Direct Lending by Alternative Investment Funds: The Italian Regulatory and Tax Framework

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Italy has a comprehensive set of regulations that allows direct lending by alternative capital providers, which include Italian and EU alternative investment funds. This article outlines the conditions and formalities that these funds must satisfy before engaging in lending transactions in Italy, along with the applicable tax regime.

1. Introduction

Under Legislative Decree 385 of 1 September 1993 (the Banking Code)[1] and Decree 53 of the Minister of Economic Affairs of 2 April 2015 (Decree 53/2015), the provision of credit in any form to the public on a professional basis is a restricted activity in Italy. Lending, which is defined as the granting of credit in any form and also includes the purchase of receivables for consideration,[2] was traditionally limited to licensed banks[3] and certain other financial intermediaries.[4] However, a series of legislative statutes have been enacted in Italy since 2014, in response to the worsening of the credit crunch and the tightening of regulatory capital requirements for EU banks, with a view to mitigating the regulatory and tax hurdles that prevented alternative finance providers from lending to Italian companies, diversifying firms’ fund sources and compensating the drop in bank lending.

In particular, Law Decree 91 of 24 June 2014[5] (Decree 91/2014) allowed Italian insurance companies and securitization vehicles to lend directly to businesses, subject to certain restrictions. Decree 91/2014 also included amendments to Legislative Decree 58 of 24 February 1998[6] (the Finance Code), aimed at permitting Italian alternative investment funds as well to engage in direct lending transactions. However, the regulatory landscape concerning lending by Italian alternative investment funds remained uncertain.

The set of regulations was completed in 2016. First, Decree 18 of 14 February 2016 (Decree 18/2016) added to the Finance Code a new set of provisions on “credit funds”. Ultimately, on 23 December 2016, the Bank of Italy[7] issued the long-awaited implementing rules outlining the ability of EU alternative investment funds to extend credit to Italian borrowers.

2. EU Regulatory Landscape

2.1. Alternative Investment Fund Managers Directive

The Alternative Investment Fund Managers Directive (AIFMD)[8] is a comprehensive regulatory framework for alternative fund managers within Europe. It is a “framework” Level 1 Directive, which has been supplemented by technical delegated and implementing measures.[9]

An alternative investment fund is a collective investment undertaking, including investment compartments of such an undertaking, which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and does not require authorization under article 5 of the UCITS Directive.[10]

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[3] Italian banks, EU banks licensed and/or passported by the Bank of Italy and non-EU banks acting from an Italian facility office.
[4] Italian financial intermediaries enrolled in a specific register held by the Bank of Italy under article 106 of the Finance Code and subject to regulatory and prudential provisions broadly mirroring those applicable to banks.
[7] Banca d’Italia, the central bank of the Republic of Italy.


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Italy has transposed the AIFMD through Legislative Decree 44 of 4 March 2014 (the AIFMD Decree), which included significant changes to the tax and regulatory framework concerning collective investment undertakings and introduced SICAFs as a new form of collective investment undertaking set up in corporate form.[11]

2.2. A path for a common EU framework for loan origination by alternative investment funds?

In the Action Plan on Building a Capital Markets Union of 30 September 2015 (the Action Plan),[12] the European Commission acknowledges that some EU Member States have introduced specific regimes in their domestic law to frame the conditions under which alternative investment funds may engage in loan originating activities. As to the current situation in the Member States, the Action Plan states the following:

Some Member States have also introduced bespoke regimes in their national legal frameworks to frame the conditions under which alternative investment funds can originate loans. This situation results in funds operating cross-border needing to comply with different requirements for their loan-originating activities. Clarification of the treatment of loan-originating funds in the regulatory framework could facilitate cross-border development whilst ensuring they are regulated appropriately from an investor protection and financial stability perspective.[13]

As outlined in the Action Plan, the Commission intends to work with Member States and the European supervisory authorities to assess the need for a coordinated approach to loan origination by funds and the case for a future EU framework. The European Commission therefore asked the European Securities and Markets Authority (ESMA) to provide input on the key issues in view of the establishment of a common EU approach.

On 12 April 2016, the ESMA published an opinion[14] (the Opinion) addressed to the European Parliament, the Council and the Commission on the components necessary for a common European framework concerning loan origination by investment funds.

In line with the Commission’s request, the Opinion focuses specifically on loan origination (i.e. it covers only investment funds that act as sole or primary lenders).[15] The Opinion also focuses specifically on alternative investment funds (as UCITS are generally prohibited from originating loans) and does not consider those particular types of alternative investment funds for which direct lending is already regulated (i.e. alternative investment funds which qualify as European venture capital funds, European social entrepreneurship funds or European long-term investment funds).

The ESMA believes that “funds should provide credit under a suitable framework such that systemic risk is mitigated, and, in any case, is no higher than that posed by bank lending”. [16] Accordingly, the European Commission should, in its work on the Capital Markets Union, “assess the need for frameworks which harmonize the loan participation activities and variations on these activities that fall somewhere between loan participation and loan origination”.[17] A consistent EU regulation would contribute, according to the ESMA, to a more level playing field between EU jurisdictions, reduce regulatory arbitrage and ultimately facilitate loan origination activities across Europe.

The Opinion, which forms part of the ongoing work of the ESMA on capital markets, takes into account the bespoke frameworks currently in place in several Member States for loan origination by funds domiciled in the respective country (including Italy). In the Opinion, the ESMA sets out its views on the key principles that should be taken into account for any loan origination framework. In particular, the ESMA recommends that loan-originating alternative investment funds be set up as closed-ended undertakings and should not be allowed to have liabilities with a shorter maturity than the loans granted by the fund.[18] The Opinion also includes suggestions on the types of investors (generally, non-retail), eligible investments and debtors, the organization requirements that alternative investment fund managers managing loan-originating alternative investment funds should have in place to address the specific risks arising from the loan-originating activity, limits on leverage, liquidity rules, stress testing, and an update of the AIFMD reporting rules.

13. European Commission, supra n. 12, at 10, sec. 1.4.
15. ESMA notes that “provision of credit by investment funds is possible in several ways, notably in the form of ‘loan origination’, ‘loan participation’, or ‘loan restructuring’. From a pay-off perspective, all these activities have similarities. Furthermore, they ultimately all provide credit in one form or another. At a more detailed level, however, there are a number of differences between these activities as regards their business models and business requirements, among other things. By carrying out loan origination, an investment fund provides credit (originates a loan), while acting as a sole or a primary lender. By contrast, examples of loan participation typically involve funds which have gained exposure to loans through secondary market participations. Typical examples of loan restructuring include situations where a fund invests in reaction to the restructuring of existing debt”.
16. ESMA, Opinion, supra n. 14, para. 11.
17. Id.
18. ESMA, Opinion, supra n. 14, para. 25.
3. The Italian Regulatory Framework

3.1. Direct lending by Italian alternative investment funds

The AIFMD Decree, Decree 91/2014 and Decree 18/2016 amended the definition of “collective investment undertakings” in the Finance Code, to include therein also funds granting loans to non-consumer borrowers out of their own assets. Indeed, under the Finance Code, a collective investment undertaking is:

an undertaking set up to provide collective management services, the assets of which are collected from a plurality of investors by means of the issue and offer of units or shares, managed on a pooled basis in the interest of the investors and independently from them, and invested in financial instruments, credits, including those advanced to persons different from consumers, using their own assets, shareholdings or other movable or non-movable assets, on the basis of a pre-defined investment policy.

Consistently, Decree 30 of the Ministry of Economic Affairs of 5 March 2015 (the Ministry of Economic Affairs Decree), enacting certain provisions of the Finance Code, states that “the assets of a collective investment undertaking may be invested in […] credits and instruments representing credits, including credits granted out of the collective investment undertaking assets”. Based on the same Decree, Italian alternative investment funds that intend to invest in credits (Italian credit alternative investment funds) must be established as closed-ended funds. The underlying rationale of this requirement is that credits – being illiquid assets – are not compatible with the features of an open-ended structure.

Decree 18/2016 (containing “Urgent measures regarding mutual banks, guarantees on securitization of Italian banks non performing loans, tax regime applicable to bankruptcy procedures and collective investment schemes’) amended the collective investment undertaking definition in the Finance Code, specifying that Italian alternative investment funds may not lend to consumer clients, and added to the Finance Code a new set of provisions on “credit funds”.

Article 46-bis of the Finance Code expressly states that Italian alternative investment funds are permitted to directly lend into Italy to non-consumer clients by using the fund’s resources, in compliance with the provisions of the Finance Code and with the implementing regulations enacted by the Ministry of Economic Affairs and the Bank of Italy. In this regard, reference must be made to the Ministry of Economic Affairs Decree and to the Regulation of the Bank of Italy on collective asset management of 19 January 2015 (as amended from time to time) (the Collective Asset Management Regulation).

Article 46-ter of the Finance Code sets out the conditions under which EU alternative investment funds may directly lend into Italy, setting forth for procedures and requirements that are equivalent to those applicable to Italian credit alternative investment funds.

Article 46-quater of the Finance Code outlines the transparency rules applicable to both Italian alternative investment funds and EU alternative investment funds carrying out lending activities in Italy.

3.2. Direct lending by EU alternative investment funds

3.2.1. Introduction

Article 46-ter of the Finance Code allows EU alternative investment funds to directly lend into Italy to non-consumer clients by using the fund’s resources (EU credit alternative investment funds), provided that they (i) are so authorized by the Bank of Italy and (ii) satisfy certain conditions. Article 46-ter(5) requires the Bank of Italy to enact the implementing regulations, detailing the procedural formalities that must be complied with by EU alternative investment fund managers to be authorized to grant credit in Italy.

Following a public consultation launched in July 2016, the Bank of Italy published the required rules updating its Collective Asset Management Regulation in late 2016.

19. Art. 1(1)(k) Finance Code, as amended by the AIFMD Decree and, subsequently, by Decree 91/2014 and by Decree 18/2016 (author’s translation). The definition in article 1(1)(k) is inspired by the wording of article 4(1)(a) of the AIFMD, whereby an AIF is a “collective investment undertakings, including investment compartments thereof, which: (i) raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorization pursuant to article 5 of Directive 2009/65/EC [the UCITS Directive].


21. Art. 10(1) Ministry of Economic Affairs Decree: “Italian alternative investment funds shall be established in a closed-end form if they are invested […] in the assets referred to in article 4, para. I, lett. e) [i.e. credits and instruments representing credits, including credits granted out of the UCI assets]” (author’s translation).


23. The previous amendments to the Finance Code, enacted by the AIFMD Decree and Decree 91/2014, were already aimed at expanding the definition of “collective investment undertaking” to capture therein funds investing in credits. However, it remained unclear whether direct lending by funds was possible, given that the list of authorized lenders in art. 106 Banking Code did not include investment funds. Even though art. 106 was not amended by Decree 18/2016, the new section on credit funds in the Finance Code clarifies that Italian and EU alternative investment funds are indeed allowed to engage in direct lending transactions in Italy, subject to compliance with a number of requirements.


3.2.2. Conditions for lending into Italy by EU credit alternative investment funds

Under article 46-ter of the Finance Code, EU credit alternative investment funds can lend directly to Italian borrowers (other than consumers) subject to the following conditions:

- they are authorized by their home country authority to carry out direct lending transactions in the jurisdiction where they are established;
- they are established in the form of closed-ended funds and are subject to functioning rules, in particular as regards the modalities of participation by their investors, equivalent to those applicable to Italian credit alternative investment funds;
- they are subject in their home country to limitations on risk mitigation and diversification and financial leverage equivalent (i.e. equal or stricter) to those set out under Italian law for Italian credit alternative investment funds. Equivalence can be assessed also by making only reference to the constitutional documents of the alternative investment funds (i.e. their management rules or bylaws that expressly contain those limitations), provided that the home country authority ensures compliance by the EU credit alternative investment funds with their constitutional documents (including those limitations); and
- a 60-day notice is sent to the Bank of Italy prior to commencing the lending activity in Italy.

In addition, the current approach of the Bank of Italy is that EU credit alternative investment funds shall be managed by a “full-scope” alternative investment fund manager.

3.2.3. The authorization procedure

An EU fund manager of an EU credit alternative investment fund intending to engage in direct lending in Italy must file a prior notice (the notice) with the Bank of Italy containing the corporate details of the fund manager itself and of the relevant EU credit alternative investment fund, as well as the documentation listed below (which may be drafted in either English or Italian):

- a statement issued by the home country supervisory authority confirming that such manager is authorized to manage the EU alternative investment fund referred to in the notice. In lieu of such statement, the applicant may file a copy of its management authorization, together with a statement signed by its legal representative attesting the enrolment of the fund manager under the relevant register;
- a statement issued by the home country supervisory authority of the EU credit alternative investment fund confirming that it is authorized to engage in lending transactions. If direct lending activity is not subject to any specific authorization in its home jurisdiction, the applicant may alternatively deliver a legal opinion attesting that the EU credit alternative investment fund is entitled to carry out lending activities without any authorization being necessary in its own jurisdiction;
- a copy of the constitutive documents of both the fund manager and the EU credit alternative investment fund (bylaws and/or management rules), certified by the competent authorities as in force confirming the validity and enforceability of such documents. In lieu of such declaration, the applicant may file a statement executed by its legal representative;
- a declaration signed by its legal representative pointing out the home country provisions of law applicable to the EU credit alternative investment fund on risk diversification and financial leverage deemed to be equivalent to the rules applying to Italian credit alternative investment funds, together with a legal opinion attesting such equivalence. Alternatively, if such equivalence is assessed by reference only to the constitutional documents of the EU credit alternative investment fund, the applicant shall deliver a statement of its home country supervisory authority ensuring that it supervises the compliance by the fund manager with the risk mitigation and diversification limits as well as the financial leverage limits set forth under the constitutional documents of the EU credit alternative investment fund;
- a copy of the last annual and half-year report (if and to the extent available); and
- a memorandum outlining the operational scheme of the EU credit alternative investment fund, focusing in particular on the terms concerning the redemption and subscription of units and/or shares, as well as on the investment policy. The memorandum must indicate whether or not the EU credit alternative investment fund entered or intends to enter into side letters with its investor. The content of such side letters (if any) must be disclosed as well.

The release of the authorization is based on a tacit-approval mechanism. The notice must be filed at least 60 days in advance of the commencement of the lending activities in Italy (although some preliminary activities, such as scouting for investment opportunities, are allowed). The Bank of Italy evaluates the completeness of the filed documentation, and, in the case of a positive outcome, it confirms in writing the suitability of the application through a confirmation receipt (the confirmation receipt); otherwise it is entitled to request the applicant to provide additional information. The Bank of Italy may prohibit the applicant from engaging in lending activity within 60 days following the issuance of the confirmation receipt. If no explicit refusal to grant the authorization is communicated, the EU credit alternative investment fund will be free to commence originating loans.
4. Italian Tax Issues

4.1. Italian credit alternative investment funds

4.1.1. Corporation tax and local tax regime

Under Decree 917 of 22 December 1986 (Decree 917/86), Italian credit alternative investment funds, being collective investment undertakings, qualify as “non-commercial entities” (enti non commerciali) and are among the taxpayers that fall under the scope of corporate income tax (imposta sul reddito delle società, IRES), generally levied at the rate of 24%. An alternative investment fund is deemed to be tax resident in Italy when it is established therein. In this regard, the tax authorities clarified in Circular 21/E/2014 that a collective investment undertaking is deemed to be tax resident in Italy when established on the basis of Italian rules, regardless of the place of effective management of the undertaking or the state where the management company is established.

Italian credit alternative investment funds are exempted from corporation tax, provided that the undertaking itself or its management company is subject to prudential supervision and from local tax (regional tax on productive activity, i.e. imposta regionale sulle attività produttive (IRAP), generally levied at the rate of 3.9%, with possible regional variances.

Despite being exempted from IRES, Italian credit alternative investment funds may still be liable to a 26% final (i.e. unrecoverable) withholding tax that is deducted at source from certain categories of financial income, such as interest on certain bonds and interest on financial instruments that qualify as atypical securities (i.e. they do not satisfy the requirements to be treated as equities or bonds). However, no withholding tax is deducted from interest payments on loans granted to Italian borrowers.

The above exemptions, however, apply only to Italian credit alternative investment funds that comply with the regulatory requirements under the Finance Code. The Italian tax authorities have indeed stated, on a number of occasions, that the tax regime for collective investment undertakings applies only if the legal and regulatory requirements are met.

As a consequence, regulatory compliant Italian credit alternative investment funds are granted an extremely beneficial tax regime, which implies, in essence, that all revenues and profits generated from the lending activities carried out by them are exempt from income taxes in Italy.

4.1.2. Withholding tax regime applicable to foreign investors in Italian credit alternative investment funds

Under article 44 of Decree 917/86 and article 26-quinquies of Decree 600 of 29 September 1973 (Decree 600/73), as amended by the AIFMD Decree, income from the investment in Italian credit alternative investment funds qualifies as “income from capital” (reddito di capitale) and is determined, without any deduction for costs and expenses, as the difference between the value of redemption, liquidation or sale of the units/shares and the weighted average cost of the units or shares.

Under article 67 of Decree 917/86, the proceeds from the sale or refund of units/shares of collective investment undertakings qualify as “other income” (redditi diversi), including where the securities were subscribed at issuance or not purchased from third parties in a sale for consideration. The income is equal to the difference between the amount collected upon sale or redemption of the units/shares and their cost or acquisition value, net of all relevant expenses (e.g. commissions) and of any accrued but not collected “income from capital”.

The combination of the above rules implies that:

- when the sale/redemption proceeds exceed the weighted average cost of the units/shares that are being sold or redeemed, the “gain” always qualifies as “income from capital” and is liable to the withholding tax charge set out in article 26-quinquies of Decree 600/73 (see below); and

27. Art. 73(1)(c) Decree 917/86.
28. The rate was reduced from 27.5% to 24% by art. 1, para. 61, Law 208 of 28 Dec. 2015. The 24% rate applies from 2017, for tax periods following the one in progress at 31 Dec. 2016. Based on art. 1, para. 65 of the same Law 208, credit and financial institutions (excluding fund managers) are liable to a 3.5% surcharge, which leaves the corporate income tax rate, in aggregate, to 27.5%.
29. Art. 73(3) Decree 917/86.
30. Art. 73(5-quinquies) Decree 917/86.
31. Collective investment undertakings established in the form of fixed capital investment companies (SICAFs) are not exempted from IRAP. They are liable to IRAP, but the taxable base is limited to the difference between the subscription fees (commissioni di sottoscrizione) and the fees due to placement agents (commissioni passive dovute a soggetti collocatori).
32. Art. 73(5-quinquies) Decree 917/86.
33. Collective investment undertakings are exempted from local tax (IRAP) if they are subject to prudential supervision.
34. In particular, collective investment undertakings must comply with the plurality of investors and the independent management requirements, under the Finance Code definition. With specific reference to the “plurality of investors” requirement, the tax authorities have clarified in the above-mentioned documents that an undertaking with a sole investor may still satisfy the requirement where that investor represents itself a plurality of investors.
35. The previous wording of the rule made reference to both the corporate income tax rate, in aggregate, and the amount of redemption, liquidation or sale of the units/shares, as resulting “in any event” from the fund’s periodic financial statements as of, respectively, the date of redemption, liquidation or sale of units/shares and the date of subscription or purchase of the units/shares.
36. Art. 67(1)(c-ter) and 67(1-quater) Decree 917/86.
- when the weighted average cost of the units/shares that are being sold or redeemed exceeds the sale/redemption proceeds, the “loss” qualifies as “other income”.

Under article 26-quinquies of Decree 600/73, a 26% withholding tax is deducted from any proceeds that are distributed to the investors and, upon sale or redemption of the units/shares, from the (positive) difference\(^{[37]}\) between the sale/redemption proceeds paid to the investors and the average weighted subscription or purchase price of the units/shares that are being redeemed (collectively referred to as the distributions).\(^{[38]}\) As a general rule, the withholding tax must be deducted by the Italian asset management company (i.e. the società di gestione del risparmio) or by the Italian credit alternative investment fund itself (if established in the form of a SICAF). However:

- where the units/shares of the Italian credit alternative investment fund are traded, the withholding tax is levied by the Italian resident entity\(^{[39]}\) that has been entrusted with their trading by the investor. That entity does not necessarily correspond to the management company, as this depends on whether the latter has received an assignment to trade the units or shares from the investor;

- with regard to units/shares held in a central securities depository that is managed by a duly authorized depository company, the withholding tax is deducted by the financial intermediaries with which the units/shares are deposited and which participate, whether directly or indirectly, in the central securities depository or by the non-Italian resident financial intermediaries that participate in the central securities depository or in other central securities depositories that participate in the depository where the units/shares are held;\(^{[40]}\) and

- with regard to Italian credit alternative investment funds that are established and managed by a foreign management company under the freedom to provide services, this entity is required to take care of all withholding tax formalities and obligations, either directly or by appointing an Italian fiscal representative.\(^{[41]}\)

The withholding tax is levied as a provisional tax when the investors are companies or commercial entities tax resident in Italy (e.g. Italian banks, insurance companies and financial intermediaries). These investors must include the distributions in their IRES annual return and, possibly (depending on their status) in their IRAP annual return as well, being entitled to credit the withholding tax against their IRES liability. On the other hand, the withholding tax is levied as a final tax in respect of all other Italian taxpayers (including non-commercial entities and entities that are exempted from IRES). No withholding tax is deducted from distributions paid to Italian collective investment undertakings or pension funds.

Distributions made to all categories of foreign investors are generally liable to withholding tax, at the domestic 26% rate or at a reduced rate under an applicable income tax treaty.\(^{[42]}\) By way of exception, no withholding tax will be deducted from distributions paid to the non-resident investors listed in article 6 of Legislative Decree 239 of 1 April 1996 (Decree 239)\(^{[44]}\) and accrued during the period in which such investors owned the units/shares. The ownership period is confirmed by the deposit of the securities with Italian resident intermediaries.

Article 6 of Decree 239/96 governs the exemption that is available to certain non-Italian investors in respect of interest accruing on bonds and similar securities issued by the Italian Treasury and by certain other qualifying issuers (the Decree 239 exemption). The following are exempted investors under article 6 of Decree 239/96, which also benefit from the exemption under article 26-quinquies(5) of Decree 600/73:

- non-Italian resident persons that are the beneficial owners of the proceeds collected and are resident for income tax purposes in a white-listed state;\(^{[45]}\) [46]

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\(^{[37]}\) This positive difference qualifies as “income from capital” under art. 44 Decree 917/86.

\(^{[38]}\) Investors must document the average weighted subscription or purchase price of the units/shares that are being redeemed. For this purpose, they must provide the withholding tax agent with appropriate documentary evidence or, in the absence of supporting documents, with a written statement that certifies the amount.

\(^{[39]}\) Among those identified in art. 23 Decree 600/73.

\(^{[40]}\) These non-Italian resident financial intermediaries must appoint an Italian fiscal representative for the purpose of complying with their withholding tax obligations. The fiscal representative must remit the withholding tax to the Italian Treasury and provide the Italian tax authorities, within 15 days of their request, with any information or documents that can provide evidence that the withholding tax obligations have been duly fulfilled.

\(^{[41]}\) See art. 26-quinquies(6-bis) Decree 600/73. The tax representative is to be identified among those listed as “withholding tax agents” in art. 23 Decree 600/73. The Italian tax representative is jointly liable with the foreign investment management company in respect of the obligation to both determine and pay the withholding taxes and will have to file the relevant tax returns.

\(^{[42]}\) In this regard, the tax authorities clarified in Circular 2/E/2012 that reference is to be made to the interest provisions of tax treaties. Generally, tax treaties executed by Italy limit to 10% the withholding tax applicable in respect to Italian-source interest income (even though some treaties provide for a lower rate). In addition, several treaties exempt from tax in the source country interest paid to the government of the other contracting state or local authority thereof. In some cases such exemption is also extended to any agency or instrumentality (including a financial institution) wholly owned by that other contracting state or local authority thereof.

\(^{[43]}\) Foreign investors that seek the application of a reduced income tax treaty rate must deliver to the withholding tax agent the following documents: (i) a written statement from the actual beneficiary of the distributions, containing all its identification and confirming that all the conditions for the income tax treaty rate to apply are satisfied and (ii) a statement from the competent tax authorities, confirming that the beneficiary is resident in the foreign state for purposes of the income tax treaty signed with Italy.

\(^{[44]}\) See art. 26-quinquies(5) Decree 600/73.

\(^{[45]}\) White-listed states are those jurisdictions that allow an adequate exchange of information with Italy for tax purposes, as listed in Decree of 4 Sept. 1996. The list was significantly broadened by Ministerial Decree of 9 Aug. 2016 (published in the Official Gazette of 22 Aug. 2016) which added 50 additional jurisdictions (including Bermuda, the Cayman Islands, Hong Kong, Liechtenstein, Saudi Arabia and Switzerland) and grants the Italian authorities the right to remove from the list those countries that repeatedly do not comply with their exchange of information obligations. The updated white list should have entered into force from the 15th day following the date on which Decree was published in the Official Gazette (i.e. 6 Sept. 2016). However, according to a different interpretation, the Decree entered into force on the same day of its publication in the Official Gazette (i.e. on 22 Aug. 2016); this view seems to be supported by the fact that on the website of the Italian tax authorities, the Decree of 9 Aug. 2016 is stated to be effective as from 22 Aug. 2016. Further clarifications from the tax authorities are therefore expected in this regard.

\(^{[46]}\) Tax residence will be determined, in first instance, on the basis of the domestic rules that apply in the relevant foreign state. However, income tax treaty provisions should be taken into account in the event of dual-resident persons. In this regard, see Circular 23/E of 1 Mar. 2002 and Circular 20/E of 27 Mar. 2003.
- “institutional investors” that are established in a white-listed state, even if not subject to taxation therein;
- organizations established in accordance with international agreements ratified in Italy;[47] and
- central banks or organizations that manage the official reserves of foreign states.

The notion of “institutional investors” is not defined in Decree 239/96. The Italian tax authorities have provided some guidance, as follows.

First, the definition of institutional investor is contained in paragraph 4 of the instructions to the self-declaration form that must be filed for purposes of the Decree 239 exemption, as confirmed by Circular 23/E of 1 March 2002 (Circular 23/E) and by Circular 20/E of 27 March 2003 (Circular 20/E):

> for the purposes of the above mentioned exemption, the term ‘institutional investors’ refers to those entities which, regardless of their legal or tax status in their country of residence, have as their principal activity that of managing investments on their own account or on behalf of third parties, such as insurance companies, investment companies, investment funds, SICAV (open-end investment companies) and pension funds.[48]

Second, Circular 23/E points out that article 6 of Decree 239/96 includes amongst the institutional investors both taxable entities and entities that are not taxable in their state of formation. In this regard, the Circular 23/E clarifies that, for the sole purposes of article 6 of Decree 239/96, the fact that entities are not taxable in their home country may be due to different circumstances, such as exemptions granted under domestic law, or tax transparency regimes whereby taxes are charged on the participants or exclusions from taxation.

Third, the Italian tax authorities clarified in Circular 23/E and Circular 20/E that classification as institutional investors applies to both entities that are subject to regulatory supervision (vigilanza) in their country of formation (regulated institutional investors) and entities that are not subject to any regulatory supervision (vigilanza) in their country of establishment (unregulated institutional investors). However, unregulated institutional investors must satisfy additional conditions, as they are required to possess specific skills and expertise in transactions on financial instruments and they may not have been created to manage investments made by a limited number of investors resident in either Italy or a privileged tax jurisdiction with the aim of unduly benefiting from the exemption (otherwise not allowed).

Neither Decree 239/96 nor article 26-quinquies(5) of Decree 600/73 clarify what is meant by “supervision”. Based on the guidelines concerning the withholding tax regime applicable to foreign investors in Italian real estate funds and SICAFs,[49] one could argue that the supervision requirement is deemed to be satisfied when either the entity itself or the management company is subject to supervision by the competent foreign regulator, such that the commencement of the activity is subject to prior authorization and the entity’s activities are subject to ongoing mandatory controls, on the basis of the laws in force in the foreign home state.

4.2. EU credit alternative investment funds

4.2.1. Italian income tax regime applicable to EU credit alternative investment funds

An EU credit alternative investment fund, being established in a foreign jurisdiction, is not deemed to be resident in Italy and, therefore, may be taxable therein only in respect of Italian-source income. Such a fund providing loans to Italian borrowers derives interest proceeds that qualify as Italian-source income[50] and are generally subject to a 26% withholding tax.[51] The 26% withholding tax rate may be reduced (generally, to 10%) under an applicable income tax treaty, provided that all the requirements under the treaty are satisfied.

New rules enacted in 2014, and subsequently amended in 2015 and 2016, provide an exemption that is available in certain specific circumstances (the withholding tax exemption). This exemption is governed by article 26(5-bis) of Decree 600/73 and applies to interest derived in an EU Member State, (ii) insurance companies established and authorized under the laws of an EU Member State and

4.2.2. Withholding tax exemption under article 26(5-bis) of Decree 600/73

Under the original wording of article 26(5-bis) of Decree 600/73, as enacted by Decree 91/2014, the withholding tax exemption was available in respect of interest and other proceeds derived from medium- to long-term loans granted to enterprises by (i) credit institutions established in an EU Member State, (ii) insurance companies established and authorized under the laws of an EU Member State and

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47. Such as the European Bank for Reconstruction and Development, the European Investment Bank (EIB), and the International Bank for Reconstruction and Development.
48. Author’s translation.
50. Art. 23(1)(b) Decree 917/86.
51. Art. 26(5) Decree 600/73.
As a consequence, the withholding tax exemption should be available only to regulated institutional investors, which should include EU credit alternative investment funds. In this respect, the Italian tax authorities considered the scope of application of the withholding tax exemption in a private ruling of 2016 (the private ruling), dealing with a French 
\textit{fond commun de titrisation} (FCT) that had purchased a medium- to long-term loan receivable from a French bank. The loan was originally granted by the Italian permanent establishment of the French bank. In the private ruling, the Italian tax authorities confirmed the availability of the withholding tax exemption in respect of the interest payments collected by the French FCT, given that its management company is subject to supervision in France by the competent regulator (\textit{Autorité des Marchés Financiers}).

Decree 18 of 14 February 2016 slightly amended the wording of article 26(5-bis), stating that the withholding tax exemption applies without prejudice to the rules in the Banking Code concerning lending to the public as a restricted activity. This means that the withholding tax exemption applies only where the underlying loan is granted by foreign entities that are allowed to lend into Italy based on the applicable rules. This issue was specifically addressed in the public ruling mentioned above. Indeed, the tax authorities acknowledged that the loan was originally granted by the Italian permanent establishment of the French bank, which is an entity allowed to lend based on the Banking Code, and accordingly the interest paid to the French FCT could benefit from the withholding tax exemption.

Article 26(5-bis) of Decree 600/73 does not include any definition of “medium- to long-term loans”. Neither Ruling 84/E nor the private ruling provide any guidance in this regard. However, Decree 91/2014 enacted both the withholding tax exemption and the extension of the scope of application of the substitute tax regime set out by article 15 of Decree 601 of 29 September 1973 (Decree 601/73).[53] Both provisions apply to “medium- to long-term loans”. Article 15 of Decree 601/73, however, specifically states that these are loans with a contractual maturity in excess of 18 months. As a consequence, it would be reasonable to argue that the same minimum contractual maturity should be required for purposes of the withholding tax exemption. However, it is not a requirement that the loan actually be subject to the substitute tax under article 15 of Decree 601/73.[55]

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53. See sec. 4.3.

54. See sec. 4.3.3.

55. By way of example, a loan with a contractual maturity in excess of 18 months would not be liable to the substitute tax under art. 15 Decree 601/73 if executed outside of Italy or if the election for the substitute tax is not made in the loan agreement. That same loan, however, would be eligible for the withholding tax exemption (provided, of course, that it is granted by one of the qualifying lenders in art. 26(5-bis) Decree 600/73).
On the borrowing side, article 26(5-bis) of Decree 600/73 limits the withholding tax exemption to loans granted to Italian enterprises and, accordingly, it is debatable whether the same benefit may also be applicable when the borrowers are Italian real estate funds, investment funds, pension funds or other entities that do not carry on business activities.

As a final remark, the withholding tax exemption applies in respect of both loans originated by any of the qualifying lenders and, as clarified in the private ruling, loan receivables purchased by a qualifying lender on the secondary market.

### 4.3. Substitute tax regime on medium- to long-term loans

#### 4.3.1. Background

Facility agreements executed in Italy by certain qualifying lenders with a maturity in excess of 18 months are eligible for the optional 0.25% substitute tax regime under article 15 of Decree 601/73. If this regime is opted for, the facility itself and the related security package are exempted from the registration, stamp, mortgage and cadastral taxes otherwise due.

Article 15 of Decree 601/73 applies to:

- medium- to long-term financing transactions and all acts, contracts, deeds and formalities relating to such transactions, their execution, amendment and termination, any guarantees of whatsoever nature granted by anyone at any time in respect thereof, as well as any subrogation, substitution, postponement, division and cancellation, also partial, including any assignment of receivables executed in relation to such financing transactions and any subsequent disposal of the relevant agreements or receivables and the transfers of the guarantees relating thereto;[58]

The substitute tax regime under article 15 of Decree 601/73 applies to medium- to long-term facilities satisfying the following conditions:

- the facility has a contractual maturity in excess of 18 months (i.e. equal to at least 18 months plus one day);[57]
- the facility is granted by certain qualifying lenders (the article 15 qualifying lenders);[58]
- the facility agreement is properly executed in Italy;
- the facility implies a cash financing (**finanziamento**) with new liquidity being provided to the borrower, as opposed to facilities that do not include a cash advance (e.g. letters of credit, bonds or bank guarantees); and
- a specific election for the substitute tax regime is made in the facility agreement.[59]

If the substitute tax regime applies, under article 15(1) of Decree 601/73, any document related to the facility and all the procedures, deeds, agreements and formalities connected with the execution, amendment or redemption of the relevant agreements, as well as the security documents relating thereto will be exempt from registration tax, stamp duty tax, mortgage tax, cadastral tax and any other government concession tax otherwise applicable.[60] In particular, the execution of the security package will be exempt from the above taxes, provided that the secured obligations under the security package are those arising from the relevant facility only (and chargeable to the substitute tax). The application of this regime is crucial when the security package granted in connection with the financing is one that would trigger a material cost in terms of Italian registration tax and mortgage tax (e.g. mortgage loans). In such circumstances, the 0.25% substitute tax is levied in lieu of the afore-mentioned taxes, and significantly reduces the tax cost that would have been otherwise triggered by the security package.

The substitute tax regime was originally available in respect of loans granted by banks only and was automatically applied on agreements falling within the scope of application of the provision (i.e. the parties were not allowed to decide whether or not to apply the regime). The provisions were amended in 2013 and 2014 in order to clarify and broaden the scope of application of the optional 0.25% substitute tax regime on medium- to long-term loans from both an objective and subjective standpoint.

#### 4.3.2. Article 15 qualifying lenders

The substitute tax regime under article 15 of Decree 601/73 was originally available only to medium- to long-term facilities granted by Italian banks, EU banks or non-EU banks acting through a permanent establishment located in Italy. Under Decree 91/2014, the optional 0.25% substitute tax regime has been extended also to new categories of lenders such as Italian securitization vehicles operating under Law 130 of 30 April 1999, insurance companies incorporated and authorized under provisions enacted by EU Member States and collective investment undertakings formed in the European Union or in white-listed EEA countries.[61]
4.3.3. The minimum contractual maturity

As mentioned, the substitute tax regime applies, provided that, amongst other conditions, the loan facility has a contractual maturity in excess of 18 months. Under the guidelines of the Italian tax authorities and the judgments of the Italian Supreme Court, this requirement is not fulfilled – and, thus, the substitute tax regime is not available – when the lender has a full discretionary right to call in the facility before the expiration of the minimum required maturity.

On the other hand, the application of the article 15 regime is not prevented in the case of contractual provisions that entitle the lender to early terminate the facility or request a prepayment on the basis of circumstances that are either contemplated by the applicable law (e.g. under article 1186 of the Italian Civil Code, whereby “even though the term is set in favour of the borrower, the lender may immediately claim the money back if the borrower is in default or has wilfully decreased the guarantees provided or has not delivered the guarantees it had undertaken to provide”) or specifically identified in the agreement and connected to the lender’s ability to preserve its credit.

In this regard, the Supreme Court, in Decision 2188 of 6 February 2015, stated that financing agreements allowing the lender an early termination of the loan for valid reasons (giustificati motivi) would not satisfy the minimum duration requirement and, thus, would not be eligible for the substitute tax regime. The decision is very synthetic and does not describe in detail the “valid reasons” considered in the relevant financing agreement. In particular, it does not appear evident from the decision whether the agreement clearly specified the cases and circumstances in which the lender was allowed to request an early termination or repayment, or rather it simply made reference to generic valid reasons, with no further specifications.

4.3.4. Election for the substitute tax regime

Prior to changes enacted in December 2013, the substitute tax regime automatically applied when the conditions stated in article 15 of Decree 601/73 were fulfilled (i.e. when a medium- to long-term facility was executed in Italy by an article 15 qualifying lender), whether or not the facility had a security package and irrespective of whether the substitute tax cost was higher than the taxes otherwise due on the facility and its security package.

Decree Law 145 of 23 December 2013 rendered the substitute tax regime optional, amending article 17(1) of Decree 601/73, which now provides as follows:

The entity carrying out the transactions referred to in articles 15 and 16, following a specific option, may pay a substitute tax, in lieu of registration tax, stamp tax, mortgage tax, cadastral taxes and taxes on government concession. The option shall be exercised in writing in the credit facility agreement.[63]

As a consequence, the substitute tax regime under article 15 of Decree 601/73 now applies only if a specific election is made in writing in the facility agreement, thus leaving the parties full discretion as to whether they wish to take advantage of the regime.

4.3.5. Syndication of the loans

Prior to the changes enacted by Decree 91/2014, article 15 of Decree 601/73 read as follows:

all the deeds, agreements and formalities related to execution, amendment and redemption of a medium-long-term financing, to security interests of whatsoever nature granted by anyone at any time and relevant amendments, subordination, division and cancellation of the securities, including the assignment of credits executed in relation to said medium-long-term loans […] are exempt from registration tax, stamp duty, mortgage tax, cadastral tax and government concession taxes.

It was debated whether the substitute tax would also replace the mortgage tax ordinarily due upon annotation of a mortgage in the case of a syndication. Indeed, according to the tax authorities[64] and the Supreme Court,[65] the transfer of the loan receivable and the execution of the formalities for the annotation of the underlying mortgage in the hands of the transferor(s) were not covered under the umbrella of the substitute tax regime; accordingly a mortgage tax at the rate of 2% was chargeable, under article 9 of the Tariff attached to Legislative Decree 347 of 31 October 1990 (Decree 347/90), as this broadly refers to “transfers of mortgage secured credits”. On the other hand, the substitute tax would apply on the amount secured by the mortgage under art. 3(1) of Decree 347/90.

62. Author’s translation.
63. Author’s translation.
64. In Ruling 310932 of 4 Apr. 1989 (Ruling 310932) the tax authorities considered the tax regime applicable to an assignment without recourse (cessione pro soluto) of receivables arising from medium-to-long-term loans, to be executed between a savings bank and another bank. The tax authorities argued that the assignment would not fall within the scope of application of art. 15(1) of Decree 801/73, being “a subsequent and autonomous event of the debt-credit relationship derived from the loan transaction already executed” (una successiva ed autonoma vicenda del rapporto di debito e credito nato dall’operazione conclusa). According to the tax authorities, art. 15(1) of Decree 601/73 referred only to the assignments of receivables relating to a loan still to be drawn down, whilst it was not applicable to an assignment of receivables arising from a loan already drawn down. In this latter scenario, in the tax authorities’ view there would be no connection (inerenza) between the assignment of the receivables and the original loan agreement. In particular, an assignment of receivables would be “covered” by the substitute tax when it represents the way in which the financing is granted (i.e. when the funding is provided by way of a purchase of receivables from the financed party). This ruling is in line with the previous Ruling 310273 of 18 Apr. 1988, relating to an assignment without recourse of receivables arising from a medium- to long-term loan and to the associated annotation of the mortgage in accordance with art. 2843 of the Italian Civil Code. In Ruling 3173 of 2 Nov. 2006 the tax authorities indirectly confirmed the principles established in the above mentioned previous rulings, stating that the execution of the formalities for annotation of mortgages under art. 2843 of the Italian Civil Code in connection with an assignment of credits would trigger a mortgage tax charge.
65. In Decision 22743 of 9 Sept. 2008, the Italian Supreme Court re-affirmed the principles established in previous decisions (see e.g. Decision 24164 of 2004), stating that the formalities for the annotation of mortgages in connection with the subrogation of a new lender into the rights of a previous lender under a mortgage loan would be subject to the 2% mortgage tax and could not be exempted by application of the substitute tax originally paid on the underlying facilities.
66. The 2% mortgage tax would apply on the amount secured by the mortgage under art. 3(1) of Decree 347/90.
based on the wording of article 15, which also made reference to the “assignment of credits” pertaining to the original financing, the Italian Banking Association (Associazione Bancaria Italiana, ABI) and the Italian National Council of Notaries (Consiglio Nazionale del Notariato) maintained – differently from the position adopted by the tax authorities and the Supreme Court – that the transfer of the loan receivable and the execution of the formalities for the annotation of the underlying mortgage were indeed covered under the umbrella of the substitute tax regime so that no additional taxes were due in respect of the execution of such formalities.

Decree 91/2014 amended article 15 to clarify that any assignments of receivables arising from facility agreements falling under the substitute tax regime, as well as any assignment of agreements (including the facility agreement itself) and of the related security interests will continue to benefit from the application of the substitute tax regime. This legislative change implies that the restrictive interpretation of the tax authorities and the Supreme Court on the old wording of the provision is no longer of relevance and syndications of medium- to long-term loans falling under the scope of application of the substitute tax should now no longer trigger any additional transfer tax charges.

67. ABI analysed the issue at hand in its opinion (Parere ABI) no. 438 of Dec. 1998, arguing that the interpretation adopted by the tax authorities in Ruling 310932 had to be revisited, also in light of the Supreme Court decision 2460 of the 15 Mar. 1994. In that decision the Supreme Court, held that the benefits set out by art. 15 and following of Decree 601/73 “are clearly aimed at encouraging the recourse to the banking credit. This objective, which is reached through the granting of the loan, is not vanished by any further transfer of the credit arising from the loan and of the related mortgage, taking into account that the benefits available to the borrower would not be affected, irrespective of the status of the person that is entitled to obtain the repayment of capital and interest. In addition, and to support the previous remarks, it is worth mentioning that art. 15 Decree 601 expressly relates to the assignment of credits and in such a way denies that any subsequent transfer to third parties of the duties of the lender may imply the loss of the substitute tax benefit” (author’s translation). According to the ABI, the rationale behind the substitute tax regime is to encourage the recourse to bank credit granting a favourable treatment to the borrower; against that background, ABI argued that the sentence “including the assignment of receivables executed in relation to said medium- to long-term loans” in art. 15(1) Decree 601/73 could not be interpreted in the sense supported by the tax authorities in the rulings mentioned above, whereby only an assignment of receivables in connection with a loan still to be drawn down may be covered under the umbrella of the substitute tax regime.

68. The National Council of Notaries reached the same conclusion as the ABI in Study 104/2000/T, according to which an assignment of receivables arising from medium- to long-term loan facilities governed by art. 15 Decree 601/73 would itself be covered by the “umbrella” of the substitute tax regime, being the assignment an event connected to the original loan.