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Italy Introduces Measures to Facilitate Alternative Funding

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Law Decree No. 91 of the 24th of June (the "**Decree**") has introduced various measures meant to boost the competitiveness of the Italian economy.

Our focus will be directed to Articles 21 and 22 of the Decree, where new tax and regulatory rules are meant to facilitate both issue of bonds by non-listed companies and credit to enterprises by non-conventional sources of funding.

The Decree is already imposed, but will become final only upon its conversion into a law, which must occur within 60 days from the publication of the Decree.

Such new regulation contains a specific focus on foreign investors and follows the recent introduction of a competitive legal framework for the issuance of listed bonds by non-listed companies (*mini-bonds*) and the (still in progress) implementation of the alternative investment fund managers directive whereby Italian closed investment funds would be allowed to grant loans.

Credit to Enterprises

Credit by Insurance Companies and Securitisation Vehicles

Under Italian law, the granting of loans is traditionally reserved to banks and authorised financial intermediaries. According to the Decree, Italian insurance companies and securitisation vehicles would be allowed to grant loans to corporate borrowers (other than very small businesses) upon certain conditions being met:

- the debtors are selected by a bank or a financial intermediary;
- the bank or financial intermediary retains a significant economic interest in the transaction until its maturity;
- with respect to the insurance companies only:
  - the internal control system and the risk management of the insurance company must be adequate and must allow one to fully understand the risks related to such activity, and
  - capital requirements must be adequate; and
- with respect to the securitisation vehicles only, the bonds issued to finance the granting of loans must be subscribed by qualified investors only.

Abolition of Withholding Tax

Another innovative provision is the abolition of withholding tax (recently increased from 20% to 26%) on interest paid to banks located in the EU and in the European Economic Area (Norway and Iceland). The only condition for the non-application of the withholding tax is that the loan or the financing has a duration higher than 18 months.

The same as above is also applied to European insurance companies and unleveraged European or white-listed EEA investment funds (organized as collective investment undertakings).

The abolition of the withholding tax on interest is a real break with Italy's traditional international tax law. In the past, a similar exemption from withholding tax on interest was applicable within the limits of the EU Interest and Royalties Directive and within the application of Treaties (to be noted, however, that zero withholding tax on interest was applicable only in the treaty with Hungary).

The exemption seems applicable also to medium- and long-term loans already in place, even though specific clarifications are needed. Finally, the certificate of residence from the beneficial owner of the interest should not be forgotten in order to benefit from the exemption.

Extension of the Application of the Substitute Tax

Further new provisions intended to facilitate credit to enterprises also contemplate an extension of the application of the 0.25% substitute tax on medium- and long-term loans. Substitute tax applies in lieu of stamp duty, registration duty and mortgage tax, which, altogether, would be much higher than 0.25%. Thus, substitute tax is considered a form of reduced taxation and is currently only applicable to financings granted by Italian and EU banks or financial intermediaries.

According to the Decree, substitute tax would be applicable to the following transactions:

- any sale transaction of loans to which such tax was originally applied; and
- medium- and long-term loans granted by Italian securitisation vehicles, EU resident insurance companies or European or white-listed EEA investment funds.

This measure should boost the debt secondary market and also offer Italian corporate borrowers a wider choice of debt providers.

Issue of Bonds

Other measures have also been taken to encourage the issuance of bonds by non-listed companies, and in particular private placements (non-listed bonds subscribed by qualified investors). In fact, Article 21 of the Decree extends the application of the so-called "239 regime"[1] to non-listed bonds if they are held by one or more qualified investors (as defined by the Italian Financial Act in line with the Prospectus Directive), the listing of bonds being no longer a requirement in order to benefit from such a favorable regime.

In addition, a blanket exemption from withholding tax will apply to private placements where the bonds are subscribed by domestic or European investment funds or Italian securitisation vehicles provided that the following conditions are met: (i) at least 50% of their assets are invested in such bonds; and (ii) the units of the investment fund (or the bonds issued by the securitisation vehicles) are fully owned by qualified investors.

Possible Further Measures

In our view there are at least three items which are missing from the described picture. The first item is real estate investment funds, where legislation has rapidly evolved in past years, but is still linked to views on the real estate business which are now too formal and traditional in respect of what a post-crisis market expects.

The Italian government has in fact promised to investors that a reform on real estate funds and the real estate market will be enacted soon.

The second item relates to the granting of loans by investment funds. As mentioned, a reference to the right of Italian closed investment funds to grant loans is made in the Decree even though a more explicit legislative coordination would be invaluable. In this respect, it is also worth mentioning that the financial intermediaries' regulation framework (deeply reviewed in 2011) is still awaiting implementing measures. Hopefully, this will be the occasion to coordinate the relevant legal frameworks.

The third item is related to the application of substitute tax and of the withholding tax exemption on loans. Other than in respect of Italian securitisation vehicles, the Italian government seems to have made a decisive pro-Europe choice in that the lending restriction is to be relaxed and/or a level tax playing field has been finally achieved only in relation to players (banks, insurance companies and investment funds) which are established within the EU and/or the EEA. Whilst the rationale of this choice presumably lies in the existence of an underlying level regulatory field at European level, non-European players (even where resident in White Listed countries) will find themselves at a competitive disadvantage both in the primary and in the secondary market of Italian financings.

The potential changes to the law during its Parliamentary path towards conversion could be an occasion to revise and modernize the text of art. 15 of Legislative Decree No. 601/73, which introduced substitute tax, whose main features effectively date back to 1973.

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[1] In summary, Italian Legislative Decree 239 of 1st April 1996 provides that interest on certain bonds (i) is subject to a 26% substitutive tax if it is received by individuals and entities resident in Italy not in connection with the exercise of a business activity; (ii) it is not subject to tax at source if it is received by entities resident in Italy in connection with the exercise of a business activity; and (iii) it is not subject to tax at source if it is received by foreign entities resident in White-Listed countries provided that certain requirements are met.