial reporting in all its components (profit and loss statement, balance sheet and notes) and, at the same time, there was no danger of losing opportunities for tax deductions useful to reduce taxable income. It is important to emphasise that the tax legislator himself had envisaged these opportunities to favour companies.

With the 2008 reform, this can no longer be implemented. According to the legislation passed in 2008 and currently in force (with the amendments that are made to the tax law from year to year), financial reporting must be prepared by recording only and exclusively the economically correct values, while the tax return does not allow deductions higher than the amounts recorded in profit and loss state-ment.

It is evident that this situation places companies in a complicated decision-making situation:

(a) Either prepare true and fair financial reporting and forgo potential tax deductions and, as a result, pay more tax than if it had reported the maximum amount deductible for tax purposes in its profit and loss statement;

[4] This paper does not consider IAS/IFRS adopting companies but focuses on companies that prepare their financial statements according to the civil code supplemented by the national accounting standards OIC.

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(b) or prepare financial reporting that is contaminated by tax valuations and, as a result, unlawful, which allows total tax deductions for negative income components recognised in the profit and loss statement.

From a theoretical point of view, the scholar must affirm that the company must draw up a financial reporting true and correct in all its parts even if this leads to a loss of tax-deductibility of some negative income components.

From a pragmatic point of view, however, it is undoubtedly true that this situation inevitably leads to the drafting of financial reporting tainted by tax interferences, since there are certainly few companies that give up tax deductions, paying more taxes, to draw up perfect financial reporting: understandable, true and correct as per Article 2423 of the Italian Civil Code.

Lupi states, in this regard, that "we are therefore back to square one, about thirty years ago, and this arouses a sense of unease in all those who have been trying to clarify the point for decades.

The books, the discussions, the conferences, the articles, the reflections of some decennial seem to have been swept away abruptly. All the talks on the pollution of financial reports, the abolition of the fiscal appendix, and the different purposes of civil and fiscal laws assessments have been neglected as if they had been a tremendous waste of time. This isn't very encouraging. Scholars should probably examine their consciences concerning the often unsystematic, overly self-referential, overly technical and flattened by "regulatory data" ways in which they have dealt with the subject over the years"[5].

As we shall have occasion to prove this series in volume III, empirical studies bear this conviction. However, the judgment of companies is almost permeated by a feeling of injustice. "If it is not blackmailing, it is something like this. For the theorists of financial reporting, it is worse than a Pyrrhic victory, but it is a real defeat since it has been established that financial reporting can only harm the company but never benefit it; on the contrary, financial reporting always benefits the tax authorities but never harms them. When it conflicts with tax rules, financial reporting is a wastepaper, while when it serves to limit deductions, financial reporting is an additional fiscal safeguard"[6].

he elimination of tax benefits such as accelerated depreciation/amortization and accelerated depreciation/amortization[7] As a result of these deletions,

[5] Lupi, "Reddito fiscale e bilancio d'esercizio civilistico: a sorpresa tornano gli inquinamenti", *Corriere Tributario*, n. 40, 2007, p. 3231 ss.
[6] Lupi, ult. op. citata, p. 3235.
[7] On the subject of accelerated depreciation, however, Pino points out that: "I don't think that the abolition of accelerated depreciation will cause significant discomfort among operators, given the poor, or relatively non-existent, application of this institution in the first thirty-five

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the tax base increased, and companies had no intention of increasing it further. As a result of these deletions, the tax base underwent an evident increase that the companies had no purpose of growing further, losing the possibility of tax deductions for preparing financial reportings with economically correct values. In essence, many companies prefer to draw up unrealistic financial reportings with tax-related valuations to reduce the IRES tax base, knowing that this creates the basis for a challenge to the financial reporting approval resolution. Financial reporting, if not true and correct, is illegitimate, and, as a result, the resolution approving it can be challenged and, consequently, declared null and void.

Concerning this issue, which we will return to in Volume III of this series, we should recall a historic judgment of the Court of Cassation no. 22016 of 17 October 2014.

The ruling concerned depreciation and, more specifically, addressed the issue of the relationship between depreciation provided for by tax legislation and depreciation recognised in the financial reporting.

However, the general principles set out in the decision apply to any income component. For this reason, the above conclusion is undoubtedly destined to become a leading case.

The ruling, as mentioned above, sets out four fundamental principles:

a) **THE VALUES INCLUDED IN FINANCIAL REPORTING MUST REFLECT THE "ECONOMIC" CONTENT OF THE PRODUCTIVE FACTOR SUBJECT TO ACCOUNTING.**

The Supreme Court has stated that "the valuation criteria laid down in Article 2426 above, and therefore also in paragraph 2) which affects the case in question, must be recognised as mandatory because they guarantee the function, proper to financial reporting, of transparency to ensure readability and controllability by shareholders and third parties (Court of Cassation no. 23976/2004 and Court of Cassation no. 4874/2006).

Indeed, in the absence of specific provisions, the statutory conditions on the preparation of financial reports also apply for tax purposes.

On the contrary, it is not valid to rely on the provisions of Article 67 (now Article 102(2)) of the TUIR, which recognises the deductibility of depreciation, as negative income components, to the extent indicated in the special table drawn up by the Ministry of Finance and allows the taxpayer, who in specific years has declared depreciation lower than the maximum amount

years of tax reform". Pino, "Finanziaria 2008: l'abolizione degli ammortamenti anticipati", *Corriere Tributario*, n. 46, 2007, p. 3778.

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allowed, the possibility of recovering the lack of benefit of the increased depreciation in subsequent years, provided that the limits allowed for each of those years are not exceeded.

However, this provision does not relieve the entrepreneur required to prepare financial reports of the obligation to calculate the actual depreciation of assets attributable to each financial year, for the correct preparation of the financial report, following the provisions of Articles 2423 et seq. of the Civil Code".

b) **THE CONTRIBUTOR CAN NOT BE GRANTED FULL DISCRETION IN DETERMINING TAX-DEDUCTIBLE AMORTISATION**.

In the judgment as mentioned above, it was pointed out that 'about income tax, having regard to the determination of business income, and in particular to the deduction of depreciation expenses, the taxpayer cannot be granted full discretion to determine, in the tax return, the annual depreciation allowances for assets, varying them from year to year.

Depreciation can only comply with the systematic criterion set forth by Article 2426 no. 2) of the Italian Civil Code based on a depreciation plan that indicates the value to be depreciated (difference between the cost of the fixed asset and its presumed residual value at the end of its useful life), the residual possibility of use and the criteria for reallocating the value to be depreciated, which tend to consist of either straight-line depreciation - which is the ordinary criterion for allocation - or declining rates.

The use of reduced depreciation rates only for the first years of use of the assets does not, therefore, appear to be in line with the obligation, incumbent on the entrepreneur, to determine, in a unitary manner, the actual extent of the depreciation of the assets attributable to each financial year, in the application of the more general obligation of truthfulness and understandability in the preparation of financial reporting.

The depreciation quotas cannot be determined and varied arbitrarily by the company. Still, they must be related, in a uniform manner, to the expected duration of use of the capital goods since Article 67 (now 102) TUIR does not introduce an exception to the provisions of the Civil Code on the subject of the preparation of financial reporting, which are also intended to apply for tax determinations".

c) **ANY CHANGE IN THE VALUATION CRITERIA APPLIED WHEN PREPARING THE FINANCIAL REPORTING MUST BE DULY JUSTIFIED AND EXPLAINED IN THE NOTES OF THE FINANCIAL STATEMENT UNLESS THE APPROVAL OF THE FINANCIAL REPORTING SO BE DECLARED NULL.**

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The obligation to adequately justify in the notes to the financial statements any changes to the valuation criteria adopted in the preparation of the financial reporting is imposed by Article 2423 u.c. of the Italian Civil Code. In judgment no. 22016/2014, the Supreme Court pointed out that failure to comply with this principle renders the financial reporting invalid and, consequently, causes the nullity of its approval resolution.

The Court of Cassation reiterated that "the change in the depreciation criterion, in contrast, as already noted, with the provisions of Article 2426 of the Italian Civil Code and the principle of systematic and uniform depreciation codified therein, is not based on a valid economic reason and has not found any justification in the notes to the financial reporting so.

As mentioned above, the taxpayer did not provide any justification for such a change in the depreciation rate in the notes to the financial statements, and such omission implies a violation that is not merely formal but directly contrary to the obligation of truthfulness and understandability in the preparation of financial reporting [...]. It follows that the adoption, in the preparation of financial reporting, of a valuation criterion for an asset that differs from that used in previous years, in violation of the principle of continuity of accounting values enshrined in Article 2423-bis of the Italian Civil Code and without the notes to the financial statements providing adequate justification for the requested derogation, renders the financial reporting null and void".

d) **THE INCLUSION IN PROFIT AND LOSS STATEMENTS AND/OR BALANCE SHEETS OF TAX AMOUNTS WITHOUT ECONOMIC CONTENT MADE THE APPROVAL OF THE FINANCIAL REPORTING SO NULL BECAUSE THE PRESENCE OF TAX INHERENCIES IN THOSE DOCUMENTS IMPLIES THE FAILURE TO COMPLY WITH THE POSTULATES OF TRUTH AND CORRECTNESS IMPOSED BY ART. 2423 C.C.**

The Court of Cassation sanctioned the illegitimacy of the recognition of purely fiscal values in the financial reporting, stressing that "the criteria for allocating the value to be depreciated must [...] ensure a rational and systematic allocation of the value of assets during their estimated useful life so that any changes in the depreciation criteria of the coefficients applied must be justified by a valid economic reason and specifically motivated in the notes to the financial statements. In a case in point, the taxpayer used, in the tax periods before the one under examination, depreciation coefficients to its capital assets equal 50% of those established by the tax legislation. At the same time, since 1999, it has applied the coefficients found by the same legislation to the maximum extent to the same assets.

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The change in the allocation criterion, in contrast, as already mentioned, with the provisions of Article 2426 of the Italian Civil Code and with the principle of systematic and uniform depreciation codified therein, is not based on a valid economic reason and has not found any justification in the explanatory notes to the financial statements.

The use of reduced depreciation rates only for the first years of use of the assets does not, therefore, appear to comply with the obligation, incumbent on the entrepreneur, to determine, in a uniform manner, the actual amount of depreciation of the assets attributable to each financial year, in the application of the more general obligation of truthfulness and understandability in the preparation of financial reporting.

The depreciation quotas cannot be determined and varied arbitrarily by the company. Still, they must be related, in a uniform manner, to the expected duration of use of the capital goods, since Article 67 (now 102) TUIR does not introduce an exception to the provisions of the Civil Code on the subject of the preparation of financial reporting, which are also intended to apply to the purposes of tax determinations [...].

c) **ANY CHANGE IN THE VALUATION CRITERIA APPLIED WHEN PREPARING THE FINANCIAL REPORTING MUST BE DULY JUSTIFIED AND EXPLAINED IN THE FINANCIAL STATEMENT NOTES UNLESS THE APPROVAL OF THE FINANCIAL REPORTING SO BE DECLARED NULL.**

The obligation to adequately justify in the notes to the financial statements any changes to the valuation criteria adopted in the preparation of the financial reporting is imposed by Article 2423 u.c. of the Italian Civil Code. In judgment no. 22016/2014, the Supreme Court pointed out that failure to comply with this principle renders the financial reporting invalid and, consequently, causes the nullity of its approval resolution.

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accounting values enshrined in Article 2423-bis of the Italian Civil Code and without the notes to the financial statements providing adequate justification for the requested derogation, renders the financial reporting null and void".

d) **THE INCLUSION IN PROFIT AND LOSS STATEMENTS AND/OR BA-LANCE SHEETS OF TAX AMOUNTS WITHOUT ECONOMIC CONTENT MADE THE APPROVAL OF THE FINANCIAL REPORTING SO NULL BECAUSE THE PRESENCE OF TAX INHERENCIES IN THOSE DOCUMENTS IMPLIES THE FAILURE TO COMPLY WITH THE POSTULATES OF TRUTH AND CORRECTNESS IMPOSED BY ART. 2423 C.C.**

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The change in the allocation criterion, in contrast, as already mentioned, with the provisions of Article 2426 of the Italian Civil Code and with the principle of systematic and uniform depreciation codified therein, is not based on a valid economic reason and has not found any justification in the explanatory notes to the financial statements.

The use of reduced depreciation rates only for the first years of use of the assets does not, therefore, appear to comply with the obligation, incumbent on the entrepreneur, to determine, in a uniform manner, the actual amount of depreciation of the assets attributable to each financial year, in the application of the more general obligation of truthfulness and understandability in the preparation of financial reporting.

The depreciation quotas cannot be determined and varied arbitrarily by the company. Still, they must be related, in a uniform manner, to the expected duration of use of the capital goods, since Article 67 (now 102) TUIR does not introduce an exception to the provisions of the Civil Code on the subject of the preparation of financial reporting, which are also intended to apply to the purposes of tax determinations [...].

Also, in 2015, the Supreme Court reiterated the above. In its judgment, no. 451 of 14 January 2015, the Supreme Court pointed out that "it is clear

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from the documents (see page 6 et seq. of the counter-appeal) that the allegation made against the taxpayer in the appraisal report referred to in the notice of assessment in question - consisted in having "contaminated the taxpayer's financial reporting with interferences". - The Supreme Court pointed out that "it is clear from the documents (see p. 6 and following of the counter-appeal) that the finding made against the taxpayer in the tax assessment report referred to in the notice of assessment at issue - consisted in having "contaminated the civil-law financial reporting with tax interferences carried out for the sole purpose of taking advantage of a tax benefit, without disclosing in the notes to the accounts the criteria adopted for such operation", as well as having consequently "artificially lengthened the depreciation period of individual assets compared to their natural economic life in the life of the company, transferring negative income components in subsequent years compared to those of economic competence and reaching, in the end, a point where the taxpayer could not be held responsible for the depreciation of the individual assets. This led to a covert extension of the duration of the total territorial exemption from IRPEG (applicable until March 1999) [...]. The tax rule involved in the case is Article 67 of the old Consolidated Income Tax Law ('Admissibility'). 67, old Consolidated Income Tax Law ("Depreciation of tangible assets"), which also in the text in force ratione temporis provided for precise limits and constraints on the deductibility of depreciation quotas (para. 1: "Depreciation quotas of the cost of tangible assets instrumental to the business are deductible from the financial year in which the asset comes into use"; para. 2: Paragraph 2: "The deduction is allowed to an extent not exceeding that resulting from the application to the cost of the assets of the coefficients established by decree of the Minister of Finance published in the Official Gazette, reduced by half for the first year. The coefficients are established for homogeneous categories of goods based on the normal period of wear and tear, and consumption in the various production sectors"), as well as precise and strict conditions for increasing the deductibility beyond the maximum limit provided for therein (paragraph 3: "The maximum amount indicated in paragraph 2 may be exceeded in proportion to the more intensive use of the goods compared to the normal use of the sector. It may be increased up to two times by accelerated depreciation in the year in which the assets are put into operation for the first time and in the two following years, provided that the excess, if in the respective financial reports it has not been charged to the depreciation of the assets, has been set aside in a special reserve which for tax purposes constitutes an integral part of the depreciation; in the case of assets already used by other parties, accelerated depreciation may be performed by the new user only in the year in

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which the assets are put into operation. By decree of the Minister of Finance, the aforesaid maximum measure may be varied, up or down, within the limit of a quarter, concerning the period of usability of the assets in particular production processes. The depreciation quotas allocated in financial reporting after the depreciation for fiscal purposes are not deductible. The appropriate reserve will contribute to the formation of income for the amount withdrawn by the entrepreneur or distributed to the shareholders or charged to capital more than the quotas not deducted") and to the reduction of the maximum amount of depreciation, with the possibility of recovery in subsequent years (paragraph 4: "If in one financial year the depreciation is made to an extent lower than the maximum amount indicated in paragraph 2, the depreciation allowances relating to the difference are deductible in subsequent financial years, without prejudice to the limits referred to in the preceding paragraphs. However, suppose the depreciation made in one year is less than half of the maximum amount. In that case, the lower amount does not contribute to the depreciable difference, unless it depends on the actual lesser use of the asset compared to the normal use in the sector"). In both cases, the reference in terms of 'effectiveness' to a 'more intense', or 'lesser' (if less than half of the maximum amount), use of the goods compared to the 'normal use of the sector' is explicit.

It is therefore clear that, from a fiscal point of view, the management of depreciation is not left - contrary to what the appellant assumes (which in the corresponding ground of appeal referred to it as a "free choice of the taxpayer", as stated on page 2 of the contested judgment) - to the discretion of the entrepreneur, but is strictly bound to a series of quantitative, temporal and financial reporting parameters, in compliance with the accrual principle (art. 75 old Consolidated Income Tax Law).

At the civil law level, this corresponds synergistically to the provision of art. 2426 Civil Code, paragraph 1, no. 2) - according to which "the cost of tangible and intangible fixed assets, whose use is limited in time, must be systematically depreciated in each financial year concerning their residual possibility of use. Any changes in the depreciation criteria and coefficients applied must be justified in the notes to the financial statements" - which in turn derives from the principles of understandability, truthfulness and correctness of financial reporting (Article 2423, paragraph 2 of the Italian Civil Code).

In the present case, it is undisputed that no supplementary note contained the slightest reasoning regarding the radical modification of the depreciation coefficients which took place as from the 1999 financial year, therefore precisely at the same time as the cessation of the ten-year Irpeg territorial exemption regime, which entailed a sort of "prolongation", to the extent that

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the sudden (and unjustified) doubling of the negative components led to a reduction in income, at the time when they had become newly taxable. Nor, it should be noted, was any justification in this regard subsequently provided by the taxpayer, not even in the course of the proceedings.

As recently confirmed by this Court, "the purpose of the rules which, in the field of income tax, govern the depreciation of the costs of capital goods is to avoid misrepresentation of business income, both about the accrual principle according to Article 109 TUIR, and in consideration of the principle of autonomy of tax obligations relating to "each tax period" (corresponding, in the absence of different legislative or statutory indications, to the calendar year: Article 76 TUIR), and therefore a false representation of business income. 76 TUIR), and therefore an inaccurate determination of the taxable base in the case of deduction of expenses relating to capital goods whose use and exploitation is long-lasting"; consequently, any abusive use of a different depreciation regime, "aimed at unduly anticipating the deductibility of the negative income component", would affect the constitutional principle of ability to pay" (Court of Cassation, 5 December 2014, no. 25758, on leasing).

The United Sections of this Court (Court of Cassation, s.u. no. 30055 of 2008) have also recognised for some time the existence of a general anti-extortion principle, the source of which is to be found not only in the typical case law but, for harmonised taxes (such as direct taxes) also and above all in the constitutional principles that inform the Italian tax system, such as the ability to pay (Article 53 of the Constitution, paragraph 1) and the progressiveness of taxation (Article 53 of the Constitution, paragraph 2), "which are the basis both of the tax rules in the strict sense and of those that attribute to the taxpayer advantages or benefits of any kind, since the latter rules are clearly aimed at ensuring that the taxpayer is able to benefit from the advantages or benefits of any kind, paragraph 2), "which form the basis both of the tax rules in the strict sense and of those which attribute to the taxpayer advantages or benefits of any kind, the latter rules being clearly aimed at the fullest implementation of those principles"; from that principle it must therefore follow that "the taxpayer may not derive undue tax advantages from the distorted use, even if not contrary to any specific provision, of legal instruments capable of obtaining a tax saving, in the absence of economically appreciable reasons justifying the operation, other than the mere expectation of that tax saving.

In fact, according to the highest courts, abusive conduct (or abusive practice) is "that eco-nomic transaction which, taking into account both the will of the parties involved and the factual and legal context, sets as a predominant and absorbing element of the transaction the aim of obtaining tax

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advantages", with the consequence that the prohibition of abusive conduct does not apply where those transactions can be explained otherwise than by the mere, attainment of tax savings" (Cassazione No 653/14 cited above; ECJ in Klub OOD, para. 48; ECJ 21 February 2006, C-255/02, Halifax and others, paras. 74 and 75).

In the light of the above observations, it must be concluded that, in the present case, all the elements exist to consider that the amortisation methods followed by the taxpaying company corresponded to an elusive intent and were, therefore, the expression of those "abusive practices" rejected by both the European Union and the international legal system.".[8]

Consequently, at the end of the topic concerning the 2008 reform, it must point out that Article 1 of Law 244/2007 has given the Financial Administration a power previously unknown.

In particular, the Article as mentioned above 1 provides:

Art. 1, paragraph 34 of Law 244/2007

[...] Amortisation, depreciation, provisions and other value adjustments charged to the profit and loss statement starting from the financial year from which, as a consequence of the amendment introduced by paragraph 33, letter q), number 1), the elimination of non-accounting deductions takes effect, may be disallowed by the tax authorities if they are not consistent with the accounting behaviour systematically adopted in previous financial years, without prejudice to the possibility for the company to demonstrate the economic justification of such components based on correct accounting principles [...].

From what can be seen, Article 1 of Law 244/2007 has given the tax authorities powers to check the economic truthfulness of depreciation and Amortisation and provisions in financial reports. From the wording of Article 1, it would seem possible to deduce that it could only apply these powers in the year when the method of preparing the tax return was changed (2008)[9].

The intention is clear: since until the year before the 2008 reform, non-economic differences could be deducted through the recognition of the amount only for tax purposes in the Schedule EC of Uni-co, the Tax Authorities wanted to avoid that after the change in the regulations, taxpayers, to take full advantage of the tax-deductibility of negative income components arising from subjective valuations, would record in the profit and loss

[8] Cassation Court 17 ottobre 2014, n. 22016.

[9] On this point see Capolupo, "Deduzioni extra contabili. Un ritorno al passato", *Fiscalitax*; n. 1, 2008, p. 6 ss.

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statement the value of the previous year supplemented by the part previously registered in the Schedule EC of Unico.

This rule, therefore, was used by the Italian Revenue Agency to avoid potential distortions of the repeal of off-balance-sheet deductions through the recognition in the profit and loss statement of subjective valuations regarding depreciation, provisions and value adjustments, without economic content and, therefore, about which the characteristics imposed by the Civil Code and accounting standards were absent.

It is believed that it should have only applied this rule in the year following the entry into force of Law 244/2007.

It should note that it would be technically impossible for the Tax Authorities to enter into the merits of all the subjective valuations carried out in profit and loss statements since, to do so, it is necessary to possess specific technical accounting skills, which, in general, do not characterize the staff dealing exclusively with taxation and taxation. In this regard, Zizzo points out that the intervention in question is "very insidious, and above all of the difficult systematic collocation".

Concerning this power, both the Inland Revenue Agency and Assonime have intervened by making two clarifications.

In particular, the Revenue Agency, with Circular no. 12 of 19 February 2008, established the following principle:

Circular Italian Revenue Agency 19 February 2008 no. 12 § 7.1

"The rule provides for the possibility for the tax authorities to disallow the recognition in the profit and loss statement of the aforementioned negative components if it is inconsistent with the accounting policies adopted in previous years, without prejudice to the possibility for the company to demonstrate the economic justification of the recognition in the profit and loss statement.

In this regard, it is considered that the consistency of the accounting behaviours adopted can be demonstrated by the taxpayer and verified by the tax authorities using any element deemed helpful for the achievement of the purpose as mentioned above (e.g., the use of the taxpayer's financial statements).

The taxpayer and verified by the tax authorities using any element deemed valid to achieve the purpose as mentioned earlier (for example, the indications provided in the notes to the accounts, the comparison with the financial reporting for previous years, etc.). However, it cannot understand

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the signals mentioned above in the explanatory notes as precluding the powers of control of the tax authorities."

The Assonime Circular No. 22 issued on 31 March 2008 also emphasises that, after the explanations provided by the taxpayer regarding the depreciation and provisions subject to control, the tax authorities.

"(1) must initiate a discussion on the merits of such justifications;

2) moreover, according to Article 7 of Law No. 212/2000, it cannot fail to set out the factual reasons justifying its claims, specifying the reasons why the reasons put forward by the taxpayer should be considered insufficient".

Therefore, in the writer's opinion, it limited the power to disallow financial reporting values according to Article 1 of Law 244/2007 to transition the financial reporting and tax calculation methods. It would be challenging to assume, even today, that the tax authorities can invalidate subjective evaluations of the financial reporting preparer unless the technical preparation of the staff of the Revenue Agency is not in the future ample also in the field of financial reporting, subjective evaluations and, above all, accounting principles. Even in such a hypothesis, however, it should be noted that there would be an inappropriate invasion of the field by an authority that has no direct powers on the preparation of financial reporting. Imagine, for example, the case of an appealed financial reporting. In the event of such a case, four parties would have to intervene, expressing an opinion on the truthfulness and correctness of the subjective accounting entries:

1) the plaintiff
2) the directors who drew up the financial reporting documents
3) the judge
4) the tax authorities.

There is no need to further detail to understand how such a situation would be illogical and undoubtedly inappropriate.

Therefore, it is believed that the above-mentioned rule conferring powers of disallowance of subjective values to the Tax Authorities was issued to avoid circumvention of the rules in the transitional phase from the pre-2007 provisions to the post-2008 rules.

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3.2. IRES and the 2017 mini-reform: the enhanced derivation also applied to companies that prepare their financial reports following the Italian Civil Code and the national accounting standards OIC

With the Legislative Decree no. 38, Article 4, paragraph 7-ter, of February 28February 28, 2005, the tax legislator amended Article 83 of the Consolidated Income Tax Law by providing the so-called enhanced derivation for IAS adopting companies. With the above-mentioned amendment, Article 83 was modified in 2005 as follows:

Art. 83 TUIR

"The comprehensive income is determined by adding to the profit or loss shown in the profit and loss statement for the financial year ending in the tax period [...] the increases or decreases resulting from the application of the criteria set out in the following provisions of this section. In the case of activities benefiting from partial or complete income tax relief, the relevant tax losses shall be considered to the same extent as positive results. For entities that prepare their financial reports following the international accounting standards referred to in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of July 19 July 19 2002, also in the formulation resulting from the procedure provided for in Article 4, paragraph 7-ter, of Legislative Decree No. 38 of February 28 February 28 2005, the criteria of qualification, temporal allocation and classification in financial reporting provided by those accounting standards shall apply, also by way of derogation from the provisions of the subsequent articles of this section"[10].

The enhanced derivation for IAS adopting companies consists of the circumstance that, as an exception to the tax rules in force, the qualification, temporal imputation and classification criteria in financial reporting provided for by the international accounting standards apply since 2005. For these companies, substance prevails over form as the IAS/IFRS principles base the structure of every other international standard on this fundamental principle. There are restrictions to this rule which we will not go into here. The circumstance that should be pointed out is that, in the period before 2017, for non-IAS adopting companies, the tax criteria established by the TUIR enjoyed a critical application that could also contrast with the

[10] Art. 83 TUIR modificato dal D. Lgs. 38/2005.

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principles set out in the Civil Code in the OIC national accounting standards. Therefore, for IAS adopting companies, substance prevailed over form, not only in financial reporting but also in taxation. For companies that prepared their financial reporting according to the Italian Civil Code and the national accounting standards OIC, substance prevailed over form in financial reporting, following a widespread interpretation of Article 2423 bis. This, however, had no fiscal impact. From a tax point of view, the tax rules dictated the principles, even conflicting with the code, which had to be applied when determining the IRES tax base.

Interesting, in this respect, to fully understand the meaning of such enhanced derivation is the observations in the Circular of the Revenue Agency No. 7E of 28 February 2011. The following is § 3.1 on the subject in question because, from reading this part of the circular, one can perceive the scope of the enhanced derivation provided for IAS adopter companies:

Italian Revenue Agency Circular 7E of 28 February 2011 entitled: "The rules for determining the income of entities required to adopt IAS/IFRS - General part - Legislative Decree no. 38 of 28 February 2005, Law no. 244 of 24 December 2007 and Decree no. 48 of the Ministry of Economy and Finance of 1 April 2009".

"3.1 The principle of enhanced derivation.

The general principle of "enhanced derivation", which informs the new tax rules, is contained in the current Article 83 of the TUIR, which, as a result of the amendments introduced by Article 1, paragraph 58, letter a), of Law No. 244 of 2007, provides that for determination of business income "apply, even as an exception to the provisions of the subsequent articles of this section, the criteria of quantification, temporal allocation and classification in financial reporting provided by these accounting standards".

In particular, it should note that the provisions of the Law as mentioned above No 244 of 2007 have eliminated, in the text of Article 83 of the TUIR, the words "increased or decreased by the components that as a result of international accounting standards are charged directly to equity". The IAS Regulation confirmed this approach, reiterating how, according to Article 83, paragraph 1, third sentence, of the Consolidated Income Tax Act, for IAS adopters, "to apply Chapter II, Section I, of the Consolidated Act, income and balance sheet items represented in financial reporting based on the criterion of the prevalence of substance over form provided by IAS".

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In particular, as highlighted in the illustrative report of the aforementioned regulation, the novelty of the reference to Article 83 of the Consolidated Law on Income Tax consists in the assumption that financial reporting representations are inspired by the principle of substance over form, which strongly pervades the entire IAS accounting discipline, instead of the traditional reference to contractual results.

Indeed, the principle of substance over form is a general principle that is not always perfectly defined: paragraph 35 of the Framework states only that transactions and other events must be "recognised and accounted for in accordance with their substance and economic reality and not merely in accordance with their legal form"; consequently, IAS/IFRS give preference to economic substance over legal form in cases where these two aspects conflict.

Therefore, the IAS/IFRS principle generally removes the representation of business events according to their legal-formal nature (which was the exclusive reference of the previous regulation) and gives way to a representation that - favouring the view of the reader-investor of financial reporting - highlights the substantial effects of each transaction in the light of the actual transfer of the related risks and benefits.

In other words, for the IAS adopters, instead of the legal-formal evidence of the equity and/or income cases, the representation of the transactions carried out according to their economic-financial substance is relevant for tax purposes.

Therefore, with the amendments introduced by the 2008 Finance Act, the tax structure provided for by the Consolidated Income Tax Act for IAS adopters – by re-allowing

With the amendments introduced by the 2008 Finance Act, therefore, the taxation structure provided by the TUIR for IAS adopters – by re-recognising for tax purposes the representation of business transactions according to the qualifications, temporal imputations and classifications of IAS com-pliant and thus overcoming the previous legal-formal approach – significantly reduces the discrepancies between financial reporting profit and business income.

The new rules thus abandon the tax structure outlined by Legislative Decree No. 38 of 2005 – which had maintained the management of values (financial reporting and tax) in "double track" and the relevance for tax purposes of the legal-formal representations of business operations - and strengthens the direct dependence of tax income on the qualifications, classifications and temporal imputations of IAS-compliant financial reporting.

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Precisely because this dependence is limited to the recognition of "qualification", "classifications", and "temporal imputations", it represents a "reinforced" (and not "full") derivation: In fact, the valuation phenomena are generally excluded from this context, as they are not expressly mentioned in the letter of Article 83, as well as, as we will see, some specific cases for which the tax legislator, with exceptions and/or additions to the principle as mentioned above of reinforced derivation, wanted to provide different rules (sometimes maintaining the previous taxation scheme).

The provisions of Article 15 of Decree-Law No. 185 of 2008 (the subject of Circular No. 33 of July 10, 2009), which mitigate the "differences" between financial reporting items and tax values, also go the same direction. The provisions of Article 15 of Decree-Law No. 185 of 2008 (the subject of Circular No. 33 of July 10 2009), which introduced the possibility for IAS adopting companies to realign, employing a specific option in their income tax returns, the differences between the statutory and tax values of financial reporting items relating to transactions - carried out before the entry into force of the rules of enhanced derivation - which from a tax point of view have been qualified differently, (as well as, for the sole purpose of the realignment as mentioned earlier, also differently valued) concerning the qualifications, classifications and temporal imputations (as well as, again solely for the above-mentioned realignment, concerning the valuations) resulting from the IAS compliant financial reporting (for such transactions, in the absence of the exercise of the (for these transactions, in the absence of the realignment option, the different representation of financial reporting concerning the qualifications, classifications, valuations and temporal imputations of the fiscal order generated a "transitional regime", with the consequent possible suprathreshold of the previous rules).

The same Article 2 of the IAS Regulation, after affirming the fiscal relevance of the principle of substance over form, provides, consequently, that "the provisions of Article 109, paragraphs 1 and 2, of the Consolidated Act shall not apply to such entities".

The provision in question introduces an exception to the provisions of Article 109, paragraphs 1 and 2, of the Consolidated Law on Income Tax (TUIR) which, concerning the fiscal relevance of costs and revenues, refer to:

1) the requirements of certainty and determinability of the income components (paragraph 1)

1) the certainty and determinability of the income components (paragraph 1);

2) the results of negotiations and, in particular,

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to the acquisition or transfer of ownership or other real

or other rights in rem over the assets (paragraph 2).

The no-application of the provisions of paragraphs 1 and 2 of Article 109 is necessary, as highlighted in the explanatory report, "to overcome the uncertainties generated by the reference to the criteria of certainty and objective determinability identified in a different way from what is provided in the IAS/IFRS financial reporting."

It was also necessary to associate the fiscal irrelevance of the recognition of the management events based on the contractual/legal nature of the same, as in financial reporting, such events are ordinarily recognised based on the transfer of the related risks and economic benefits and not based on the acquisition or transfer of ownership.

For example, the transfer of a loan does not correspond to the cancellation of the loan from the financial reporting because the transfer of the relative "control" (in terms of risks and benefits connected to it) is not realised. In this

In this case, the general criteria of tax competence under Article 109, paragraphs 1 and 2, of the TUIR do not apply.

Therefore, concerning cases arising after the entry into force of the enhanced derivation regime, the interpretative solutions adopted under the tax system based on Legislative Decree No 38 of 2005 can no longer be recognised, where the tax relevance of the IAS compliant accounting treatment was disallowed, and the (different) legal representation was given tax relevance.

In other words, the principles of certainty and objective determinability, as well as the legal-formal recognition of phenomena – which, according to the provisions of paragraphs 1 and 2 of Article 109 of the TUIR, constitute the basis for the application of the criteria of temporal imputation of the TUIR – are not always compatible with the recognition criteria used for IAS-compliant financial reporting, based on the principle of the prevalence of substance over form. Therefore, to the extent that the principles mentioned above of codicil matrix diverge from the "substantial representation" of business events, the tax legislator had to provide for their no-application for IAS adopter subjects".

On the occasion of Telefisco on 2 February 2017, to the question:

QUESTION: "Can the principle of "enhanced derivation" typical of IAS adopters also be applied to entities that adopt national accounting standards or, for tax purposes, must the legal-formal representation of business transactions prevail (principle of legal derivation)? In the latter case, a double

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civil-tax track is determined, and it may happen that the same phenomenon, treated identically from the accounting point of view, results in a different tax regime between IAS and non-IAS subjects.

The Italian Revenue Agency gave this answer[11]:

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The Italian Revenue Agency gave this answer:

Answer: "The principle of "enhanced derivation", based on which the different qualifications, classifications and time entries provided for by the accounting standards concerning the rules of the TUIR are recognised to determine the IRES taxable base, laid down in Article 83 of the TUIR, as amended by Article 1, paragraph 58 of Law No. 244/2007, is reserved, by express provision of law, only to entities that prepare their financial reporting following IAS/IFRS. Therefore, it is to be considered that any extension of this principle to ITA Gaap entities that prepare financial reporting following the rules introduced by Legislative Decree No. 139 of 2015 can only take place through a regulatory amendment. It is clear that this will result in ITA Gaap companies having to manage a double accounting/taxation system and that, for the same phenomenon accounted for similarly according to international and national standards, different tax regimes are adopted".

From the position of the Italian Revenue Agency, it is clear that, to be able to operate the enhanced derivation recognised to IAS adopter companies, to companies that prepared their financial reporting according to the civil law and according to the national accounting standards OIC, a legislative intervention was necessary.

[11] Circolare Italian Revenue Agency 7E del 28 febbraio 2011, § 3.1 Derivazione rafforzata.

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In fact, such an intervention was implemented by Law Decree No. 244 of 30.12.2016, converted, with amendments, by Law No. 19 of 27.2.2017.

The decree-law, known as the "Milleproroghe" decree, 30.12.2016 no. 244, converted, with amendments, by Law no. 19 of 27.2.2017, introduced, with regard to the relationship between financial reporting and tax provisions, the principle of "enhanced" derivation of taxable income for companies that prepare their financial reports under the OICs, except micro-enterprises.

In other words, with Article 13-bis, the income determination methods provided for IAS-adopters are also applicable to companies that prepare financial reports based on the Civil Code supplemented by the national accounting standards OIC. The only companies excluded from the principle of 'enhanced derivation' are the micro-companies referred to in Article 2435-ter of the Italian Civil Code, as these companies are subject to particular simplifications and, therefore, the legislator did not consider it necessary to extend the enhanced derivation to this type of company already enjoying benefits, advantages and, above all, simplifications.

With art. 13-bis, paragraph 2, letter a), no. 1, of Law Decree no. 244 of 30.12.2016, converted, with amendments, by Law no. 19 of 27.2.2017, this enhanced derivation has been, therefore, extended to all companies that prepare financial reporting based on the rules of the Civil Code and accounting standards, with the sole exclusion of micro-companies.

Therefore, also for these companies, the principle is now applicable according to which the substance of the transactions, recorded in financial reporting, prevails over the legal form (except for leasing, for which the format continues to prevail over the substance).

For the sake of clarity, Article 83 of the Consolidated Income Tax Act as amended by Article 13-bis, paragraph 2, letter a), no. 1, of Law Decree no. 244 of 30 December 2016, converted, with amendments, by Law no. 19 of 27 February 2017.

Art. 83 TUIR after integrating Article 13-bis, paragraph 2, letter a), no. 1, of DL 30.12.2016 no. 244, converted, with amendments, by L. 27.2.2017 no. 19.

"It shall determine comprehensive income by adding to the profit or loss shown in the profit and loss statement for the year ending in the tax period [...], the increases or decreases resulting from the application of the criteria set out in the following provisions of this section. In the case of activities benefiting from partial or total income tax relief, the relevant tax losses shall

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be considered to the same extent as positive results. For entities that prepare their financial reports following the international accounting standards set out in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002, including in the formulation resulting from the procedure set out in Article 4, paragraph 7-ter, of Legislative Decree No. 38 of 28 February 2005, and for entities other than those that prepare their financial reports under the international accounting standards set out in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002. 38 of 28 February 2005, and for entities, other than micro-enterprises referred to in Article 2435-ter of the Italian Civil Code, which prepare their financial reports by the provisions of the Italian Civil Code, the criteria for qualification, time allocation, and classification in financial reporting provided by the respective accounting standards shall apply, also by way of derogation from the provisions of the subsequent articles of this section.

1a. For paragraph 1, for entities other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which draw up their financial reports following the provisions of the Civil Code, the conditions issued in implementation of Article 1 (60) of Law No 244 of 24 December 2007 and Article 4 (7-quater) of Legislative Decree No 38 of 28 February 2005 shall apply mutatis mutandis".

In operational terms, the amendment introduced to Article 83 of the Consolidated Income Tax Act by Article 13-bis, paragraph 2, letter a), no. 1, of Law Decree no. 244 of 30.12.2016, converted, with amendments, by Law no. 19 of 27.2.2017, means that the formal and legal evidence of certain items, previously relevant for tax purposes, can be replaced by the economic substance applied in the context of financial reporting.

The consequence of such a situation can be summarised as a desirable replacement of the representation of facts according to their formal juridical nature with the correct practice of representing events according to their substantial effects and, therefore, in the light of the actual transfer of the related risks and benefits. In theory, this should bring statutory income and taxable income closer together and, therefore, one cannot but express a positive opinion on the change as mentioned earlier.

Concerning the prevalence of substance over form, it is worth remembering the following.

With Legislative Decree 139 of 18 August 2015, EU Directive 34 of 2013 was transposed in Italy. Before illustrating what is established by the transposition of this directive and, therefore, before highlighting how the principle of the prevalence of substance over form has been transfused into our civil

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legislation, it is appropriate to summarise the evolution that has brought the legislation its current state.

A comparison between Article 2423-bis of the Italian Civil Code and the provisions of the 2006 (and 2008) OIC reform project and the EU Directive 34/13 seems to show a difference. While, in fact, in the Italian Civil Code, before the implementation of the EU Directive 34/13, it was required to take into account the economic function of the assets and liabilities considered, and the principle of substance over form was absent, at least formally, in the 2006 (and 2008) OIC projects and the EU Directive 34/13, on the contrary, this principle was highlighted. No mention was made of the economic function of the asset or liability considered.

However, in light of legislative developments and national and international accounting standards, such a conclusion would be erroneous and misleading.

It introduced the legislative concept of the "economic function" of assets and liabilities in 2004 following the implementation of the company reform (Legislative Decree 12/12/2003 no. 344 entered into force on 1/1/2004).

The imposition of the above principle in Article 2423 bis of the Italian Civil Code gave rise to doubts about the real pragmatic meaning of the terms used by the legislator and, consequently, gave rise to different interpretations.

The same OIC, in the principle 1 The main effects of the reform of corporate law on the preparation of financial reporting, issued in October 2004, expressed doubts about the conceptual clarity of the expression "economic function of assets and liabilities" and, for this reason, it was perceived the need to provide, within the same principle, some useful considerations for the correct interpretation of the concept of "economic function of assets and liabilities".

In the document OIC 1 principle 1 The main effects of the reform of company law on the preparation of financial reporting, it was stressed that the legislator, by using this expression – as shown by the report accompanying the Legislative Decree no. 6 – intended to refer to the postulate of the prevalence of substance over form, a concept, however, illustrated in detail in the accounting standard OIC 11 Financial Reporting. Purpose and postulates. In this way, the 2006 (and 2008) OIC regulations had implemented the indications inferable from the Italian and international accounting standards, which prescribed that, in the preparation of financial reportings, the substance of the transactions should be privileged over their legal form. In this regard, art. 6 of delegated law no. 366 of October 3, 2001 - Delegation to the government for the reform of company law – provided for the revision of the financial

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reporting discipline for some critical transactions such as, for example, finance leases, repurchase agreements and derivative financial instruments, transactions that previously – as specified in the accompanying report - were accounted for according to the formal aspects of the underlying contracts. The legislator's intention in 2004, referring to modern corporate doctrine and international practice, was to provide that the representation in financial reporting of these transactions, and in general for all economic events, should be carried out according to the economic reality underlying the formal aspects.

The OIC, in providing interpretative elements to the principle of "economic function" mentioned in Article 2423 bis, no. 1, pointed out that from a technical point of view, it would have been preferable if the legislator, at the time of the delegation, had made express reference to the already known principle of substance over form.

In fact, it was pointed out that the principle of the prevalence of substance over form may have significant effects on the valuation criteria of balance sheet items with consequent effects on the economical components and the accounting standards and representation of values. This is a principle which, when adequately linked to specific valuation criteria, not only provides a useful general indication for the solution of interpretative questions that arise concerning the recognition of exceptionally structured and complex transactions (for example, the methods of recognition of derivative finance transactions and other financial transactions) but also a general criterion that can be profitably applied to other controversial issues.

In this regard, the OIC 1 principle The main effects of the company law reform on the preparation of financial reporting mentioned the accounting principle OIC 11 Financial reporting. Purpose and postulates stated that " for financial reporting to apply to its users and to provide an accurate and fair view of management events, it is necessary to determine and understand the substance of each such event and not just its formal aspects.

Substance represents the necessary essence of the event or fact, i.e. its true nature. Operating events have different origins and present additional problems. By way of example, many of these facts are contracts that may be governed by general or specific legislation. Some of these contracts are single and independent; others are more complex operations. For many contracts, the essence of the transaction is easily intelligible. For others, the clauses' particularity or complexity requires interpretation to understand the true nature of the contract and avoid misleading conclusions. In many situations, there is concordance between the substantive and the formal aspects of the contract; in other situations, such concordance does not occur. For each

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transaction or event, and in any case for each business event, it is essential to know the same's economic substance, whatever its origin (contractual, legislative, etc.). The identification of the economic substance of transactions is fundamental for the entire process of financial reporting. Therefore, it is essential that at the stage of recognition of the transaction in the accounting records, one knows all the elements relevant to the determination of its economic substance. This implies identifying the characteristics of the isolated event and those relating to events and transactions that are related or correlated to it, which together determine the unitary nature of the transaction in its material aspects. The economic substance of the transaction that has been identified in this way is, except for the cases indicated below, the prevailing element for the accounting, measurement and presentation of the event in the financial reporting so that the latter can ensure the consistency of the preparation and a true and fair view of the financial position and results of the financial year".

The OIC 1 Principles The main effects of the company law reform.

The OIC of 2006 (and 2008), to improve the financial reporting of 2004, concluded the analysis by stating that, following the explicit reference to the concept of "economic function" imposed by Article 2423 bis of the Italian Civil Code, the application of the principle of substance over form should therefore be considered mandatory like any other postulate and operating principle (provided, of course, that this was not expressly in conflict with other specific rules on financial reporting). Legislation, it was proposed to replace the expression "economic function of the items" with the principle, much more intelligible, of substance over form.

In the OIC reform, the principle of substance over form was therefore clearly expressed and not subject to interpretation doubts.

It should be noted that 2006 (and 2008) OIC reform project reflected the requirements of international accounting standards. In the Conceptual Framework for Financial reporting, in fact, since its first issue in 1989, it was highlighted that "in assessing whether an item meets the definition of an assetasset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits of the use of the leased assetasset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an assetasset and a liability and are recognised as such in the lessee's balance sheet". This principle was also reiterated in the

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subsequent revision of the Framework. In the 2010 Conceptual Framework for Financial Reporting, in § 4.6, it is stated that:

" in assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form".

Therefore, the standard analysed here identifies a concept that is now well established in both national and international standards.

In light of the above development, it is understandable why the EU Directive 34/13, in Article 6(h), requires that the recognition and presentation of items in the profit and loss statement and balance sheet must consider the substance of the transaction or arrangement in question.

From the above, it is clear that even if, when transposing EU Directive 34/13, the national legislator had opted for the formula outlined in Article 6, point h, as has happened, no substantial change would have occurred concerning the current provisions of the Italian Civil Code, just as no change would have occurred if Article 2423 ter point 2 of the 2006 OIC reform project had been converted into law.

Notwithstanding the different wording of Article 2423-bis point 1, Article 2423-ter point 2 of the 2006 (and 2008) OIC reform project and Article 6 letter h of the EU Directive 34/13, the principle to which each of the above sources refers is that of substance over form. In this respect, therefore, even in the context of the re-enactment of EU Directive 34/13, there should have been no change to what is already established by the provisions currently in force.

"A first element [to understand the enhanced derivation, n.d.a.] from which to start is the statement of art. 2, paragraph 1, of Ministerial Decree 48 of 2009, according to which "pursuant to Article 83, paragraph 1, third period, of the Consolidated Act, for IAS subjects, for the purposes of the application of Chapter II, Section I, of the Consolidated Act, the income and balance sheet elements represented in financial reporting according to the criterion of the prevalence of substance over form provided by the IAS are relevant". This provision, regarding IAS adopters, intended to

Concerning IAS adopters, this provision was intended to clarify that the principle of enhanced derivation contained in Article 83 of the TUIR was intended to give fiscal relevance to the various expressions of the principle of substance over form included in the IAS/IFRS system. It is to be considered that this clarification applies today, mutatis mutandis, also to OIC companies, in the sense that the principle of derivation also applies to OIC companies.

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It is to be considered that this precept applies today, mutatis mutandis, also to OIC companies, in the sense that the principle of enhanced derivation introduced by Article 13-bis of Decree-Law No. 244 of 2016 is certainly functional to the fiscal re-acceptance of accounting criteria that comply with the principle of substance over form as identified by Legislative Decree No. 139 of 2015 and by the new OIC standards. Of course, as already mentioned and as we will see better, later on, the

IAS companies are different and do not always coincide with OIC companies".[12] [13].

[12] Assonime Circular, 21 giugno 2017 n. 14, § 2.2.1.

[13] "To complete this overall Schedule of reference, it seems correct to consider that the provisions of the "IAS decrees" that deactivate the principle of logical derivation also apply to OIC companies. In particular, we refer to the rules on equity securities and on withholding taxes or tax credits, whose purpose is to ensure a generalised and uniform application of institutions that are intended to have a transversal value for all companies, avoiding duplications (such as the PEX regime and the exemption of dividends). As regards equity investments, it should reconstruct the tax regime of transactions involving equity securities under the legal-formal criteria (Article 3, paragraph 3, of Ministerial Decree No. 48 of 2009) with the sole exception of those implemented by the issuing company concerning instruments representing its assets (e.g. purchase of treasury shares). In addition, the identification of equity securities must be made by the criteria of Article 44, paragraph 2, letter a) of the Consolidated Income Tax Act, i.e. having regard to the fact that the remuneration is entirely related to the profits earned by the issuer (Article 5, paragraph 1, of Ministerial Decree 8.6.2011)109. As regards tax credits and withholding taxes, the identification of the persons entitled to benefit from them is also linked to the legal status of the management acts, regardless of the qualifications of the financial statements [....] Under these rules for the deactivation of the principle of enhanced derivation, for example, it must exclude the accounting representation indicated in OIC 21 par. 58, according to which a shareholder who receives sums from its investee should always recognise proceeds by way of dividend, irrespective of the reserve used, except in the case of a write-down of the shareholding for the reduction in equity suffered by the investee. In particular, paragraph 58 states that 'the dividend is recognised as financial income regardless of the nature of the reserves being distributed. The investee company shall verify that, following the distribution, the recoverable amount of the investment has not decreased to the extent that an impairment loss is recognised'.
However, for tax purposes, the dividend tax relief scheme is an alternative to the elimination of double taxation of corporate profits based on the recognition of a tax credit on dividends. And since tax credits continue to be recognised based on the formal legal approach, it is logical to assume that the dividend tax relief scheme must also follow the same application criterion. It follows that even if the approach suggested by OIC 21 were to be brought back to the economic substance of the phenomenon as identified by the national accounting standards, the income recognised by the shareholder could be subject to the dividend tax regime only if the investee company has earned it and distributes it to shareholders (or if the presumption of distribution outlined in Art. (or if the presumption of distribution under Article 47(1) of the TUIR is applicable). On the other hand, if the company returns contributions in the absence of profit reserves available for tax purposes, it must be considered that instead of a dividend there has been a return of the contributions with a corresponding reduction in the cost of the shareholding". Circular Assonime cited above, § 2.2.1.

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On 3 August 2017, the Ministry of Finance issued a Ministerial Decree implementing the Article mentioned above 13 bis.

In particular, Article 2 of the Ministerial Decree of 3 August 2017 MEF states:

"Article 2

(Compatible provisions for entities that prepare financial reports under the Civil Code, other than micro-enterprises according to Article 2435-ter of the Civil Code)

1. For the persons referred to in paragraph 1-bis of Article 83 of the Consolidated Law on Income Taxes, the provisions of:

a) the Decree of the Minister of Economy and Finance no. 48 of 1 April 2009, contained in the following articles:

1) article 2, paragraphs 1, 2 and 3;

(2) Article 3:

i. subparagraphs 1, 3 and 4;

ii. paragraph 2, first sentence, also to transactions between the micro-enterprises referred to in Article 2435-ter of the Civil Code and the persons referred to in paragraph 1-bis of Article 83 of the Consolidated Income Tax Law and, second sentence, to transactions between the persons referred to in paragraph 1-bis of Article 83 of the Consolidated Income Tax Law.

b) to the Decree of the Minister of Economy and Finance of 8 June 2011 contained in the following articles:

1) article 2, paragraph 2

2) article 3, paragraph 1, for the properties referred to in the accounting standard OIC 16;

(3) Article 5;

(4) Article 7, paragraphs 2, 3 and 4;

(5) Article 9, for liabilities of uncertain maturity or amount meeting the requirements of OIC 31"[14].

[14] Art. 2 D.M. Mef 3 August 2017.

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In the explanatory memorandum of the Ministerial Decree of 3 August 2017, concerning Article 2, it is noted that "Article 2, paragraph 1, letter a), lists the provisions of Ministerial Decree No. 48 of 1 April 2009, applicable "insofar as compatible" also for the determination of the IRES taxable base of the New OIC entities according to paragraph 1-bis of Article 83 of the TUIR.

In particular, number 1), recalling Article 2, paragraphs 1, 2 and 3, aims to extend also to New OIC entities the declination of the concept of enhanced derivation already provided for IAS/IFRS entities. To this end, the financial reporting requirements inspired by the principle of substance over form, as set forth by the Italian Accounting Standards Board in the national accounting standards, are also recognised for tax purposes.

In this sense, the waiver of the provisions of Article 109, paragraphs 1 and 2, of the Consolidated Income Tax Act (TUIR) has been extended to the New OIC entities, which, in the assumption of costs and revenues, mainly refer to the conditions of certainty and determinability of income components (paragraph 1), to the results of negotiations and the acquisition/passage of ownership of assets (paragraph 2), as well as to any other tax rule that refers to the management of representation that do not comply with the aforementioned principle of the prevalence of substance over form. Conversely, the tax provisions limiting the relevance of depreciation, valuations and conditions remain unaffected. These include, in particular, provisions providing for the taxation/deduction of positive and negative components on a cash basis rather than on an accrual basis (interest on arrears, directors' fees, dividends, etc.) and those that do not allow or limit the deduction of costs because they are not inherent, or that provide for the taxation of positive components spread over time for reasons of tax expediency (such as the pro-rata taxation of certain capital gains) or that provide for the exemption or exclusion of positive components"[15].

The report, concerning the Ministerial Decree of 8 June 2011, also points out that "number 5) (i.e. Article 5 of the Ministerial Decree of 8 June 2011, n.d.a.), finally, makes Article 9 applicable, concerning 'liabilities of uncertain maturity or amount that meet the requirements of OIC 31'. Paragraph 79 of OIC 12 (December 2016 version) states that 'provisions for risks and charges are recognised first in the profit and loss statement items of the relevant classes (8, C or O), with the classification of costs "by nature" prevailing'. Therefore, the rules set out in Article 107 of the Consolidated Income Tax Act concerning provisions apply to all components recognised as a

[15] Accompanying report to the Ministerial Decree Mef 3 August 2017.

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balancing entry to liabilities of uncertain maturity or amount that meet the requirements of OIC 31, even if they are negative income components classified based on the nature of the expenses generating the said liabilities (and not as provisions). It should be noted that paragraph 79 of OIC 12 (December 2016 version) states that 'provisions for risks and charges are recognised in priority in the cost items of the profit and loss statement of the relevant classes (8, C or O), with the criterion of classification "by nature" of costs prevailing'"[16].

– The discounting charges provided in the accounting rules are also relevant for tax purposes as provisions. In this regard, it should be noted that, at the time of updating OIC 31 (December 2016), the provision that precluded the discounting of provisions for risks and charges was eliminated, clarifying that the time horizon is one of the elements that can be taken into account when estimating those provisions for charges that have the characteristics of a long-term outlay and that derive from a certain legal obligation.

– Article 3, in substance, is without prejudice to any behaviour adopted in a manner inconsistent (i.e. consistent) with the provisions contained in Articles 1 and 2, for tax periods before the date of entry into force of this decree, the deadlines for the payment of income taxes having expired before that date.

– With the so-called enhanced derivation, the statutory principle of substance over form takes on a particular value. Concerning this principle, it should note that its introduction, when not explicit, dates back to the issue of Legislative Decree 139/15, which implemented EU Directive 34/13.

– Following the enactment of Legislative Decree 139/15, Article 2423 bis was amended as follows:

– Art. 2423 bis Principles of financial reporting

– The following principles must observe when preparing financial reports:

1) it must make the valuation of items following prudence and on a going concern basis [...][17];

[16] Accompanying report to the Ministerial Decree Mef 3 August 2017.

[17] The words ", as well as taking into account the economic function of the asset or liability item considered" have been deleted by Article 6, paragraph 3, letter a), of Legislative Decree no. 139 of 18 August 2015, published in the Official Gazette no. 205 of 4 September 2015. According to Article 12 (1) of Legislative Decree no. 139/2015, the provision comes into

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(1-bis) the recognition and presentation of items shall be made taking into account the substance of the transaction or contract;

(2) only gains realised at the end of the reporting period may be disclosed;

(3) account shall be taken of income and expenses about the financial year, irrespective of the date of collection or payment

(4) account shall be taken of risks and losses attributable to the financial year, even if they become known after the end of the financial year;

(5) heterogeneous items included in individual items shall be valued separately;

(6) the accounting policies cannot be changed from one financial year to the next.

Exceptions to the principle stated in number 6) of the previous paragraph are permitted in exceptional cases. The notes to the financial statements must state the reasons for the exception and indicate its influence on the presentation of the financial position and results of operations.

Therefore, as can be seen, even formally, after the transposition of EU Directive 34/15, the principle of substance over form, explicitly and not applied using formulas of dubious interpretation, must be used for financial reporting.

The enhanced derivation introduced in our legislation, not only for IAS adopting companies but also for companies that prepare their financial reporting according to the Civil Code and accounting standards, excluding micro-enterprises [18], therefore applies the principle of substance over form in the Civil Code. . With regard to micro-businesses, Article 8, paragraph 1, letter a) of Law Decree No. 73 of 21.6.2022 (the so-called 'Fiscal Simplifications') amended Article 83, paragraph 1 of the Consolidated Income Tax Act (TUIR), establishing that, starting from the tax period in progress as of 22.6.2022, the principle of enhanced derivation does not apply to micro-businesses 'that have not opted to prepare financial statements in the ordinary form'.

Consequently, for micro-companies that choose not to adopt the accounting simplifications to be provided for, the misalignments between accounting

force on 1.1.2016 and applies to financial statements relating to financial years starting on or after that date.

[18] "All of the above leads to the conclusion that the new principle of rationalised derivation concerns companies that are required to adapt to the changes introduced by Legislative Decree no. 139". Assonime Circular no. 14 of 21 June 2017, § 2.1. of 2015 and to follow the new OIC accounting practice, with the sole exception of micro-enterprises.

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entries (based on the principle of substance over form) and the relative tax values (based on legal-formal criteria), which were determined under the previous regime, are reduced.

The rule literally does not seem to allow the application of the principle of enhanced derivation also to micro enterprises that have opted for the preparation of abridged financial statements. However, according to the opinion of some scholars, reading the law in a systemic manner would lead to an extensive interpretation of the new provision.

Some scholars, with reference to micro enterprises that prepare financial statements in the ordinary form, believe that it does not seem possible to apply the tax rules for recognising the fair value measurement of derivative financial instruments, which is provided for by Article 2426, paragraph 1, no. 11-bis of the Civil Code but excluded for micro enterprises by Article 2435-ter, paragraph 3 of the Civil Code.

The DL 21.6.2022 no. 73 (G.U. 21.6.2022 no. 143)

Urgent measures on tax simplifications and labour clearance, State Treasury and further financial and social provisions (so called "Tax Simplifications" DL) established, with the aforementioned Art. 8:

Art. 8 – **Extension of the principle of enhanced derivation to micro enterprises and provisions on accounting errors**

"Article 83, paragraph 1 of the Consolidated Income Tax Act, approved by Presidential Decree No. 917 of 22 December 1986, shall be amended as follows:

(a) the words 'other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which' shall be replaced by the following: 'other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which have not opted for the preparation of financial statements in the ordinary form, which';

(b) the following sentences shall be added at the end: 'The timing criteria referred to in the third sentence shall also apply for tax purposes in relation to items accounted for following the correction of accounting errors. The provision referred to in the fourth period shall not apply to negative income components for which the time limit for filing the supplementary return referred to in Article 2, paragraph 8, of Presidential Decree No. 322 of 22 July 1998 has expired."

This principle is explained in a clear and intelligible manner, without expressions whose interpretation may be subject to subjective evaluations.

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It should note that the prevalence of substance over form determines, as a consequence, a necessary no-application of the rules provided for by Article 109, paragraphs 1 and 2 of the Tuir, which make reference:

a) to the requirements of certainty and determinability of the income components (paragraph 1);

(b) the results of the negotiations and, in particular, the acquisition or transfer of ownership or other fundamental rights over the assets (paragraph 2).

Article 109 TUIR states:

1. Revenues, expenses and other positive and negative components, for which the preceding rules of this Section do not provide otherwise, shall contribute towards forming income in the year in which they accrue; however, revenues, expenses and other components whose existence is not yet certain or whose amount can be objectively determined in the year in which they accrue shall contribute towards forming income in the year in which those conditions are satisfied.

2 to determine the chargeable period

(a) the consideration for the supply shall be deemed to be received, and the cost of acquiring the goods shall be deemed to be paid, at the date of delivery or dispatch in the case of movable property and at the date of the conclusion of the deed in the case of immovable property and businesses or, if different and later, at the date on which the transferor constitutive effect of the ownership or other right in rem occurs. It shall not take the retention of title clauses into account. A lease with a transfer of ownership clause binding on both parties shall be treated as a conditional sale;

(b) the consideration for the rendering of services shall be deemed to be received, and the costs of acquiring services shall be deemed to be incurred on the date on which the services are completed or, in the case of services dependent upon a lease, loan, insurance or other contracts from which periodic payments are derived, on the date on which the payments become due;

(c) in the case of companies and bodies which have issued bonds or similar securities, the difference between the sums due on maturity and the sums received in respect of the issue shall be deductible in each tax period to an extent determined following the amortisation schedule of the loan.

3. Revenues, other income, and inventories shall be included in income even if they are not charged to the profit and loss account.

3a. Capital losses realised following Article 101 on shares, units and financial instruments similar to shares which do not meet the requirements of

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Article 87 shall not be taken into account up to the amount of the non-taxable amount of dividends, or interim dividends, received during the thirty-six months preceding the realisation. This provision shall also apply to negative differences between the revenues of the assets referred to in Article 85 (1) (c) and (d) and their costs. (2)

3b. The provisions of paragraph 3-bis shall apply concerning shares, units and financial instruments similar to shares acquired in the thirty-six months before realisation, provided that they satisfy the requirements for exemption under letters c) and d) of paragraph 1 of Article 87. (2)

3c. This is without prejudice to the application of Article 37-bis of Presidential Decree No. 600 of 29 September 1973, also concerning negative differentials of a financial nature deriving from transactions initiated in the tax period or the preceding one on the shares, units and financial instruments similar to shares referred to in subparagraph 3-bis. (2)3 quinquies. Paragraphs 3a, 3b and 3c shall not apply to entities that prepare their financial reports following the international accounting standards as set out in Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002. (3)

3e. To disapply the provisions referred to in paragraphs 3-bis and 3-ter, the taxpayer shall apply to the administration according to Article 11 (2) of Law No. 212 of 27 July 2000 on the Statute Taxpayers' Rights. (4)

Expenses and other negative components shall not be deducted if and to the extent that they are not charged to the profit and loss statement for the year in question. Expenses and other negative items are not deductible if and to the extent that they are not recognised in the profit and loss statement for the period in question. However, the following are deductible

(a) those charged to the profit and loss statement of a prior period if the deduction has been deferred following the preceding rules of this section that provide or permit deferral;

(b) Those are deductible by operation of law but are not included in the profit and loss statement. (7) Expenses and charges explicitly relating to revenues and other income which, although not included in the profit and loss statement, contribute to the formation of income, maybe deducted if and to the extent that they result from specific and precise elements.

Expenses and other negative components other than interest expense, except for tax, social security and charitable contributions, are deductible to the extent that they relate to activities or assets from which income or other revenues are derived and which are included in income or are excluded from income. Suppose they refer indiscriminately to activities or assets generating computable income and to activities or assets generating income that cannot

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computebecause they are exempt in income determination. In that case, they are deductible for the part corresponding to the ratio between the amount of revenues and other income that contribute to forming the business income or that do not contribute to it because they are excluded and the total amount of all revenues and income (8). The capital gains referred to in Article 87 are not relevant for applying the preceding period. Without prejudice to the provisions of the preceding periods, expenses relating to hotel services and the supply of food and beverages, other than those referred to in paragraph 3 of Article 95, are deductible to the extent of 75%. (9)

6. [...] (10)

7. By way of derogation from paragraph 1, it shall include interest on arrears in income in the year in which it is received or paid.

8. By way of derogation from paragraph 5, the cost incurred for acquiring the right of usufruct or another similar right with a shareholding from which profits excluded under Article 89 are derived shall not be deductible.

9. Any remuneration due is not deductible:

a) on securities, financial instruments however denominated, as referred to in Article 44, for the part of it that directly or indirectly involves participation in the economic results of the issuing company or of other companies belonging to the same group or of the business in connection with which the financial instruments have been issued;

b) in respect of joint ventures contracts and those referred to in Article 2554 of the Civil Code where provision is made for a contribution other than works and services.

ADDITIONS AND AMENDMENTS TO ARTICLE 109 TUIR

(1) Article replaced by Article 1, Legislative Decree No 344 of 12.12.2003, in force from 1.1.2004.

(2) Paragraph inserted by Article 5-quinquies, subparagraph 1, Decree-Law No 203 of 30.9.2005, converted, with amendments, into Law No 248 of 2.12.2005. The provisions shall apply to capital losses and negative differences realised from 1.1.2006.

(3) Paragraph inserted by Article 1, paragraph 58, letter h), Law 244 of 24.12.2007. According to paragraph 61 below, the provision applies from the tax period following the one in a course on December 31 2007.

For the preceding tax periods, the effects on the determination of the tax produced by the conduct adopted based on the correct application of the international accounting standards are not affected, provided that they are consistent with those that would have resulted from the application of the provisions introduced by paragraph 58.

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(4) Paragraph inserted by Article 7 (11) of Legislative Decree No 156 of 24.9.2015, published in the Official Journal No 233 of 7.10.2015, S.O. No 55.

(5) The words "adopted by the undertaking" have been replaced by the former "international" by Article 13-bis, paragraph 2, letter d), Decree-Law No 244 of 30.12.2016, converted, with amendments, by Law No 19 of 27.2.2017. Pursuant to paragraph 5 below, the provision is effective regarding income and equity components recognised in financial reporting starting from the financial year following the one in progress as of December 31 2015. The income statement and balance sheet effects on the financial reporting of the year as mentioned earlier and of subsequent years of transactions that are differently qualified, classified, measured and time-stamped for tax purposes concerning the qualifications, classifications, measurements, and time-stamping resulting from the financial reporting of the year in progress as of December 31, 2015, continue to be subject to the previous tax rules. For the transition period, see paragraph 7 below.

(6) Period inserted by Article 11(1)(d)(1) of Legislative Decree No 38 of February 28 2005. According to Article 13 below, the provisions also apply to the components charged directly to equity in the first year of international accounting standards.

Amortisation, depreciation, provisions and other value adjustments charged to the profit and loss statement starting from the financial year from which, as a consequence of the amendment brought about by paragraph 33, letter q), no. 1, the elimination of non-accounting deductions begins, may be disallowed by the tax authorities if they are not consistent with the accounting behaviour systematically adopted in the previous financial years, without prejudice to the possibility for the company to demonstrate the economic justification of said components based on correct accounting principles. (7) Periods deleted by Article 1, paragraph 33, letter q), no. 1, Law no. 244 of December 24, 2007. According to paragraph 34 below, the provision takes effect from the tax period following the one in the course as of December 31 2007, without prejudice to the transitional application of the requirements of the abolished periods, in the text preceding the amendments made by Law 244 of December 24 2007, for the recovery of the surpluses resulting at the end of the tax period in the course as at December 31 2007. However, the taxpayer has the option of eliminating the availability constraint on the suspended reserves, but without any effect on the tax values of the assets and other items, subjecting them in whole or in part to substitute tax at a rate of 1%; the substitute tax must be paid in a single instalment by the deadline for payment of income tax for the tax period in progress at 31.12.2007.

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Previous text: "The depreciation of tangible and intangible assets, other value adjustments, provisions, expenses relating to studies and development research and the differences between the financial rents referred to in Article 102 (7), and the sum of the depreciation of assets acquired under finance leases and of the interest expenses arising from the relevant contracts charged to profit and loss statement are deductible if a unique statement in the tax return shows their total amount, the civil and fiscal values of the assets, the expenses referred to in Article 108 (1) and the provisions.

In the event of distribution, the equity reserves and profits for the year, even if earned after the tax period to which the deduction refers, contribute towards forming the income if and to the extent that the amount of the remaining equity reserves other than the legal reserve and the remaining retained earnings is less than the excess of depreciation and amortisation, value adjustments and provisions deducted concerning those charged to the profit and loss account, net of the deferred tax provision related to the amounts deducted. The part of the reserves and distributed profits that contribute to the income formation according to the previous period is increased by the corresponding deferred taxes. The excess amount shall be reduced by the depreciation, capital gains or losses, value adjustments relating to the same assets and provisions, as well as by the equity reserves and distributed profits for the financial year, which have contributed to the formation of the income.

(8) The words "for the part corresponding to the ratio between the amount of revenues and other proceeds that contribute to forming business income or do not contribute to it because they are excluded and the total amount of all revenues and proceeds" were replaced by "for the part corresponding to the ratio referred to in paragraphs 1, 2, and 3 of Article 96" by Article 1, paragraph 33, letter q), no. 2, Law 244 of 24.12.2007. Pursuant to paragraph 34 below, the provision applies from the tax period following the one in the course on 31 December 2007.

Pursuant to paragraph 28-quinquies below, the provisions shall come into force from the tax period following the one in the course on 31 December 2008. (9) Paragraph inserted by article 83, paragraph 28-quater, lett. a), DL 25.6.2008 n. 112 converted with modifications by L. 6.8.2008 n. 133, in force from 22.8.2008.

(10) Paragraph repealed by Article 1, Paragraph 33, letter q), no. 3, Law 244 of 24.12.2007. According to paragraph 34 below, the provision shall apply from the tax period following the one in progress as of 31 December 2007.

Previous text: "If during the financial year the interest and income referred to in Article 96 (3) have been earned more than the amount of the

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interest expense, up to the extent of that exception, the expenses and other negative components referred to in the second sentence of the preceding paragraph are not deductible and, for the ratio provided for by the Article as mentioned earlier 96, an amount corresponding to that which has not been deducted is not taken into account" from what has been stated above regarding the concept of reinforced derivation, it is clear that paragraphs 1 and 2 of Article 109 may not be applied for determining the IRES taxable base if the event under consideration has been recognised in financial reporting based on truthfulness and correctness and, consequently, bearing in mind the operational principle, imposed by Article 2423 bis, of the primacy of substance over form.

However, it should note that art. 13 bis of Law Decree no. 244 of 30 December 2016, converted into Law no. 19 of 27 February 2017, provides only a few amendments to the articles of the Consolidated Income Tax Law[19].

[19] Art. 13 bis – Coordination of the rules on IRES and IRAP with Legislative Decree no. 139 of 2015 (1)Related documents
1. The entities referred to in paragraph 1-bis of Article 83 of the Consolidated Income Tax Law are referred to in Presidential Decree no. 1. For the persons referred to in paragraph 1-bis of Article 83 of the Consolidated Law on Income Taxes, referred to in Presidential Decree no. 917 of 22 December 1986, as introduced by number 2) of the letter a) of paragraph 2 of this Article, concerning the tax period in which the income and balance sheet components recognised in the financial statements for the financial year starting from the financial year following the one in progress on 31 December 2015 are to be declared, the time limit referred to in paragraph 2 of Article 2 of the Regulation referred to in Presidential Decree no. 322 of 22 July 1998, for the submission of the declarations for the financial year in which the income and balance sheet components recognised in the financial statements for the financial year starting from the financial year following the one in progress on 31 December 2015 are to be declared, shall not apply. 322 of 22 July 1998, for the submission of income tax and IRAP declarations, shall be extended by fifteen days to facilitate the first application of the provisions introduced by Legislative Decree no. 139 of 18 August 2015 and of the coordinating provisions contained in the following paragraphs.
2. The following amendments shall be made to the Consolidated Text of Income Taxes, referred to in Presidential Decree No 917 of 22 December 1986:
(a) in Article 83:
1) in paragraph 1, after the words: "legislative decree n. 38 of 28 February 2005," the following shall be inserted: "and for entities, other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which draw up their financial statements following the provisions of the Civil Code," and the words: "by said accounting standards" shall be replaced by the following: "by the respective accounting standards";
2) the following paragraph is added after paragraph 1:
"1-bis. For paragraph 1, for entities other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which draw up their annual accounts following the provisions of the Civil Code, the provisions adopted in implementation of Article 1 (60) of Law No 244 of 24 December 2007 and Article 4 (7-quater) of Legislative Decree No 38 of 28 February 2005 shall apply mutatis mutandis";

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b) in paragraph 2 of article 96, after the words: "lease payments of capital goods", the following is inserted: ", as well as the positive and negative components of an extraordinary nature deriving from transfers of business or branches of business";
c) in Article 108
1) paragraph 1 shall be replaced by the following:
"1. Expenditure relating to more than one financial year shall be deductible within the limits of the proportion attributable to each year;
2) it shall delete the first sentence of subparagraph 2 3) Paragraph 3 shall be replaced by the following:
"3. The depreciation of assets acquired due to studies and research shall be calculated on the cost of such assets less the amount already deducted. Article 88(3) shall apply to contributions paid by the State or other public bodies under the law in respect of the costs relating to studies and research";
4) in paragraph 4, the words: "1, 2 and 3" shall be replaced by the following: "1 and 2";
d) in article 109 (4), introductory sentence, the word: "international" shall be replaced by the following: "adopted by the undertaking";
(e) at the end of paragraph 9 of Article 110, the following sentence shall be added: "However, the alternative exchange rates provided by independent international operators used by the undertaking in accounting for foreign currency transactions shall be applicable, provided that the relevant quotation is made available through public and verifiable sources of information";
(f) in Article 112
1) it shall delete Paragraph 1 ;
2) in paragraph 2, the words: "of current off-balance sheet transactions" are replaced by the following: "of derivative financial instruments";
3) in paragraph 3-bis, after the words: "19 July 2002," the following is inserted: "and for entities, other than micro-enterprises referred to in Article 2435-ter of the Civil Code, which draw up their financial statements following the provisions of the Civil Code,";
4) in subsection 4, the words: "the transactions referred to in subsection 1 are carried out" are replaced by the following: "the derivative financial instruments referred to in subsection 2 are recorded in the financial statements so as to";
5) in subsection 5, the words: "the transactions referred to in subsection 2 are carried out" shall be replaced by the following: "the derivative financial instruments referred to in subsection 2 are recorded in the annual accounts so";
6) Paragraph 6 is replaced by the following:
"6. For this Article, the derivative financial instrument shall be regarded as a hedging instrument based on the correct application of the accounting standards adopted by the undertaking";
(7) the heading is replaced by "Derivative financial instruments".
3. In paragraph 1 of article 5 of legislative decree n. 446 of 15 December 1997, after the words: "with the exclusion of the items under numbers 9), 10), letters c) and d), 12) and 13)" it shall insert the following words : ", as well as the positive and negative components of extraordinary nature deriving from transfers of undertakings or company branches".
4. The reference in the current tax laws to positive or negative components referred to in letters A) and B) of Article 2425 of the civil code shall be understood as referring to the same elements taken net of positive and negative components of an extraordinary nature deriving from transfers of undertakings or business units.
5. The provisions referred to in the preceding paragraphs shall be adequate regarding income and balance sheet items recognised in the financial statements as from the financial year following the one in progress as of 31 December 2015. The income statement and balance sheet affects the financial statements of the year mentioned above and of subsequent years of transactions that are differently qualified, classified, measured and charged to the income statement

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for tax purposes concerning the qualifications, classifications, measurements and time entries resulting from the financial statements of the year in progress as of 31 December 2015 shall continue to be subject to the previous tax rules. In contrast to the last period:
a) the valuation of derivative financial instruments other than those recorded in the annual financial statements for hedging purposes under Article 112(6) of the Consolidated Act referred to in Presidential Decree No. 917 of 22 December 1986, outstanding in the financial year current on 31 December 2015, but not recorded in the relevant annual financial statements, shall be appropriate for determining income at the time of realisation;
b) Article 112 of the Consolidated Act referred to in Presidential Decree No. 917 of 22 December 1986, paragraph 6, which had already included in the financial statements for the year ending 31 December 2015, shall apply to the valuation of derivative financial instruments other than those included in the biannual financial statements for hedging purposes referred to in Article 112 of the aforesaid Consolidated Act, in the text in force before the date on which the law converting this decree came into force.
6. The provisions referred to in paragraph 5 shall also apply for determining the taxable amount referred to in legislative decree n. 446 of 15 December 1997.
7. In the first year of applying the accounting standards in article 9-bis, paragraph 1, letter a), of legislative decree no. 38 of 28 February 2005, updated according to paragraph 3 of article 12 of legislative decree no. 139 of 18 August 2015
(a) the provisions of Article 109 (4) of the Consolidated Act referred to in Presidential Decree no. 917 of 22 December 1986 shall also apply to components directly charged to assets;
b) the components directly charged to shareholders' equity shall contribute towards forming the taxable base referred to in Article 5 of Legislative Decree no. 446 of 15 December 1997, if, based on the criteria applicable in previous years, they would have been classified under the items referred to in letters A) and B) of Article 2425 of the Civil Code relevant for said Article 5;
c) the reinstatement and elimination, in the balance sheet assets, respectively, of costs already charged to profit and loss statements of previous years and of costs recorded and no longer capitalisable do not affect the determination of income or the fiscally recognised value; for the latter, the deductibility based on the criteria applicable in previous years remains unchanged;
d) the elimination from the balance sheet of liabilities and provisions, considered deducted as a result of the application of the provisions of the Consolidated Act referred to in Presidential Decree No. 917 of 22 December 1986, is not relevant for the determination of income; the non-deductibility of the charges against which such funds have been set up remains unchanged, as well as the taxability of the relevant contingency in the event of their non-occurrence;
e) the provisions of subparagraphs c) and d) shall apply, to the extent compatible, also for the purposes of determining the taxable base under Legislative Decree no. 446 of 15 December 1997.
8. The provisions under paragraphs 5 to 7 shall also apply if changes occur in the accounting standards pursuant to paragraph 3 of article 12 of legislative decree no. 139 of 18 August 2015, and in case of changes in the financial statements disclosure requirements resulting from changes in the size of the undertaking.
9. For parties that draw up their annual accounts according to international accounting standards, the provisions contained in article 108 (3), last sentence, of the consolidated act referred to in presidential decree no. 917 of 22 December 1986, in the text in force before the date of entry into force of the law converting this decree, shall continue to apply about the expenses incurred up to the financial year in progress as of 31 December 2015.
10. In Article 4 of legislative decree n. 38 of 28 February 2005, it shall add the following paragraph after paragraph 7-quater:

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Consequently, not all statutory components are fiscally deductible as they are recognised in profit and loss statements and represent substance over form.

From a careful reading of the Article as mentioned earlier 13 bis, it can understand it, for example, how, in the tax area, the rules concerning the maximum deductible limits of depreciation and amortisation and the law of taxation of specific income components on a cash basis have remained in force.

Therefore, the enhanced derivation does not turn into an uncritical acknowledgement of the statutory values, but rather subdivides, in substance, between amounts for which this rule should be applied and accounts that, despite being recorded in the profit and loss statement and representing the substance of the transaction, are not recognised by the tax legislator who, for such amounts, provides for the application of the rules contained in the various articles of the TUIR.

"“7-quinquies. The Minister for the Economy and Finance shall, where necessary, within 150 days from the date of approval or update of the accounting standards referred to in Article 9-bis, paragraph 1, issue any coordination provisions for the determination of the taxable base for IRES and IRAP”.
11. With a decree of the Minister of Economy and Finance, to be issued within 60 days from the date of entry into force of the law converting the present decree, the provisions for revising the decree of the Minister of Economy and Finance of 14 March 2012, bearing the “Provisions for the implementation of Article 1 of the decree-law of 6 December 2011, no. 201, concerning the Aid to Growth”, shall be adopted. 14 March 2012, on “Provisions implementing Article 1 of the Decree-Law No. 201 of 6 December 2011, concerning the Aid to economic growth (Ace)”, published in the Official Gazette No. 66 of 19 March 2012, to coordinate the rules contained therein for entities applying the international accounting standards with those provided for entities applying the provisions of this Article. One or more decrees of the Minister of Economy and Finance shall be adopted to revise the conditions issued in implementation of paragraph 60 of Article 1 of Law 244 of 24 December 2007, in compliance with the criteria set out therein, as well as paragraph 7-quater of Article 4 of Legislative Decree 38 of 28 February 2005.
12. The cost deriving from paragraph 2, letter c), estimated at 18 million euros for the year 2017, 4.1 million euros for the year 2018, 2.8 million euros for the year 2019 and 0.6 million euros for the year 2020, shall be covered by a corresponding reduction of the Fund for structural economic policy interventions, referred to in article 10, paragraph 5, of decree-law n. 282 of 29 November 2004, converted, with amendments, by lawn. 307 of 27 December 2004. The Minister of Economy and Finance is authorised to make the necessary changes to the budget with his own decrees.
13. The Fund for Structural Economic Policy Interventions, referred to in article 10, paragraph 5, of decree-law no. 282 of 29 November 2004, converted, with modifications, by law no. 307 of 27 December 2004, shall be increased by 1.7 million euros in 2021. The relevant cost shall be covered by the corresponding use of the higher revenues deriving from the measures provided for by paragraph 2, letter c)”.

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In short, we can summarise the situation in which enhanced derivation coexists for specific values and the determination according to tax rules for other income components.

A particularly effective summary of the characteristics and effects of the enhanced derivation for OIC adopters is made in the document CNDCEC – Fondazione Dottori Commercialisti of 8 August 2017, periodic information, Taxation, Document "The taxation of OIC Adopter companies". In that document, even if legislative changes have been made subsequently, the fundamental peculiarities of the enhanced derivation illustrated above are summarised in a detailed manner. Although, as pointed out above, in the meantime, changes have been made to the legislation, it is valid, in order to facilitate the understanding of the issue, to quote what is written in the CNDC document of 2017 as it is synthetic, clear and comprehensive:

"The new art. 83 of the TUIR, in paragraph 1 (as amended by art. 13-bis of Decree-Law no. 244 of 30 December 2016, converted with amendments by Law no. 19 of 27 February 2017), provides "for entities with a taxable income of more than one year". Article 83 of the Consolidated Law on Income Taxes, paragraph 1 (as amended by Article 13-bis of Legislative Decree no. 244 of 30 December 2016, converted into law by Law no. 19 of 27 February 2016), provides "for entities, other than the micro-enterprises referred to in Article 2435-ter of the Italian Civil Code, which prepare their financial reports following the provisions of the Italian Civil Code" the principle of enhanced derivation according to which, to determine business income, "the criteria of qualification, temporal allocation and classification in financial reporting provided for by the respective accounting standards shall apply, even as an exception to the provisions of the subsequent articles of this section".

It should also note that, based on the literal wording of Article 83 of the Consolidated Income Tax Act, purely valuation phenomena that are not relevant for tax purposes do not fall within the scope of enhanced derivation[20].

After the above rules, the legislator has intervened several times to regulate individual items based on enhanced derivation, but the above principles have remained intact. This is not the place to discuss the taxation of enhanced derivation. The purpose of this text is to reference this issue to highlight how, for the items envisaged explicitly by the legislator and subject to enhanced derivation, there is no longer the problem of tax interference. However, since

[20] In this sense, see Italian Revenue Agency Circular No. 7/E, 28 February 2011, par. 3.3.

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the latter does not concern depreciation, provisions and inventories, the issue of taxation of financial reporting with tax rules remains topical as it is precisely these items that create the most extraordinary tax interference in financial reporting.

Since this text does not focus on enhanced derivation, the reader is referred to specific works on the subject to analyse the legislative changes that occurred in recent months.

At the end of this summary of enhanced derivation, it should note that this legislative innovation has certainly brought statutory income closer to tax income. From this point of view, tax interferences have disappeared with specific reference to the items subject to enhanced derivation.

After the above rules, the legislator has intervened several times to regulate individual items based on enhanced derivation, but the above principles have remained intact. This is not the place to discuss the taxation of enhanced derivation. The purpose of this text is to reference this issue to highlight how, for the items envisaged explicitly by the legislator and subject to enhanced derivation, there is no longer the problem of tax interference. However, since the latter does not concern depreciation, provisions and inventories, the issue of taxation of financial reporting with tax rules remains topical as it is precisely these items that create the most extraordinary tax interference in financial reporting.

Since this text does not focus on enhanced derivation, the reader is referred to specific works on the subject to analyse the legislative changes that occurred in recent The serious problem that remains unresolved is that the taxation of financial reporting generally appears to be linked to the set of provisions that are not derogated and, consequently, not subject to enhanced derivation (e.g. limits on the deductibility of depreciation and amortisation and provisions for risks and charges).

It follows that, while enhanced derivation applied to all companies, including companies that prepare financial reports following the Italian Civil Code and the national accounting standards of the Italian Accounting Standards Board (OIC), has reduced, albeit to a minimal extent, the tax implications of financial reporting, the problem of tax interferences has remained almost intact since, in most cases, it is related to subjective evaluations that, for tax purposes, are deductible within maximum limits which have not been subject to derogation related to the enhanced derivation. In Vol. III of this book, we will see what impact tax interferences in financial reporting have

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had in the past and still have today through the results of empirical research in the field covering almost twenty years.

3.3. IRES and IRAP: from the shared tax track to the separation of the principles for determining taxable income. Outline of this problem

In this paragraph we do not intend to deal with the issue of the determination of IRAP and the interconnections between IRES and IRAP as this issue is beyond the scope of this text.

However, we cannot avoid highlighting a peculiarity of the determination of the IRAP tax base, which, indirectly and by law, limits or even cancels the tax interferences in financial reporting related to the calculation of this tax.

IRAP was introduced by Legislative Decree No. 446 of 15 December 1997 and amended several times since then. We want to highlight in this text is not the complex IRAP legislation and the amendments made over time, but the basic concept on which the determination of this tax is based.

From reading Article 5 of Legislative Decree 446/97, it is clear that IRAP is determined based on the profit and loss statement results, with no changes to the values recorded therein due to limitations on the deductibility of amounts connected to subjective assessments.

IRAP is determined by considering only part of the revenues and part of the costs recorded in the profit and loss statement. Not all costs and revenues are affected by IRAP. We do not intend to detail which components are affected by the tax but intend to point out that the costs and revenues from which the determination of the IRAP taxable base derives directly from the profit and loss statement. For these income components, it could be said that, since 1997, a "strengthened derivation" has been in force without the rule outlined in the first paragraph of Article 5 of Legislative Decree 446/97 being applied. Lgs. 446/97 is attributed with this expression.

From what has been stated above, it is clear that, for IRAP, it does not make sense to speak of tax interferences in financial reporting dictated by requirements directly related to the tax in question. Beyond the fact that various costs and revenues are not affected by the regional tax on productive activities, the circumstance that should be emphasised here is that the tax values are taken, directly and without tax limits, from the financial reporting entries.

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Therefore, in Vol III, when we will illustrate the results of the various field investigations that have involved hundreds of companies to verify the existence of tax contamination in financial reporting, we will refer only to IRES and not to IRAP. For IRAP, at least at a theoretical level, the problem of tax interference in financial reporting should never arise due to the tax's characteristics.

However, it should be noted that, since the profit and loss statement is unique, the fiscal impact on the statutory values that determine the IRAP taxable amount occurs equally because, obviously, in the profit and loss statement, two different values are not reported for IRAP and IRES but, referring to the same financial reporting for the two taxes, the income components of reference are the same.

For this reason, even for IRAP, although there is no immediate need for tax interference in the financial reporting to reduce the tax base, there is, inevitably, the issue of tax interference because the values recorded for IRAP purposes are also the amounts that determine the reference data for the quantification of the IRES tax base.

It should note that Article 1 January 2022, Article 1, paragraph 8 of Law 234/2021 abolished IRAP for self-employed persons, sole proprietorships, and professionals starting from the tax period in progress. The number of taxpayers who are exempt from IRAP is thus increased, in addition to those who used to participate in the flat-rate regime or who did not have a permanent establishment.

Therefore, the following are subject to IRAP: associated professional studios, partnerships, corporations, commercial entities and third sector entities.

Consequently, tax interferences are transversal to the two taxes as the financial reporting is unique and the reference values for both IRAP and IRES are unique.

Regarding the real impact of tax interferences on the financial reporting of Italian companies, the reader is referred to Vol. III (The mirage of truthfulness: a comparison between doctrinal elaborations and empirical research results, with some considerations on the legitimacy of financial reporting characterised by tax interferences) of this series.

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3.4. Suspension of depreciation and amortization due to Covid: outline of the legislation and highlighting the impact of this rule on tax interference

As noted in the preceding pages and seen in the third volume, depreciation and amortisation is one of the most contaminating tax items in statutory financial reporting. In 2020 and 2021, a unique situation arose due to the worldwide covid pandemic. Our legislature has also adapted its regulations to this exceptional health situation, which has indirectly caused severe economic damage to the various business entities. As this text focuses on the taxation of financial reporting, it is not the right place to go into the issue of the suspension of depreciation in a particularly analytical manner. Still, we must point out the reference legislation for this legislative innovation, which is occasional and can no longer be applied until 2022.

Particularly clear on the legislation that will come into force in 2020 and its consequences in terms of accounting and financial reporting are INTERPRETATIVE DOCUMENT 9 Law no. 126 of 13 October 2020 "Transitional provisions on the principles of preparing financial statements-suspension of depreciation" concerning the suspension of depreciation. This INTERPRETATIVE DOCUMENT 9 Law no. 126 of 13 October 2020 "Transitional provisions on the principles of financial statement preparation - suspension of depreciation and amortisation" highlights the most relevant points of the regulations governing this suspension. In particular, the OIC, as mentioned earlier document underlines that "the .... document analyses from a technical accounting perspective the provisions of paragraphs 7-bis - 7- quinquies of Article 60 of Decree-Law no. 104 of 14 August 2020, as amended upon its conversion by Article 1, paragraph 1, of Law no. 126 of 13 October 2020 (in the future, for simplicity, "Law no. 126"). This document applies to companies that prepare financial statements following the provisions of the Italian Civil Code. It also applies to companies required to prepare consolidated financial statements under the provisions of Legislative Decree No. 127 of 9 April 1991.

REFERENCE REGULATIONS

1. Article 60 of Law n.126 provides that:

7 -bis. Entities that do not adopt international accounting standards may, in the financial year in progress at the date of entry into force of this decree, also by way of derogation from Article 2426, first paragraph, number 2), of the Italian Civil Code, not depreciate up to 100 per cent of the annual cost of tangible and intangible fixed assets, maintaining their book value, as shown

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in the last annual financial statements duly approved. According to this paragraph, the portion of amortisation not carried out shall be charged to the profit and loss account for the following financial year. The subsequent portions shall be deferred on the same basis, thus extending the original amortisation plan one year. In relation to the evolution of the economic situation following the SARS-COV-2 pandemic, this measure may be extended to subsequent years by decree of the Minister of Economic and Finance.

7-ter. Entities availing themselves of the option under paragraph 7-bis shall allocate to an unavailable reserve profit for an amount corresponding to the share of depreciation not carried out in application of the provisions of the same paragraph. In the event of profits for the financial year of an amount less than that of the depreciation mentioned above quota, it shall supplement the reserve by using profit reserves or other available equity reserves; failing that, the reserve shall be supplemented, for the difference, by setting aside the profits of subsequent financial years.

7-c. The notes to the financial statements shall give an account of the reasons for the exemption and the recognition and amount of the corresponding unavailable reserve, indicating the influence on the presentation of the financial position and results of operations for the year.

7-quinquies. For the persons referred to in paragraph 7-bis, the deduction of the depreciation quota referred to in paragraph 7-ter is allowed under the same conditions. With the same limits provided for in Articles 102, 102-bis and 103 of the Consolidated Law on Income Tax, referred to in Presidential Decree No. 917 of 22 December 1986, regardless of whether it is charged to the profit and loss account. For the determination of the value of net production referred to in Articles 5, 5-bis, 6 and 7 of Legislative Decree no. 446 of 15 December 1997, the deduction of the depreciation quota referred to in paragraph 7-ter is allowed under the same conditions and with the same limits provided for by said articles, regardless of whether it is charged to the profit and loss account.

SCOPE OF APPLICATION OF THE RULE

2) The rule introduces an option to derogate exclusively from the requirement of Article 2426, first paragraph, no. 2 of the Italian Civil Code (hereinafter "derogation") concerning the annual depreciation of tangible and intangible fixed assets, whose use is limited in time. Therefore, all other provisions concerning the accounting treatment of tangible and intangible fixed assets remain unaffected.

The rule's scope relates to the depreciation of tangible and intangible fixed assets referring to the financial year in progress as of the date of entry

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into force of Decree-Law 104/2020 or 15 August 2020 (e.g. financial statements as of 31 December 2020).

3) The exercise of the option of Article 60 of Law No. 126 of 13 October 2020 does not exclude the possibility of revaluing tangible and intangible assets according to Article 110 paragraphs 1-7 of Law No. 126 of 13 October 2020.

4) although the rule does not explicitly mention the possibility of applying for the exemption also to fixed assets acquired during the 2020 financial year, nevertheless, consistent with the provisions relating to other fixed assets, the exemption is also applicable to such fixed assets. The calculation of the depreciation rate for tangible fixed assets follows the provisions of para. 61 of OIC 16 – Tangible fixed assets (see example 5).

5) Micro-enterprises that decide to take advantage of the exemption may, according to Article 2435-ter of the Italian Civil Code, prepare the Notes to the Financial Statements or provide the information required by the law at the foot of the financial statements.

METHOD OF APPLICATION

1) The rule does not identify which level of fixed assets it shall be applied to, if to the single asset or classes of fixed assets (basic accounting unit). Therefore, it is possible to use the exception to individual tangible or intangible fixed assets, groups of tangible or intangible fixed assets, or the full balance sheet item. The choice of the elementary unit of accounting must be consistent with the company's reasons for not depreciating the assets (see example 2).

2. Article 60 para. 7-bis is divided into two parts:

a. The first part establishes the procedures for departing from Article 2426, paragraph 1, no. 2 of the Civil Code for the financial year in progress as of 15 August 2020;

b. The second sets out the technical modalities on how to reflect the exercise of the derogation in subsequent financial years.

3) The first part of Article 60 para. 7-bis provides that up to 100 per cent of the cost of tangible and intangible assets may not be amortised. Article 60 para. 7-quater requires an account to be given of the reasons that led the company to charge a lower depreciation rate to the profit and loss account than that provided for in the depreciation plan. The choice of the depreciation charge that the company decides not to make must be consistent with the reasons provided in the notes to the financial statements under paragraph 7-quater (see example 1). It should note that the rule is included in a regulatory context to introduce relief measures due to the pandemic.

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4) The second part of Article 60, paragraph 7-bis, starting from the assumption that the lower depreciation of the asset is associated with an extension of one year of its residual useful life, provides that the portion of depreciation not made according to this paragraph is charged to the profit and loss account relating to the following financial year. The next parts are deferred with the same criterion, thus extending the original depreciation plan by one year for this portion. These are cases where the depreciation charge for the following period (the ratio of the depreciable amount of the asset to its updated remaining helpful life) does not change in amount because the asset's useful life has been extended by one year (see example 3).

The Standard does not deal with the case where lower asset depreciation is not associated with extending its useful life, for example, because of contractual, technical or legislative constraints. In this case, the depreciation charge for the following period (equal to the ratio of the depreciable amount of the asset to its updated useful life) changes in amount because the valuable life remains the same. In such cases, depreciation expense not recognised in the period is allocated over the asset's remaining useful life, increasing the depreciation expense pro-rata.

The exemption permits the use of non-homogeneous group valuation criteria for depreciation. 5) It nay apply the provisions contained in this document to the consolidated financial statements prepared by the parent company. In this case, the consolidated financial statements reflect the effects of the waiver with reference only to the consolidated companies that use it in preparing their financial statements.

6)The derogation application may generate deferred taxation, which must be accounted for following the provisions of OIC 25 - Income Taxes.

"NOTES TO THE ACCOUNTS

1) Article 60, paragraph 7-quater provides that "The notes to the financial statements shall give an account of the reasons for the exemption, as well as the recognition and amount of the corresponding unavailable reserve, indicating the influence on the representation of the financial position and economic result of the financial year."

1)The company using the exception provided for by the rule shall provide information on the choice made in the accounting policies according to point 1) of Article 2427 of the Italian Civil Code.

Therefore, in the notes to the accounts, the company shall indicate

a. on which fixed assets and to what extent no depreciation has been applied;

b. the reasons that led it to make use of the exemption; and

c. the impact of the derogation in economic and patrimonial terms.

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2) All other provisions relating to the information provided in the Notes to the Financial Statements shall remain unchanged.

3) In the Notes to the Consolidated Financial Statements, in addition to the provisions of paragraph 14 above, account must be taken of which consolidated companies have applied the exemption envisaged by the rule".

It clarity above in a telefisco of the Italian Revenue Agency 2002 held on 27 January 2022. In this online meeting, the Italian Revenue Agency provided many clarifications regarding the suspension of depreciation according to Article 60, paragraph 7 bis of Decree-Law 104/2020, converted into Law 126/2020. "The derogating provision, originally introduced for the financial year in progress as of 15 August 2020 and, therefore, for entities with a fiscal year coinciding with the calendar year, concerning the 2020 financial statements, was extended by Law No. 234/2021 (the 2022 Budget Law), under certain conditions and in consideration of the evolution of the economic situation following the SARS-COV-2 pandemic, to the financial year following the one in progress as of 15 August 2020 and, therefore, for "so-large" entities, concerning the 2021 financial statements.

However, significant doubts remained as to interpretation, some of which have now been resolved by the answers provided by the tax authorities.

First of all, it should be noted that, from a tax perspective, Article 60, paragraph 7-quinquies of Decree-Law 104/2020, as converted, establishes that, for parties who avail themselves of the option not to depreciate the cost of tangible and intangible assets on an annual basis, the deduction of the depreciation referred to in paragraph 7-ter (i.e., the portion of depreciation not carried out) "is allowed" under the same conditions and with the same limits provided by Articles 102, 102-bis and 103 of the Consolidated Income Tax Act, regardless of whether or not it is charged to the income statement.

The Italian Revenue Agency's response to a questionnaire No. 607/2021, putting an end to the extensive debate developed in the literature, clarified that, having regard to the exceptional nature and facilitating the function of the provision in question, the expression "is allowed" must be interpreted in the sense of allowing taxpayers the option (and not the obligation) to deduct the suspended depreciation allowances, even without the recognition in the Income Statement.

Concerning the extent of the deduction, Circular Assonime No. 2/2021, assuming that the off-balance sheet deduction of the suspended depreciation allowance was mandatory in the same tax period (a view, as mentioned, denied by the answer to Interpretation No. 607/2021), had considered that the depreciation should not necessarily be computed to the maximum extent allowed for tax purposes.

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In fact, according to the Association, "since even for tax purposes the depreciation process is configured as a mechanism of systematic allocation of costs", it seemed logical that companies that in previous years had recognised and "deducted depreciation amounts lower than the tabular limits" could "adopt the same approach also concerning the amount to be deducted extra-accounting" in 2020 and were not therefore required to comply – only for the tax period under suspension – with the maximum limits.

This was also the direction taken by the Italian Revenue Agency during the meeting.

In particular, it was asked whether, if the company decides to deduct the suspended depreciation for tax purposes, to quantify the decrease in depreciation, it is necessary to refer to the depreciation schedules used by the taxpayer in the previous years, or whether it is possible to refer to the maximum depreciation allowed for tax purposes.

According to the authorities, the reference by paragraph 7-quinquies to paragraph 7-ter, which refers to the "portion of depreciation not carried out", leads to the conclusion that, for the quantification of the deductible depreciation, reference should be made to the depreciation schedules used by the taxpayer in previous years.

This solution is, moreover, preferable for systemic reasons, since both the civil and tax legislation, by providing for the principle of systematic depreciation, have the aim of avoiding that depreciation can be charged in the different years based on changing assessments of expediency"[21].

The decree converting Decree-Law 4/2022, approved on 17 March 2022 by the Italian Senate, again amended the rules on the suspension of depreciation pursuant to Article 60, paragraph 7-bis of Decree-Law 104/2020 (converted into Law 126/2020), providing for the application of this suspension also to the 2021 and 2022 financial statements.

From the above, it can be understood that, for the period in which the depreciation has been suspended, the problem of the fiscal contamination of the financial reporting does not arise concerning this accounting item. In fact, the item depreciation does not appear in financial reporting, i.e. the item that generally creates the most fiscal interference.

After the return to the regular regulations, it can only show whether tax interference will continue to contaminate financial reporting or whether it will reduce this harmful accounting practice.

[21] Latorraca S., "La quota di ammortamento sospesa si deduce in misura inferiore ai limiti tabellari", *Eutekne*, 31/1/2022.

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In this volume has discuss in detail the concept of tax interference from Law Visentini to today.

To complete what has already been illustrated and to underline some peculiarities of the phenomenon of tax pollution of financial reporting, we report below some observations that may help to understand better the reasons of tax interferences in profit and loss statement, balance sheet and notes as well as in the cash flow statement.

As already pointed out that in many entrepreneurial realities of our country, it can identity financial reports, frequently, characterized by a trib-veridicality, fiscal evaluations by a "truthfulness" influence. As can be easily understood, the values recorded in such a document do not identify "economically truthful" data but rather represent values relevant in different areas (in this specific case, tax) from the one we are interested in.

In addressing the issue of tax interferences and the identifiable relationship between general accounting/financial reporting and taxable income, we intend to focus our attention on possible interrelationships/interconnections of data deriving from the application of economic/business/civil law valuation principles and values quantified based on rules dictated to determine taxable income.

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La passione per le conoscenze