

# Insight: Capital Markets

July 2012

## New Italian Rules on Bonds for Italian Non-Listed Companies – *Italy has taken significant steps to facilitate the issuance of corporate bonds*

Italian non-listed companies have struggled to find efficient structures for corporate bond issuances. The Italian government has taken an important step to facilitate access to the corporate bond market for Italian companies which are not issuers of financial instruments on a Qualified Exchange (as defined below) ("**Non-Listed Companies**")<sup>1</sup> by approving Law Decree no. 83 of June 22, 2012 on "Urgent Measures for Growth of the Country" (the "**Decree**"). Article 32 of the Decree resolves most of the tax and corporate issues that have obstructed access to, or increased the cost for, corporate bonds for Non-Listed Companies.

The Decree became effective on June 26, 2012 (the date of its publication in the Italian Official Gazette). In order to remain effective, the Italian Parliament will need to convert the Decree into law within 60 days (i.e. August 25, 2012) of publication in the Italian Official Gazette (and may amend the law during such process). This Client Insight will be updated to reflect any material change upon its conversion into law.

The Decree establishes two regimes for Non-Listed Companies: a relatively simple regime for those Non-Listed Companies that list the corporate bonds on a regulated market or on multilateral trading facilities (a "**Qualified Exchange**")<sup>2</sup> and a more complex regime for those Non-Listed Companies who do not list the corporate bonds.

Under both regimes (subject to certain conditions) the Decree provides for the deductibility of interest paid on corporate bonds.

### Deductibility of Interest Paid on Corporate Bonds

Under the Decree, issuers may deduct interest paid on corporate bonds which would otherwise be subject to certain limitations (i.e. deductibility would be limited to a rate of interest on the bonds not exceeding twice the official base rate). In order for Non-Listed Companies to fully deduct interest paid on corporate bonds, such bonds must be (a) subscribed for by qualified investors<sup>3</sup> and (b) owned by qualified investors that are not, directly or indirectly (through fiduciary companies or third parties), shareholders of the issuer. We note that it will be the responsibility of the issuer to implement measures to ensure that the above conditions are satisfied, failing which, the deductibility of interest would be limited as noted above.

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## Regime for Corporate Bonds Listed on a Qualified Exchange

To the extent that the corporate bonds are listed on a Qualified Exchange:

- **Current corporate “thin-cap rules” will no longer apply:** Prior to the Decree, 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 (this restriction also applied in most cases to guarantors of such corporate bonds) and were subject to very limited exceptions. The Decree now permits Non-Listed Companies to issue corporate bonds without complying with this limitation, thereby providing them with the same treatment enjoyed by listed companies in Italy.<sup>4</sup>

The exemption to the “thin-cap rules” also applies to convertible or exchangeable bonds, presumably because they are treated as hybrid instruments having features more similar to equity.

- **Withholding tax on interest will be reduced to zero for investors resident in ‘white-listed’ countries:** Prior to the Decree, 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 20% and 5%<sup>5</sup> and/or being subject to a tax audit by Italian tax authorities.

The Decree grants Non-Listed Companies the same withholding tax treatment that listed companies in Italy currently enjoy under Legislative Decree no. 239 of April 1, 1996 (“**Decree 239**”). Decree 239 provides for an exception to the application of withholding or substitute taxes on interest and other payments to investors which are (a) beneficial owners resident in “white listed” countries, or (b) institutional investors, not subject to tax, established in ‘white-listed’ countries. Such provision will only apply in respect of corporate bonds issued after June 26, 2012.

## Regime for Corporate Bonds Not Listed on a Qualified Exchange

If the corporate bonds are neither offered to the public<sup>6</sup> nor listed on a Qualified Exchange, the Decree sets out additional conditions for Non-Listed Companies to benefit from privileged treatment: (a) the issuance must be supported by a sponsor (the Decree provides an exemption to this rule for large Non-Listed Companies<sup>7</sup>); (b) the issuer’s most recent financial statements must be audited by an appropriately qualified auditor or independent auditing firm; and (c) the corporate bonds must be issued to, and intended to be traded exclusively among, qualified investors that are not, directly or indirectly, shareholders of the issuer.

The Decree imposes significant requirements on a sponsor. Significantly, a sponsor is required to: (a) support the issuer in the issuance and the placement; (b) hold in its portfolio to maturity of the corporate bonds: (i) not less than 5% of the issuance value of the corporate bonds for issuances up to Euro 5 million; (ii) not less than 3% of the value for the portion exceeding Euro 5 million (up to Euro 10 million); (iii) not less than 2% of the value of the corporate bonds exceeding Euro 10 million; and (c) evaluate, at least on a semi-annual basis, the value of the corporate bonds and classify the issuer in a category of risk that takes into account its creditworthiness.

Under the Decree, the following entities may act as sponsors: banks, investment companies, asset management companies (SGRs); harmonized management companies, open-end investment companies (SICAVs), financial intermediaries registered in the list provided by article 107 of Legislative Decree no. 385 of September 1, 1993, and banks authorized to provide investment services in Italy, even if their registered seat is outside of the EU.

**Application to Commercial Paper:** The Decree applies the same dual regime and similar rules to the issuance of commercial paper (*cambiali finanziarie*), which pursuant to the Decree can now also be issued in dematerialized form, in an amount not exceeding the issuer’s “current assets” (as defined in the Decree), as recorded in its most recent audited financial statements. In addition, the Decree extends the range of maturities for commercial paper from a minimum of 1 month to a maximum of 18 months as of the date of issuance.

**Subordinated bonds and/or with profit participation:** The Decree also sets out specific provisions allowing the issuance of notes with subordination clauses and/or profit participation clauses. The application of such provisions is subject to specific conditions under the Decree.

The Decree represents a significant and welcome liberalization of the corporate bond market 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. We do expect that there will be some difficulty in applying the Decree where a sponsor is required for instances where an issuer determines not to list the corporate bond on a Qualified Exchange. Of course, while resolving many issues, the Decree gives rise to a number of interpretative issues.

The Decree 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 Basle III.

## Notes:

- 1 The Decree appears to have a drafting error by its application only to those companies that have not previously listed a financial instrument, thereby precluding further issues of corporate bonds under the Decree by Non-Listed Companies which have listed financial instruments in the past. We would expect this to be clarified upon conversion into law.  
  
Furthermore, the Decree does not apply to banks and micro-companies (defined by European Commission Recommendation no. 2003/361/CE defines micro-companies as enterprises which employ fewer than 10 persons and have annual turnover and/or annual balance sheet totals that do not exceed Euro 2 million).
- 2 The Decree 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 authorised 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 Pursuant to paragraph 3 of the Decree, qualified investors are those defined in Article 100 of Legislative Decree no. 58 of February 24 1998, which in turn refers to CONSOB Regulation on Intermediaries no.16190 of 29 October 2007. Accordingly, qualified investors 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.
- 4 Paragraph 26 of Article 32 of the Decree 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 Decree 239 requires 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.
- 5 Pursuant to the general rule, the rate of withholding tax on interest payable to persons not resident in Italy was 20%, generally reduced to 10% under relevant double taxation treaties. Exemption to the application of withholding taxes existed 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 were not repatriated into Italy. If the funds were repatriated into Italy, it was 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 were listed. If the bonds were guaranteed by an Italian entity controlling the non-Italian issuer, then the guarantee was subject to a 0.25% registration tax.
- 6 "Offer to the public" refers to the definition in Legislative Decree no. 58 of February 24 1998 in article 1, paragraph 1, letter t), i.e. a "communication to persons, in any form and by any means, presenting sufficient information on the terms of the offer and the securities offered so as to enable an investor to decide to purchase or subscribe to these securities, including the placement through authorized financial intermediaries".
- 7 Large companies are those which exceed the thresholds for small and medium sized companies 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).