The Italian government extensively amended the laws governing corporate bonds through *Growth Decrees*¹ and *Destinazione Italia Decree*,² with the aim of rendering the corporate bond market an effective source of financing, alternative to traditional bank funding, for non-listed companies, and removing certain unfavorable features of civil and tax law rules, which made the issuance of bonds by non-listed companies impractical.

### 1. Issuance of Bonds by Non-Listed Companies

As of 2012, Italian corporate bonds have only been issued by large companies. After the legal provisions described above, which apply to non-listed companies other than banks and micro-sized enterprises,³ entered into force small and medium companies falling within one of the following definitions also are allowed to issue bonds, notes and commercial papers:
(i) **Small-Sized Companies**, employing more than 10 and less than 50 employees and having an annual turnover and/or a total annual balance sheet higher than €2 million and not exceeding €10 million;

(ii) **Medium-Sized Companies**, employing less than 250 employees and having an annual turnover not exceeding €50 million and/or a total annual balance sheet not exceeding €43 million; and

(iii) **Non-Listed Companies other than those referred to under (i) and (ii) above**: including large commercial and industrial non-listed companies, other than small and medium-sized enterprises, based on the aforesaid quantitative criteria.

### 2. Main News Introduced by the Growth Decrees

Under the 2012 Growth Decrees, Italian joint stock companies can turn to the bond market. The amount of bonds such a company can issue is unlimited if the bonds are convertible into common equity of the issuer or, alternatively, if not convertible, are intended to be listed on either a regulated market or a multilateral trading facilities (MTFs) within the EU.

Non-listed companies are now allowed to issue bonds with a profit-sharing clause (including in the form of subordinated participating bonds), provided that payments to the holders of the issued bonds can benefit from the same tax treatment applicable to bonds issued by banks and listed companies, to the extent that such bonds are listed on a regulated market or a MTF of an EU member State or of States part to the Agreement on the European Economic Area and included in the “white list,” provided for under Article 168-bis of the Italian Income Tax Code (respectively, **Qualified Regulated Market** and **Qualified MTF**).

In addition, the Growth Decrees have removed certain limitations on the deductibility of interest payments with respect to bonds issued by non-listed companies. This benefit applies in so far as the bonds are either listed on a Qualified Regulated Market or a Qualified MTF or where not so listed, are held by qualified investors.\(^4\)

### 3. Exceptions to the Limits on the Issuance of Bonds

Firstly, the Growth Decree derogated and widened the limits for the issuance of bonds by joint-stock companies set forth under Article 2412 of the Italian Civil Code.\(^5\) Such limits do not apply to non-listed companies when the non-convertible bonds are intended to be listed on either a EU regulated market or a EU MTF, or convertible bonds entitle the holder to purchase or subscribe for the issuer’s common equity. As a consequence, in order to exceed the limits on bond issuances, it is sufficient that the bonds are listed on either an EU regulated market or an EU MTF.

In order to issue corporate bonds, the Italian joint stock companies must satisfy the following conditions. Notes and commercial paper can only be issued up to an aggregate value equal to twice the issuer’s share capital together with its legal or available reserves, as indicated in its most recent financial statements; the issuer’s
most recent financial statements must be approved internally and audited by external auditors; and, in respect of offerings relating to commercial paper only, a sponsor is required.

The above quantitative limits may be exceeded if either of the following requirements is satisfied:

(i) The part of the offering that exceeds the limits is only distributed among qualified investors, provided that if the debt instruments are subsequently passed onto a non-qualified investor, the qualified investor will have to reimburse the principal amount as well as any interest due under the bond when the original issuer defaults;

(ii) Notes are secured by a first ranking mortgage over the issuer’s real estate assets for an amount equal to 66 percent of the value of the assets;

(iii) The corporate bonds are listed on regulated markets or any other multilateral trading facility; or

(iv) The corporate bonds are structured so to allow the investors to convert them into equity.

Offerings of notes and commercial paper issued by Italian limited liability companies are subject to the same restrictions set out above for Italian joint stock companies. However these companies can only distribute their debt instruments among qualified investors.

4. Participating Bonds

As described above, the Growth Decree allows non-listed companies to issue bonds and similar securities, such as notes and commercial paper, with a profit sharing clause. Participating bonds bear a floating remuneration related to the issuer’s financial results, entitling their holders to directly share a portion of the issuer’s net profits. Participating bonds also may include subordination clauses, subordinated participating bonds, and benefit from the same tax treatment described with reference to ordinary bonds issued by non-listed companies. The subordination clause specifies that the issuer’s creditors are to be paid in preference to the note holders (with the note holders to be paid only ahead of the shareholders).

The main characteristics of participating bonds are as follows. Their initial maturity shall be equal to, or longer than, three years (36 months) and any profit to be paid on the notes is composed of a fixed as well as a floating part.

Particularly, the floating remuneration representing a portion of the issuer’s net profits must be paid to bondholders on an annual basis, within 30 days from approval of the issuer’s annual financial statements. Such floating remuneration shall be proportional to the ratio between (X), the aggregate nominal value of issued and outstanding participating bonds and (Y) the amount of the shareholders’ equity (share capital, legal reserve, and available reserves) as resulting from the last financial statements approved by the issuer, plus the aggregate nominal value of issued and outstanding participating bonds. The method of calculating the floating
remuneration must be set out upon issuance of the participating bonds and may not be changed until maturity, must depend on objective criteria and cannot derive, even partially, from corporate resolutions adopted at the end of each relevant financial year.

Even if the issuer does have profits, at maturity the bondholder has the right to the full reimbursement of the principal outstanding amount of the participating bonds.

Regardless of the issuer’s financial results, bondholders are in any case entitled to receive - on top of the floating remuneration - fixed interest not lower than the official reference interest rate applicable at the time of the payment.

To further foster the distribution of such bonds, the floating remuneration will not be subject to the limits arising from the anti-usury provisions set forth in Law No. 108/1996.

5. Tax Incentives

One of the main objectives pursued by the recent Decrees described above includes the introduction of tax incentives, (both for the bond holders and for the issuers) removing the hurdles that have prevented non-listed companies from issuing bonds and similar securities.

5.1 Deductibility of Interest Payable by Non-Listed Issuing Company Before and After the Growth Decree

Firstly, issuers without stock-market listings are allowed to deduct the cost of servicing the bond debt from their tax bill, provided that the notes are traded on regulated markets or other multilateral trading facilities in Italy or in another white-list country.

The deduction of passive interest paid in connection with bonds issued by companies (other than banks), whose shares were not traded on a Qualified Regulated Market was subject to certain limitations provided by Law No. 549/1995.

Passive interests were deductible by the issuer, for corporate income tax purposes, provided that, at the issue date, the effective yearly return of the debt instruments was not higher than:

(i) twice the official reference interest rate established by the European Central Bank for bonds and similar securities traded on a Qualified Regulated Market, or offered to the public; or
(ii) the official reference interest rate increased by two thirds, for debentures different from those under (i).

Therefore, whenever the effective yearly return exceeded the thresholds under (i) or (ii) above, the portion of passive interest exceeding such thresholds could not be deducted by the issuer for corporate income tax purposes. In light of the current levels of the official reference interest rate, the possibility for such companies to deduct passive interest accrued on the corporate bonds issued by them was significantly impaired.
Article 32 of the Growth Decree abolished such limitations concerning the deduction of passive interest in the hands of corporate issuers, provided that the mini-bonds, to which such interest relates:

(a) have been issued after the entry into force of the Growth Decree bis (i.e., 20 October 2012);

(b) are traded on a Qualified Regulated Market or a Qualified MTF; or

(c) in case the requirement under (b) above is not met, are subscribed by and circulate only among qualified investors, as defined by Article 100 of TUF, not holding, either directly or indirectly, even through intermediaries, more than 2 percent of the share capital or equity of the issuer and provided that the beneficiary is resident either in Italy or in a State allowing the exchange of information with the Republic of Italy.

Provided that all the above requirements are met, the interest deduction regime for the issuer falls within the general provisions of Article 96 Italian Income Tax Code, pursuant to which passive interests are deductible within the amounts of active interest accrued and, with reference to the portion exceeding such threshold, up to 30 percent of EBITDA.

5.2 Tax Treatment of Interest in the Hands of Investors

Secondly, the Growth Decree also introduced a provision aimed at making the purchase of mini-bonds more appealing to foreign investors, due to an exemption from taxation in Italy, similar to exemptions that apply to securities issued by banks and listed companies. Any cost relating to the offering can be deducted from the issuer’s tax bill in the tax period in which they have been incurred, thus effectively representing a substantial tax credit for issuers.

Particularly, Article 32 extended the substitutive tax regime applicable to bonds issued by banks or companies whose shares are traded on a Qualified Regulated Market to the following securities:

(i) corporate bonds issued by companies whose shares are traded on a Qualified MTF; and
(ii) mini-bonds issued by non-listed companies (other than banks), provided that the mini-bonds themselves are listed in a Qualified Regulated Market or a Qualified MTF.

Based on the foregoing:

(a) interest paid on the aforementioned securities to Italian institutional investors (including banks and insurance companies) does not trigger any withholding tax or substitutive tax and is subject to ordinary income taxation in the hands of the recipient;

(b) non-Italian investors established in “white list countries” may benefit from a full exemption from Italian taxation on interest paid to them, subject to compliance with certain requirements and fulfilments;
(c) in all other cases, interest remains subject to a substitutive tax at a 20 percent rate.

5.3 Deductibility of the Issuance Charges

All costs related to the issue of mini-bonds are deductible by the issuer, for corporate income tax purposes, in the tax return of the fiscal year during which they have been incurred, irrespective of their computation criterion for accounting purposes. Taxes that could potentially apply to a bond offering in Italy and the related security included: registration tax, stamp duty, mortgage tax or taxes relating to the granting of other forms of securities.

5.4 Lower Substitute Tax

The Destinazione Italia Decree introduced a new rule whereby issuers may opt for the application of the more favorable regime of the 0.25 percent substitute tax, which will replace any other applicable tax. The 0.25 percent substitute tax shall apply to the aggregate principal amount of the debt offering and extend to the granting of any security, even when they are given by third parties, in connection with the debt offering and on the occurrence of any subsequent change such as the transfer of the bonds or their cancellation.

Issuers must elect the application of the 0.25 percent substitute tax in the corporate resolution authorizing the debt offering. The taxpayer liable for the payment of the substitute tax is the financial intermediary that has arranged the debt offering or the issuer when no financial intermediary participates in the transaction.

5.5 Withholding Tax Exemption

Pursuant to the Growth Decree no withholding tax (currently at 20 percent) shall be paid by professional investors, whether established in Italy or not, on interest and other floating profits paid on notes and commercial paper issued by small and medium sized companies, provided that they are traded on regulated markets or other multilateral trading facilities in Italy or in another white list country.

Thanks to the Destinazione Italia Decree, the withholding tax exemption for corporate bonds now also applies to investment funds whose investors are exclusively “qualified investors” under Italian law and whose assets are for the most part invested in corporate bonds. Therefore, no withholding tax shall apply to the payment of interest and other profits made by issuers of corporate bonds, including small and medium sized companies without stock-market listings, for the benefit of such investment funds.

6. Additional Incentives for Italian Corporate Bonds

Offerings of corporate bonds with a maturity longer than 18 months and that are only distributed among qualified investors can now be secured by the super-priority ranking (so-called privilegio speciale). Such super-priority ranking previously could only be granted by borrowers to secure their bank loans. Now it applies to assets that the chargor is free to deal with and often comprise a shifting pool which,
provided that the registration requirements below are complied with, may be turned over on a regular basis in the ordinary course of the chargor’s business.\textsuperscript{7}

The deed creating the \textit{privilegio speciale} will specify the assets that are covered and the general conditions of the bond offering that is secured. To be enforceable against third parties (e.g., creditors of the issuer other than the bond holders), the document must be notarized and registered with the competent office of the court in the district in which the relevant parties are based.

The \textit{Destinazione Italia Decree} introduced provisions allowing for the appointment of a bond holder representative in the aforesaid deed in order to avoid an amendment to the bond holder details, which have to be registered, when the bonds are subsequently transferred onto other investors.

Finally, the \textit{Destinazione Italia Decree} clarified that corporate bonds and other debt instruments issued in the context of securitization transactions shall be eligible in terms of assets (i) that can be used by insurance companies as technical reserves and (ii) are in line with the investment limits set out for pension funds, even when they are not listed on any regulated market or any other multilateral trading facility and have not received an independent rating.

\section*{7. Conclusions}

The Italian bond market has become a real alternative to bank loans for small and medium companies, due in part to the Italian Stock Exchange, which in 2012 set up a platform, the ExtraMot Pro, allowing institutional and other qualified investors to trade bonds issued by such companies without stock market listings, and to the \textit{Destinazione Italia Decree}, which has completed the legal framework for Italian corporate bonds.

\textit{Luigi Santa Maria and Ada Villa contributed to this article.}

\textsuperscript{1} Law Decree No. 83/2012 (Growth Decree) and Law Decree No. 179/2012 (Growth Decree\textit{bis}), respectively converted into Law No. 134/2012 and Law No. 221/2012.

\textsuperscript{2} Law Decree No. 145/2013, converted into Law No. 9/2014.

\textsuperscript{3} Micro-sized enterprises have less than 10 employees and a total turnover of less than €2 million.

\textsuperscript{4} Pursuant to Article 100 of the Italian Unified Financial Code, qualified investors are not holding, either directly or indirectly, more than 2 percent of the issuer’s share capital or equity, and the beneficiary of the payments under the bonds is resident either in Italy or in a “white-list” country. Consob, the Italian supervisory authority, has identified three types of qualified investors: (i) banks, financial institutions, financial investment companies, insurance companies and other regulated entities; (ii) large companies with a balance sheet of at least €20M and a turnover of at least €40M; and (iii) other financial intermediaries such as SPVs formed in the context of securitization transactions.
Article 2412, paragraph 1, of the Italian Civil Code, lays down the maximum aggregate amount of allowed bonds issuances (i.e., twice the sum of the share capital, legal reserves and available reserves); and Article 2412, paragraph 2, of the Italian Civil Code, sets forth the possibility to exceed the above mentioned limit if the bonds are placed with professional investors subject to prudential supervision which remain liable for the issuer’s solvency in the case of subsequent re-sale to non-professional investors.

See Section 46 of the Italian Banking Act.

Generally, the super-priority covers the following asset classes: plants and machinery; raw materials, inventory, finished products and commodities; any of the above assets that are acquired with the proceeds of the corporate bonds; and receivables arising out of the sale of the above assets.

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