

Insight: Capital Markets

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Draft Decree on Bonds for Italian Non-Listed Companies – *Italy is on the verge of taking significant steps to facilitate the issuance of corporate bonds*

Italian non-listed companies have struggled to find efficient structures for corporate bond issuances. On June 15, 2012, the Italian government took 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**”)¹ by approving a law decree on “Urgent Measures for Growth of the Country” (the “**Draft Decree**”). Article 32 of the Draft Decree, if approved in its current form, would resolve most of the tax and corporate issues that have obstructed access to, or increased the cost for, corporate bonds for Non-Listed Companies.

This Client Insight is based on the Draft Decree; the final decree may differ from the Draft Decree. This Client Insight will be updated to reflect any material change in the final published decree and its conversion into law. A decree, in order to remain effective, must be converted into law within 60 days of publication in the Italian Official Gazette.

The Draft 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**”)² and a more complex regime for those Non-Listed Companies who do not list the corporate bonds.

The Draft Decree also confirms the deductibility of interest paid on corporate bonds, which is currently subject to certain limitations. In order for Non-Listed Companies to fully deduct interest paid on corporate bonds such bonds must be (a) subscribed for by qualified investors³ and (b) owned by qualified investors that are not, directly or indirectly (through fiduciary companies or third parties), shareholders of the issuer.



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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 “thin-cap rules” will no longer apply:** Non-Listed Companies are 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 are subject to very limited exceptions. The Draft Decree would permit 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.⁴

The exemption to the “thin-cap rules” also appears to apply to convertible or exchangeable bonds although there remain some interpretative issues to be clarified with respect to this application of the Draft Decree.

- **Withholding tax on interest will be reduced to zero for investors resident in ‘white-listed’ countries:** Non-Listed Companies have 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%⁵) and/or being subject to a tax audit by Italian tax authorities.

The Draft Decree would grant 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.

Regime for Corporate Bonds Not Listed on a Qualified Exchange

If the corporate bonds are neither offered to the public⁶ nor listed on a Qualified Exchange, the Draft Decree sets out additional conditions for Non-Listed Companies to benefit from privileged treatment: (a) the issuance must be supported by a sponsor (the Draft Decree provides an exemption to this rule for large Non-Listed Companies⁷); (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 Draft 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 Draft 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 Draft Decree would apply the same dual regime and similar rules to the issuance of commercial paper (cambiali finanziarie), which can be issued in an amount not exceeding the issuer’s “current assets” (as defined in the Draft Decree), as recorded in its most recent audited financial statements. In addition, the Draft Decree would extend 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.

The Draft Decree, if published in its current form, would represent a significant and welcome liberalization of the corporate bond market for Italian Non-Listed Companies. We expect that many Non-Listed Companies would, 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 Draft 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 Draft Decree gives rise to a number of interpretative issues.

The Draft Decree would be 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 Draft 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 Draft Decree by Non-Listed Companies which have listed financial instruments in the past. We would expect this to be clarified before the Draft Decree is officially published or upon conversion into law.

Furthermore, the Draft Decree would 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 Draft 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://mifidatabase.esma.europa.eu/>.
- 3 Pursuant to paragraph 3 of the Draft 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 Draft 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).