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Implementation of the Italian investment management exemption

On 22 February 2024, the Minister of Economy and Finance approved a decree (the "**Decree**"), soon to be published in the Italian Official Gazette, implementing the Italian investment management exemption ("**IME**").

1. Background

IME is a legal presumption introduced in Italy at the beginning of 2023, when Article 1, para. 255, of 2023 Budget Law[1] amended the definition of permanent establishment ("**PE**") set forth by Article 162 of the Italian Income Tax Code[2] (the "**ITC**") clarifying that - conditional upon certain requirements - an entity operating in Italy in the name and on behalf of a "*foreign investment vehicle*", or of its controlled entities, and habitually concluding, or in any way contributing to the conclusion of, purchase, sale and/or trading contracts of financial instruments (including derivatives, equity participations and credits) does not amount to an Italian PE of the foreign investment vehicle, even if it exercises discretionary powers.

The main conditions are detailed in Article 162 of the Italian Income Tax Code[3]. They generally deal with:

a) the establishment of the foreign investment vehicle and its controlled companies in a white-list country[4];

b) certain independency conditions to be complied with by the foreign investment vehicle;

c) limitation in the roles assumed by the entity into management or supervisory bodies of the foreign investment vehicle (and any of its direct or indirect subsidiaries) (including any persons of the entity acting on its behalf) and maximum thresholds of participation (as determined on a cumulative basis with other companies of the same group) to the economic results of the foreign investment vehicle, and

d) the availability of a compliant transfer pricing documentation supporting the arm's length remuneration for the provision of services rendered by the entity (or its PE) operating in Italy with related entities.

Specifications on the independency condition and on the other conditions under b) and c) above had been referred to a ministerial decree, which is now coming to light. Further guidance regarding the determination of the arm's length remuneration for the managers has been released by the Revenue Agency on 28 February 2024[5].

2. The Decree

The Decree sets forth the criteria for the foreign investment vehicle and its investment manager / advisors to be considered "independent", including details for the computation of the profit participating threshold (set in a maximum of 25 percent) and for the roles of the managers which can be run within the portfolio companies

[1] Law no. 197 of 29 December 2022.

[2] Attached to Presidential Decree no. 917 of 22 December 1986.

[3] Defining the concept of permanent establishment.

[4] I.e., a country allowing a satisfactory exchange of information with Italy, listed in the Ministerial Decree of 4 September 1996, issued in accordance with Article 11, para. 4, let. c), of Legislative Decree No. 239 of 1 April 1996.

[5] A tax alert will follow illustrating the indications of the Provision of the Director of the Revenue Agency ref. 68665/2024.

without triggering a PE risk of the foreign investment vehicle or of its controlled entities.

2.1. The definition of foreign investment vehicles for IME purposes

Pursuant to Article 1 of the Decree, for the purposes of IME, "foreign investment vehicle" means:

1. collective investment undertakings (UCIs) established in a EU Member State or in a EEA State allowing for an adequate exchange of information with Italy, provided either (i) they comply with the Directive 2009/65/EC (the "**UCITS Directive**"), or (ii) their manages are subject to forms of supervision in the country in which they are established pursuant to Directive 2011/61/EU (the "**AIFM Directive**") (here also, respectively, referred to as "**UCITS**" and "**AIFs**")
2. collective investment undertakings (UCIs), established in a white-list state or territory[6], which meet the following requirements:
    a) the assets are collected from a plurality of investors, managed on a pooled basis in the interest of the investors and independently from them, and invested based on a pre-determined investment policy; [and]
    b) either the collective investment undertaking or its manager is subject to regulatory supervision and regulated under legislative framework which are "substantially equivalent" to those set forth by the UCITS Directive and the AIFM Directive, (here also referred to as "**Foreign UCIs**");
3. entities resident or located in a white-list country, which are subject to prudential supervision and have as their principal activity that of managing investments of capital raised by third parties based on a pre-determined investment policy, to the extent the following conditions are met:
    a) no person holds a stake of more than 20 percent in the share capital or assets, including stakes held by persons with close ties under Article 1, paragraph 6-bis.3, of Legislative Decree No. 58 of 24 February 1998. Stakes without administrative rights are excluded from the computation of the 20 percent threshold. The application of the 20 percent threshold is suspended when the foreign investment vehicle raises additional capital or reduces existing capital, provided that the suspension does not exceed 12 months. From the moment the vehicle starts the activities of liquidating the assets, in order to reimburse the units or shares to the investors, the above threshold shall not be applied; [and]
    b) the capital raised is managed on a pooled basis in the interest of the investors and independently from them, (here also referred to as "**Supervised Institutional Investors**").

The explanatory notes to the Decree clarify that the terms "foreign collective undertaking" must be interpreted broadly[7], to include all those entities which main purpose is to make or manage investments on their own behalf or on behalf of [a plurality of] third parties, as well as undertakings for collective investments. On the contrary, family offices and club deals are not included in the definition.

The Decree specifies that companies which are directly or indirectly controlled by the foreign investment vehicles (as defined above) must also be resident for tax purposes in a white-list State.

2.2. The independency of the manager or other person acting for the investment vehicle

UCITS and AIFs, as well as Foreign UCIs (i.e., those investment vehicles mentioned under no. 1 and 2 above), have been considered independent from both their investors and their managers, thanks to their specific regulatory features. Indeed, the segregation of capital raised among a plurality of investors with respect to the management company (which is provided by law and subject to ongoing supervision) leads to a clear cut between the financial

[6] Currently listed in the Ministerial Decree of 4 September 1996, issued in accordance with Article 11, para. 4, let. c), of Legislative Decree No. 239 of 1 April 1996.

[7] In line with the concept of "institutional investors" already encompassed by the Italian tax authorities for the purposes of other provisions regarding taxation of certain financial income.

risk, borne by the investors, and the investment management risk, borne by the manager[8]. Hence, in principle, for the presumption to apply, said foreign investment vehicles and their controlled companies or entities shall only (i) be resident in a white-list country and (ii) comply with the transfer pricing documentation requirement.

By contrast, Article 2 of the Decree provides for the following further conditions to be complied with for the purposes of the independency presumption, where the relevant person or entity (whether resident or not resident in Italy) operates in the Italian territory in the name or on behalf of other Supervised Institutional Investors (those under no. 3 above) or of its (directly or indirectly) controlled entities.

To this extent, the person operating in Italy in the name or on behalf of the investment vehicle, as well as its employees or directors:

1. must not hold any offices in the administrative and control bodies of the investment vehicle and in those of its direct or indirect subsidiaries [other than those resident in Italy], of the same investment vehicle. The limitation refers to roles with general operational proxies granted by the administrative body, while specific proxies, approved by the administrative body, granted to the relevant persons with reference to individual acts, are not relevant;
2. must not be entitled to more than 25 percent of the total amount of the economic results of the foreign investment vehicle, including participations to the economic results of controlled entities and considering the gearing-down due to participating chains. For the purpose of computing the participation to the economic results, both the pro-rata share of return from any investments in the vehicle itself and its subsidiaries and the component of return that exceeds such pro-rata share of return (e.g., the enhanced economic rights deriving from carried interest schemes) shall be taken into account.

2.3. Provisions of general application

Article 3 of the Decree eventually clarifies (among other things) that:

1. the term "*controlled*" should be interpreted in light of Article 2359, para. 1, of Italian Civil Code[9], and
2. the entity carrying out the activities in the name or on behalf of the foreign investment entity or other group companies must prepare a compliant transfer pricing documentation, in line with Article 1, para. 6, of Legislative Decree no. 471 of 18 December 1997 (providing for a penalty protection for transfer pricing adjustments, if specific documentation is put in place and held by the relevant entity for a certain period). In line with the documentation requirements, the explanatory notes specify that any transfer pricing adjustments made by the tax authorities with respect to the remuneration do not jeopardize the application of the presumption under the IME regime, being its impact limited to the taxation of the entity operating in Italy.

The explanatory notes to the Decree also clarify that:

1. the investment activities which may be "sheltered" by the IME regime are limited to investments of a financial nature, i.e., those investments characterised by (i) the employment of capital, (ii) the promise/expectation of a financial return and (iii) the assumption of a risk directly related to the employment of capital. For these purposes, the financial instruments (including derivatives, participations and interests in the capital or equity of companies and entities, and receivables) must be the object of the relevant investments;

[8] This has been clarified by the explanatory notes to the Decree.

[9] Article 2359, para. 1, of Italian Civil Code provides for that "*They are considered controlled companies: 1) companies in which another company holds the majority of the voting rights that can be exercised in the ordinary shareholders' meeting; 2) companies in which another company holds sufficient voting rights to exercise a dominant influence in the ordinary shareholders' meeting; 3) companies under the dominant influence of another company by virtue of specific contractual obligations with the latter*". Para. 2 specifies that "*voting rights held by controlled companies, trust companies and third parties are to be included in the calculation for the purpose of applying points 1) and 2) of the first paragraph: voting rights held on behalf of third parties shall not be counted*".

2. lacking the conditions for the application of the presumption under the IME regime, the tax authorities cannot assess taxpayers automatically, but must make a case-by-case assessment where a PE may be deemed to exist only if all the "ordinary" conditions are met.

3. Side notes

The Decree seems to confirm that IME does not cover possible PE issues (not of foreign investment vehicles, but) of investment management companies and advisory companies.

Assets which do not characterize as financial investments (like real estate assets[10] or artworks) are excluded from the scope of application of IME.

Notwithstanding the above, the release of these further details regarding IME is a further step forward to eventually provide much clarity and comfort to (certain) investment management companies operating in Italy on a cross-border basis. As a matter of fact, such exemption relates to the measures to attract (re)location of economic activities within the Italian territory, in addition to the reshoring incentive and the specific "repatriated" employees.

Investment management companies and their affiliates should assess whether their current or perspective operations in Italy would fall within the scope of application of IME.

[10] It is not clear to date if participations held in companies which equity is mainly invested in such type of assets are included in the scope of work of IME. More guidelines will hopefully be provided by official interpretation of the tax authorities.

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