

ClientAlert

Milan Office

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Italian rules on Debt for Italian Non-Listed Companies – Italy has passed clean-up rules concerning the issuance of corporate bonds and commercial paper

The Italian Government has approved new rules concerning the issuance of corporate bonds and commercial paper through Law Decree no. 179 of October 18, 2012 on "Further Urgent Measures for Growth of the Country," which was converted into law (with amendments) by Law no. 221 of December 17, 2012, published in the Italian Official Gazette on December 18, 2012 ("**Decree 179**").

Article 36 of Decree 179 resolves most of the issues that were left open by Law Decree no. 83 of June 22, 2012 ("**Decree 83**"), which was converted into law (with amendments) by Law no. 134 of August 7, 2012 and published in the Italian Official Gazette on August 11, 2012.

Decree 179 introduces amendments to both the regime for corporate bonds and commercial paper, in particular concerning:

- the deductibility of interest paid on corporate bonds;
- the definition of "Qualified Investors;"
- subordinated bonds and/or bonds with profit participation; and
- the exemption from withholding tax on interest for commercial paper.

For your convenience, below is the text of our prior Client Alerts on corporate bonds and commercial paper, to which we have added a discussion of the most recent changes adopted through Decree 179 in underlined text.

Before the approval of Decree 83, Italian non-listed companies struggled to find efficient structures for debt issuances and did not find help in Italian law. However, things have changed. Italy has passed rules to greatly facilitate access to the corporate bond and commercial paper market for Italian private companies whose equity securities are not listed ("**Non-Listed Companies**").¹ The new rules resolve most of the tax and corporate issues that had obstructed access to, or increased the cost for, corporate bonds and commercial paper for Non-Listed Companies.

Decree 83 establishes two new regimes for issuing debt for Non-Listed Companies:

- a relatively simple regime for Non-Listed Companies that list their corporate bonds on regulated markets or on multilateral trading facilities (a "**Qualified Exchange**")²; and
- a more complex regime for Non-Listed Companies that intend to issue commercial paper.



If you have questions regarding this Alert, please contact any of the lawyers listed below:

Michael S. Immordino

Partner, London and Milan

+ 44 20 7532 1399 (London)

+ 39 02 0068 8310 (Milan)

mimmordino@whitecase.com

Ferigo Foscari

Partner, Milan

+ 39 02 0068 8320

ffoscari@whitecase.com

Iacopo Canino

Partner, Milan

+ 39 02 0068 8340

icanino@whitecase.com

Nicholas Lasagna

Partner, Milan

+ 39 02 0068 8330

nlasagna@whitecase.com

Rob Mathews

Partner, London

+ 44 20 7532 1429

rmathews@whitecase.com

Stuart Matty

Partner, London

+ 44 20 7532 1430

smatty@whitecase.com

Colin Chang

Partner, London

+ 44 20 7532 1481

cchang@whitecase.com

David Becker

Partner, London

+ 44 20 7532 1405

dbecker@whitecase.com

White & Case LLP
5 Old Broad Street
London EC2N 1DW
+ 44 0 20 7532 1000

Regime for Corporate Bonds Listed on Qualified Exchange

Decree 83 introduces significant advantages for Corporate Bonds issued by Non-Listed Companies, including:

- the deductibility of interest paid
- the disapplication of corporate ‘thin-cap rule’
- the exemption from withholding tax on interest for investors resident in ‘white-listed’ countries

■ Deductibility of Interest Paid on Corporate Bonds:

Decree 83 (as amended by Decree 179) provides for the deductibility of interest paid on corporate bonds issued by Non-Listed Companies after October 20, 2012.³ In order to fully deduct interest paid, such securities must either (i) be listed on a Qualified Exchange of countries in EU member states or EEA member “white-listed” states or (ii) (to the extent the securities are not listed) be subscribed for by ‘qualified investors’⁴ that do not, directly or indirectly,⁵ hold more than 2% of the share capital or assets of the issuer and provided that the ultimate beneficial owner of the proceeds is resident in Italy or in “white-listed” states (“Relevant Qualified Investors”). Failure to comply with such conditions would limit deductibility of interest paid in an amount not exceeding twice the official base rate. The general tax rule that limits the deductibility on interest to 30% of EBITDA still applies.

Decree 179 expands the coverage of the provisions concerning the deductibility of interest paid on corporate bonds to ‘similar securities’ (*titoli similari*). Such provisions are no longer limited to joint-stock companies (*società per azioni*) issuing corporate bonds (*obbligazioni*), but may also apply to other entities and/or the issuance of debt securities which are similar to *obbligazioni* (e.g., debt securities issued by limited-liability companies (*società a responsabilità limitata*)), provided that the relevant conditions set forth by Decree 83 are met.

■ Corporate “thin-cap rule” no longer applies:

Prior to Decree 83, Non-Listed Companies were restricted by article 2412 of the Italian Civil Code in issuing corporate bonds in an amount not exceeding twice the value of the capital and reserves of the issuer available for distribution (this restriction also applied in most cases to guarantors of such corporate bonds) and were subject to very limited exceptions. Decree 83 now exempts Non-Listed Companies issuing corporate bonds listed on a Qualified Exchange from such limitation, thereby granting them the same treatment enjoyed by listed companies in Italy⁶.

The exemption to the corporate ‘thin-cap rule’ also applies to convertible or exchangeable bonds, whether or not listed on a Qualified Exchange.

■ Withholding tax on interest reduced to zero for investors resident in ‘white-listed’ countries:

Prior to Decree 83, Non-Listed Companies had great difficulty in structuring corporate bond issuances without either being subject to a withholding tax on interest and other payments (at a rate of between 5% and 20%) and/or being subject to a tax audit by Italian tax authorities.

Decree 83 grants Non-Listed Companies issuing corporate bonds listed on a Qualified Exchange the same withholding tax treatment enjoyed by listed companies in Italy under Legislative Decree no. 239 of April 1, 1996 (“**Decree 239**”) and applies to corporate bonds issued after June 26, 2012. Decree 239 provides for an exception to the application of withholding or substitute taxes on interest and other payments to investors that are (a) beneficial owners resident in ‘white listed’ countries, or (b) institutional investors, not subject to tax, established in ‘white-listed’ countries. Proper measures must be implemented to ensure that beneficial owners of interest payments certify that they are resident in a ‘white-listed country’ for the purposes of Decree 239.

■ Subordinated Bonds and Bonds with Profit Participation:

Under Decree 83 Non-listed Companies may issue corporate bonds with subordination clauses (“**Subordination Provisions**”) and/or with profit participation provisions (“**Participation Provisions**”). The general rules applicable to other corporate bonds under Decree 83 (as described above) also apply to corporate bonds with Subordination Provisions and/or Participation Provisions. The initial maturity of corporate bonds with Participation Provisions and/or Subordination Provisions must exceed 36 months.

Through Decree 179 this provision has now been extended also to ‘similar securities,’ thereby envisaging possible issuances of debt securities with Subordination Provisions and Participation Provisions also by limited liability companies (*società a responsabilità limitata*).

The Subordination Provisions provided for in Decree 83 establish the subordination of bondholders vis-à-vis other creditors of the issuer and are similar to existing provisions under Article 2411, paragraph 1 of the Italian Civil Code.

Participation Provisions may provide a new and potentially useful instrument to finance Italian corporates. According to Decree 83, Participation Provisions may have a fixed and a floating rate portion: the fixed portion of interest cannot be lower than the official base rate, while the floating rate portion must be calculated as a percentage of the issuer’s profits,⁸ to be paid annually within 30 days from the date of approval of the issuer’s financial statements (the “**Participation Payment**”). Decree 83 also confirms that Participation Payments are not subject to Italian usury law limitations.

The calculation of the Participation Payment must be based on objective criteria, must be established upon issue and cannot subsequently be amended. These elements differentiate Participation Provisions from dividends, which are resolved upon annually by companies on a discretionary basis. Another

significant difference is the accounting treatment of corporate bonds with Participation Provision: to the extent a corporate bond with a Participation Provision (i) contains a Subordination Provision and envisages an undertaking not to reduce (other than within the limits of dividends available for distribution) the issuer's share capital; (ii) envisages a fixed portion of interest (in addition to the Participation Payment); and (iii) is subscribed by Relevant Qualified Investors; then, the Participation Payment may be deducted from the issuer's net income, thereby reducing the issuer's taxable income.⁹

Regime for Commercial Paper

Decree 83 has significantly amended the regime for the issuance of commercial paper (*cambiali finanziarie*):

- deductibility of interest paid
- maturities extended from a minimum of one month to a maximum of 36 months
- issuance in dematerialized form
- exemption from withholding tax on interest for investors resident in 'white-listed' countries.

■ Deductibility of Interest Paid on Commercial Paper:

Decree 83 (as amended by Decree 179) provides for the deductibility of interest paid on commercial paper issued by Non-Listed Companies¹⁰ after October 20, 2012, subject to the same conditions applicable to corporate bonds (*i.e.*, they must be subscribed for by Relevant Qualified Investors or listed on a Qualified Exchange of countries in EU member states or EEA member "white-listed" states).

■ Range of maturities extended:

The range of maturities for commercial paper has been extended from a minimum of one month to a maximum of 36 months (increased from three to 12 months, respectively, before Decree 83).

■ Issuance in dematerialized form:

Prior to Decree 83 commercial paper could only be issued in paper form, while it may now be issued in dematerialized form.

■ Exemption from withholding tax on interest:

Decree 179 clarifies that the exemption from withholding tax on interest for investors resident in 'white-listed' countries is also applicable to commercial paper issued by Non-Listed Companies. To the extent the commercial paper is listed on a Qualified Exchange, Decree 239 also applies, thereby providing an exception to the application of withholding or substitute taxes on interest and other payments to investors that are (a) beneficial owners resident in 'white listed' countries or (b) institutional investors, not subject to tax, established in 'white-listed' countries. The corporate 'thin-cap rule' of article 2412 of the Italian Civil continues not to apply to commercial paper.

Commercial paper under Decree 83 may be issued by limited liability companies (*società di capitali*), cooperative companies (*società cooperative*) and mutual assurance companies (*mutue assicuratrici*) and is subject to the following conditions:

- the issuance must be assisted by a sponsor (Decree 83 provides an exemption to this rule for large Non-Listed Companies¹¹) which must be a bank, an investment company, an asset management company (SGR), a harmonized management company or an open-end investment companies (SICAV), in each case to the extent it has a branch in Italy;
- the issuer's most recent financial statements must be audited by an qualified auditor or independent auditing firm; and
- the commercial paper must be issued to, and intended to be traded exclusively among, Professional Investors¹² that are not, directly or indirectly, shareholders of the issuer.

A sponsor is required to: (a) assist the issuer in the issuance and the placement of the securities; (b) notify if the amount of commercial paper outstanding exceeds the issuer's 'current assets' (as defined in Decree 83); (c) upon issuance, provide a rating (to be made public) of the issuer's creditworthiness in one of five categories of risk ('strong', 'good', 'satisfactory', 'weak' and 'bad') to be matched, for guaranteed or secured transactions, with a corresponding level of guarantees or security ('high', 'normal' or 'low'); and (d) hold in its portfolio to maturity¹³ of the commercial paper:

- not less than 5% of the issuance value of the commercial paper for issuances up to Euro 5 million;
- not less than 3% of the value for the portion exceeding Euro 5 million (up to Euro 10 million); and
- not less than 2% of the value of the commercial paper exceeding Euro 10 million.

Decree 83 represents a significant and welcome liberalization of the corporate bond and commercial paper markets for Italian Non-Listed Companies. We expect that many Non-Listed Companies will, subject to market conditions, look to issue corporate bonds on a Qualified Exchange.

Decree 83 is particularly significant for Italian companies that may be affected by scarcity of bank credit as a result of the current credit crisis and the restrictions on credit which will result from the application of Basel III.

Notes:

- (1) Italian listed companies already enjoyed the benefits provided by the new rules under the legislation in force prior to Decree 83, placing Italian Non-Listed Companies at a comparative disadvantage.
- (2) Decree 83 does not directly define 'Regulated Market' or 'multilateral trading facilities', however, such language is commonly used to refer to European MIFID Directive no. 2004/39/EC, which defines them as follows: (i) "'Regulated market' means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments- in the system and in accordance with its non-discretionary rules- in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly [...]" and (ii) "'Multilateral trading facility (MTF)' means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments- in the system and in accordance with non-discretionary rules- in a way that results in a contract [...]" Some of the most commonly used Qualified Exchanges include the Luxembourg Euro MTF and the Irish Global Exchange Market. For a list of current Qualified Exchanges, see <http://mifiddatabase.esma.europa.eu/>.
- (3) Decree 83 does not apply to banks and micro-companies (defined by European Commission Recommendation no. 2003/361/CE as enterprises that employ fewer than 10 persons and have annual turnover and/or annual balance sheet totals that do not exceed Euro 2 million).
- (4) While Decree 83 did not explicitly define "Qualified Investors," Decree 179 has now defined such term under Art. 100 of the Legislative Decree no. 58 of February 24, 1998 and, therefore, it coincides with the definition of "professional client" in CONSOB Regulation on Intermediaries no. 16190 of 29 October 2007. Accordingly, 'Qualified Investors' would include, *inter alia*, (a) persons authorized and regulated to operate in financial markets, both Italian and foreign (e.g., banks, investment firms, other authorized and regulated financial institutions, insurance companies and pension funds); (b) large companies (e.g., companies satisfying at least two of the following requirements: total assets of at least Euro 20,000,000, net revenues of at least Euro 40,000,000 and capital resources of at least Euro 2,000,000); (c) institutional investors whose principal activity is investment in financial instruments, including companies dedicated to the securitization of assets; (d) other institutional investors who request to be treated as qualified investors; and (e) national and regional public entities.
- Neither Decree 83, nor Decree 179 has defined 'Professional Investors.' Also in this case, it is reasonable to argue that such term should also coincide with the definition of 'professional client' as defined above.
- We would expect that a selling restriction limiting the subscription of corporate bonds to Relevant Qualified Investors would be included in the relevant underwriting agreements (and possibly in the terms and conditions of the corporate bonds) so that the Issuer has sufficient information to ensure the relevant portion of interest remains deductible. Similar restrictions are commonly included in contractual documentation for bond issuances in order to fall within the exemption from the 'public offer' regime under Directive 2003/71/EC, as amended.
- (5) The 2% holding takes into account any holding held by the relevant qualified investor directly or indirectly, also through fiduciary companies (*società fiduciaria*) or through third persons (*interposta persona*).
- (6) Paragraph 26 of Article 32 of Decree 83 states that the exemption to the 'thin-cap rule' applies to bond issuances "which are intended to be listed" on a Qualified Exchange. In theory, this would also allow a listing to be made post-issuance of the relevant bond. However, since most interpretations of Decree 239 require the bonds to be listed upon issue, we believe most issuers will seek to list bonds at the time of issuance in order to obtain the exemption from withholding provided by Decree 239 or the deductibility of interest paid.
- (7) Pursuant to the general rule, the rate of withholding tax on interest payable to persons not resident in Italy is 20%, generally reduced to 10% under relevant double taxation treaties. Exemption to the application of withholding taxes exist only for (a) direct issuances by Italian listed companies under Legislative Decree no. 239 of April 1, 1996, or (b) indirect issuances by a special purpose non-Italian vehicles, where the funds raised are not repatriated into Italy. If the funds are repatriated into Italy, it is possible to mitigate withholding taxes (at a rate of 5% instead of 20%) on interest and other amounts paid by an Italian entity to a foreign associated issuer under Law 111 of July 15, 2011 if the bonds are listed. If the bonds are guaranteed by an Italian entity controlling the non-Italian issuer, then the guarantee is subject to a 0.25% registration tax.
- (8) Bonds with Participation Provisions differ from bonds envisaged under Article 2411, paragraph 2 of the Italian Civil Code, which allow the issuance of corporate bonds whose interest rate is linked to the economic results of the issuer (e.g. the interest rate may step up to the extent certain objective profit levels are attained) but do not give rise to a right to receive a percentage of the issuer's actual profits.
- (9) Decree 179 clarified the method for calculating of the Participation Payment, which must be calculated on the basis of the face value of the corporate bonds divided by the sum of the share capital, the reserves and the face value of the bonds.
- (10) See note (3) above.
- (11) Large companies are those which exceed the thresholds for small and medium sized companies as set out by the European Commission Recommendation no. 2003/261/CE (i.e., exceed the thresholds of 250 employees and annual turnover of Euro 50 million and/or an annual balance sheet total of Euro 43 million).
- (12) See note (4) above.
- (13) The exception to the rule requiring retention of commercial paper by a sponsor applies to guaranteed commercial paper, but only to the extent the guarantee (which must be provided by specified guarantors) exceeds 25% of the value of the commercial paper upon issue.

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