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Italian Government announces breakthrough tax and legal measures to foster credit to Italian businesses

The Italian Government just presented a set of measures to boost access to financing for Italian businesses. The new measures will soon be published through a law decree "*Decreto Competitività*" (the "**Decree**") and will then have to be converted into law by the Italian Parliament.

Even though such measures have not yet made their way into final legislation, they provide a clear insight of the direction that the Italian Government is willing to take and possibly represent one of the most significant steps towards greater efficiency of domestic and, most importantly, cross-border financings.

The Decree introduces the following key aspects:

- Wider exemptions from interest withholding taxes, including on cross-border loans; scope of the 0.25% substitute tax substantially widened (to include secondary trading);
- Italian insurance companies allowed to extend financing to borrowers directly (primary market);
- Italian securitisation vehicles also allowed to grant financings within the scope of the Italian securitisation law.

1. Tax measures

The main tax measures related to financing transactions are as follows.

Tax measures on lending

- **Repeal of interest withholding tax** on interest on medium- and long-term loans paid by Italian businesses to (i) EU banks, (ii) EU insurance companies, and (iii) collective investment schemes (unleveraged) and established within the EU or in an EEA State allowing an adequate exchange of information. Under current legislation, the withholding tax would apply at 20% (soon to be increased to 26%), possibly reduced under the applicable tax treaties (generally to 10%). However, in the case of funders not having access to tax treaties (e.g. investment funds) the cost of the taxation at source made lending into Italy virtually impossible.
- **The 0.25% substitute tax on medium-term loans**, which franks financing transactions from the application of stamp duty and other taxes on the funding and the relevant security package, would be extended to cover also the **subsequent transfer of the receivables**, and other associated security, on the secondary market. Before the change, any transfer was itself subject to tax and tax costs associated to the re-registration of the securities, especially mortgages, which made the transfer of receivables arising out of secured loans uneconomical from a tax perspective. Moreover, the tax will be applicable **also to loans made by Italian securitisation vehicles, collective investment schemes and insurance companies**.

Tax measures on bonds

The new measures include a significant boost to the tax regime applicable to bonds and similar securities issued by Italian non-listed companies (the so called “mini-bonds”), with the objective of facilitating private placements by Italian issuers. Under the new rules, **the listing of the bonds will no longer be necessary** to access a favourable withholding tax regime. Under the new legislation, bonds held by “qualified investors” pursuant to article 100 of the Italian Consolidated Financial Act will also be eligible for the tax regime under Legislative Decree 239 of 1 April 1996, thus allowing full exemption at the source for all eligible white-listed investors. The following table illustrates the changes:

	Current regime	New regime
Deduction of interest expenses by the issuer	Allowed only if the relevant security is: - Listed on a regulated market or multilateral trading facility; or - Held by Italian or white-listed qualified investors established in a white listed jurisdiction and not connected to the issuer by more than 2%	Unchanged
Possible exemption from tax at source under Legislative Decree 239/96	Allowed only if the relevant security is listed on a regulated market or multilateral trading facility.	Allowed if the relevant security is: - Listed on a regulated market or multilateral trading facility; or - Held by qualified investors.

Moreover, no withholding tax will apply on interest on bonds and similar securities paid to:

- collective investment undertakings established in Italy or another EU member State which invest more than 50% of their assets in such bonds or similar securities and whose investors are solely "qualified investors"; or
- Italian securitisation vehicles which invest more than 50% of their assets in such bonds or similar securities and whose investors are solely "qualified investors".

"*This is probably the single most significant change to the tax rules on cross-border financing in the last 40 years*" – comments Carlo Galli, head of the Tax Department at Clifford Chance in Italy – "*The new tax measures are a huge step forward in widening the access to the Italian market for foreign lenders and investors in general. Lending into Italy will be easier and more cost effective for a variety of foreign lenders that have so far been discouraged by the associated tax costs*".

Other significant tax measures have been presented and will be addressed in separate briefings.

2. Regulatory measures

From a regulatory standpoint, Italian **insurance undertakings** and **securitisation vehicles** will be permitted to extend financing to businesses (as opposed to individuals), provided that the following conditions are met:

- the borrower is identified by a bank or financial intermediary (a 'financial intermediary' is an Italian regulated entity professionally engaged in financing activities);
- the above bank/financial intermediary retains a 'significant interest' in the transaction until the relevant maturity;
- in the case of **insurance undertakings only**: the insurance undertaking maintains adequate internal control and risk management systems, enabling it fully to appreciate the underlying risks; in addition, the insurance undertaking must be adequately capitalised;
- in the case of **securitisation vehicles only**: the notes issued under the securitisation transaction are to be subscribed for by qualified investors pursuant to article 100 of the Italian Consolidated Financial Act.

The loans so granted by Italian insurance undertakings will be eligible to cover the technical provision requirements applicable to insurance undertakings, subject to the more detailed rules to be set by IVASS, the regulator of the insurance industry.

In addition, the definition of collective investment scheme (CIS) has been amended to the effect that, while CISs may invest in, among other asset types, receivables, the term 'receivables' includes those "*extended out of the assets of the CIS*" (to be understood as to mean receivables *arising from loans* extended out of the assets of the CIS).

It does not appear that, solely as a result of such amendment, CISs will be allowed to lend directly to borrowers, like Italian insurance undertakings and securitisation vehicles (but without the restrictions that apply to them, discussed above). Indeed, the Ministries of Treasury and of Economic Development have announced that a draft ministerial decree shall be published for public consultation on the matter of the granting of financing by CISs.

According to Lucio Bonavitacola, head of the regulatory group within the Clifford Chance Italian capital markets practice, "*This is a breakthrough, and long awaited for, reform, that opens up the traditional Italian 'banking monopoly' regime by allowing for the first time entities other than banks and financial intermediaries to extend financing directly to borrowers on the 'primary market' (i.e. by originating loans rather than only by purchasing on the 'secondary markets' loans originated by others). Yet, this opportunity must be seized to do even more, when the Decree is converted into law (which must take place within 60 days): also foreign insurance companies, for example, and Italian as well as foreign CISs (credit funds) should be allowed to grant financing, to ensure that Italian businesses can access the huge pools of liquidity available from those entities. For CISs, it appears that this is indeed the intention, since a draft ministerial decree is expected to regulate the granting of financing by CISs*".

Allowing foreign – at least EU – insurance undertakings, as well as CISs (at least EU and not leveraged), to grant financing would be only consistent – Lucio Bonavitacola notes – with the tax measures which are being simultaneously approved, notably the repeal of interest withholding tax on interest paid, inter alia, to EU insurance companies and EU (unleveraged) CISs and the extension of the 0.25% substitute tax on medium-term loans to loans made by EU insurance companies and EU (unleveraged) CISs. These tax measures would likely miss the target of attracting foreign liquidity to the Italian businesses, unless they are accompanied by the ability, at least for EU insurance undertakings and EU (unleveraged) CISs, to engage in the direct financing of borrowers.

In relation to the requirement, which applies to financings by securitisation vehicles, that the 'sponsor' bank or financial intermediary retain a 'significant interest' in the transaction until maturity.

Tanja Svetina, head of the structured finance group at Clifford Chance in Italy, comments: "*This is understandable in substance, although possibly limits the recourse to such financings and duplicates the analogous 'skin in the game' requirement (through the 5% retention rule) that is already applicable to banks and alternative investment funds under the relevant EU legislation, in relation to investments in securitisations. We will need to wait for the Bank of Italy's implementing regulations to see how the two requirements interplay*".

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3. Securitisation measures

Securitisation financing activity carried out through the granting of loans by the SPVs. Further clarifications on scope of segregation.

As mentioned in section 2 above, the Decree is to amend, among other things, the Italian securitisation law by allowing special purpose vehicles ("**SPVs**") to grant financings and sets out the relevant requirements summarised below.

In this respect, the Decree clarifies certain structural aspects as follows:

- article 7 of the Italian securitisation law is being supplemented to clarify that the securitisation law applies also to securitisation transactions carried out through the granting of one or more loans by the SPV;
- from the date (to be certain at law) the loan is drawn , in whole or in part, no action is permitted on the receivables and on any sums paid by the assigned debtors other than in satisfaction of the rights of the noteholders and to cover the other costs of the securitisation;
- the servicer of the securitisation is to be responsible to verify the correctness of the financing transactions and the relevant compliance with the applicable legislation.

The above provisions are in addition to those described under section 2 above (*Regulatory measures*) as being applicable to securitisation SPVs.

The possibility for SPVs to perform lending activity is in line with the opening of the Italian banking framework to foreign qualified institutions and to investments through securitisation transactions, so granting a prospective access to liquidity to private companies (including SMEs) as an alternative channel to the ordinary banking system, ensuring at the same time an adequate regulatory control through the involvement of regulated entities acting as servicers of the securitisation. Tanja Svetina comments: "*Although the new measures provide for a very important new financing tool, the actual scope of the segregation still needs to be clarified*".

Further extension of segregation effects on securitisation proceeds and accounts

The proposed measures also clarify and strengthen the segregation in connection with (i) the accounts held by the servicers and other depositories (the "**Depositories**") and (ii) other proceeds of the securitisation (including eligible investments). In particular:

- it is specified that the statutory **segregation effects** under the Italian securitisation law cover (both) the receivables towards the assigned debtors and (also) any other claims owed to the SPVs in the context of the transaction, as well as any relevant collections and financial assets purchased through the proceeds of the receivables;
- new provisions are set, clarifying the operation of the bank accounts that may be opened by the SPV with the Depositories, for the collection of the sums paid by the assigned debtors and any other sums paid or otherwise due to the SPVs in the context of the securitisation. In particular:

  (a) **any sums** paid into the segregated accounts can be freely and **immediately disposed of** by the SPVs to pay exclusively the noteholders, the hedging counterparties covering the risks on the securitised receivables / notes and other transaction costs, and **no actions** are permitted on the segregated accounts by other creditors;

  (b) should any insolvency procedure be opened against one of the Depositories, **no suspension of payments** will affect the moneys standing to the credit of the segregated accounts, nor any sums that will be credited during the insolvency procedure. Hence, **any sums transferred or credited in the segregated accounts will be immediately available to effect the payments due under the securitisation**;

  (c) similarly, **no actions** are permitted by the creditors of the servicers or sub-servicers on the accounts opened with any other Depositories to collect any amounts on behalf of the SPVs, other than for amounts exceeding the moneys due to the SPV under the securitisation. Should any insolvency procedure be opened against a Depository, any sums existing or that will be credited on such accounts during the insolvency procedure will be **immediately returned to the SPVs without need of procedural requests, filing or submission of claims/petitions, and without waiting for any composition and/or restitutions among the creditors**.

The amendments at stake are intended to be legal and economic positives for the Italian credit framework because they clarify that the securitised assets, which benefit from the portfolio segregation effect, expressly **include** (not only the receivables towards the assigned debtors but also) **any other monetary claims owed to the SPVs** in relation to the securitisation, and any cash-flows generated by the collection of the assigned receivables, **including any eligible investments and financial assets purchased by the SPVs for the purpose of the transaction**.

These measures strengthen the securitisation structures, and eliminate interpretative doubts as to whether the investments made by the SPVs could benefit from the statutory segregation effect provided by the Italian securitisation law. Similarly, the reformed provisions protect the cash-flows due to the SPVs under the securitisation by stating that any collections are **immediately available** to make payments under the transaction, independently of any insolvency proceedings involving a Depository or a servicer and excluding petition by any other creditors.

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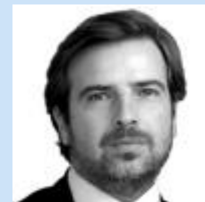

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*Linda Widyati & Partners in associazione con Clifford Chance.