

Italian debt securities: the market opens up

Contents

1. Lighter restrictions on bond issuance
2. A more favourable tax regime for bonds
3. Commercial paper
4. Subordination and profit participation clauses
5. Questions and areas of uncertainty
6. Conclusions

A series of reforms introduced by the Italian government and aimed at encouraging economic growth are now definitively on the statute book, including a significant relaxation of legal and tax restrictions on the issuance of debt securities by Italian unlisted companies. This process began earlier this summer with the enactment of Law Decree No. 83 of 22 June 2012 (“**Decree No. 83**”) and has now been completed with the coming into force of Law No. 134 of 7 August 2012 (“**Law No. 134**”), which made a number of amendments to Decree No. 83. Happily, the overall effect of Law No. 134 is to take the reform process a step further, removing many of the more controversial aspects of the original text of Decree No. 83.

The provisions of Decree No. 83, as amended by Law No. 134, are summarised below but should be read in conjunction with Appendix 1 (containing a glossary of the words and expressions shown in bold below) and Appendix 2 (containing a flow-chart showing the requirements and restrictions that apply to unlisted corporate bond issuers in a more user-friendly form).

1. Lighter restrictions on bond issuance

1.1. Disapplication of statutory limits

Article 2412 of the Italian Civil Code imposes limits on the principal amount of bonds that may be issued and/or guaranteed by companies limited by shares (*società per azioni* or *S.p.A.’s*) other than banks, *i.e.* up to an amount equal to twice the aggregate of the issuer’s share capital, legal reserves and distributable reserves. These limits no longer apply to bonds which:

- are intended to be listed on a **regulated market** or **multilateral trading facility**; or
- give the right to acquire or subscribe for shares.

In contrast to the previous rules, this new exemption applies regardless of whether the issuer is a listed or an unlisted company, *i.e.* regardless of whether its shares are listed.

However, in relation to limited liability companies (*società a responsabilità limitata* or *S.r.l.’s*), there is no corresponding relaxation of the statutory restrictions on the issuance of debt securities contained in Article 2483 of the Italian Civil Code.

1.2. New requirements for first-time issuers are abandoned

When Decree No. 83 initially came into force in June, the benefits of these exemptions were somewhat offset by a series of new requirements imposed on first-time issuers of bonds (including, most critically, the obligation to appoint a sponsor where the issuer is a **small or medium-sized enterprise**). Law No. 134 has now dropped these requirements which, as described below, will now only apply to commercial paper issues.

2. A more favourable tax regime for bonds

2.1 Withholding tax

Where **bonds or similar securities** are issued by an Italian unlisted company and are traded on a **regulated market** or **multilateral trading facility** situated or operating in a **white list country** in the European Economic Area, as long as they are not **atypical securities**, the same regime applicable to bonds issued by banks and listed companies will apply, namely:

- the issuer is no longer required to apply a 20% withholding tax on interest from the bonds; and
- as provided for under Legislative Decree No. 239 of 1 April 1996, a 20% substitute tax applies (normally via the clearing systems) on interest, premium and other income from the bonds but, in most cases, investors in **white-list countries** and institutional investors in Italy are entitled to receive those payments without any deduction of substitute tax.

If the **bonds or similar securities** are unlisted, the withholding regime is unchanged, *i.e.* a 20% withholding tax is applied.

2.2 Deductibility of interest

The payment of interest on bonds by Italian unlisted companies (other than **micro enterprises**) is no longer subject to the severe limitations on deductibility for corporation tax purposes that previously applied. This is as long as:

- the bonds are issued on or after the date on which Decree No. 83 came into force, *i.e.* 26 June 2012; and
- they are subscribed for by **qualified investors** who are not shareholders of the issuer, either directly or indirectly, including holdings via fiduciary companies or other intermediate persons.

This tax benefit applies regardless of whether the bonds are admitted to trading on a **regulated market** or a **multilateral trading facility**.

The original wording of Decree No. 83 seemed to suggest that only first-time issuers could benefit from these rules, *i.e.* companies that had neither shares nor bonds listed on a **regulated market** or a **multilateral trading facility**. Thankfully, the amended wording now makes it clear that the new rules on deductibility apply to any company (other than a **micro enterprise**) whose shares are not listed on a **regulated market** or a **multilateral trading facility**, *i.e.* regardless of whether that company is a first-time issuer.

2.3 Deducibility of expenses

Fees and other expenses related to the issue of bonds and similar securities traded on a **regulated market** or **multilateral trading facility** situated or operating in a **white list country** in the European Economic Area are deductible when incurred regardless of their accounting treatment.

2.4 Notification to tax authorities

Decree No. 83 originally required the issuer to provide the Italian tax authorities with information on certain bond issues for tax avoidance monitoring purposes but this requirement has now been dropped.

3. Commercial paper

Under Decree No. 83, limited companies, co-operatives and mutual insurance companies (other than banks and **micro enterprises**) may issue commercial paper (*cambiali finanziarie*) with a maturity of at least one month. Law No. 134 has lengthened the maximum maturity of commercial paper from 18 months to three years and has removed the limits on the aggregate amount of commercial paper that an issuer may issue (previously equal to the amount of the issuer's current assets). Decree No. 83 also allows for commercial paper to be issued in dematerialised form.

3.1 Notification to tax authorities

For unlisted companies, the issue of commercial paper is subject to the following requirements:

- if the issuer is a **small or medium-sized enterprise**, it must be assisted by a sponsor;
- the most recent financial statements of the issuer must be audited by independent auditors; and

- the commercial paper must be issued and subsequently transferred solely to “professional investors” who must not be shareholders of the issuer (either directly or indirectly).

For these purposes:

- a company is “unlisted” if its capital is not represented by securities traded on a securities market but, in contrast to the other provisions of Decree No. 83, regardless of whether that market is a **regulated market** (which means, for example, that a company whose shares are traded on an HKEx market would not be regarded as “unlisted”); and
- although “professional investors” is not defined in Decree No. 83, it is presumed to mean **qualified investors**.

3.2 Role of sponsor

Where the **unlisted issuer requirements** apply, the role of the sponsor is, *inter alia*, as follows:

- it assists the issuer in the issue and placement of the commercial paper;
- it holds a proportion of the commercial paper to maturity (set out in detail in Decree No. 83);
- if the amount of the issuer’s outstanding commercial paper exceeds its current assets, it reports those circumstances (presumably to the issuer, although the legislation does not specify); and
- it classifies the issuer at the time of issue according to its creditworthiness and publishes the classification.

All of this represents a much reduced role in comparison to that originally envisaged under Decree No. 83, which included obligations to ensure the liquidity of the commercial paper, to carry out periodic credit assessments of the issuer (i.e. not just at the time of issue) and also to perform periodic valuations of the securities at least every six months.

The following persons may act as sponsors: banks, investment firms, asset management companies (*società di gestione di risparmio* or SGR), harmonised EU asset management companies or SICAV’s, in each case as long as they have a branch in Italy.

3.3 Exemptions from unlisted issuer requirements

The **unlisted issuer requirements** are subject to the following exemptions:

- the issuer does not have to appoint a sponsor if it is not a **small or medium-sized enterprise**;
- the sponsor is not required to hold a proportion of the commercial paper in its portfolio if repayment of at least 25 per cent. of the principal amount of the commercial paper is guaranteed by a bank or investment firm or by an underwriting syndicate or one of the underwriters; and
- if the guarantee described above covers at least 50 per cent. of the principal amount of the commercial paper, then the statutory provision requiring the issuer’s financial statements to be audited is suspended for the first 18 months from its coming into force.

3.4 Taxation

The tax treatment of commercial paper has been largely aligned to that applicable to **bonds and similar securities**.

4. Subordination and profit participation clauses

Decree No. 83 also allows for the issuance of bonds containing profit participation and subordination provisions, subject to those bonds having an initial maturity of at least three years (instead of five years, as originally required under Decree No. 83).

For bonds with a profit participation clause, the interest payable to bondholders may contain a profit-related component (*i.e.* depending on the financial results of the issuer) but must also contain a fixed income component, which cannot be less than the ECB base rate from time to time. However, although Decree No. 83 states that the profit-related portion of an interest payment is tax deductible, there is some uncertainty as to whether this is actually the case.

5. Questions and areas of uncertainty

Some of the questions arising from the Decree are set out below.

5.1 Disapplication of Article 2414 – “intended to be listed”

The limits on bond issuance under Article 2414 of the Italian Civil Code no longer apply to bonds which are “intended to be listed” on a **regulated market** or a **multilateral trading facility**. The expression “intended to be listed” is curious and, where the bonds are not listed on their issue date (or very shortly afterwards), it is not clear what the issuer would need to do in order to be able to demonstrate its “intention” to list the bonds.

5.2 Limited liability companies – no change

The vast majority of **small and medium-sized enterprises** in Italy are limited liability companies (*società a responsabilità limitata* or *S.r.l.*'s). Under Article 2483 of the Italian Civil Code, debt securities issued by an S.r.l. may only be subscribed for by professional investors subject to adequacy requirements and, in any subsequent transfer of the securities to any other category of investor (other than the issuer's shareholders), transferors are liable to transferees if the issuer becomes insolvent. This is not attractive to the market and, disappointingly, Decree No. 83 has not made any changes to Article 2483. At the same time the Decree imposes a number of requirements for the issue of commercial paper which, as discussed below, represent one of the more doubtful areas of the new legislation. As a result, one option for an S.r.l. wishing to issue bonds might be to convert into an S.p.A., as this would offer a better opportunity to benefit from the relaxation of legal and tax restrictions under Decree No. 83. However, any S.r.l. would need to consider carefully whether this might be outweighed by the loss of the benefits of being an S.r.l. (e.g. lower share capital requirements and a lighter corporate governance structure).

5.3 Substitute tax – “traded”

For the substitute tax regime to apply (including the possibility for many investors to receive payments free of substitute tax), the bonds must be “traded” on a regulated market or multilateral trading facility: in other words, not just “admitted to trading” but actually “traded”. This would be problematic for certain bond issues, such as private placements, in which the intention of the initial investors may be to hold the bonds to maturity.

5.4 Tax deductibility - Non-shareholder qualified investors

One of the conditions for tax deductibility of interest payments is that the bonds must be subscribed for by **qualified investors** who are not shareholders of the issuer. Although this condition does not cover subsequent dealings on the secondary market, issuers will need to consider carefully what steps they ought to take in order to verify that only investors of this category have subscribed for the bonds.

5.5 Commercial paper – unlisted issuer requirements

The requirements imposed on unlisted companies wishing to issue commercial paper may be problematic, even though some of them have been significantly relaxed. In particular, it is still not known how many banks or other institutions eligible to act as sponsor would be willing to take on all of the responsibilities envisaged under that role and, for some of them, the obligations to hold a proportion of the commercial paper to maturity and to perform and publish credit assessments of the issuer may be unattractive. Similarly, it is far from clear how the issuer (or anyone else) can verify compliance with the requirement that commercial paper be held solely by non-shareholder professional investors and neither is it clear what the consequences of non-compliance would be. Furthermore, aside from any legal considerations, it remains to be seen whether there is a significant market for commercial paper.

6. Conclusions

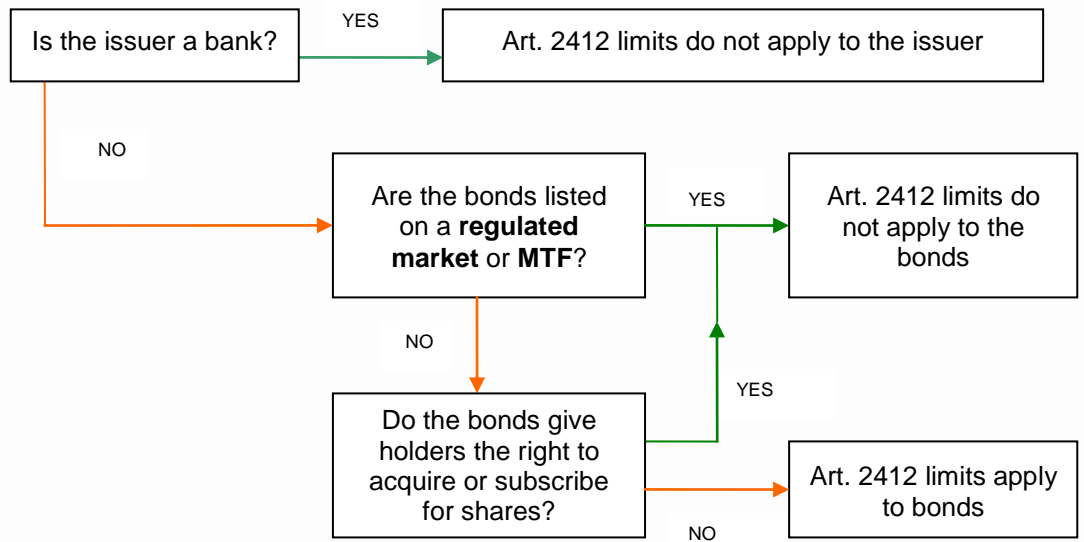
Notwithstanding the points highlighted above, Law No. 134 has successfully resolved some of the more dubious aspects of the original provisions of Decree No. 83, at least in relation to bond issues, and the overall effect of the new legislation is now much closer to achieving its original purpose of opening up the market for unlisted companies wishing to issue debt securities.

APPENDIX 1 - Glossary of terms

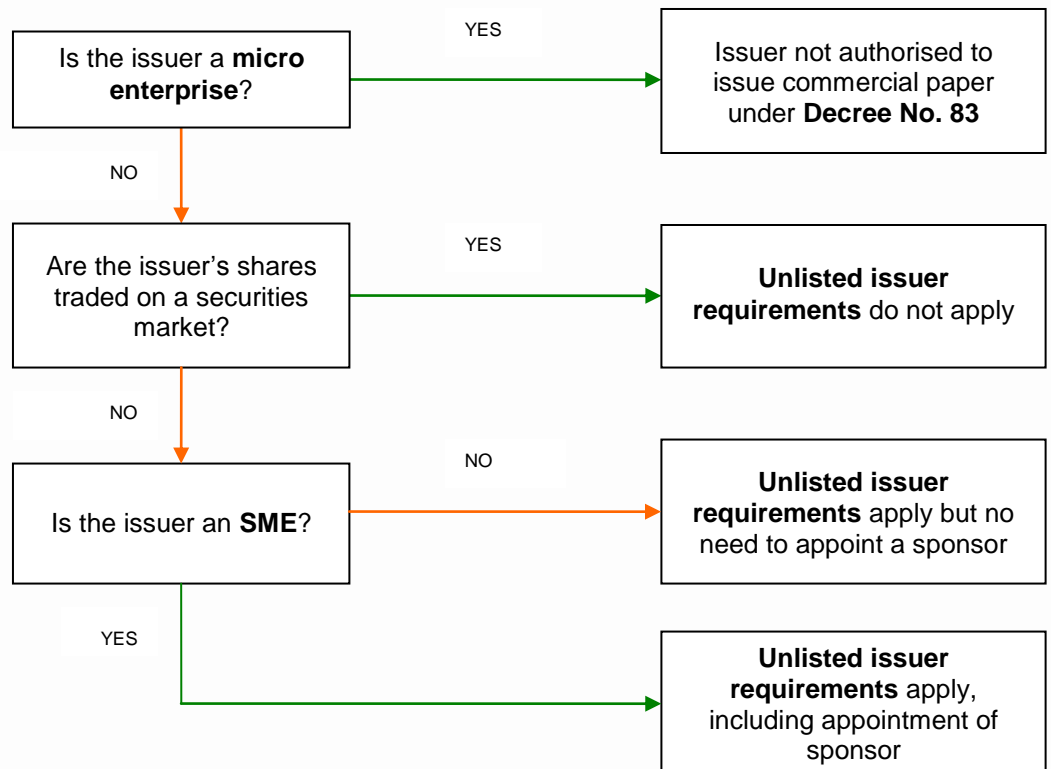
atypical securities	Debt securities not classified as bonds or similar securities .
bonds or similar securities	Debt securities classified as <i>obbligazioni</i> or <i>titoli similari</i> , which must contain: <ul style="list-style-type: none"> (i) an unconditional obligation to repay the principal amount at maturity; and (ii) no direct or indirect right for bondholders to control or participate in the management of the issuer.
Decree No.83	Law Decree No. 83 of 22 June 2012.
Issuers' Regulations	CONSOB Resolution 11971 of 14 May 1999, as amended.
Law No. 134	Law No. 134 of 7 August 2012.
micro enterprise	As defined in the SME Recommendation , an enterprise with: <ul style="list-style-type: none"> (i) fewer than 10 employees; and (ii) an annual turnover and/or balance sheet total not exceeding Euro 2 million.
MiFID	The Markets in Financial Instruments Directive 2004/39/EC, as implemented in Italy.
multilateral trading facility or MTF	Not defined in the Decree but believed to mean a multilateral trading facility, as defined in Article 4(15) of MiFID , situated or operating in an EU (or, where applicable, EEA) member State.
qualified investors	As defined in the Issuers' Regulations, which in turn follow the definition of "professional client" contained in MiFID .
regulated market	A regulated market, as defined in Article 4(14) of MiFID , situated or operating in an EU (or, where applicable, EEA) member State.
small or medium-sized enterprise or SME	As defined in the SME Recommendation , an enterprise with: <ul style="list-style-type: none"> (i) fewer than 250 employees; and (ii) an annual turnover not exceeding Euro 50 million and/or an annual balance sheet total not exceeding Euro 43 million.
SME Recommendation	Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.
unlisted issuer requirements	Additional legal requirements under Decree No. 83 applicable to unlisted companies wishing to issue commercial paper (<i>cambiali finanziarie</i>).
white list countries	Certain states and territories included in the list set out under Ministerial Decree of 4 September 1996, as amended, which may be viewed on the website of the Italian <i>Agenzia delle Entrate</i> at the following address: http://www.agenziaentrate.gov.it/wps/content/Nsilib/Nsi/Documentazione/Fiscalita+internazionale/White+list+e+Autocertificazione/Elenco

APPENDIX 2 - Flow chart

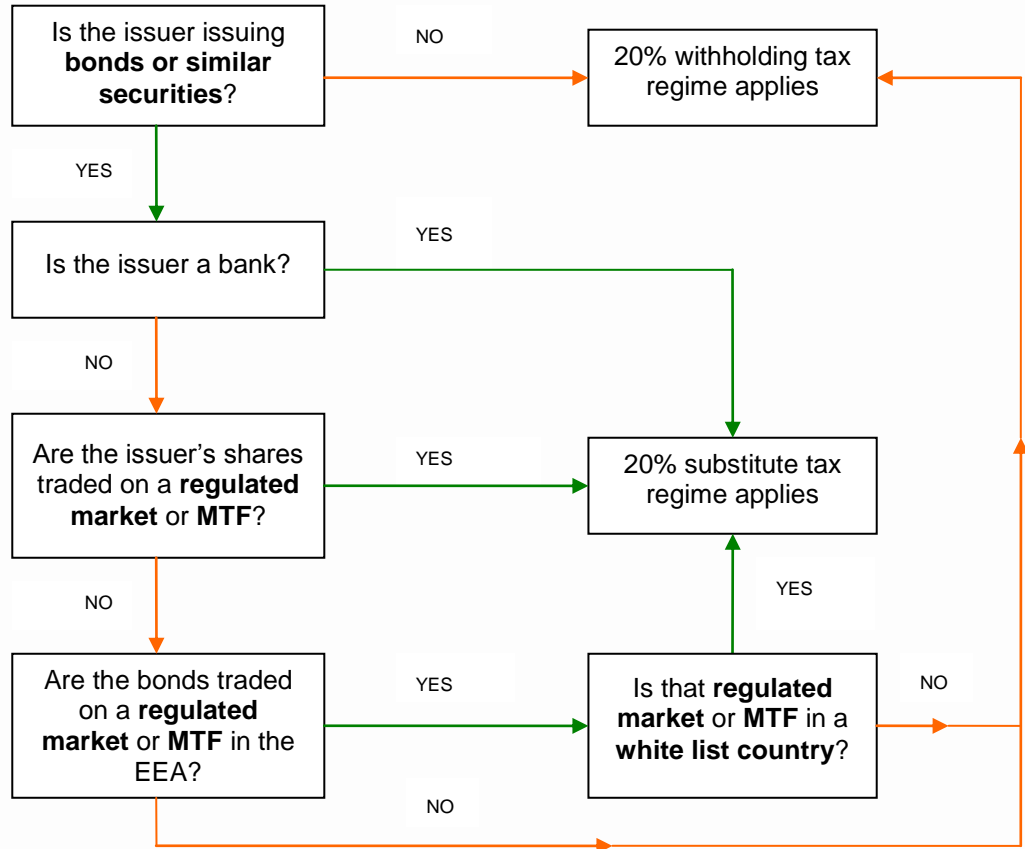
BONDS – ARTICLE 2412 LIMITS



COMMERCIAL PAPER
UNLISTED ISSUER REQUIREMENTS



BONDS – WITHHOLDING TAX



This document is delivered for informative purposes only.

It does not constitute a reference for agreements and/or commitments of any nature.

For any further clarifications or research please contact:

Milan

Richard Hamilton
Tel. +39 02 763741
rhamilton@gop.it

Fabio Ilacqua
Tel. +39 02 763741
filacqua@gop.it

London

Marco Zaccagnini
Tel. +44 20 7397 1700
mzaccagnini@gop.it

Rome

Milan

Bologna

Padua

Turin

Abu Dhabi

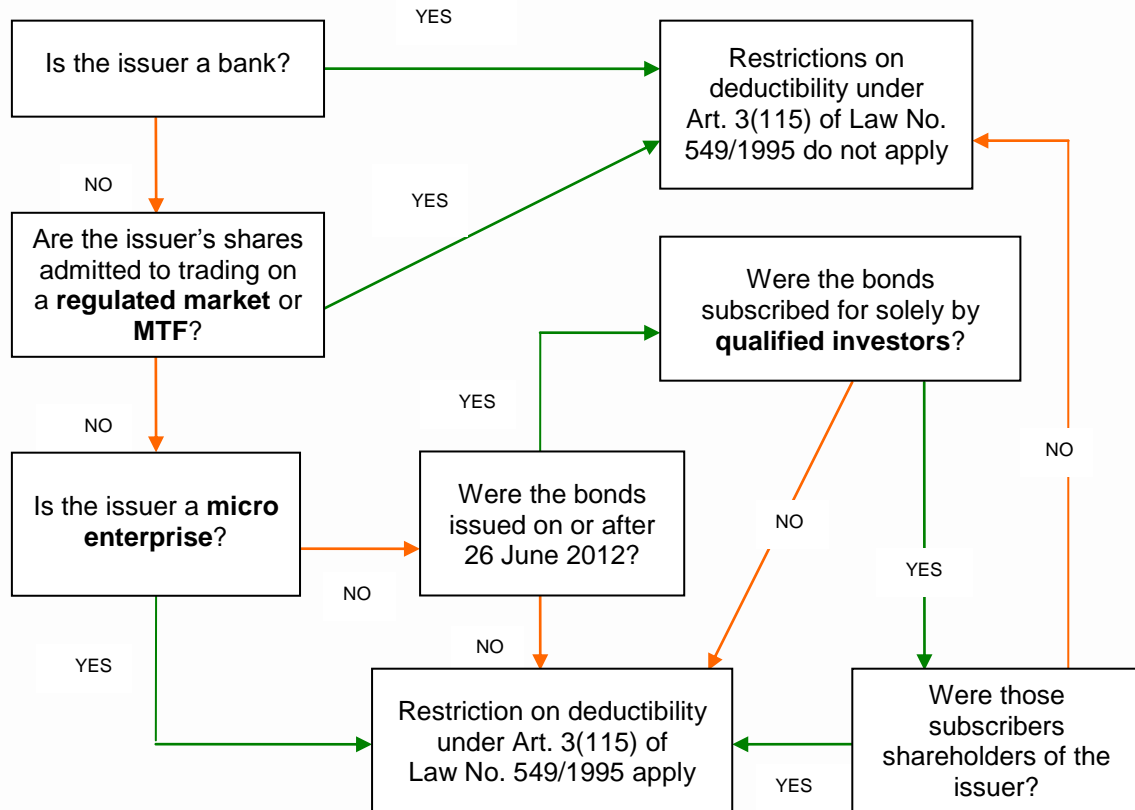
Brussels

London

New York

www.gop.it

BONDS – TAX DEDUCTIBILITY



INFORMATION PURSUANT TO ARTICLE 13 OF LEGISLATIVE DECREE NO. 196/2003 (Data Protection Code)

The law firm Gianni, Origoni, Grippo, Cappelli and Partners (hereafter "the Firm") only processes personal data that is freely provided during the course of professional relations or meetings, events, workshops, etc., which are also processed for informative/divulgate purposes. This newsletter is sent exclusively to those subjects who have expressed an interest in receiving information about the Firm's activities. If it has been sent you by mistake, or should you have decided that you are no longer interested in receiving the above information, you may request that no further information be sent to you by sending an email to: relazioniesteme@gop.it. The personal data processor is the Firm Gianni, Origoni, Grippo, Cappelli & Partners, whose administrative headquarters are located in Rome, at Via delle Quattro Fontane 20.