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BRIEFING

UPDATE ON THE NEW ITALIAN CARRIED INTEREST TAX REGIME

MAY 2017

- THE ITALIAN GOVERNMENT HAS ISSUED NEW TAX RULES FOR CARRIED INTEREST AND PROCEEDS DERIVING FROM SIMILAR ARRANGEMENTS

On 24 April 2017, the Italian Government introduced a new tax regime addressing carried interest and similar arrangements that involve shares, quotas units and other financial instruments. The new legislation makes Italy more attractive to fund management companies and top executives. These rules were effective from 24 April 2017, and must be converted into law within 60 days (potentially with amendments).

"THE DECREE OF 24 APRIL 2017 CLARIFIES THE TAX TREATMENT OF CARRIED INTEREST AND MAKES ITALY MORE ATTRACTIVE FOR FUND MANAGEMENT COMPANIES AND TOP EXECUTIVES."

Background

The Decree of 24 April 2017 no 50 (the "Decree") has laid down new rules in respect of the tax treatment of carried interest and proceeds deriving from similar arrangements. In particular, it clarifies that they are always to be considered as income from investment if certain conditions are met. The tax qualification of proceeds from these schemes has been a matter of debate in the past: namely, it was debated whether these types of income should qualify as income from employment (or similar personal services), which is generally taxed at marginal rates up to 43% (plus local surcharges), or income from investment that under certain circumstances may trigger a flat rate of 26%.

The new rules

The new rules address proceeds deriving from the direct or indirect participation in companies, entities or collective investment undertakings, resident or established in Italy and in other jurisdictions, that allow adequate exchange of information (the "Qualified Entity(ies)") that are represented by shares, quotas or other financial instruments granting economic rights.

According to the new rules, when these proceeds are received by employees and directors of the Qualified Entities, or other persons that directly or indirectly control, or are controlled by the Qualified Entities, or are managing the same (typically the management company of a fund) (the "Eligible Person") they qualify always as "income from capital" or "other income" (i.e. capital gain) provided that each of the following conditions are satisfied:

1. The effective disbursment by all Eligible Persons for their participation in a Qualified Entity represents an amount not lower than 1% of the net equity of the relevant Qualified Entity (or 1% of the total investment of the Qualified Entity if this is an investment undertaking).
2. The proceeds from the shares, quotas or financial instruments are due only once all other shareholders and/or participants have received an amount equal to the invested capital plus a minimum yield, which is set out by the articles or regulations. In case of change of control on the Qualified Entity, this latter condition is deemed to be satisfied if, on disposal, all other shareholders and/or participants have realised an amount not lower than the invested capital plus said minimum yield.
3. The shares, quotas or other financial instruments have been held by the above eligible individuals (or by their heirs) for at least five years or, if earlier, until the date of change of control on the relevant entity, or change of the management company of the collective investment undertaking.

Notably, the new rules do not affect the rule according to which, in case of assignment, subscription or purchase of financial instruments, the positive difference (if any) between the arm's length value of the financial instrument and the relevant subscription or purchase price represents a fringe benefit for the eligible individual, which qualifies as income from employment (or from professional services) and is taxed at marginal rates. In this respect, however, the new rules set out that the fringe benefit is considered as an effective disbursement for the purpose of the condition sub-point 1 above.

Welcome clarification

The new provisions are welcome as they clarify the tax treatment of carried interest and similar schemes with the above mentioned features. This opens new opportunities to formulate incentive schemes for managers and top executives resident in Italy and makes Italy more appealing from a tax perspective.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with one of the authors below or your regular contact at Watson Farley & Williams.

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