



K&L GATES

A Guide to Doing  
Business in Italy

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# WHY ITALY

Italy is renowned for its rich art, cuisine, history, fashion, and culture; its beautiful coastline and beaches; its mountains; and priceless ancient monuments. In fact, Italy is a top tourist destination and has more World Heritage Sites than any other country in the world.

## POPULATION

Italy is a unitary parliamentary republic, which covers an area of 301,338 km<sup>2</sup> (116,347 sq mi) and, due to its shape, is often referred to as lo Stivale (the Boot). With 61 million inhabitants, it is the fourth most populous EU member state. Located in the heart of the Mediterranean Sea, Italy shares open land borders with France, Switzerland, Austria, Slovenia, San Marino, and Vatican City.

## GENERAL

The capital of Italy is Rome, which has 2,627 million inhabitants. Milan is the second-most populous city in Italy and is the main industrial, commercial, and financial center in the country. Its business district hosts the Borsa Italiana (Italy's main stock exchange) and the headquarters of the largest national banks and companies. The city is a major world fashion and design capital. Milan's museums, theaters, and landmarks attract over 8 million visitors annually. The city hosts numerous cultural institutions and universities. Milan is also well known for several international events and fairs, including Milan Fashion Week and the Milan Furniture Fair, the largest of its kind in the world. The city also hosted the Expo 2015.

## ECONOMY

Italy has the world's eighth largest economy but was severely affected by the financial crisis of 2008-2009, the effects of which can still be seen in the highly public debt-to-GDP ratio of 113 percent. The services sector is the largest component of GDP, representing approximately two thirds of GDP, with tourism as the largest contributor. Approximately 19 percent of national income is derived from the tourism industry (including the construction sector) and a remaining small proportion (approximately 2 percent) is generated from agriculture. The strongest industrial sectors are the engineering industry and textiles.

Italy emerged from recession in the first quarter of 2015 and it is now on its way to becoming one of the most attractive countries for business in the European region.

Political instability—a major issue in Italy since the end of the Second World War—seems to have been restrained by the current Prime Minister through the ambitious reform agenda.

Our doing business in Italy guide offers key considerations for foreign investors entering Europe's challenging national economy.

Italy is one of the G7 countries that will benefit the most from the current low oil price. This is good news for a country that—since its ban on nuclear energy hot on the heels of the Chernobyl disaster back in 1986—has been on a competitive disadvantage in relation to other industrialized countries that are either oil-rich or have not shut the door on nuclear energy.

Lower energy costs will be a big boon for the Italian economy, especially in conjunction with a weak euro and the European Central Bank's bond-purchasing program.

Will these optimistic growth expectations impact asset prices? There is no doubt that asset prices will increase in the long run, but in the short to midterm, there are many opportunities available. We are seeing numerous technology-rich industrial assets for sale. Many companies have just about survived the longest post-war recession and credit crunch. They are undervalued as a result of the crisis and represent an excellent opportunity for investors.

The 2008-2014 crisis was a wake-up call for other businesses that now understand the need to embrace best international practices in terms of corporate governance, business intelligence, and talent acquisition and retention if they want to survive the post-crisis business environment.

The recent overhaul of employment legislation resulted in more flexibility in the job market. In particular, the concept of “red protection” has been significantly mitigated and companies employing over 15 staff members do not risk having to reinstate dismissed employees. This is a big achievement of the current government and it is expected that Italian companies will grow in size and geographical reach as a consequence.

During the crisis, Italy's bankruptcy laws were amended to minimize company wind-ups by making out-of-court agreements with creditors easier. This has created an interesting market for distressed and semi-distressed assets.

## CONCLUSION

Italy is not yet out of the woods—for instance, corporate tax rates need to be pushed down and red tape further tackled—but there is light at the end of the tunnel. Investors may find it beneficial to bet on Italy soon in order to capitalize on opportunities.

We hope this guide will provide you with useful information on the Italian economy and the business, corporate, tax, dispute resolution, and intellectual property environments in the country.



# ABOUT K&L GATES

Our global platform includes approximately 2,000 lawyers who operate in fully integrated offices across five continents, including eight offices in Europe.

## RECOGNITIONS

- named to *Law360's* Global 20 for four consecutive years for being one of the “20 law firms that had the biggest global presence and handled the largest, significant and groundbreaking international and cross-border matters over the past year”
- noted as the fastest growing international law firm in the Asia Pacific by the 2014 *Financial Times Innovative Lawyers—Asia Pacific*
- ranked among the top ten firms in the world for client service by the 2016 BTI Client Service 30 for the second consecutive year

## OUR ITALIAN TEAM

Our team in Milan collaborates with lawyers across our global platform to offer distinctive national and international experience in corporate, business, intellectual property (IP), tax, litigation, policy, and regulatory matters.

We provide clients with unparalleled depth and breadth of advice in domestic and cross-border legal matters, including transactions involving the United States, Asia, Australia, Europe, the Middle East, and South America.

## MAIN PRACTICE AREAS

- corporate/mergers & acquisitions
- restructuring & insolvency
- banking and finance
- private equity
- real estate
- tax
- antitrust and EU law
- arbitration and dispute resolution
- energy
- internationalization
- food and beverage

# CORPORATE

We want to give in a nutshell a very quick overview of the main rules governing corporate entities in Italy.

## MOST COMMON FORMS OF CORPORATE ENTITIES

The most common form of corporate entities is the so called, *S.p.A.* or *Società per Azioni* being a company with limited liability where the capital is represented by shares. There is a minimum subscribed capital requirement of €50,000 that applies to *S.p.A.s*.

The second most common form of entities are the so called, *S.r.l.* or *Società a Responsabilità Limitata*, in which ownership is represented by so-called “quotas”, being nominal fractions of capital which are not embodied in negotiable instruments. The minimum capital requirement is, in this case, €10,000, but this requirement can be waived on condition that the lower capital is fully paid-in upon incorporation and the 20% of the annual profits of the company are set aside in a special reserve until the €10,000 threshold is reached.

The setting up procedure may take normally 15/20 days, and shelf companies are not normally used in Italy, as, even when dormant, a company incurs costs, such as drafting and filing of annual accounts, holding of AGM, registration annual duties, etc.

Generally speaking, *S.r.l.s* are the preferred vehicle for setting-up of NewCos and JVCos, in view of their higher flexibility in the allocation of governance rights and their lower maintenance costs.

## GOVERNANCE

There are generally no restrictions to the composition of an Italian company governing bodies, except in specific instances, e.g. banks, insurance companies, financial intermediaries, where officers must comply with certain professional and integrity requirements. Generally speaking foreigners are admitted to cover directorships in Italian companies.

*S.p.A.s* can apply one of the following three organizational models:

- **Traditional Model:** consists of a managing body—being a Board of Directors or a Sole Director—and a supervising body, which is called “Board of Statutory Auditors” and has competence to exercise control over the actions of the directors and over the accounts of the company. Both bodies are appointed by the shareholders meeting;
- **Dual System:** comes from the German tradition and consists of a supervisory board, which is appointed by the shareholders and is granted some of the powers which would belong to the shareholders in the traditional model, including the approval of the annual accounts of the company. The second body of the dual system is the so-called management board which is appointed by the supervisory board and exercises the day-to-day management of the company;
- **Unitary Board System:** consists of a Board of Directors which is appointed by the shareholders. There is an internal audit committee which is appointed by the same Board of Directors among its members.



S.r.l.s can be governed by:

- a board of directors which takes its decisions and resolutions collegially
- a sole director
- directors required to take resolutions unanimously or with several powers, so that each director is granted the power to decide on his/her own on certain specific matters
- shareholders, to whom can be attributed specific management rights, where it is so provided by the bylaws. The flip-side of the coin is that, in this case, this may have an impact on the shareholders' liability, to the extent a loss of the company is a consequence of the concerned shareholders' action in the performance of its management powers beyond or against the law.

## FUNDING

Having a look at the ways in which an Italian company can be funded, in terms of equity, S.p.A.s can issue non-voting shares and shares with limited voting rights up to 50% of their total share capital. No shares with multiple voting rights can be issued. Whereas, shares deferred in losses (so-called "preferential shares") and so-called "tracking shares" linked to specific performance measures can be issued.

S.r.l. companies can provide for specific rights, not only for governance but also in terms of economic rights, which are attaching to individual quotaholders.

In terms of the debts that can be raised by a company, S.p.A. companies are permitted to issue bonds up to twice their equity and beyond, if the placement is reserved to professional investors.

Subordinated bonds and bonds linked to the company's economic performance can also be issued.

## SECURITY

As to the securities that can be taken over Italian companies, **shares and quotas can be pledged** respectively by way of 1) notarized endorsement of share certificate and subsequent recording of the pledge in the shareholders ledger, whereas quotas of an S.r.l. shall be recorded by 2) notarial deed to be registered with the company registry and recorded in the quotaholders ledger of the company, where such a book has been instituted. There is also the possibility for S.p.A.s to create so called "ring-fenced assets," in other words S.p.A. companies can create "segregated assets" which are set aside as security for debt providers of specified business projects carried out by the company. The assets in question are "earmarked" and cannot be attached by the company's general creditors but only of those who have funded the company in connection with the specific projects for which the assets in question have been ring-fenced.

Pursuant to a recently enacted piece of legislation, on certain conditions security interests over a debtor's inventory loosely comparable to common law floating charges, can be created in Italy.

## TRANSFER/ACQUISITION OF SHARES

The Italian legal system provides for rules in the matter of financial assistance, in particular art. 2358 of the Italian Civil Code prevents companies from granting loans or security for the acquisition of their own shares, nor can they accept their own shares by way of security, unless with the authorization of a qualified majority of shareholders, based on a motivated opinion of the board of directors. In any event, the aggregate amount committed, this way, cannot exceed the amount of distributable profits and reserves of the company, as resulting from the latest approved financial statements.

The transfer of shares in an S.p.A. requires, similarly to what seen in connection with pledges, a notarized endorsement of the share certificate and the subsequent recording of the transfer in the shareholders ledger, whereas, for an S.r.l., a notarial deed needs to be entered into by the seller and the purchaser and this deed needs to be filed with the company registry and recorded in the quotaholders ledger, where this book has been instituted.

## SHAREHOLDERS AGREEMENT

Shareholders agreements are generally admitted, but in principle, in case of breach, the aggrieved party will only have a remedy for damages. Whereas the rights provided for in the company's bylaws can in principle be enforced by way of specific performance and can be enforced against third parties. Shareholders agreements cannot contravene to mandatory provisions of law and their duration cannot exceed five years, with the exception of those which have been entered into in connection with a joint venture, a consortium or similar arrangements. According to a majority of authors, the five-year limitation does not apply to quotaholders agreements, being those agreements entered into in respect of an S.r.l company.

Shareholders and quotaholders are entitled to withdraw from the company in certain specific instances provided by law, such as in the presence of clauses in the bylaws preventing or restricting materially the ability to dispose of interests in the company, or in case of dissenting vote on resolutions impinging on the company's structure (e.g. change of corporate object, merger or de-merger, transfer of the registered office abroad, etc.). In case of withdrawal, the shareholders will be entitled to liquidation of the portion of the company's current net asset value proportional to its interest, but the bylaws can provide for alternative solutions insofar as they are not detrimental to the shareholders' position.

## MERGERS AND DE-MERGERS —VOLUNTARY-WINDING UP

Legal mergers, where one company absorbs the other, and de-merger, where one company is split into more companies, are possible and regulated under law.

Exchange ratios of the shares previously held in the company that ceases to exist with the newly issued ones in the company/companies resulting from the merger or de-merger are judicially controlled.

The procedure involves filing several documents (a merger plan, financial statements, a director's report, an expert report) with the Companies Registry and obtaining approval from the shareholders of each company involved. Execution of the final deed of merger can only take place after 60 days from the date of the last filing. The 60-day-term can be waived with

- the creditors' express consent to merger;
- the payment of non-consenting creditors; or
- the payment into an escrow of an amount equivalent to the debts which are outstanding

Companies can be voluntarily wound up. A qualified majority of the shareholders can resolve on the dissolution of the company. As a consequence, liquidators need to be appointed to take up the management from directors with a view of liquidating the company's asset and paying all outstanding debts. The timeframe can be lengthy depending on the size of the company and its liquidity. Liquidation is completed with the approval of a final balance-sheet and cancellation of the company from the Companies Registry. Post cancellation, any supervening creditors can only have recourse to the shareholders assets in the limits of the quota that has been liquidated to them, and to the liquidators, insofar as the failure to pay those debts is due to breach of their statutory duties. As a consequence, it is customary—for liquidators—to obtain an indemnity covenant from the shareholders upon their appointment.

Shareholders agreements are generally admitted, but in principle, in case of breach, the aggrieved party will only have a remedy for damages.



# INTELLECTUAL PROPERTY

Italian intellectual property laws concern several intangible assets such as patents, trademarks and design, and include legislation on copyright, data protection, and unfair competition. K&L Gates' Milan office offers comprehensive assistance in each of these issues. Reference Italian legislation on intellectual property includes the Industrial Property Code, the Copyright Law, the Privacy Code, and the Civil Code. As an EU member state, Italy applies all relevant EU regulations and has implemented all EU directives on IP matters.

Consequently, the Italian IP legal framework has been influenced by European legislation in compliance with the harmonization process carried on over the last few decades. Italy is also a contracting party to several international agreements such as the TRIPS Agreement and the Madrid Agreement (WIPO system), as well as the Agreement of the Unified Patent Court.

## PATENTS

In Italy, patents are regulated by the Industrial Property Code. Patents can be granted for industrial inventions, utility models, and new plant varieties. The registered patent awards the registrant with a temporary monopoly on the exploitation of the patent itself, by way of forbidding any and all related exploitation activities to unauthorized third parties. The protection period varies according to the nature of the patent: while inventions are protected for a period of 20 years and utility models for a shorter period of 10 years, both starting from the date of their filing, new plant varieties are protected for 20 years starting from the date of granting, provided that certain requirements are met. Eligibility of industrial inventions and utility models to the registration as a patent is fulfilled when four basic conditions are met: (a) novelty, (b) inventive step, (c) industrial applicability, and (d) compliance to public order. Eligibility of plant varieties to the registration as a patent is fulfilled when the following conditions are met: (a) novelty, (b) homogeneity, (c) distinction, and (d) stability. A patent is granted after examination of the fulfillment of such conditions by the Italian Patent and Trademark Office. Priority in granting a patent is based on the "first to file" principle. In Italy, it is not possible to request a provisional patent. The patent registrant can enforce his rights against any unauthorized exploitation of the patent by

way of specific remedies provided by the Industrial Property Code, such as injunction and recall of infringing products from the market. The right holder is also entitled to ask for damages compensation. Such remedies are applicable likewise to trademarks as well as to design and models.

## TRADEMARKS

In Italy, trademarks are regulated by the Industrial Property Code as well.

According to Italian law, signs (including words, designs, letters, digits, symbols, sounds, shapes of products, and chromatic combinations) capable of being represented graphically and capable of identifying and distinguishing products and services of an entrepreneur from similar or identical products or services provided by competitors can be registered as a trademark. A sign can be validly registered as a trademark if the following conditions are met: (a) novelty, so that the sign cannot be confused with prior different signs; (b) distinctive character, so that the sign is capable to distinguish a product or service from others; and (c) lawfulness. By granting trademark protection, the trademark proprietor is entitled to use the trademark within the Italian territory with the possibility to oppose to any use of similar or identical signs by any unauthorized party. The protection period of a trademark is 10 years and can be extended every 10 years in perpetuity. Trademark registration procedure requires the submission of the application to the Italian Patent and Trademark Office including exhaustive information about the sign and indication of the goods for which the sign will be used. Trademarks enjoy of both civil and criminal law protection. Protection against counterfeiting is also granted by customs authorities. Besides the faculty

of enforcing rights before tribunals, the trademark proprietor may alternatively oppose any imitations or forgeries of his trademark through an administrative procedure to be brought before the Italian Patent and Trademark Office. Unregistered trademarks which have been used prior to the registration of the sign by another party may enjoy some protection even if within the limits of local circulation and previous use.

## DESIGN AND MODELS

In Italy, also design and models are regulated by the Industrial Property Code.

Design or models are relevant for a wide range of products in industry, fashion, and handcraft. In particular, the appearance of an entire product or part of it, such as the features of the lines, the contours, the colors, the shape, the surface structure, the materials, and the ornamentation of the product may be subject to registration as designs and models, as long as they are new and individual. In order to ensure that the novelty requirement is met, it is necessary to keep the design secret until registration is confirmed. Whether design is disclosed before its registration, it can be protected only if disclosed under specific conditions during the so-called “grace period” which coincides with the 12-month period preceding the date of filing the application for registration or, when claiming priority, the date of such a

claim. By registering a design or a model before the Italian Patent and Trademark Office the registrant acquires the exclusive right of use on the design or model which can be enforced in case of unauthorized copying or imitation of the design or model by third parties. The protection period of the design or model lasts five years starting from the date of submission of the application and the rights holder can obtain the extension for one or more five-year periods, up to a maximum of 25 years. Design and models also enjoy of those specific remedies provided by the Industrial Property Code for patents and trademarks.

## COPYRIGHT

In Italy, copyright is regulated by the Copyright Law.

Italian copyright law protects, inter alia, literary, musical, architectural, cinematographic, and theatrical and artistic works constituting a personal intellectual creation. A work is protected by copyright if it is (a) creative, (b) new and original, and (c) fixed in any form of expression. Works do not have to be registered in order to enjoy legal protection. In Italy, copyright grants to the right holders both moral and economic rights on the protected work. While the latter are transferable, moral rights are vested and remain only in the author of the protected work. Within such limits, the right holder may grant to third parties permission to use the work under a license agreement and is entitled to transfer economic rights which include, among others, publication, reproduction, public performance, communication, renting, or lending to the public. The duration of economic rights for most works protected under the Copyright law is 70 years from the death of the author, or from the death of the last surviving author in case of multiple authors. Works protected under Copyright law enjoy both civil remedies, such as injunction, damages compensation, destruction of infringing works, and criminal remedies, such as fines and imprisonment.

## DATA PROTECTION

In Italy, processing of personal data is regulated by the Privacy Code along with specific regulations provided by the Italian Data Protection Authority.

The legal framework on data protection basically enforces EU legislation on the matter. Personal data is considered to be any information relating to an identified or identifiable natural person, while information relating to the legal entities do not fall within the definition of personal data. Collection and processing of data must comply with specific conditions set out in the relevant provisions of the Privacy Code. Prior requirement for processing personal data is the obtainment



of the consent of the relevant individual. Specific protective and precautionary measures are provided for the storage and processing of data via electronic means and for sensitive data. Sensitive data is personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership, and data concerning health or sex life. Personal data can be freely transferred to other countries within the EEA, while the transborder data flow outside the EEA is subject to specific conditions.

## UNFAIR COMPETITION

In Italy, unfair competition is mainly regulated by section 2598 of the Civil Code.

The above provision of law identifies different acts which, if engaged, may constitute unfair competition, provided that both parties are entrepreneurs and that there is a competitive relationship between them. The acts include: (a) the use of signs capable of producing confusion with names and distinctive signs legitimately used by others, or slavish imitation of products of competitors or behaving in any other way which may generate confusion with the products or activity of a competitor; (b) the broadcasting of information and evaluations about the products and activities of a competitor in a way which may cast disrepute on the competitor or stealing the merit of the products and activities of the competitor; or (c) the direct or indirect use of any other means which do not comply with the principles of professional fairness and in a manner that damages the competitor's business. Common practices deemed to be unfair competition are, inter alia, misleading naming of the company, goods or services which may create confusion with other goods or services, slavish imitation of products, derogatory commercial communication or appropriation of the merits of the products or the company of a competitor (for instance through the use of others' trademark to promote products), false or fraudulent description of geographical origin of the goods or services, and violation of trade secrets. If unfair competition behaviors occur, the offended party may be entitled to claim compensation of economic damage as well as to request cease-and-desist orders and to have the effects of such illegal behavior removed by the offender. Nevertheless, Italian law punishes acts of unfair competition irrespective of whether a breach has actually occurred.

## GOVERNMENT INCENTIVES TO INTELLECTUAL PROPERTY DEVELOPMENT

The Italian government has provided several economic incentives addressed to micro, small, and medium-sized (including startup) companies (SME) interested in developing their own intangible assets with the scope of boosting innovation, research, and development in the Italian IP industry. The two main incentives are the National Innovation Fund and the Patent Box.

The National Innovation Fund aims to grant micro, small, and medium-sized companies access to private equity and venture capital instruments in order to obtain support for the realization of a project for the maximization of the value of patents on industrial inventions. Specifically, the National Innovation Fund consists of a closed-end investment fund, the capital of which derives from funds that are invested by the Italian Economic Development Ministry for approximately 50 percent and by private investors for the remaining share. The fund purchases a minority or majority interest in the participating SME, either in the form of an equity holding or in the form of quasi-equity instruments issued by the SME, the value of which generally varies on the basis of the SME's performance. IP assets eligible to benefit from the National Innovation Fund are patents valid on the Italian territory (with reference to which a not negative EPO report has been issued) relevant for the introduction of new products or services in the market, or for the increase of their innovative content.

The Patent Box (recently introduced by the 2015 Italian Stability Law) consists of a progressive tax credit applicable to revenues arising from the use of intellectual property rights. In particular, it provides tax relief for revenues deriving from the exploitation and assignment of relevant IP assets such as software (protected by copyright), patents, trademarks, designs and models (capable of being legally protected), industrial, and commercial and scientific know-how (capable of being protected as confidential information and capable of being legally protected). Individual entrepreneurs, Italian companies and other Italian entities running commercial activities are typical taxpayers eligible to access the Patent Box. The Patent Box lasts five years and is renewable.

The Italian IP legal framework has been influenced by European legislation in compliance with the harmonization process carried on over the last few decades.

# DISPUTE RESOLUTION

The judicial system is a key factor to take into account when a company has to make a decision as to which foreign country may be more suitable for starting a new business.

Clear and fast court decisions preventing unfair competition, efficient court measures to collect debts, and highly educated judges on business matters are all features of a judicial system working properly and contributing to a competitive and attractive business environment.

The Italian civil justice system is perceived abroad as inefficient, mostly due to its slowness.

In the last few years, such perception has been proven to be justified as Italian courts become the field of a litigation defensive strategy known as “torpedo action,” aimed at taking advantage of the delay of the Italian courts. The goal of an Italian torpedo action is to take advantage of delays on court decisions to sink the damaged party’s claim on the merits.

Data collected by the World Bank in 2015 confirms this delay: about 900 days—on average—were required to obtain a final decision by an Italian court, and 200 more days were needed to execute this decision. This is two or three times the expected duration for U.S. or UK judgments.

In 2014, the Italian government recognized that the long duration of proceedings before the Italian courts adversely affected economic growth and was particularly detrimental to attracting foreign investments. Therefore, a full package of reforms for the Italian judicial system has been issued and executed:

- An Internet-based IT platform has been designed and fully implemented so that all parties involved in proceedings—such as judges, clerks, and lawyers—are always connected to each other and are now able to take any action through the internet and in real time. For instance, lawyers can enroll the cause before the court; file claims, requests, and defensive briefs; and have access to court files and to the judges in charge of the relevant proceedings.
- Procedural rules have been amended in order to have faster, less complicated trials.
- A second reform provided lawyers with new powers and duties previously under the control of clerks and judges only. For instance, lawyers can now serve judicial deeds—even through the internet—using a special

certified email address. Lawyers can also take depositions out of the court or certify copies of judicial deeds, making proceedings more flexible and efficient.

- Through a fully implemented reform, the government established “specialized courts” for company and business matters; since such courts deal exclusively with these kinds of matters, they have acquired a higher level of expertise in these fields.
- As to the workload of the courts, which creates a real quagmire and negatively affects the speed and efficiency of new trials, special measures have been set up to decrease the volume of old pending litigations.
- New measures have been taken to promote alternative dispute resolutions; as a matter of fact, alternative dispute resolution is an area in which the government is pushing full steam ahead.
- Reforms also addressed territorial court distribution and competence, which have been reorganized in order to have the smallest court abolished.
- Reforms also dealt with the enforcement of court decisions, making them faster and more effective.

The above is not a complete list of the reforms already made. Others have yet to be implemented or are currently under discussion before the Italian Parliament.

In any event, practical outcomes of the above reforms appear to be positive.

As practical examples of the improvement of the judicial system, it should be noted that the required time to obtain an order of payment by a court may now range from three or four days up to 60 days, and the average duration of a trial before the specialized courts for company and business matters is lower than 500 days. These durations put the Italian civil judicial system in line with the more efficient systems of other EU or non-EU countries.

This means the Italian judicial system is now on a fast track to becoming a favorable factor in deciding whether or not a company should do business in Italy.

## TAX

## TAXES ON BUSINESS OPERATIONS

## Italian Resident Corporations

Italian resident corporations (SRLs/SPAs) are “tax opaque” entities. They are liable to corporation tax (IRES), levied at the rate of 27.5%<sup>1</sup> on their worldwide income, and to regional tax (IRAP), levied at the base rate of 3.9%<sup>2,3</sup> on the added value generated in Italy.

## Italian Partnerships

Italian partnerships are “tax transparent” entities for IRES purposes. Accordingly, they do not pay IRES in their own right. Rather, the entity’s taxable profits or losses are allocated to the entity’s partners, who in turn report their respective shares of profits or losses on their income tax returns. This allocation of profits or losses to the partners is accomplished by the partnership filing an income tax return on an annual basis with the Italian tax authorities, showing all the partners’ names and Italian taxpayer identification numbers.

Differently from IRES, IRAP is imposed directly on partnerships (rather than on their partners) in a fashion comparable to corporations.

## Non-Italian Resident Companies

Non-Italian resident companies are taxable in Italy if and to the extent that they derive Italian source income. This is typically the case of a foreign company that operates directly in Italy through a “permanent establishment” located therein: the foreign company is subject to both IRES and IRAP on the income that is attributable to its Italian operations and shall follow basically the same rules applicable to SRLs/SPAs.

A foreign company that operates in Italy through a representative office, on the other hand, is not liable to IRES/IRAP, provided that the activities have a preparatory/auxiliary nature.

## Main Differences Between IRES and IRAP

IRES	IRAP
Deductions are available for interest expenses on third party or related party debt and for notional interest on qualifying equity increases.	No interest <sup>4</sup> /notional interest deduction.
Tax losses may be offset against up to 80% of taxable income in each year (100% if the tax losses are incurred in the first 3 years of activity and refer to a new business). Any difference can be carried forward indefinitely <sup>5</sup> . No loss carry-back is available.	No loss carry-forward/carry-back.
Fiscal unity.	No fiscal unity.

## Deduction of Interest Expenses

The following rules limit the deduction of interest expenses for IRES purposes:

- no deduction is allowed if the loan is profit participating;
- interest expenses on loans granted by non-Italian resident group companies shall comply with transfer pricing rules and regulations<sup>6</sup>; and
- interest expenses that survive the above limitations are deductible on the basis of the “EBITDA Rule”<sup>7</sup>.

According to the EBITDA Rule:

- interest expenses are fully deductible up to the amount of interest revenues;
- the “net interest expenses” are deductible within 30% of a company’s EBITDA (increased, as from 2016, by dividends paid by foreign controlled subsidiaries); and
- if the “net interest expenses” exceed 30% of the EBITDA, the excess can be carried forward with no time barriers, becoming deductible if and when there is EBITDA capacity.

<sup>1</sup> The corporation tax rate will drop to 24% in 2017. However, a 3.5% surcharge will apply to credit and financial institutions.

<sup>2</sup> The rate can be increased or decreased, on a regional basis, by up to 0.92%.

<sup>3</sup> Higher rates apply to banks, financial institutions, and insurance companies as well as other specific industries.

<sup>4</sup> Different rules apply for financial companies.

<sup>5</sup> Tax losses are forfeited if (a) the majority of the voting rights of the company are transferred and (b) in the tax year in which the transfer occurs, or in any of the two preceding

or subsequent periods, the activity of the company changes from the activity that generated the losses. The forfeiture does not apply, however, if the loss-making company had, in the tax year preceding the transfer, at least 10 employees and gross revenues and personnel costs higher than 40% of the average figures of the two previous years.

<sup>6</sup> Italian transfer pricing rules limit the deduction of interest on shareholder loans if the level of funding exceeds that which the company could have borrowed from an unrelated third party or the interest rate charged is higher than an arm’s length rate.

<sup>7</sup> Different rules apply to financial companies.

### The Notional Interest Deduction

A notional interest deduction is allowed for IRES purposes only, in respect of the “new equity” over the “2010 base amount”:

- the “2010 base amount” is the 2010 book net equity, net of the yearly profit;
- the “new equity” is the algebraic sum of (+) cash equity injections (including waivers of shareholder loans) and profit retentions and (-) dividends and equity repayments, all of them occurring after 2010; and
- the annual notional interest deduction amount is determined by applying a notional rate to the aggregate “new equity”: 4.5% in 2015, 4.75% in 2016, to be determined for the following years.

## WITHHOLDING TAXES

### General Overview

As a general rule, dividend and interest payments by an Italian company to a foreign lender are subject to a 26% withholding tax (**WHT**).

However, (full or partial) WHT relief may be available under:

- domestic rules
- double tax treaties (**DTT**);
- the EU Parent-Subsidiary Directive (**EU-PSD**)
- the EU Interest and Royalties Directive (**EU-IRD**); together with EU-PSD referred to as **EU-Directives**)

### WHT Reliefs on Cross-border Dividends

The domestic WHT rate (26%) is reduced to 1.375% (1.2% in 2017) for dividends paid to companies and entities that are:

- resident in the EU or in EEA states that allow an adequate exchange of information<sup>8</sup>, and
- subject to corporation tax in their home country.

Under the EU-PSD, no WHT is levied on dividends paid to a parent company in another EU member state if:

- both the parent and the subsidiary are “qualifying companies” under the Directive;
- the parent has held at least 10% of the capital of the subsidiary continuously for at least one year.

If the parent company is resident in a country that is a treaty partner with Italy, the DTT rules may limit the WHT on dividends. The DTT rate is generally 15%, even though some DTTs provide for a lower rate (5% and/or 10%) if certain conditions are met.

### WHT Relief on Cross-border Interest Payments

A domestic WHT exemption applies to interest on medium-long term loans (> 18 months) granted to Italian enterprises by certain qualifying lenders (the Qualifying Lenders):

- credit institutions established in EU member states;
- entities under Article 2(5)(4) to 2(5)(23) of Directive 2013/36/EU (these are development promotion institutions established in different EU member states);
- insurance companies incorporated and authorized under rules enacted by EU member states;
- foreign “institutional investors” that, regardless of their tax status, are resident or established in countries with an adequate exchange of information and are subject therein to forms of supervision<sup>9</sup>.



<sup>8</sup> Norway and Iceland, at present.

<sup>9</sup> These “institutional investors” are entities which have as their principal activity that of managing investments on their own account or on behalf of third parties, such as insurance companies, investment companies, investment funds, SICAVs and pension funds.

A domestic WHT exemption applies to interest on bonds issued by certain qualifying Italian issuers:

- qualifying issuers are: (1) banks, (2) listed companies, (3) unlisted companies, provided that (a) the bonds are traded on regulated markets or multilateral trading platforms, or (b) if not traded on regulated markets or multilateral trading platforms, the bonds are reserved to qualified investors (i.e., they can circulate only amongst qualified investors);
- the exemption is available to (1) foreign investors that are resident in states with an adequate exchange of information with Italy and (2) foreign “institutional investors” (e.g., investment funds<sup>10</sup>) that are established in states with an adequate exchange of information with Italy, regardless of their tax status in their home country;
- the bonds must be deposited with qualifying intermediaries and certain formalities need to be completed.

Under the EU-IRD, no WHT is levied on interest paid to an EU resident “associated company”<sup>11</sup> if certain requirements are satisfied. In particular, a one-year holding period is required and the recipient of the interest payments must satisfy the beneficial ownership test<sup>12</sup>. The WHT relief does not apply to the interest in excess of the arm’s length amount and if the loan is profit participating, has no maturity date, or a maturity date in excess of 50 years.

If the parent company is resident in a country that is a treaty partner with Italy, the DTT rules may limit the WHT on dividends (generally, 10%).

## CAPITAL GAINS

A different regime applies for “substantial” and “non-substantial” participations.

A participation is considered to be “substantial” when it entitles the holder to:

- more than 2% of the voting rights or more than 5% of the capital for listed companies, or
- more than 20% of the voting rights or more than 25% of the capital in other companies.

A participation is considered “non-substantial” when the above thresholds are not exceeded.

A 26% tax is due on capital gains on “non-substantial” participations, but:

- no tax is due if the shares are listed (the income is deemed not to be Italian source);
- if the shares are unlisted, an exemption is available to sellers that are resident/established in “white-listed” jurisdictions (i.e., states allowing an adequate exchange of information with Italy);
- DTTs usually exclude Italy’s right to tax.

Capital gains on “substantial” participations are liable to corporation tax on 49.72% of their amount. In this event, no domestic relief is available, but DTTs usually exclude Italy’s right to tax.

## ANTI-AVOIDANCE & BENEFICIAL OWNERSHIP

The availability of the WHT reliefs in respect to interest and dividend payments (under domestic rules, or the EU Directives or a DTT) and the availability of the tax reliefs in respect of capital gains (under domestic rules or a DTT) are subject to anti-avoidance and beneficial ownership tests.

### Anti-avoidance Rule

A new general anti-avoidance rule (GAAR) was enacted in 2015. The GAAR replaces and supplements the previous (semi-general) anti-avoidance provision set out by Art. 37-bis of the Decree 600/73<sup>13</sup> and the abuse of law doctrine developed by the Supreme Court<sup>14</sup>, which has been extensively applied by the Italian tax authorities and tax courts beyond the narrow borders ruled by Art. 37-bis.

An abuse of law exists when one or more transactions “lack any economic substance and, despite being formally in compliance with tax laws, are essentially aimed at obtaining undue tax advantages.” These abusive schemes are not enforceable toward the tax authorities, which shall disregard the tax advantages so achieved and compute the taxes on the basis of the rules and principles that have been circumvented, taking into account any tax payments made by the taxpayer in connection with the abusive transactions.

<sup>10</sup> See the previous footnote.

<sup>11</sup> Two companies are deemed to be “associated companies” for the purposes of the WHT relief if (a) they have one legal form listed in the Annex of the Directive, (b) they are resident in two different EU member states, (c) they are subject to corporate income tax in their home jurisdiction and (d) one of them holds directly at least 25% of the voting rights of the other or a third EU company holds directly at least 25% of the voting rights of the two companies

<sup>12</sup> If all the requirements for the WHT relief under the IRD-Directive are satisfied, except for the beneficial ownership, the relief cannot apply. However, in certain circumstances the WHT rate is reduced to 5%. This is the case where (i) the interest is paid on a loan

granted by a foreign associated company issuing bonds that are listed on a regulated market of an EU member state or of an EEA state that allows an adequate exchange of information with Italy and (ii) the bonds issued by the foreign company are guaranteed by either the Italian resident company or by its controlling company or by another group entity controlled by the same company.

<sup>13</sup> The scope of application of Art. 37-bis was limited to Italian income taxes and to a closed list of transactions.

<sup>14</sup> According to the Supreme Court, prohibition of abuse of law is a general, unwritten principle which stems from the Constitution and from the EU Directives.

The GAAR specifically states that transactions are deemed to be lacking any economic substance when they consist of facts, acts, and contracts, even interconnected, that are not suitable to generate economic effects different from the tax advantages. The inconsistency between the individual transactions and the underlying rationale of their aggregation or between the legal instruments that have been adopted and common market practices can be regarded as being evidences of a lack of economic substance.

The undue tax advantages that can be challenged under the GAAR consist of benefits, even if not achieved in the short term, that are in conflict with the purpose of the tax provisions or with the principles of the tax legal framework.

There is no abuse when a transaction is justified by sound and non-marginal non-tax reasons, including managerial and organizational ones aimed at improving the structure or the functionality of the business. Taxpayers are allowed to choose between different optional tax regimes provided by the law or between alternative transactions leading to a different tax burden. In other words, it is recognized that under Italy's detailed rules, taxpayers frequently have a choice as to the way in which transactions can be carried out, and that different tax results arise depending on the choice that is made. The GAAR does not challenge such choices. It may, however still come into operation if the course of action taken by the taxpayer cannot be regarded as reasonable and essentially aims to achieve a favorable tax result that the lawmaker did not anticipate when it introduced the tax rules in question.

The GAAR also sets out the formalities that need to be followed for abuse of law tax assessments and specifically states that abuse of law does not amount to a tax crime.

### Beneficial Ownership

The beneficial ownership test (generally in combination with the anti-avoidance test) is relevant for the tax relief that is available in respect to dividend/interest payments and capital gains.

No beneficial ownership definition is available in the Italian tax rules, except for the provisions implementing the EU-IRD where it is stated that foreign associated companies receiving Italian source interest or royalties are deemed to be beneficial owners if they receive such payments as final beneficiaries and not as intermediaries (i.e. acting as agents or nominees).

In general terms, the beneficial owner is the person who has the "availability" of the relevant income. In this respect, an intermediate holding company with no substance and acting as a conduit entity between the Italian target/subsidiary and the ultimate investor(s) would generally not pass the beneficial ownership (and anti-avoidance) tests, as confirmed by the Italian tax authorities on a number of occasions, including the recent guidelines on leveraged acquisitions (the Guidelines)<sup>15</sup>.

## TRANSFER TAXES AND VAT

### Asset Deals

An asset deal over a "going concern" falls out of the scope of Italian VAT rules and triggers the payment of registration tax at rates that vary depending on the nature of the assets:

- real estate assets: 9%
- receivables: 0.5%
- all other assets and goodwill: 3%

In the case of an asset deal over real estate properties, transfer taxes are due at rates that vary depending on the nature of the assets, VAT regime, and status of the parties:

- residential real estate assets: 9% registration tax (not applicable if VAT is charged on the sale)
- non-residential real estate assets: 4% (2% if one of the parties is a real estate fund/SICAF)

Sales of real estate assets are generally VAT exempted. However, 10%/22% VAT may/shall be due in some circumstances. Where due, the VAT may be accounted for by the purchaser under the reverse charge regime.

Unlike other jurisdictions, the purchase of shares in a property holding company does not trigger real estate transfer tax charges in Italy.

### Share Deals

In the event of a share deal:

- financial transaction tax is due by the purchaser on the transfer of shares of an SPA (rate: 0.2% for OTC transactions; 0.1% for on-exchange trades); and
- no financial transaction tax is due on the transfer of quotas of an SRL.

<sup>15</sup> Circular 6/E/2016 published on 30 March 2016. In particular, the tax authorities have clarified in the Guidelines that the WHT relief under the IRD-Directive shall be disregarded whenever a foreign parent company is financing an Italian subsidiary under back-to-back arrangements. In these circumstances, adopting a full look-through approach (to be applied on a case-by-case basis), the applicable WHT regime should

be the one available in case of payment directly to the lenders of the foreign parent. To this end, the domestic WHT exemption on interest on medium-long term loans paid to qualifying lenders should be taken into account, thus possibly ensuring that the WHT relief remains available.



## TAX CONSIDERATIONS FOR INVESTING

### Asset Deal or Share Deal?

Investments in Italian assets are generally structured as share deals. One reason is the lower complexity of a share transfer as compared with the transfer of several different assets. Furthermore, from the seller's perspective, the sale of corporate shares is generally subject to no or marginal capital gains tax, whereas the sale of assets at a profit is taxed at the ordinary IRES rate. Lastly, transfer taxes are generally much more burdensome for an asset deal than for a share deal.

A corporate share deal, however, has two main downsides for the purchaser. First, the takeover of all contingent liabilities of the target company (including tax liabilities, which evidently lie with the company). Second, differently from what happens in an asset deal, a share deal does not typically result in a step-up of the target company's assets for tax purposes (unless an appropriate pre or post acquisition restructuring is carried out and a step-up tax is paid).

### Acquisition Vehicle - Push Down

In case of an acquisition in Italy, a foreign investor needs to consider whether the level of the target's taxable profits would allow an effective tax relief (for the interest expenses deriving from the acquisition financing and/or for the notional interest deduction).

Unless a tax deduction may be available at higher rates in other jurisdictions (which is however unlikely to be the case), the acquisition is typically structured via the establishment of (at least) one holding company established in a foreign appropriate jurisdiction and an Italian resident corporate acquisition vehicle (**Italian BidCo**). The Italian BidCo acquires the shares in the Italian target company (**Target**) and is generally funded with a combination of third-party bank debt, shareholder loan (**SHL**), and equity. Post closing, Italian BidCo and Target elect for fiscal unity or merge together (up or downstream) to offset Italian BidCo's interest charges<sup>16</sup> on bank debt and/or SHL<sup>17</sup> and notional interest deduction<sup>18</sup> against the Target's profits.



<sup>16</sup> Interest expenses on bank debt/SHL are deductible for IRES purposes based on the EBITDA rule. No deduction is allowed for IRAP purposes.

<sup>17</sup> Transfer pricing rules need to be taken into account in respect of the SHL.

<sup>18</sup> The notional interest deduction available in respect of cash equity injected in Italian BidCo.

Leveraged acquisitions and push-down structures have been extensively challenged in the past by the Italian tax authorities on the ground that the sole purpose of the transactions, albeit carried out through lawful arrangements, was to allow the abusive tax deductions and savings. However, the tax authorities have recently changed their approach, stating that debt push down structures should generally not be deemed to be abusive. Indeed, the Guidelines acknowledge that funding costs incurred by Italian BidCo to finance the purchase of the shares of the Target shall be regarded as legitimate business expenses, both in the case of subsequent merger and in the case of a fiscal unity between the two companies. Even though the tax authorities do not specifically address the point, the same approach should be adopted in respect to the notional interest deduction deriving from the equity injected in Italian BidCo, which should accordingly not be disregarded.

#### **Recharacterization of SHL as Equity**

A SHL with equity-like features may be re-characterized as equity for tax purposes, applying a substance-over-form approach and the OECD arm's-length principle, as clarified in the Guidelines. In this event, the interest expenses would not be deductible, but the (deemed) capital injection would in principal qualify for the notional interest deduction. In addition, dividend WHT rates instead of interest WHT rates would be applicable.

#### **Profit Repatriation and Exit**

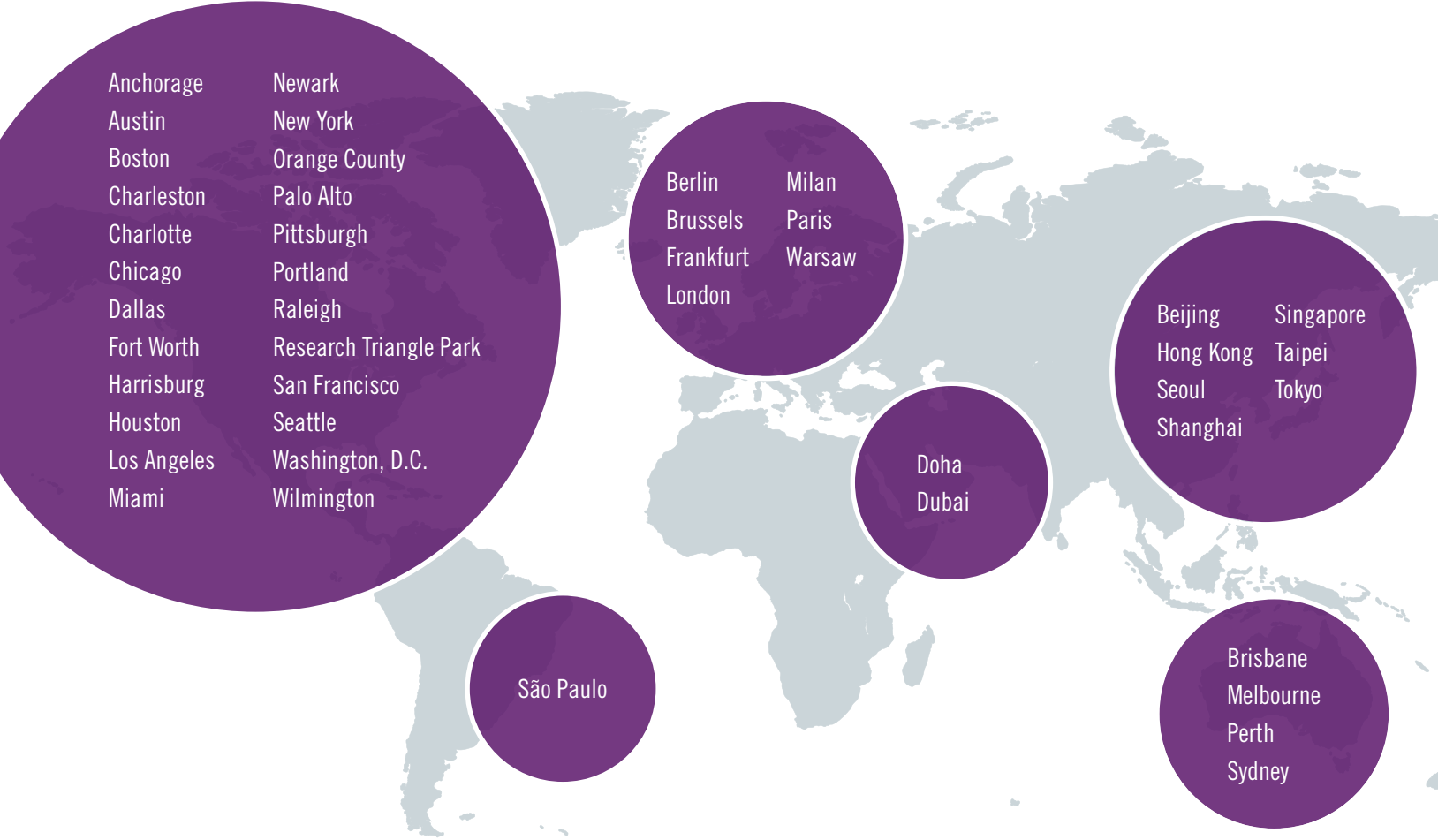
As mentioned above, Italy levies WHT on cross-border dividend and interest payments. However, (full or partial) relief may be available under domestic rules, DTTs, and/or the EU-Directives. As a rule, WHT is not levied on capital gains, which are generally not taxable in Italy under DTTs (with exceptions).

If a non-EU investor cannot (sufficiently) take advantage of the above tax relief, it may be beneficial to establish an intermediate holding company (EU-HoldCo) above the Italian BidCo in one of the other attractive European holding jurisdictions, which, among other benefits, have no or flexible WHT rules (such as Luxembourg or the Netherlands).

The intermediate EU-HoldCo could secure the benefits of the domestic rules, DTT, or EU Directives for profit repatriation, subject to beneficial ownership and anti-avoidance tests. In this respect, the Guidelines have clarified, consistently with the approach generally adopted by the Italian tax authorities when conducting audits and assessments on similar matters, that the withholding and capital gain tax relief should be disregarded when the EU-HoldCo lacks an adequate substance and acts as a mere conduit entity. This is typically the case, according to the Guidelines, when the EU-HoldCo (i) has a "light structure" (e.g. when the employees, office space, and equipment are provided by a "domiciliary company" through a management service agreement) and lacks actual business activities and actual decision-making power (e.g. on the management of the investment) or (ii) the economic and contractual conditions of the funding structure adopted for the specific transaction allow a substantial matching, at the EU-HoldCo level, between inbound and outbound cash flows (back-to-back arrangements).

Investments in Italian assets are generally structured as share deals.

# GLOBAL REACH



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