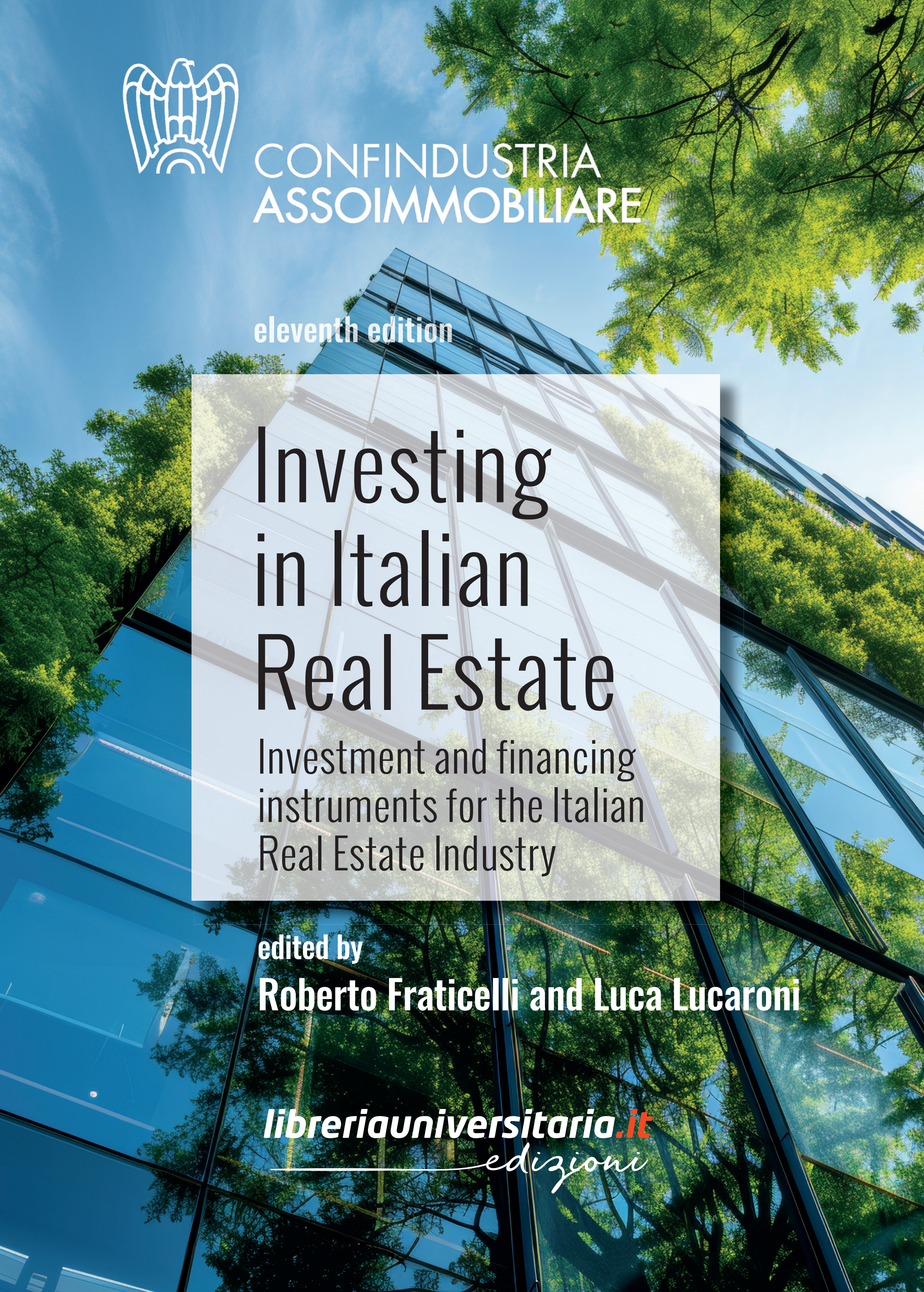

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eleventh edition

Investing in Italian Real Estate

Investment and financing instruments for the Italian Real Estate Industry

edited by
Roberto Fraticelli and Luca Lucaroni

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Eleventh Edition

Preface by Davide Albertini Petroni
Foreword by Roberto Fraticelli

Edited by Roberto Fraticelli and Luca Lucaroni

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Preface

by Davide Albertini Petroni
President of Confindustria Assoimmobiliare

The eleventh edition of the volume "Investing in Real Estate" is published with the objective of updating the overview of the characteristics of real estate investment vehicles and the tools available within the Italian regulatory framework. This volume has been made possible by the dedication of professionals and industry experts who contribute valuable insights into regulatory and market dynamics. I sincerely thank them for making this publication a valuable and widely recognized resource for professionals in the real estate sector.

2024 has marked a period of recovery for our sector, once again demonstrating its resilience in the face of recent challenges. In a context characterized by the impact of inflation, rising interest rates, and significant geopolitical uncertainties, the real estate industry has had to confront new challenges over the past four years, including the growth of e-commerce, the complex management of the pandemic, evolving demographic dynamics, and the digital transition. Despite these hurdles, the real estate market has shown signs of consolidation, thanks to the industry's ability to adapt to a changing environment.

Institutional investors have continued to focus on high-quality buildings, favoring asset classes that meet the evolving needs of society and the market. The real estate assets managed by professional investors in Italy have exceeded 150 billion euros, spanning traditional sectors such as offices and retail, alongside emerging segments such as logistics, hospitality, student housing, multifamily, and data centers. Despite this growth, these assets represent only 17% of the total value of the Italian real estate market (including public properties), compared to the European average of approximately 40%, highlighting the potential for further expansion in asset management.

Among the investment sectors gaining prominence, the residential market is undergoing a profound transformation. In recent years, housing demand has shifted significantly, driven by increased labor mobility, a growing number of out-of-town students, and changing attitudes towards home living among younger generations. These factors are fostering the expansion of the rental market and the development of residential solutions designed to meet new market needs.

In this context, Italy still lags behind other European markets in terms of residential sector investment, leading to a gap between housing demand and supply. In major European Union countries, the sector is supported by long-term capital—such as pension funds and insurance companies—that finance the development of new residential complexes built to high standards community services.

A stronger presence of institutional investors in the Italian residential market could help expand its geographical scope, fostering real estate initiatives in cities beyond Milan and Rome, which have traditionally been the main hubs of investment. Consider, for example, the student housing sector, where Italy offers promising opportunities in cities such as Florence, Bologna, Turin, and Padua, where leading developers have been active for years. These regional markets present significant potential for investors due to the shortage of student accommodations and the limited availability of modern facilities.

Similarly, the hospitality sector is experiencing significant momentum. Tourist demand is increasingly prioritizing quality over quantity, with growing attention to the level of experiences offered. In this phase of expansion, it is crucial to continue fostering the presence of major international brands—showing increasing interest in Italy—while supporting local operators who can preserve the traditions and authenticity of Italian hospitality.

Tourism services are evolving rapidly through digitalization, which provides new opportunities to enhance the efficiency and accessibility of facilities. In this context, investments in infrastructure, technology, and space redevelopment can help enhance Italy's historical heritage, improve the quality of hospitality, and make the tourism offering more competitive on a global scale.

Technological innovation is not only transforming existing asset classes but is also contributing to the emergence of new investment segments. One notable example is the data center sector, which is expected to see significant growth in the coming years, driven by the expansion of digitalization, the adoption of artificial intelligence in various processes, and the increasing demand for digital infrastructure. Italy is already emerging as a key destination for these investments, with development projections suggesting a threefold increase in volumes compared to the previous four-year period.

Digitalization is a primary driver of transformation in the real estate sector, with tangible effects on building quality and occupant well-being. There is a growing recognition that the real estate industry does not merely shape the "physical containers" where people live, work, study, and spend their leisure time, but also plays a crucial role in shaping the overall quality of life for individuals of all ages.

For this reason, urban regeneration remains a key element for the growth of the real estate sector. Many Italian cities are undergoing transformation, with an increasing demand for the redevelopment of existing spaces to meet new residential, workplace, and social needs, equipping neighborhoods with the personal services required by society. Regulatory simplification, legal certainty, and targeted incentives can accelerate these interventions, helping to reduce land consumption and improve the quality of the real estate offering.

The redevelopment of large disused areas or entire neighborhoods into new urban hubs requires a forward-looking approach supported by investments from "patient" capital, capable of generating a positive impact on the territory. Urban regeneration, in fact, is based on a particularly close collaboration between the public and private sectors, where both parties play an active role in governance processes and ensure a partnership focused on tangible results and aligned objectives.

This is even more relevant when regeneration and enhancement initiatives involve public real estate assets. This year, Confindustria Assoimmobiliare has initiated a collaboration with the Agenzia del Demanio (State Property Agency) to explore innovative public-private partnership models that, through the repurposing of state-owned properties and areas, can generate significant economic and social impacts on local communities. Italy's public real estate assets are vast and spread across all municipalities, yet they are often underutilized. Unlocking their potential can serve as a catalyst for profound territorial transformation, creating both social and economic value for communities.

To realize these transformations, it is essential to have a regulatory and fiscal framework capable of attracting capital and facilitating the entry of new players into the market. The ability to mobilize large-scale resources depends on the availability of efficient investment instruments and a regulatory environment that supports their application, ensuring stability and competitiveness for the entire sector.

One of the key developments introduced in 2024 concerns the asset segregation regime applicable to Alternative Investment Funds (FIA) and real estate SICAFs. Recently, the new issued Capital Law has introduced significant reform in this area, strengthening investor protection and providing greater legal certainty in the management of segregated assets. This legislative measure consolidates a fundamental principle, offering a clearer and more reliable framework for structuring investments.

In this context, the listed real estate sector deserves particular attention, as it can play a strategic role in attracting new capital and ensuring a more efficient allocation of private savings. The SIIQs (Listed Real Estate Investment Companies), introduced in 2006 to attract foreign Real Estate Investment Trusts (REITs), still show untapped potential due to a tax regime that is not fully aligned with international standards. Strengthening the SIIQ segment would not only enhance the attractiveness of the Italian market but would also allow for a more efficient mobilization of private savings, offering new regulated and transparent investment opportunities.

Alongside the potential growth of the listed market, another increasingly relevant investment tool is securitization. Real estate securitization is experiencing expansion and consolidation, establishing itself as an effective mechanism for attracting capital and optimizing investment management. Thanks to their structural flexibility, these instruments enable capital modulation based on investor needs and the nature of the underlying assets, making them suitable for a wide range of operators, from investment funds to asset managers, developers, and institutional investors.

Targeted reforms in investment instruments and the regulatory framework can further strengthen Italy's positioning, enhancing its competitiveness. This is a crucial factor in supporting the necessary investments for upgrading the built environment, including residential buildings, offices, schools, hospitals, and senior living facilities. Modernizing these assets is a strategic challenge that can only be met through a balanced mix of private capital and regulatory tools designed to incentivize their deployment.

Leveraging the practical experience and expertise of its members, Confindustria Assoimmobiliare looks forward to a new phase of investment and urban development capable of generating positive impacts across the entire country. The Italian real estate industry is ready to meet the challenges of the future, fully aware of its central role in fostering sustainable economic growth, inclusivity, and an improved quality of life for all citizens.

Premise

edited by Roberto Fraticelli

2024 has substantially confirmed the importance of the themes already identified in the previous edition and their evolution at different speeds. 2025 looks like the year in which some of these will play a role of great importance for the global geopolitical and economic balance with important consequences for the European economy and real estate.

1. **Globalization**: with the election of Trump as president of the USA and the implementation of his protectionistic policies, global trade is undergoing a radical change compared to the past. The imposition of mutual duties and sanctions and the search for alternative trade routes are leading to the creation of multiple economic spheres of influence and bilateral agreements, which are becoming increasingly relevant.
2. **Geopolitics**: geopolitical tensions intensified in recent years, in particular among the various superpowers, highlighting the fragility of current trade routes and the uncertainty related to the stability of supply chains, further incentivizing onshoring, stimulated by the new tariff policies. The various wars in Europe, the Middle East and Africa and the growing diplomatic tensions are pushing countries towards an arms race where the obsolescence of conventional weapons is now so obvious as to lead to a drastic revision of military budgets and their allocation.
3. **Economic performance**: There are strong differences from country to country. The United States continue to find strength from internal economic stimulus policies, while China seems unable to emerge from the stalemate situation in which it fell in recent years. India, as well as other Asian countries, seem to be succeeding in the implementation of their policy of sustained economic growth. Europe, on the other hand, still seems to be stuck at a standstill with its main economies practically experiencing zero growth and with many sectors where the technological gap appears to be difficult to fill in the short term.

4. **Inflation and interest rates**: Here too we note a divergence in the approach of the various central banks which, to protect their economies, are forced to adopt different monetary policies. The policies of sharp increase in interest rates, desired by the main central banks to contain the inflation phenomenon, seem to have had the desired effect in Europe, where the growth estimates of the economy and inflation are very limited, leaving room for further cuts. This could help businesses reduce financial costs, containing debt sustainability issues. The situation is different in the United States where the FED has basically suspended its policy of rates reduction while dealing with an American economy that is still growing.
5. **Climate change**: Europe has adopted a very stringent legislation to protect the environment asking sector operators for important analyses to identify climate risks and their consequences and to satisfy the new reporting requirements foreseen by the ESG criteria (i.e. CSRD reporting). Other countries, instead, seem to have adopted less demanding policies and the Trump administration is pursuing an ecological policy that seems to be diametrically opposed to that of Europe.
6. **Demography**: The continuous increase in the world population in certain geographical areas to the detriment of others is leading to the exacerbation of issues on immigration and the role of demography in general, with important repercussions on the choices of voters and the formation of governments. In many countries, like those in Europe, low demographic growth and the fight against immigration are further promoting the progressive aging of the population.
7. **New social realities**: The vast use of new methods of socialisation (i.e. Social Media) and the ever-increasing role of artificial intelligence in our daily lives are leading to much larger, quicker and more complex relational developments among generations and among groups of individuals (communities).
8. **Cybersecurity, digitalisation, artificial intelligence and supercomputers**: Having now become an integral part of our daily lives, artificial intelligence continues to make giant strides thanks to the double combination of exponential developments in software and hardware. In a world where technology is no longer an option, we can glimpse enormous advantages for humanity, but also multiple risks, with consequences that are increasingly difficult to fully evaluate.
9. **Space technology and biorobotics**: Commercial space technology, still in a very embryonic stage, could see exponential developments in the short-

term thanks not only to the giant strides in computational capabilities, but also to the scientific revolutions brought by new discoveries in the fields of physics and mathematics . Even biorobotics, still not well known to the larger public, is destined to play a fundamental role in the coming years both thanks to the increasing capabilities and decreasing dimensions of nano-bots and the bio-machine connections of cyber- robotics.

10. **Information**: The evolution of the level of information and/or disinformation of these past years has been nothing short of astonishing. Obtaining information and processing it a few hundredths of a second before others has today significant repercussions. We have gone from a situation of scarcity of information to one of overabundance, often managed by sophisticated algorithms. Topics such as polarization, disinformation, but also practically infinite and immediate dissemination of knowledge are the subject of daily debates. It is important to understand what (new) values are spreading and how vulnerable we all are to potential manipulation attempts.

The impacts on Real Estate: Each of these issues has a very different and significant impact on real estate, some more in the short term, while others decidedly more in the medium/long term.

Current geopolitical tensions could be leading to drastic changes for the real estate industry. Among the most obvious measures we see the reconversion of real estate and industrial structures towards new functions and important investments in the infrastructure of the various countries. The nationalistic policies of the Trump government with their system of duties and sanctions are increasing doubts over investment decisions of many companies. Onshoring and logistical uncertainties are inducing many companies to make significant strategic choices on their production and supply chains.

The global macroeconomic trend, with a forecast of growth, albeit limited, bodes anyway well for the investment potential in the real estate sector and the spending capacity of the population. However, this trend varies significantly from region to region, with Europe lagging behind other geographical areas.

Inflation and the interest rate, whose sudden and significant fluctuation caught many operators off guard in 2023 leading to strong doubts about the sustainability of the debt for many companies, now seem to have returned to levels more in line with "historic" ones, at least in the projections from 2025 onwards. This should help companies operating in very capital intensive sectors, such as real estate.

The rigorous policies adopted by the European Union regarding ESG are having very significant impacts on European industries, especially those operating in the infrastructure and real estate sectors. These policies, not followed globally by other nations, in particular by the United States after the election of Trump, could constitute very important barriers to the development of the real estate sector in Europe.

The progressive demographic changes, both in numerical terms and in terms of composition, and the strong socio-demographic changes (with the related evolutions in social relationships) are at the heart of the changes in the real estate industry, as they answer fundamental questions such as "who we are building for" and "with what objectives". The needs of our customers are, in fact, constantly evolving and, given the timescales with which real estate is able to move, it is essential to be able to anticipate them as much as possible.

Looking at digitalisation, we can say that it began for real estate in the 1980s with the automatised collection and elaboration of data on rentals and vacancies. Already today, the amount of data available on real estate investments allows, in addition to their continuous and immediate monitoring (think for example of consumption data), for the use of probabilistic models for the optimization of management and to assess the need for further future investments. The amount of variables which could be used in the analysis is enormous and varies from climate forecasts in the medium/long term, to the demographic change expected in certain areas, to the consumer's spending capacity. The constant improvements in the granularity, immediacy and accuracy of data and the developments of increasingly sophisticated but easy to manage software have led to the flourishing of many specialized PropTechs and to the creation, within already established investment and real estate management companies, of dedicated teams. All this technology (AI) brings with it many innovations, from research, creation and use of (new) materials, to use of innovative construction techniques, from the realisation of eco-sustainable spaces to building structures and infrastructures capable of efficiently supporting the growth of the industry. Digitalisation, though, also brings with it numerous risks, both for the safety of the properties themselves and those inside them, and for the operations of less prepared companies in the field of cybersecurity.

Italy's choices: The points reported above provide us with many ideas on how the Italian political system and the real estate industry could operate to best position themselves in the different scenarios.

The current geopolitical instability naturally offers interesting insights into the opportunity/need for relevant infrastructure investments, enabling us, for example, to ask ourselves questions about the role the logistics sector could play or which types of customers will, prospectively, be more "compatible" for the hospitality sector.

Making predictions on the performance of the economy helps us to get an idea of what strategies could be adopted in the office segment. An estimate, for example, of the evolution of spending power of individuals could provide useful indications for the valuation of investments in the residential and retail sectors.

Prospects on inflation levels and interest rates are pivotal to make correct investment decisions and select which investments to carry forward and which to postpone or dismiss and/or which types of financing sources to resort to, when and to what extent.

Climate changes can lead us to seek new uses or new locations for some investments or lead us to implement new infrastructural works, like for example the construction of water reservoirs, to partially mitigate the effects, or even to exploit them, like, for example, the creation of photovoltaic parks or the stimulus to create energy storage areas so as not to overload the existing electricity grid - in strong need of an upgrade - and enable its most efficient use over time.

The studies related to demographic developments, such as the progressive aging and depopulation already underway in Italy for a long time, could provide useful immediate stimuli (i.e. promoting for example investment in the senior living sector, restructuring of the Italian residential portfolio) and calls for concrete actions and policies favouring, also through specific investments in infrastructures, a demographic rebalancing in the short/medium term. The evolution of sociality and our ways of living is leading to an increasingly smaller family unit with very different needs for accommodation, entertainment, shopping and nutrition compared to the services currently offered by the Italian real estate.

Digitalisation and artificial intelligence are and will increasingly be, therefore, very important allies for the development of the real estate sector. Analysis and synthesis skills are in fact increasingly necessary: from innovations in the production of materials to the development of construction techniques, from predicting climate change to understanding the present and future needs that real estate must satisfy.

But perhaps what emerges most clearly is the need for a fresh and innovative approach with a medium-long term perspective that can lead the country to seek new tools to face very different challenges compared to those faced until yesterday. This approach cannot be proposed only by visionary politicians, but must be understood and supported by all of us, who are active in the real estate sector. The information, tools and means of dissemination are already largely at our disposal and the role of stimulating innovations and supporting investment policies typical of institutions such as Assoimmobiliare, must not be underestimated nor, most importantly, underused.

In this context of strong transformation and evolution, the primary objective of this publication remains to help the (foreign and not) investors to navigate more easily in the "regulatory sea" that norms the world of Italian real estate, trying to illustrate in a clear, detailed and comparative manner the possibilities available to them.

In this sense, therefore, our publication is proposed as one of the points of reference for those who intend to operate actively in the Italian market (such as investors, financiers, legislators, intermediaries, tenants, consultants etc.) with the aim of providing operators with all the essential information to manage the main phases of the investment process in our country, clarifying and providing indications on the most important issues in the sector.

As for the previous ones, this eleventh edition intends to bring to the attention of the Italian legislator the areas where it can operate with legislative interventions aimed at improving the legislation, simplifying and standardising the bureaucratic processes, clarifying grey areas, interpretative doubts and contradictions currently present in the legislation, with the aim of increasing the transparency, competition, professionalism and efficiency of the national real estate world and thus ultimately contributing to the increase in the overall competitiveness of the country system.

It is clear how sustainability and innovation need huge investments and capital which cannot be provided only by national and transnational institutions, but which inevitably require the intervention of the private sector. It is therefore becoming increasingly crucial to provide potential investors with clear and understandable tools to facilitate their activity, within a stable regulatory framework, comparable with that of the main European countries.

This year too, therefore, the best wishes for a profitable use of this book!

1.
Real Estate Investment

by S. Cacace, L. Lucaroni, A.Ometto, E. Pauletti

1.1. Contents of this publication

The aim of this publication is to point the spotlight at the most significant aspects of real estate investment in our country, examining key aspects such as the identification real estate transfer methods and the choice of the investment and financing instruments that may be deemed to be most appropriate from time to time. These choices depend on various factors, mainly of a legal and financial nature, that can significantly impact on the final financial result of the investment. The focus was, accordingly, on these profiles, but we did not neglect the examination of certain issues of a purely financial nature (how to choose the optimal ratio between shareholders' equity and third party's capital to finance real estate operations, interest rate risk hedging decisions) that are crucial in defining the risk-return profile of a real estate investment.

In particular in Part I of the publication, in addition to an update of the trend of real estate investments in Europe and in Italy in 2021, analyses the tax profiles related to the methods of transfer of real estate, the technical and legalaspects of real estate due diligence and the methodologies of real estate valuation, a very important matter this last not only in the acquisition phase, but also afterword in the management, exploitations and disposal phases.

Part II offers an analysis, from a tax point of view, of the various investment instruments used within the sphere of "professional" real estate activity (*i.e.* not carried out for the sole purpose of holding and developing personal or family-based real estate assets of natural persons), in order to emphasize the strengths and weaknesses of the various corporate structures ("ordinary" commercial companies, individual investors and partnerships, "Listed Real Estate Investment Companies" – SIIQs – or "Unlisted Real Estate Investment Companies" – SIINQs – and real estate investment trusts and SICAFs) that the current legal system makes available to operators in the performance of such activities. Specific sections were also dedicated to investment in residential properties, due to the peculiarities typical of this type of asset class, to the indirect taxation of some particular way of utilization of the properties and to the state incentives to the construction industry, that have assumed increasing importance in recent years also in light of the need for modernization in a sustainable sense of the national real estate assets stock.

Part III is devoted to the description of the main financing instruments available for real estate investments, and offers a general view of the various contractual structures available to the investor in real estate and related tax issues, with a specific focus on the fiscal treatment of Leverage Buy-out for the real estate sector. A new chapter has been dedicated to the tax profiles of "real estate" companies pursuant to Law 130/1999 in the context of securitization operations in line with recently introduced regulations. Significant room has also been devoted to interest rate risk hedging operations, an element that can exert significant influence on a real estate investment results, and its tax repercussions, closely connected to the accounting methods adopted.

1.2. Fundamental organisation of the taxation system and its evolution over time (the tendency to contrast the abuse of the corporate structure)

In order to proceed with method, it is necessary to single out, on apreliminary basis, the economic fundamentals of the various areas in which "professional" real estate activities can be performed (that we can summarise as "management", "trading" and "development") to be able to check, with reference to each of them, on the treatment reserved by each of the structures used.

Although it may seem obvious, it would be appropriate, nevertheless, to start with the criticism that says that real estate investment, whatever its purpose (management, trading or development) is still an investment for the medium to long term and that the recourse to borrowing is an integral part of the economic cycle it is involved in.

Therefore, the essential elements to be taken into account are the possible correlation between debt servicing (as regards the principal and the interest) and the revenue cycles, and whether they are represented by rents or proceeds from the sale of assets (revenues or capital gains). If this makes sense in general terms, it does so even more with regard to the activity known as real estate "management"; that is, that activity aimed at the renting out of assets, where, typically, the firms finance most of their activities by resorting to bank loans, often assisted by mortgages levied on property assets. In this case, in fact, it is evident that the structural characteristics and the economic logic of the activity performed essentially revolve around the equilibrium, also in terms of guarantees, of a margin that is adequate and constant over time between the costs of interest charges and the revenues from rents.

In this context, precisely for the significant connection with the timing element, a decisive role is to be played, on the debit side, by the extent and timing of the possible "recovery" of "acquisition" costs (purchase or construction) of the real estate assets, that can be summarised – in relation to the tax profiles – (i) in the actual recovery (via deduction or rebate) of the VAT paid in the "acquisition" phase of the assets, (ii) in the amortisation of the purchase/ construction costs (inclusive of any tax charges for "the deed"), and (iii) in the deductibility of *all* the "operating" costs, relating not only to the periodic maintenance and efficiency improvements of the assets, but also to the ownership of the property. On the credit side, however, one can take account of the extent and timing of taxation on the revenues or capital gains realized with respect to the sale of the assets.

These are, after all, the main reasons that have led over time to the adoption of the corporate structure for the structuring of an investment in real estate. But they are certainly not the only ones, given that the use of the corporate screen responds, then, also to the understandable needs of separation of the assets exposed to business risk, from the potential involvement of third-party investors and also to partial sales of the equity investments in question that guarantee reasonable margins of flexibility for the property investment. The inclination to opt for a corporate instrument, indeed, can also be rooted in financial considerations, including first of all the need to segregate the real estate to be financed from the other activities of the real estate investor, to protect both the lenders and the co-investors. However, the opportunities offered by the taxation regime for commercial companies in terms of the possibility of deducting costs (both acquisition and operating costs) and deducting the VAT relating thereto, on the one hand, and of postponing and partly mitigating the taxation on profits, on the other, have led to an improper use (without talking about actual abuse) of the corporate structure by individuals for the management of the real estate business. The reactions of the tax system to these forms of abuse have,over time, extensively modified and worsened the actual regimeof real estate companies, with general measures that in addition to sanctioning the exploitation of these forms, have also the effect of jeopardising the proper and efficient use of the corporate structure by professional operators, who do not want to abuse the actual regime of commercial companies. However, in order to understand the reasons for the current tax system of commercial companies, and the related profiles of inefficiency, it would be appropriate to review briefly the most important reforms adopted in this regard after the adoption of the regulations known as the "70s' Reform" which designed the current tax system.

In this regard, it is preliminarily worthwhile considering that the national tax system is characterised, historically, by a remarkable and also increasingly unreasonable distrust in the management of the real estate business, mainly with regard to the management of property rentals. The entire legislative fabric of the last fifty years (at least from the tax reform of 1971-1973 up to the present) is imbued with provisions aimed at preventing, or making particularly onerous, the instrumental use by "private individuals" of rules for the analytical determination of business income, in order to try to tax non-entrepreneurial proceeds (yields) according to the lump sum rules of real persons.

The first and most obvious legal provisions in this regard can be traced back to the provisions issued for the purposes of income tax (relating to private individuals, as well as to companies and entities), which tend to exclude rented out assets from the category of *operating* real estate properties, as they are not considered *used directly* in the enterprise's business activities but described as a mere *object* thereof.

This previous and questionable interpretative position (a reference to it is already found in Ministerial Resolution 9/2086 of 7 March 1977 which thus interprets Article 52 of Italian Presidential Decree No. 597/1973) appears to be based on a preconception (according to which all real estate "management" properties are created for operating requirements, for the management of "private" assets) which is all the more serious because it is likely to lead to entirely unjustified penalising effects on those who – conversely – truly perform their business activities through the renting out of real estate properties, and finds its expression in legislative terms primarily in Articles 43 and 90 of Italian Presidential Decree No. 917/1986 (Consolidated Law on Income Tax). As regards these statutory provisions, in fact, real estate properties *related* to businesses, when they are intended for renting out, constitute *operating* assets that are instrumental to the enterprise only if, from the objective point of view, they are typically *not susceptible to different use without radical changes* (if they are, therefore, properties that are *operating assets "by nature"*); conversely, any properties different from properties defined as operating assets by nature (typically residential properties) are, nevertheless, not considered *operating* "*by intended use*", if they are rented out, and are therefore taxed on a flat-rate basis.

According to the traditional interpretation of the Tax Authorities, which was passively accepted also by the prevailing tax publications and contested only by sporadic, albeit authoritative, opinions expressed by the most attentive legal *doctrine*[1], it would never therefore be possible for companies to make an instrumental use of "residential" real estate properties as "operating assets". As one can clearly see, this is a preconceived and unfounded position, both in its economic assumptions (according to which there is no sense in differentiating between the performance of renting out business activities whether this occurs with property that is instrumental by nature or with residential properties), but also on the basis of the reference regulations where it appears extremely difficult to believe that the properties (of any kind) held by an enterprise intended for renting out cannot be considered as "*used exclusively for business operations*" and, therefore, do not constitute "*operating assets*". The distinction, as noted, is anything but theoretical and reflects on the policy of taxation, which is analytical for *operating* properties (so that the production costs of the income relating to them reduce the related revenues) while it is, on the other hand, a flat-rate tax (based on "cadastral" criteria) for properties that are considered "*real estate assets"* (in relation to which the costs of production suffer significant limitations). It would appear, however, that the case law on legitimacy is also starting to look into this and its inconsistencies (Court of Cassation No. 26343 of 16 December 2006).

This conceptual approach, however, is the basis of changes to the VAT system regarding real estate with the subsequent reform in 1996-1997 (known as *Visco Reform*) that, on the one hand introduced a specific regime of objective non-deductibility for certain types of "residential" properties (Article 19-bis of Italian Presidential Decree No. 633/1972) and, on the other hand, analytically governed those cases where the corporate structure used must be considered "a *convenience company*", that is a dummy company, for the

1 L. Perrone, "Antiche e nuove perplessità circa la disciplina tributaria degli immobili strumentali per l'esercizio dell'impresa", in *Rass. Trib*., I, 1989, page 291 following.

purposes of taxation on turnover (Article 4 (5) of Italian Presidential Decree No. 633/1972), with the absence of the requirement on commerciality and, therefore, the ability to recover taxes paid on purchases through the system of deductions and reimbursements. In both cases, the lawmakers made a precise choice of field, again penalizing "residential" properties, albeit by introducing additional constraints on the relationships with the individual persons of shareholders or their family members.

The most significant limitation that stems from this approach, both from a symbolic and economic point of view, is the exclusion of real estate "management" companies ("*whose asset values are mainly represented by real estate assets that are different from those real estate assets whose production or exchange is effectively the core business of the undertaking, or from those installations and buildings used directly in the performance of the enterprise*") from the possibility of having the right to the application of the taxation system focused on *participation exemption*, which is the hub of the taxation of joint-stock companies in the light of the reform that introduced IRES in 2004 (known as the *Tremonti Reform*).

If that were not enough, even more stringent tightening was brought in with the next legislative move by the "*Bersani-Visco*" Decree (Law Decree No. 223/2006), which, on the one hand, changed the rules governing concerns known as "*dummy companies*" for the purposes of income tax (in Article 30 of Italian Law No. 724/1994) widening its scope of application beyond the "family" use of the corporate structure; on the other hand, it radically reformed the indirect tax regime with regard to conveyancing and renting out real estate properties, by increasing and generalizing the tax burden regarding mortgages and the land registry, even though with a view towards stopping abuses.

Finally, the subsequent reforms to the income tax system, implemented with the Budget Law for 2008 (Italian Law No. 244/2007) also had a major impact on the real estate business, although less focused on or instrumental to deterring the use of the corporate structure. Such reforms (i) on the one hand, eliminated the possibility of using depreciations purely for tax reasons (in off-balancesheet operations, through decreases in the tax return, pursuant to Article 109, paragraph 4, of the Consolidated Law on Income Tax) and (ii) on the other hand, reformed the criteria for the deductibility of interest charges from IRES (amending Article 96 of the Consolidated Law on Income Tax).

Both provisions, but especially the latter, are likely to have a decisive negative effect, thereby decreeing its definitive non-viability in economic terms, on the property management conducted through trading companies. And in fact, if the possibility of deducting tax depreciations, that were not allocated in the balance sheet, was a form of flat-rate provision of a subsidised nature, creating an advantage for those companies that benefited from it, the opportunity to fully deduct interest charges represents a vital requirement for real estate companies, precisely because of the structural characteristics of the type of business conducted (capital intensive industry), and of their character that requires heavy borrowing. The limit of 30% of the ROL for the purposes of deciding on the deductible portion of the interest is, obviously, too modest for real estate properties under management, even if the recent changes introduced by Legislative Decree n. 142/2018 could increase in the future the deductible portion, due to the transition from a ROL calculated on an accounting basis to a ROL determined on the basis of fiscal rules (this transition usually leads to and increase due to a major incidence of positive adjustments).

It is basically for this reason, due to the non-viability of property management in economic terms, as a result of the numerous measures already mentioned, that the lawmakers then decided to provide for, under the same legislative rule (Article 1, paragraph 36, of Italian Law No. 244/2007) (i) on the one hand, the establishment of a government study commission that would have to draft another, more systematic, reform, for the real estate industry, and (ii) on the other hand, a general waiver to the limits on the deductibility of interest charges related to mortgages on properties held for renting out, that would be transitional, while waiting for the outcome of the work conducted by this commission.

Even this provision, with a fairly broad literal effect, however, began to suffer from a certain stickiness in interpretation by the Revenue Agency (Circular Letter No. 37 of 22 July 2009)[2] which – rather than calming tempers – by trying to give confidence to a market in difficulty, helped create further uncertainty and embarrassment in a market already curbed due to current economic reasons. Also a further law amendment (article 4 of Legislative Decree No. 147/2015), aimed at clarifying the application of this provision, did not achieve sufficient certainty.

So, in conclusion it seems clear that the *ratio* which guided the lawmakers in this long series of restrictive measures on property investment finds its justification in a vision of little importance with regard to property invest-

2 For a more detailed analysis on this point, one should refer to par. 1.2 of Chapter 1.

ment. In reality, the thought is aimed at the individual person who intends to hide their assets or intends to use the screen of a company to unlawfully make a cost deductible, or the VAT paid on a purchase deductible, when the operation was conducted by the same natural person, as a "private" citizen. Pending the desired reforms for the sector (which for the moment seem far from being adopted, since the outcome of the work of the aforementioned government commission was affected by the premature termination of the legislature and the subsequent change of government), what is evident from the numerous measures mentioned above – all penalizing for property companies – is that, in the current state of the law, property management through the "ordinary" means of a trading company appears mostly inefficient from a tax perspective, resulting substantially uneconomical, especially with regard to the business of renting out property.

Given this state of affairs, it is worth noting, however, that the legislative developments of recent years have produced a partial counterbalance against this unfavourable regime, by providing two alternative investment vehicles that are more consistent with the activities to be performed and have a more attractive tax regime.

In the logical (not chronological) order the following governing rules have been introduced, respectively for:

- SIIQs (Article 1 (119 *et seq.*) of Italian Law 244/2007), which allow the conduct, through an entity with corporate status and a broad shareholder structure, of entrepreneurial activities for the management of real estate property, also involving investors of a purely financial type; and
- Real Estate Trusts (currently governed by Law Decree No. 351/2001), and real estate SICAFs (governed by Legislative Decree No. 44/2014) which allow the professional conduct of real estate investment activities, without actually turning into a business enterprise.

In both cases, these are measures which, despite their structural and management differences (of which one must keep careful account in the assessment of their effective suitability for the effective needs), can help solve many of the aforementioned tax inefficiencies (and in particular, but not exclusively, the limitations on the deductibility of interest charges), preserving also the needs for segregation of assets.

The following chapters will specifically and analytically cover the tax features of each of the principal juridical forms (real estate companies, real estate trusts, real estate SICAFs, SIIQs and SIINQs) used for conducting real estate business.

In order to fully understand the above, however, one must first determine the fundamental economic elements that characterise the different types of real estate business activities (management, trading and development) in order then to move on to the analysis of the rules governing each single form of investment instruments mentioned above by checking which treatment refers to each of them. For this purpose, the brief comments made in the paragraph below can be of some help.

1.3. Real Estate Management

The business of real estate management, beginning with a completed building, identifies its users and ensures its successful administration, through maintenance, technical management and provision of services related to the real estate properties and their users.

The costs are largely related to the acquisition and enhancement (if any) of the assets, which – for the part not available within the entrepreneur's equity – must necessarily be found in the credit market.

The cost of borrowing, therefore, represents a decisive element for achieving a cost-effective structure: the containment of the level of debit items, therefore, makes it necessary to conduct a careful evaluation of the credit market conditions throughout the whole cycle of the participation of the company assets within the enterprise's business activities, intervening if necessary to restructure and reschedule any previously contracted loans. In addition to the interest charges – and, in the case of variable interest, the consequent costs that may be incurred to hedge the risks arising from market trends (*i.e.* hedging derivatives) – one must include all costs for gaining access to credit, such as the financial costs, bank charges, costs for the issue of bank guarantees, etc.

Another important cost item is represented by the costs of restructuring, transformation and redevelopment (defined in real estate jargon as "*capex*") which are incumbent on the company owning the real estate (unless the contract provides for such costs being sustained by the tenant, according to patterns also known as "*double net*" schemes).

Particularly relevant is the VAT that the company has not deducted due to particular restrictions on the exercise of the related right (for example if the renting out activities and other credit operations were "exempt") as well as, more generally, the timing as regards the possibility of obtaining actual VAT refunds.

The negative components under examination are – in principle and except for interest charges[3] – capitalized on the cost of the asset, which is for the enterprise a material asset. Those who prepare balance sheets according to national accounting standards, for example, subject both the costs of acquiring the real estate assets and those of restructuring them to a process of amortisation during the period of ownership of the property.

With reference to subjects that apply international accounting standards (IAS), on the other hand, the real estate assets typically held by real estate management companies constitute real estate investments regulated by IAS 40 (real estate held by the owner to earn rentals or for capital appreciation) and can be subjected, as an alternative to the normal depreciation process, to a procedure of evaluation at market value (also known as *fair value*), resulting in the recognition (in lieu of the depreciation allowances) of revaluations and impairments in the income statement.

The taxes that must be paid on the property and possession of the property, such as the IMU (property tax), are also relevant.

The proceeds are essentially attributable to rentals but also to the sale of real estate properties, which is also part of the industrial cycle and real estate investment, since it is functional in the raising of resources needed for the replacement of the fixed assets, for reasons of obsolescence and for reasons of diversification, or for liquidity requirements or for disinvestment. Precisely due to their characteristic as property investments, thus immobilized, the sale of real estate properties produces capital gains, that must be calculated by comparing the sale price with the residual cost or the current value of the property listed in the balance sheet.

3 The interest charges and borrowing costs ordinarily constitute part of current expenditure to be recorded directly in the income statement for the year in which they accrue (cf. OIC accounting standard no. 12). However, interest charges and borrowing costs incurred for the building, either internally or through third parties (with the exception of those incurred for the purchase, unless the purchase is consequent to the construction work delegated to third parties), of tangible assets (as land and buildings are) can be capitalized into the cost to be displayed in the financial statement within the balance sheet. The accounting standards (see OIC accounting standard no. 16) require for this purpose the compliance with certain conditions (for example, that the loans to which the interest and charges relate must have been granted specifically and actually used for the acquisition of the property; that the value of the property, including the capitalised interest and charges, does not exceed the amount that can be recovered through the use of the asset; that the interest and charges must be incurred during the period between the disbursement of funds to the suppliers of goods and services related to the real estate asset and when the asset is actually ready for use). Compliance with the conditions imposed by the accounting standards, among other things, means that the capitalisation is not a means for deferring losses, but must be carried out in a reasonable manner.

Real estate management is not incompatible with the management of equity investments in other companies or investment activities in enterprises in the same sector, and thus the income statement can also include positive elements such as dividends from investee companies and negative elements such as the costs of managing these assets. Of course, in the case of the provision of the typical services of a holding company (as is the case in all sectors, not specifically that of real estate), the related economic elements will be present.

1.4. Real Estate property sale

This business involves the purchase and resale of real estate properties and also includes all instrumental activities aimed at the development of the assets between their purchase and sale; sometimes these may also be particularly significant ("trading" activities).

Unlike real estate properties that are rented out by property management companies and included among fixed assets, real estate properties that are purchased for resale are "stock-in-trade"[4] and do not undergo any systematic procedure of depreciation, since they contribute towards the formation of the P&L according to the mechanism of (purchase) costs, of revenues (from sales or temporary rental) and changes in inventories.

More specifically, the typical business costs are:

- acquisition costs (including the costs of the estate agents' fees) and all development work;
- the costs for financing the acquisition and development of the fixed assets: thus financial interest and charges (and any other costs already analysed with regard to management activities);
- the taxes for the deed (*i.e.* registration tax and cadastral and mortgage taxes) relating to the acquisition;
- VAT paid in connection with purchases and developments (not subject to recovery by deduction/refund);
- taxes relating to the ownership of the real estate properties and also their maintenance costs

4 The definition and classification of the various economic components (*i.e.* "stockin-trade", "operating assets"), that are important from a tax point of view, will be looked at in detail in the next chapter.

- costs relating to sales activities (estate agents' fees, etc.); advertising and promotional expenses as well as insurance costs alsofall into this category.

With regard to VAT, in particular, it should be noted that this item is destined to have an increasing effect (as occurs, moreover, with management activities), since the types of exempt credit transactions (sales and rentals), which impede the right to make deductions, have increased for real estate companies that are not construction and/or redevelopment companies. In the current regulatory framework, exempt transaction carried out sometimes by option are likely, therefore – if not carefully thought out – to heavily penalise the company that performs them, by burdening it with tax paid with respect to the acquisition.

The positive business components consist of proceeds from the sale of real estate *i.e.* changes in inventories, as well as revenues from temporary rentals, which, like development activities, may be compatible with the company's purpose, provided they are effectively instrumental to the efficient use of the assets pending their disposal (otherwise they would lead to a change in the classification of the real estate properties from "stock-in-trade" to "operating assets" or "investment goods").

1.5. Real estate development

In this case, the activity develops through the typical phases of the production cycle, which vary according to the type of real estate initiatives the firms are involved in, both from an economic and a financial point of view, from the commencement of the building work, in return for proceeds that will be received after a period of time from the initial investment.

Primarily, the costs of the activity are:

- the acquisition of areas, buildings and building rights, aimed at construction work and urban redevelopment schemes; the related deed registration taxes, as well as the costs incurred for any estate agency fees, notarial costs, due diligences, etc.;
- construction costs (for raw materials, capex, testing, site supervision, project management);
- loans for the construction and/or renovation costs of the property; financial costs, bank charges, costs related to the granting of bank guarantees, etc.;
- expenses relating to possession (including property taxes) and the maintenance of finished properties until the time of sale;

- costs relating to sales activities (estate agents' fees, etc.); advertising and promotional expenses as well as insurance costs.

The *business plan* must indicate with precision the building work schedule in order to estimate the outgoing cash flows and timing correctly, because errors of judgement can cause additional costs to be incurred during the execution of the works and the resulting loss of economic viability of the operation.

Particularly important, in this case, is the ability to recover (quickly) the VAT paid during construction either through deductions or through reimbursement.

Since the examined costs are related to the production of stockin-trade, they also include capex and taxes relating to the possession of real estate properties and are determined in accordance with the principle of correlation with revenues, thereby increasing the value of stock.

The proceeds of the activity under consideration essentially include the revenues from the sale of the constructed works, since the real estate properties in question are stock-in-trade for the company that produces them. In this regard, the comments mentioned concerning the trading activity are essentially valid here in the same way.

Moreover, the buildings under construction that are only partially completed or completed but not yet sold, can be rented out by the company that built them. This renting activity, from an economic-entrepreneurial point of view, is normally attributed to the administration and conservative management of the asset in view of a future sale, or is the result of a negative valuation about the foreseeable time scales for the sale and thus is seen as instrumental in relation to the achievement of the entrepreneurial program.

* * *

In terms of the negative components that may affect the investment, the legal instruments used may affect the performance of various real estate activities. In fact, each of the forms taken by thereal estate investment has its peculiarities, its obligations and related costs that, obviously, weigh in the balance with the profitabilityof the business venture.

For example, the sale and management of real estate through the use of an investment fund typically entails charges such as those arising from the management of the property portfolio, namely commissions paid to the management company for the periodic management and final performance, fees payable to the custodian bank, as well as legal fees and audit reports for the accounting and reporting of the fund, the fees for the "independent experts" and charges for the possible listing of the shareholding certificates on the regulated market.

If a corporate vehicle is used, this involves typical costs for the management of this type of structure. Additional charges may then arise, for example, from the listing on a regulated market (as is mandatory for SIIQs – *Società di Investimento Immobiliare Quotata* or real estate investment trust).

Similarly, the choice of different investment instruments is closely linked to the selection of financing instruments available. We can think for instance of Real Estate Funds, not allowed to issue obligations, or conversely to securitization operations which can only be implemented through the formation of specific vehicles that must meet the requirements set by current applicable regulations.

The choices on how to structure and finance real estate investments must therefore hold into account several factors, often mutually related. The following chapters of this book aim at providing actual and potential investors in Italian real estate with a general overview of the available investment and financing instruments, with a view to helping them in their decision-making process.

1.6. Tax treatment of Real Estate transactions

1.6.1. Main ways of transferring Real Estate assets

The choice of structure to be used to carry out the transfer of an asset is particularly important in the Real Estate investment processes. This process is complex and greatly influenced by the tax consequences of the various choices for the parties involved in the transaction. Indeed, the impact of a transfer may vary significantly depending on the structure selected, sometimes in opposite directions for the buyer and for the seller. In practice, apart from careful analysis, some long and complex work may be required to ensure that agreement between the interests and needs of the parties, which are often in conflict, is reached.

Real property can be transferred in a variety of ways. The typical mechanisms are:

1. an "asset deal", consisting of the direct sale or the contribution to capital of assets or a Real Estate business.
2. a "share deal" consisting of the transfer of securities (shares or membership quotas) representing the entire share capital of a special purpose vehicle whose assets include the Real Estate (or the business undertaking partly consisting of Real Estate).

Whether or not there is any advantage in resorting to the sale of the container ("share deal") rather than directly of the content ("asset deal") must be assessed on a case-by-case basis, considering not only the impact of a deed for the transfer of shares on both parties but also the following elements:

- the possibility, depending on the concrete factual circumstances, of setting up a special purpose vehicle to which the Real Estate assets are to be transferred
- the risk of investigation by the Tax Authorities under anti-tax avoidance rules.

1.6.2. Asset deals – direct sale of Real Estate assets

The direct sale of a Real Estate asset has both direct and indirect tax consequences.

The direct taxation treatment depends first of all on the profile of the seller, according to personal characteristics, and the context in which the property is sold. This means:

- for individuals (and other taxpayers subject in substance to the same tax rules[5]) who own real property as part of their personal estate, the sale of such real property may give rise to income classified as "other income";
- for individuals who hold Real Estate as a part of their business activity, the sale of such assets may give rise to income classified "business income";
- for corporations and commercial entities, on the other hand, only the classification as "business income" is applicable.

A further relevant element in determining the methods for taxing the sale of real property assets is represented by the tax classification of the transferred asset, *i.e.* the Real Estate, which may vary as follows:

- operational properties analytically contribute to the formation of business income (taxable income and deductible costs) and give rise when sold to capital gains or losses
- properties held as inventory forms part of the computation of business profits on the basis of the changes in "inventory stock" and give rise to revenue when sold.

5 These other taxpayers, in particular, are non-commercial entities that do not have a "residual commercial activity" (or that even though they carry on a commercial activity, do not hold the real property as part of that commercial activity) and non-residents without a permanent establishment in Italy to which the assets are connected.

- properties held as part of an individual investment estate gives rise to income calculated on a lump-sum basis depending on the "cadastral value" or on the actual rent decreased by a set flatrate percentage on account of costs) and their disposal gives rise to capital gains or losses.

For the purposes of direct tax, the same classification and treatment[6] also apply to assets which are being transferred in the context of a transfer of business concern.

Capital gains will be subject to different rules depending on whether they are realised within or without a business activity.

If the seller acts outside of a business activity (an individual who is not an entrepreneur or a taxpayer subject to the same substantial tax rules)[7] the "other income" provisions apply and any capital gain realized[8] is subject to taxation at progressive personal income tax (IRPEF) rates (for individuals) or a proportional corporate income tax (IRES) rate (for non-commercial entities or non-residents) only if the sale takes place within 5 years from the purchase of the asset. If a property is held for more than 5 years, the capital gain realized on sale is not subject to tax. If the property being sold consists of building land the gain will always be subject to tax regardless of the time of the ownership.

Conversely, if a seller acts in the course of a business activity (individual entrepreneur, company or commercial entity)[9] the provisions for business income apply and any capital gain realized[10] is subject to taxation at progressive IRPEF rates (for individuals) or a proportional IRES rate (for limited liability companies or commercial entities) on the whole amount realized, regardless of the duration of the ownership (and so including property held for less than 5 years). In this case a capital gain can, at the taxpayer's choice,

6 It must, however, be noted that pursuant to Article 176 of the Consolidated Income Tax Code (TUIR), the contribution of a going concern between commercial undertakings is carried out in a regime of natural continuity of tax values between transferor and transferee, and therefore without generating any tax impact for the transferor.

7 On the basis described in the previous section.

8 Which is given by the *"difference between the consideration received, or the sum or market value of assets received in consideration, and the purchase cost or value subject to taxation, increased by all inherent costs" pursuant to* Article 68 of the Consolidated Income Tax Code (TUIR).

9 This treatment also applies to a non-commercial entity with a residual trading activity to which the assets are referred or a permanent establishment in Italy of non-resident taxpayers.

10 The gain is calculated as the "difference between the contractual consideration or compensation received net of directly attributable accessory charges, and the non-amortized cost", pursuant to Article 86 (2) of the TUIR.

be accounted for as part of taxable profits entirely in the tax year of realization, or – if the assets have been held for more than three years – be taken on a straightline basis in the period of realization and the following periods (up to four) (Article 86 (4) of the Consolidated Income Tax Code).

A complete examination of the tax regime applicable to Real Estate gains realized as part of a business is included in chapter 4.7 below.

The regulations governing the sale of properties held as inventory stock deal with the transfer of properties, the production or commerce of which forms the object of the business activity of the seller. From an accounting point of view the purchase/production and sale process is normally represented by accounting for costs, revenues and inventories. A complete examination of the tax regime applying to the sale of "Real Estate held as inventory stock" is included in chapter 4.8 below.

Direct transfers of Real Estate can be made directly for monetary consideration (cash payment, offsetting of receivables or, as frequently happens, by taking over a debt guaranteed by a mortgage on the transferred property) or by contribution to capital or exchange ("datio in solutum"). Both situations can give rise to a capital gain, comparing the seller's tax basis in the asset with the agreed sale price or with the arm's length value of the shareholding or asset received in consideration.

Assessing the direct tax impact for the seller arising from the sale requires an accurate analysis of the actual situation, with reference to numerous elements including, but not limited to:

- the date of purchase of the property: if the property has been held for some time this normally involves a significant difference between the purchase cost and the sale price and therefore a higher taxable capital gain
- whether the seller has benefited from significant tax depreciation, which may have significantly reduced the original purchase cost of the property
- the availability for the seller of tax losses to be carried forward or of other costs and expenses in the year the property is sold, sufficient to, at least partially, offset the effects of the taxable capital gain.

As for the buyer, the direct sale of Real Estate assets does not normally involve any issue in terms of direct tax, as the price paid, increased by the costs incurred for the acquisition, represents the tax value of the property.

Indirect taxes affect the sale of real property assets in a different way depending on the characteristics of the asset sold and the person selling it.

Typical taxes applicable to the disposal of Real Estate assets are as follows:

- Registration tax
- Mortgage tax
- Cadastral tax
- Value added tax.

A detailed description of the indirect taxation applicable to the asset deals is reported in the following chapter 11.

A number of considerations can be made with regard to responsibility for prior-year tax liabilities.

Depending on the subject-matter of the contract (transfer of individual assets or business concern), the liability for debts, including taxes payable[11], of the seller prior to the transfer is different. Here reference is made mainly to property taxes (, single municipal tax (IMU)) relating to individual property assets and indirect taxes due for the purchase of the property, but also to direct and indirect taxes (Italian Corporate Income Tax (IRES), regional tax (IRAP) and VAT) relating to the exercise of commercial activity carried out through all the sold operational assets.

With regard to the sale of a business concern (or business unit), Article 2560 (2) of the Italian Civil Code provides that the buyer is jointly liable together with the seller for the debts (including tax payable) relating to the business activity carried out by the business concern and recorded in the statutory accounting records[12].

A further special rule – Article 14 of Legislative Decree no. 472/1997 dealing with taxes and tax penalties – provides that in any event the seller is liable together with the buyer (with the possibility of enforcement against the latter) (i) for taxes and penalties relating to violations committed in the year of transfer of the business and in the two previous years; and (ii) taxes and penalties already levied and assessed in the year of sale and in the two previous ones (even if these refer to previous periods). The buyer's liability is not subject to these limitations if a transfer is made in violation of tax credits.

However, unless the transfer can be deemed to consist of a transfer of a business concern, it can be affirmed that there is no legal support for attach-

11 The liability of the purchaser of a business sold as an undertaking, includes all the liabilities relating to the business concern being transferred "as long as each liability is recorded in the statutory accounting records", pursuant to Article 2560 (2) of the Italian Civil Code.

12 This liability is in addition to the liability of the seller. In general, the seller is not released from responsibility for the liabilities relating to the transferred business, unless the creditors expressly consent.

ing any liability to the buyer for taxes relating to the sold assets which were generated before the sale. Liability for these remains with the seller[13].

There is, therefore, a substantial difference between the two cases – the sale of an individual asset and the sale of a business undertaking/business unit – when it comes to the tax liability of the buyer. In the first case, a buyer may, at most, be required by the Tax Authorities to pay the indirect taxes relating to the transfer for which he is jointly liable with the transferor. But the buyer has no liability for tax obligations relating to previous issues. In the second case there is a potential joint liability for all the tax debts (including the relevant penalties) inherent to the business concern deriving from the accounts and that refer to a specific time period (the two years before the transfer) or in any case which has already been subject to assessment.

The legal system allows a limitation (except in the event of tax fraud) of this liability consisting in the filing of a request to the Tax Authorities to issue a "pending tax charges" certificate. Pursuant to Article 14 (3) of Legislative Decree no.472/1997, tax offices are required to issue a certificate of the existence of disputes in progress and those disputes which have been finalised but where amounts payable have not yet been paid. If the certificate shows no pending charges or is not issued within forty days from request, the buyer is released from any liability.

1.6.3. Sale of a special purpose vehicle

The indirect sale of Real Estate through the sale of the entire registered capital of a special purpose entity that owns the Real Estate impacts the direct and indirect tax treatment of both the seller and the buyer/transferee.

In general, it must be noted that participation in "a company whose assets predominantly consist of Real Estate that does not form part of the production or commerce that is the effective focus of the company's business" is by irrebuttable presumption excluded from the benefit of the "participation exemption" provided for under Article 87 (1 d) of the Income Tax Code

13 However, in certain cases the Tax Agency has a special preferential right in rem for tax due on the sale of Real Estate. In particular: i) pursuant toArticle 62 (5) of Presidential Decree 633 in those cases where VAT or penalties are "due by the buyer" (e.g. *reverse charge*); ii) if the buyer is jointly liable for VAT (pursuant to Article 60-bis (3-bis) of Presidential Decree 633/72, *i.e.* when the consideration is lower than the actual amount paid); iii) for registration tax pursuant to the combined provisions of Article 2772 of the Italian Civil Code and Article 56 of the Consolidated Code on Registration Tax.

(TUIR). For a detailed analysis of this legislation and the possibilities of application to certain types of sale involving real property transfers, reference can be made to paragraph 4.9.

If the seller is not carrying on a business activity (an individual who is not an entrepreneur or similar taxable person), the "other income" provisions apply and any capital gain realized[14] is subject to taxation at a rate of 26%.

If the seller acts in the context of a business activity (an individual who is an entrepreneur, company or commercial entity or similar person), the rules on "business income" apply and any capital gain realized is[15] subject to taxation:

- at progressive IRPEF rates (for individuals) or proportional IRES rate (for corporations and commercial entities) on the entire amount realized regardless of the ownership interest (whether "significant" or "non-significant");
- as mentioned, the "Participation exemption" provision in general does not apply.
- The capital gain, however, forms part of taxable profits, at the taxpayer's choice, entirely in the tax year of realization, or – if the shareholding has been held for more than three years – on a straight-line basis, in that period and in subsequent periods up to the fourth (Article 86 (4) of the TUIR).

In principle, the buyer purchases a shareholding in the special purpose vehicle, without the price paid for the purchase having any impact on the accounting or tax value of the (indirect) object of the purchase. These assets continue to be recognized in the accounts of the special purpose vehicle at their "historic value" and their tax value is unchanged.

It follows that the special purpose vehicle is subject to a "latent" negative tax effect equal to the direct tax (in principle corporate income tax and regional production tax, at an overall rate of 27.9%) calculated on the excess in the current value of the properties over their historical value, with a consequently lower depreciable value. The difference between tax value and market price

14 this arises *"from the difference between the consideration received or the sum or arm's length value of any consideration in kind and the cost or the purchase value subject to taxation, increased by all inherent charges"* pursuant to Article 68 (6) of the TUIR).

15 on the "difference between the contractual consideration or the compensation received, net of directly attributable accessory charges, and the non-amortized cost", pursuant to Article 86, paragraph 2, of the TUIR.

can however be "recovered" – under certain conditions – causing the corresponding "deficit" to emerge via a corporate integration (usually a merger).

The (merger or demerger) deficit is given by the higher book value of the shareholding owned by the merging company in the merged company compared to the book value of the equity of the company that is represented by the shareholding.

The deficit can be "allocated" to the assets that are merged as a result of the merger to the extent that they have a higher real value (that can be supported by expert valuation) compared to their residual book value.

In the regulatory "system" provided for by Legislative Decree no. 358/1997 the deficit on merger could be recognised for tax purposes either (i) through the payment of substitute tax (19%) dealt with generally in the body of the regulations (Article 7 (1)) or (ii) without payment of any tax, "Up to the total net amount… b) of the greater and lower values, compared to the relevant acquisition values, deriving from the transfer of the shares or a quota, which has been accounted in the taxable income of a resident company" (Article 7 (2 b)).

As a result of the reform which introduced the IRES corporate income tax (known as the "Tremonti reform", introduced by Legislative Decree No. 344/2003), this possibility to "realign" (paying or for free) the tax on the merger or de-merger deficit has been repealed. Therefore there is now a structural fiscal distortion regarding the tax neutrality in the choice between "asset deal" and "share deal".

The different tax values of the assets have therefore become the subject of negotiation between the seller and the buyer. This difference, in fact, is normally reflected in the process of determining the transfer price of the shareholding which tends to be reduced due to the effect of latent taxation. The scale of this reduction normally varies depending, among other things, on the plans of the purchaser for the use of the asset and on the negotiating weight of the parties.

The laws on the revaluation of business assets that have followed one another over time (starting with Law 340/2000, amended several times including by Finance Law 2020) have made it possible to recover part of these differences.

It was not until 2008 that the reform of Article 176 of the TUIR, pursuant to Law no. 244/2007, introduced a (limited) possibility of stepping up the value recognizing, by means of a payment of tax, the increased value deriving from – among other things – the accounting for a merger deficit.

Article 176 (2-ter) of the TUIR allows, at the option of the company, to be at the time of the declaration, to step up the book value of "assets consisting of tangible and intangible assets of the business received" by payment of a "substitute tax" in place of Corporate Income Tax (IRES) and regional production tax (IRAP), with the progressive rates as indicated below (12-14-16%).

Article 172 (10-bis) of the TUIR expressly recognizes the possibility of applying such "paid" step-up to the increased values shown in the accounts following a merger transaction. The same provisions are made by Article 173 (15-bis) of the TUIR for demerger operations. As clarified by Circular Letter 57/E 2008, given the reference to Article 176 in Article 172 (10-bis) the application of the system is allowed only if, at the time of the merger or de-merger, a "business concern" and not individual assets, are allocated to the company respectively resulting from the merger or beneficiary of the demerger.

The applicable rate is 18% for IRES and 3% for IRAP (with the additional of the surcharges, if any). Furthermore it shall be noted that:

- in the calculation of depreciation, from the beginning of the tax period in which the option for step-up was made
- in determining the capital gains/losses on disposal, starting from the fourth period following the period in which the option was exercised (with consequent possible "claw-back")

For VAT purposes, the sale of shares is, either, (i) outside the scope of VAT, if the interest is sold by a person (natural or legal person) that is not an entrepreneur, or (ii) within the scope of the tax but VAT exempt pursuant to Article 10 (1) no. 4, of Presidential Decree no. 633/1972[16].

Following the abolition of the tax known as "tax on stock market contracts", the sale, even if it is VAT exempt, is also subject to a fixed registration tax (€ 200) pursuant to Article 11 of the Tariff attached to the Consolidated Code on Registration Tax or as a result of the alternative application of registration tax and VAT.

The tax on financial transactions (known as "Tobin Tax") pursuant to Article 1 (491 to 500 of Legislative Decree No. 228/2012) also applies, in the standard rate of[17] 0.2% of the value of the transaction, normally borne by the purchaser.

16 The impact of which on the deductible pro rata for input VAT of the seller must be assessed on a case-by-case basis.

17 Exemptions or reduced rates are provided for in certain circumstances (e.g. for listed securities).

No indirect tax (VAT, registration tax, mortgage tax and cadastral tax) is due on the (indirect) sale of properties[18], unless – due to the characteristics of the transaction – the sale is at risk of being reclassified as a direct sale of "assets" in application of anti-tax abuse provisions (Article 10-bis of Law no. 212/2000).

1.6.4. Specific aspects of indirect sales through special purpose vehicles

If the Real Estate asset to be sold is not already "isolated" in a special purpose vehicle, this must be set up. This operation, however, presents some tax sensitive aspects, namely:

- the applicable tax regime in relation to the Real Estate, if it is to be transferred directly to a vehicle outside the transfer of a larger "Real Estate concern" or if a (demerger or merger) transaction is planned regarding the corporate entity.
- the possible tax issue concerning the actual presence of a "Real Estate business", if it is transferred within a business concern in its "totality".
- the possible tax issue concerning the presence of an "undue" tax advantage that could give rise to the possibility of a fiscal "abuse of law".

The possibility of a direct sale/contribution of property to the special purpose vehicle subject to taxation in full does not normally offer[19] any tax benefit and so there are no tax sensitive issues as it falls within the category of a direct asset sale as described above (§ 3.1.2).

The first possibility to be considered if the properties to be valued are to be "split" from the rest of the corporate assets (any additional Real Estate and commercial business, etc.) is a "corporate de-merger". The de-merger of a company, aimed exclusively at allowing the tax neutral division of a business concern into several economic units, does not involve – in itself – any tax avoidance issues.

However, this first conclusion must be reconsidered when the de-merger is "preordained" in relation to the subsequent sale of all the company's shares. This applies

18 Reference should be made to paragraph 3.1.1 above, for the applicable regime.

19 If the properties are not transferred in connection, even at different times, with other assets or rights (e.g. commercial licenses) that can substantiate the existence of a business undertaking (business unit) to which they can be said to pertain. In this case, the contribution is carried out with a roll-over of existing tax values for the purposes of direct taxes (if the sale is made from one commercial enterprise to another) and in substantial neutrality for the purposes of indirect taxes (which apply in a fixed amount).

- when the sale is made by shareholders who are individuals, so that taxation can be shifted from the assets to the shareholdings, which are subject to the more favourable capital gains regime (Regulation No. 256/2009), but also
- when the transfer is made by a shareholder subject to corporate income tax, even if only to defer the taxation of the top level assets. The operational guidance of the Tax Authorities can be interpreted in this way. In the past, the Consultation Committee has defined the fiscal neutrality of the transaction that involves the postponement of the taxation of any latent capital gain as undue advantage (Opinion 29/1999).

These initial positions have been strongly criticized and have been amended over time also by the Revenue Agency. This has occurred in particular as a result of an amendment in the law which, pursuant to Legislative Decree no. 128/2015, set out new regulations governing the "abuse of law" in tax matters through the abolition of Article 37-bis of Presidential Decree no. 600/1973 and the introduction of the new Article 10-bis of Law no. 212/2000 (Taxpayers Charter). In light of the new regulatory framework, the Revenue Agency has revised this original restrictive position and, with some recent resolutions (Nos. 97/E/2017, 98/E/2017), has finally recognized the legitimacy for direct tax purposes, of a company de-merger followed by sale of the shares in the companies. In this regard, the tax authorities have expressly excluded the possibility that any direct tax savings achieved by the seller can be considered "illegitimate"[20], thus precluding the possibility for the Tax Office (at least when the fundamental object of the transfer is a business undertaking) to re-categorize the operation on the basis of anti-abuse regulations[21].

20 In particular, it has been pointed out that the tax treatment of these transactions is different compared to the direct sale of the asset transferred to the beneficiary company. Indeed, the capital gain realized by the seller through the sale of a shareholding is potentially exempt from corporate income tax (at 95%) in application of the participation exemption regime, while the purchase cost of a shareholding does not give rise to any tax deductible depreciation for the purchaser. Conversely, the capital gain generated on the sale of an asset is, for the seller, entirely subject to corporate income tax and is also recognized by the purchaser for the purposes of deductible depreciation. However, the Tax Agency has made it clear that these different tax regimes are alternative and equally valid.

21 The Agency also specifies that the de-merger "*must consist in a business reorganization operation aimed at the effective continuation of the business activity by each participating company*" and that the companies must be trading companies and "*not essentially consist of cash, intangibles or Real Estate*". As noted by ASSONIME in Circular Letter no. 20 of 3.8.2017, this last clarification appears to be contradictory: if the tax savings made are not to be considered illicit, the existence of these circumstances should be irrelevant. On this point, further clarification from the Revenue Agency will certainly be necessary.

On the other hand, in relation to indirect taxes, a capital and corporate reorganization aimed at the carrying out a "share deal" is possibly subject to tax review in application of the rules established for registration tax (applicable also for mortgage and cadastral taxes) in matters of *"the interpretation of the deed"* pursuant to Article 20 of the Consolidated Code on Registration Tax, and of the general principle of prohibition of abuse of law for the purposes of tax law, as laid out in a number of Judgments of the Court of Cassation and later implemented in the provisions of Article 10-bis of Law no. 212/2000 mentioned above. This concerns, in particular, contributions to companies (when they are not subject to the full application of taxes) of assets or business concerns, followed by the sale of the shares or units deriving from the contribution. In this case, the reaction of the Tax Authorities usually consists of a reclassification of all the deeds so as to consider them as constituting a single deed for the direct transfer to the purchaser of the shareholding in the assets/rights contributed to the company, with consequent application of the (increased) tax liability that would arise from the direct transfer of the *asset* to that final purchaser of the participating interests.

In recent times there has also been a proliferation of claims for the reclassification of transfers of entire holdings in the capital of trading companies, even if not preceded by any contribution of assets, as a direct sale of the underlying business concern. Also in this case the challenges were based on the application of Article 20 of the Consolidated Code on Registration Tax, following a line of interpretation that has consolidated in the jurisprudence of the Court of Cassation, and is much criticized in tax doctrine and practice.

Indeed, Article 20 of the Consolidated Code on Registration Tax (which originally read "*the tax is applied according to the intrinsic nature and legal effects of the deed submitted for registration, even where the title or the apparent form* do not correspond.") is a provision that literally aims to tax the "legal" effect of the deed or series of deeds filed for registration but which very frequently – in an anti-avoidance perspective – has been deemed suitable to give tax relevance to the commercial outcome achieved by the parties. The introduction of the law to combat the abuse of law in tax matters (Article 10-bis of Law No. 212/2000) should have definitively replaced the anti-avoidance function (including the exploration of the real substance of deeds registered) of this provision and the problems arising from its application. However, the application of Article 20 of the Consolidated Code on Registration Tax has received new impetus in the most recent rulings of the Court of Cassation, which has even set out a new notion of an "interpretative" rule, that can be used regardless of any anti-avoidance requirement (and has come to affirm, albeit with criticism from legal doctrine, a direct and simple equivalence of the sale of the entire shareholding to the direct sale of the underlying business).

In order to clarify the scope of application of Article 20 of the Consolidated Code on Registration Tax, in the context of Law no. 205/2017 (Finance Law 2018), the Legislator has introduced a provision (Article 1 (87)) that should limit the possibility for the Tax Authorities to redevelop the contracts subject to registration in the context of operations that are structured through several stages and documents, limiting it to the rejection of illegitimate tax savings in cases of abuse of right under Article 10-*bis* of Law no. 212/2000. As a result of the new interpretation of the rule it is necessary to identify the tax treatment of the <u>single deed</u> (and no longer of the "deeds", in plural form as the previous wording required) filed for registration, regardless of any external interpretative element (for example, the behaviour of the parties or information outside the text of the document), as well as the provisions of other legal transactions connected with the transaction being registered. In particular, the fact that a sale of a complete shareholding is not the same as a transfer of a business concern is clarified in the Explanatory Report to the rule in question. The Report specifies that «*the interests objectively and concretely pursued by the parties when they can lead to an assimilation of a legally distinct contractual situation (for example, whether the assignment of an entire equity investment is equal to a sale of a business undertaking)* » are not relevant for the purposes of the correct taxation of the registered deed.

There follows that the reclassification of a deed filed for registration on the basis of Article 20 of the Consolidated Code on Registration Tax, whether aimed at taxing the substantial commercial impact or to challenge tax avoidance on the part of the taxpayer, should no longer be possible. These kinds of challenges, regardless of the direction of any previous case law, can now only be made on the basis of the regulations aimed at countering the tax abuse of law matters, pursuant to Article 10-*bis* of Law no. 212/2000 (the application of which remains thanks to the reference to the new wording of Article 53-*bis* of the Consolidated Code on Registration Tax), if all the conditions for the determination of tax abuse are met, namely: (i) the existence of an "illicit" tax saving, as a consequence of the avoidance of tax rules, (ii) the lack of economic substance of the transaction, (iii) the essential nature of the tax savings achieved, (iv) the absence of any valid non-tax reason, in compliance with the procedural guarantees and of the rules on the burden of proof in the regulations.

It is necessary to add, however, that the reformulation of Article 20 of TUR is an authentic interpretation and consequently it is applicable also to cases occurred prior to the entry in force of the Budget Law 2018. This was clarified by Article 1 (1.084) of Law no. 145/2018 (Budget Law for 2019), after some sentences of the Court of Cassation that stated the innovative and not retroactive nature of the new rule.

In Judgment No. 158 of 2020, Italian Constitutional Court ruled as unfounded the constitutional legitimacy issue of the new Article 20 of the TUR, as amended, with Articles 3 (principle of equality) and 53 (principle of contribution capacity) of the Italian Constitution, which was argued by the Italian Supreme Court of in ruling 23549/2019, thus considering the amended regulation fully consistent and legitimate with respect to the national system. Nonetheless, most recently the Italian Supreme Court raised further question of the lawfulness of the legislation "*de qua*" with respect to the EU principles, by referring to the Court of Justice of the European Union. The raised exception, however, relates only to the case of the indirect transfer of going-concern and would not seem to be able to relate also to the transfer of individual assets not unified under a going-concern (see ruling No. 10283/2022). The issue continues, therefore, to be disputed and to manifest particular persistence on the part of the Italian Supreme Court and, probably, of the Italian Revenue Agency itself, so much so as to suggest cautious attitudes with respect to structured transactions, since further stances and articulated reconstructive arguments, aimed at denying benefits in terms of tax reductions that instead the system would seem to grant, cannot be ruled out. It is therefore desirable that a speedy pronouncement on this matter will also be forthcoming from the EU Court, possibly in the sense of the full lawfulness of the current regulatory framework, so as to provide definitive certainty on the interpretive approach to be followed.

1.6.5. Contribution and sale of a business undertaking

A possible alternative to the sale of Real Estate or collection of Real Estate is the definition, within the business, of a "business unit" to which assets can be functionally ascribed.

This "business unit" can be sold directly (with the tax effects outlined in paragraph 3.1.2 above) or be contributed to a special purpose vehicle the shares of which are destined to be subsequently transferred. In this second case the contribution will be subject to the (natural) regime of "fiscal neutrality" set out in Article 176 of the TUIR and the fiscally recognized value of the contributed company business ("business undertaking") is transferred to the shares received by the contributor (along with the period of ownership), while the company receiving the contribution succeeds to the former's tax position with regard to the assets and liabilities of the business concern received.

The continuity of tax values, however, can be avoided under the same regulations governing the deficit on merger (payment of substitute tax of 21%).

The contribution of a business followed by the transfer of shares in the same, moreover, is expressly shielded from any allegation of tax avoidance, at least for the purposes of direct taxes (Article 176 (3) of the TUIR), by the existence of systematic provisions aligning the tax treatment of the former business owner through ownership of the shareholdings to that of taxpayers who do not have such protection.

In both cases – when the conditions in Article 87 of the TUIR are met – the sellers are entitled to participation exemption relief on sale of the shareholding. This is reasonable in view of the fact that both cases satisfy the *ratio* of the rule, which is to avoid gaps in taxation: in both cases the transfer of business is neutral (or with a paid for step-up pursuant to Article 176 (2-ter) of the TUIR), which does not lead to the right to increased depreciation for the transferee (or rather, the increased depreciation is justified, pursuant to the IRES tax reform, by the payment of substitute tax).

These considerations, however, are not shared by the Tax Authorities (nor by court decisions) with regard to indirect taxes (where contribution followed by the sale of shares is more advantageous and more easily exposed to challenge by the tax authorities) at least up to the amendment of Article 20 of the Consolidated Code on Registration Tax under Finance Law 2018 and subsequent clarifying interventions at both the regulatory and judicial levels (which, however, will be examined by the European Court of Justice fo the residual mentioned issue).

It could therefore be expected that, except for the most serious cases of abuse of law, transactions consisting of a contribution of a business concern or of single assets followed by the sale of the entire shareholding (let alone the simple transfer of a shareholding package) cannot be subject to reclassification for indirect taxes purposes as well. Except where there are obvious economic reasons (related to the capital structure of the acquisition, the needs of asset segregation, the more efficient transfer of administrative authorizations, or the organizational needs of the buyer or re-organization of the seller) the issue remains open as to whether a tax savings that, for the purposes of indirect taxation, can be made by opting for a *share deal* rather than an *asset deal* is legitimate. This is an issue that has never been really explored and is more difficult to clarify compared to direct taxation issue, mainly because of the lack, in this sector of taxation, of any express provisions in this regard (such as Article 176 (3) of the TUIR, for direct taxes).

A judgement regarding this legislative intervention can really only be expressed once some practical guidance has been issued by the Tax Agency and some initial judicial interpretations, at least on the merit, are forthcoming. Some clarification on this point by the Legislator would be strongly desirable, particularly in order to specify, as already has been done for direct taxes (Article 176, paragraph 3, of the TUIR) that these transactions do not constitute avoidance of indirect taxes.

1.7. The Joint venture in the real estate sector

The possibility of completing a real estate transaction between two parties is often linked to other factors besides purely income, tax, legal, technical and financial.

The buyer could be a foreign entity, without a stable organization in Italy, who is looking for an investment but needs a local partner that has a structure, a network and an experience gained in the sector and / or a partner with the skills and professionalism to carry out some services that, especially in the retail sector, are essential to grant management according to high quality international standards that can lead to the desired returns over the time horizon of the investment (i.e. holding period, period before a future disposal).

For example, let's think to a financial investor who wants to buy a shopping center that then needs an operational partner with the skills of asset management and property management to enhance the investment. For such an investor, especially if a foreign one, the presence of a partner who wants to invest in the transaction, putting some "skin in the game" is often a decisive element for the investment choice since it ensures an alignment of interests between the purely financial investor, without specific skills, and who is the service provider.

This alignment of interests between the financial investor and the most operational partner leads to the negotiation and incorporation of joint ventures with the objective of jointly realizing a real estate investment, sharing the return and the risk, putting the peculiarities of each player in common. The acquisition of shares (the so-called 'share deal') is undoubtedly the investment method that is the most used for this type of transaction among various company groups.

Investors therefore need to pay particular attention to the formation of the joint venture and the consequent way of conducting the company activity from its birth until the future disposal of the investment.

The negotiation of a joint venture is rather delicate, leading to the definition of shareholders' agreements among the various subjects with the definition of specialist activities that each one shall provide to the JV, due to the specific skills, governance, voting methods and exercise of the rights of the shareholders or of the majority shareholder, if any, to lock-up periods, to financing criteria and minimum leverage values to be maintained, to deadlock management procedures that may materialize during the course of company life with consequent buy-sell procedures between the shareholders and procedures to exit the investment.

A growing priority for investors is the integration of ESG practices and the definition of sustainability objectives within the joint venture, not only to enhance the attractiveness and long-term value of assets, but also to secure access to financing from banks and debt funds.

The advanced use of data, artificial intelligence, and blockchain is transforming the management and transparency of shared investments in real estate joint ventures. Big data analytics and artificial intelligence enable the optimization of asset management, the prediction of market trends, and the improvement of decision-making processes based on objective parameters. Blockchain, on the other hand, ensures greater security and transparency in transactions, facilitating the traceability of agreements between partners, the management of equity stakes, and the automation of certain contractual processes through smart contracts. These tools not only reduce operational and financial risks, but also increase trust among JV partners, improving investment efficiency and governance.

It's worth to underline how the presence of multiple subjects in the joint venture may inevitably create greater instability and uncertainty in the conduct of the joint venture activity, so that it is necessary to define adequately the procedures to exit from deadlocks. At the same time, the rights of minority shareholders must be protected so that the by-laws and the corporate purpose are maintained and / or cannot lead to a forced dilution of their interests.

For the purpose of the disposal of the investment it is typical in the joint ventures to negotiate various types of clauses for the minority shareholder as the methodology for valuing their interest, put option clauses to allow the minority shareholder to exit the investment in precise windows time frames and tag-along clauses to give to the minority shareholder the same right to transfer their shares to the same purchaser of the majority shareholder and at the same price, to avoid to remain in the company with a new third party investor.

Likewise, for the majority shareholder there is the need to have a liquid position without being impeded by the minority shareholder in order to dispose of the investment, for which the same will define the methodology of valuation of their interests, call option clauses to allow the majority shareholder to acquire the minority shares and drag-along clauses in order to be able to transfer the entire shareholding structure to third parties, including the minority shareholding, which will be sold at the same shares' price of the majority shareholder so that the same is not blocked by the minority shareholder who wants to remain an investor.

In conclusion, share deals and joint ventures are increasingly complex transactions that require adequate professional figures to provide the professional advice necessary to identify the most appropriate corporate structure and joint venture agreements in the interests of the parties in order to create a venture that is well balanced, always considering that it will be necessary to intervene over time for opportune maintenance considering the floating interests of the parties.

2.
Real Estate Investment Valuation

by S. Natalicchio

2.1. International Valuation Standards: RICS, IVS and EVS

The past few decades have already seen the development and implementation of international valuation standards that meet the need to ensure the consistency, coherence and comparability of valuations, while taking into due account the particularities of local markets.

Valuation standards formalize generally recognized and accepted principles and concepts, enabling parties to understand and communicate in a common language.

They constitute a framework for the valuation and make it comprehensible in terms of both the form and substance of professional practice, not least through the codification of best market practices.

The standards also include a glossary of terms with their generally accepted definitions and are, most importantly, accompanied by an "authentic interpretation", which prevents their incorrect or improper application.

It is also important to note what the standards are not. In particular, they provide neither a detailed analysis of valuation techniques and criteria, nor rules for the specific valuation methods to be applied according to the different valuation purposes. The standards are not a guidebook meant to teach valuation professionals how to conduct a valuation.

The international valuation standards are extremely important in the Italian real estate market and, as such, the most reputable market players demand their use, because business and market globalization requires generally accepted, shared rules, because business and investment performance analyses must be based on consistent, reliable measurements and, lastly, because market players need transparent, coherent and reliable data on which to base their decisions.

The international standards (IVS, the RICS Red Book and EVS, as described in more detail further on) emphasize the valuer's professional responsibility and the need for a rational, exhaustive presentation of each step in the valuation process (although, they do not discuss the techniques to use for the valuation).

There is no procedure or algorithm that can, in and of itself, "guarantee" the quality and accuracy of a real estate valuation, since valuation is a subjective process, influenced and characterized by the valuation professional's experience and interpretative skills.

The priority of the standards is to make the valuation comprehensive; its impact on the quality of the valuation is secondary.

While valuations that are not compliant with the standards are unquestionably poor in quality and unreliable, this does not imply that compliant valuations are necessarily and automatically up to the highest market standards, although it is highly probable that a valuation undertaken in accordance with the standards, in both substance and in form, is well done.

The two main bodies that define the valuation standards are:

- The International Valuation Standards Council (IVSC),
- The Royal Institution of Chartered Surveyors (RICS).

International Valuation Standards

The International Valuation Standards (IVS) are the most widely used standards in Europe. They are written by the International Valuation Standards Council and endorsed by the Royal Institution of Chartered Surveyors (RICS), which has cooperated with the IVSC since January 2012.

The IVSC (International Valuation Standards Council) is a not-for-profit organisation established in the 1980s by English and US valuers associations with the objective of producing common, consistent standards to be applied across borders to benefit and, especially, protect the general interests of markets and the public.

IVSC's governance is extremely well-structured so as to represent its many member organisations (currently over 120 associations in 54 different countries) while remaining effectively independent and autonomous in its decisions.

Originally, the IVS concerned the valuation of real estate exclusively, but they have been progressively extended to cover other types of assets:

- Production plant and equipment
- Extraction assets (mineral, oil and natural gas)
- Intangibles (trademarks, patents and intellectual property)
- Financial instruments (securities, bonds, derivatives and investment funds).

The global application of the IVS is not a weakness but rather their greatest strength, as it highlights the existence of a common background for all valuations, irrespective of the nature of the valued assets.

This lends consistency to the valuation approaches, preventing the various practices in the different sectors that have developed within the individual communities of specialists from diverging in their fundamental principles, which would give rise to an unjustified "conceptual fracture" between the valuations of different asset categories. Obviously, given their global nature, the IVS must be subsequently "customized" by asset class, hence the "Red Book", written by RICS and mainly dealing with the valuation of real estate.

Designed as a global platform for the valuation of all types of assets, the most important parts of the IVS are the IVS Definitions and the IVS Framework, which are found at the beginning of the document.

The IVS Definitions are a glossary intended to normalize the terms used in valuations and clarify those that could be unclear or inconsistently interpreted by professionals in the sector.

The IVS Framework consists of around 70 points, each covering a specific valuation topic. The points are grouped into thematic areas corresponding with the essential elements of a valuation (and according to which the valuation should be interpreted in order for the result to be understood correctly).

The only official version of the IVS is in English.

In Italy, OIV – Organismo Italiano di Valutazione (the Italian Valuation Body) was established in late 2011, acting as the Italian chapter of the IVSC with the operational support of Università Bocconi.

In 2015, OIV published the PIV, the Italian Valuation Principles, in force since 1 January 2016, which are not a translation of the IVS, but a version of these standards for application in Italy, covering all types of economic assets that could be subject to valuation. RICS has actively participated in the drafting of the chapter on property valuations, which substantially refers to the Red Book as the specific standard to which reference should be made.

With respect to international regulators, given their correlation with the valuation standards described above, the IAS (International Accounting Standards) should be mentioned. They are the result of a process that began in the 1970s for the worldwide standardization of accounting standards. In 2001, the International Accounting Standards Committee (IASC) became a private foundation and issues the IFRS (International Financial Reporting Standards). IAS and IFRS co-exist and today we refer to these standards as IAS/ IFRS.

In March 2014, IFRS and IVS agreed to converge their definitions of fair value.

RICS (Royal Institution of Chartered Surveyors)

RICS's mission is to be recognized internationally as the leading body promoting the highest professional standards in a variety of fields. RICS offers training to certify professionals' expertise and guarantee high professional standards in the valuation and management of assets such as land, real estate, construction and infrastructure.

Since 1974, RICS has published the valuation standards universally known as the "Red Book".

While initially the standards only applied to valuations in financial reports (financial statements), their scope of application was subsequently extended to cover most valuations and has been mandatory for all RICS members since 1991.

RICS opened its first office in Europe in 1993 in Brussels, Belgium. It has grown rapidly since and now has offices in Milan, Paris, Athens, Moscow and many other cities.

In the wake of the association's global expansion, the Red Book has been translated into a number of different languages, including Chinese, Dutch, French, German, Russian, Spanish, Portuguese, Polish, Hungarian, Greek and Italian.

The first Italian translation was published in 2009, and the most recent Italian edition "Red Book Global Standards" is dated November 2021, Effective from 31 January 2022.

The RICS standards, preceded by an introduction and glossary, are arranged as follows:

- PS – Professional Standards
- VPS – Valuation Practice Statements
- VPGA – Valuation Practice Guidance – Applications

In the global hierarchy of the standards, RICS allows countries to draft national guidelines on areas of specific interest in connection with the local market, sector-specific regulations, etc.

The system is based on voluntary proposals, directly involving RICS members in the drafting of each guideline. There are currently three Italian guidelines and information papers:

- valuation reports,
- the valuation of shopping centres,
- the valuation of hotels.

Connection between RICS and IVS

To ensure complete compliance with the IVS and avoid the risk of incorrect interpretations or misunderstandings (including unintentional misunderstandings), RICS decided to incorporate all the IVS in its Red Book (2012), specifically referring to the individual IVS in the text of the Red Book and then attaching the entire standard. By their nature (professional rules), RICS standards are presented differently than the IVS, although their principles, objectives and defined terms are identical. What sets the Red Book apart from other codes and guidelines on real estate valuation are its references to the IVS, which are at times merely formal.

In addition to the RICS Red Book, there are other international real estate valuation standards that, beyond particular differences (mainly relating to their geographical area and scope of application), are alike in that they refer to the IVS (International Valuation Standards).

In particular, they include:

- EVS – European Valuation Standards, published by TEGOVA (The European Group of Valuers' Associations)
- USPAP – Uniform Standards of Professional Appraisal Practice, published by The Appraisal Foundation, which are the most commonly used standards in the United States and Canada.

2.2. UNI standards: 11558:2014 and 11612:2015

In December 2015, the Technical Trade Commission of UNI, the Italian standard unification association, published UNI standard 11612:2015 on the Valuation of Real Estate at Market Value. With UNI 11558:2014 on Property Valuers, this standard completes the parameters and protocols of the real estate sector.

UNI standard 11612:2015 provides for:

- The adoption of the international, European and national valuation standards and the ABI guidelines;
- The application of the market, income and cost approach methods;
- The use of real and identifiable comparables, i.e., the prices and characteristics of similar properties;
- The assignment of the valuation to property valuers in accordance with UNI standard 11558 with certification of their competencies;
- The content of engagement letters;
- The steps in the valuation process;

- Market surveys;
- The methods by which the valuation report is prepared.

UNI standard 11612:2015 defines:

- the principles and procedures for the valuation of real estate at market value. This standard excludes bases of value other than market value and considers the main specifications of the relevant standards and international, European and national standards to the benefit of all involved parties to improve the quality of the valuation service;
- the processes to be used to determine the market value of real estate in accordance with specific rules and objective criteria that meet the relevant standards, making the valuation process transparent.

2.3. The Valuer and Professional and Independence Requirements

Valuers must state that they have adequate and up-to-date knowledge of the specific local, national and international market, according to where they are operating, as well as sufficient professional knowledge and skills to competently perform the valuation. Valuers must be capable of providing an objective and impartial valuation. If there are elements that could limit the valuer's ability to operate transparently, these elements must be disclosed at the start of the valuation assignment.

Valuers must have the necessary skills to perform the valuation. If they must rely on the assistance of third parties, this must be disclosed, with indication of the reasons for such assistance and the extent to which the assistance will be relied upon.

IVS 101 "Scope of Work" (# 20.3, pages 9-11) raises the important issue of conflicts of interest for which valuers are required to disclose any "connection" with the subject asset or the other parties to the valuation assignment.

It is important to distinguish third-party valuers, who have no type of relationship with the client or third parties representing the client, nor with the valuation subject, from internal valuers who are employed by the company that owns the assets or by the accounting/audit company that prepares the company's financial documents and/or financial reports (ref. Italian version of the RICS Glossary, 31 January 2020).

A key aspect of the valuer's role, professionalism and independence is the valuer's ability to anticipate market trends. This refers to the professional's sensitivity to tempering – on one hand – the proper methodological approach, requiring the valuer to base his work on market data that are consistent in terms of comparables, historical statistics (prices/rents), transaction numbers and volumes, market cycles and economic trends, with – on the other hand – his ability to "look ahead", i.e., forecast and take into account market trends that are beginning to take shape at the valuation date: signs of recovery, returns on investments, slowing price decreases, banks' positive stances, etc.

An example of the above is the impact of the ESG principles on the valuations referred to in the following paragraph § 3.3.9.

2.4. Purpose of the Valuation, Bases of Value and Valuation Assumptions

The main purposes of valuations commonly include:

- Acquisitions / Sales / Non-recurring transactions,
- Financing (market value or mortgage lending value – "MLV"),
- Financial reporting.

IVS 104 "Bases of Value" introduces the concept of Bases of Value (sometimes called standards of value), with reference to the nature of the hypothetical transaction and the characteristics, motivations and relationships of the parties involved.

The bases of value describe the fundamental premises on which the reported values will be based. It is critical for any valuation to be performed using the basis (or bases) of value that is appropriate to the terms and purposes of the valuation assignment, as a basis of value may influence or dictate a valuer's selection of methods, inputs and assumptions, and the ultimate opinion of value. A valuer may be required to use bases of value that are defined by statute, regulation, private contract or other document. Such bases have to be interpreted and applied accordingly.

It is important to note that Bases of Value:

- do not determine nor describe the valuation methodology
- do not describe nor imply the status and conditions of the asset at the transaction date
- consist of the definition of one or multiple assumptions, which may be supplemented by one or multiple special assumptions.

The basis of value used for the valuation must be appropriate to the purpose of the valuation.

The main bases of value are:

- Market Value
- Market Rent
- Investment Value
- Fair Value

Valuations based on market value rely on the definition and the conceptual framework provided by the International Valuation Standards Council (IVSC).

Market Value is *"The estimated amount for which an asset orliability should exchange on the valuation date between a willing buyer and willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion"*.

Market Rent is *"The estimated amount for which an interest inreal property should be leased on the valuation date between a willing lessor and willing lessee on appropriate lease terms in an arm'slength transaction, after proper marketing and where the parties hadeach acted knowledgeably, prudently and without compulsion"*.

Investment Value (according to the definition given in IVS 104, paragraph 60.1) is:

"*The value of an asset to a particular owner or prospective owner for individual investment or operational objectives*".

As the definition implies, and unlike market value, investment value does not involve a presumed exchange as it reflects the benefits received by the current or potential owner, and it is understood that this value might not necessarily correspond with a typical market participant's. Investment value is often used to measure the performance of an asset with respect to the owner's investment criteria.

Other bases of value subject to special assumptions are:

- Judicial Market Value (JMV): Market Value based on the special assumption that the asset is disposed via enforcement procedure;
- Mortgage Lending Value (MLV): adopted by Regulation (EU) 575/2013 of the European Parliament and of the Council and the *Codice delle Valutazioni Immobiliari* ("Italian Property Valuation Standards", Fifth edition, 2018) for the purposes of establishing capital requirements for exposures secured by mortgages.
- Liquidation Value, immediate sale value, prudent sale value, etc. Unlike the other bases of value (Investment Value and Fair Value), Market Value is *the most probable price* between all *typical sellers* and all *typical buyers*

active in a given market segment. It represents the estimated amount for which the valuer expects a transaction that meets all the criteria in the definition of Market Value could be closed. This definition refers to the principle of typicality, considered a foundation of valuations and, accordingly, one of the valuation assumptions.

Highest and Best Use.

This is a principle (described in IVS 104 "Bases of Value" paragraph 140) whereby the "Highest and Best Use" is – of all physically possible, legally allowed and financially feasible uses – only the use that would produce the highest value for an asset. This use might not necessarily coincide with the property's current use.

2.5. Valuation Methods: Market, Income, Development and Cost Approaches

The main valuation methods are defined below:

- Market approach is based on a comparison of the property with other comparable assets that were recently acquired/sold or are currently offered in the same market or in competitive markets.
- Income approach consists of two different methodological approaches:
  - *I.* *Direct Capitalization*: based on the capitalization of the future net income generated by the property at a real estate market based rate.
  - *II.* *Discounted Cash Flow (DCF) Method*, based on:
    - a. the calculation of future net income from the lease of the property over a period of *n* years;
    - b. the calculation of the property's Market Value through the perpetual capitalization of net income at the end of that period;
    - c. the discounting of net income (cash flows) at the valuation date.

The discount rate and the discounted cash flow method

The DCF method discounts, at the valuation date and using an appropriate discount rate that reflects the risk/return on the real estate investment, the estimated future net cash flows generated by the property over a certain period of time (generally 10/15 years). It is assumed that the property will be sold (exit value) at the end of the period for the amount calculated by capitalizing net income for the year after the end of the period at a market capitalization rate deemed appropriate considering similar investments.

Without examining the technicalities of determining the cash flow discount rate, we can however state that it should reflect the weighted average cost of capital (WACC), which is to say the weighted average cost of risk capital and debt, based on an appropriate financial leverage considered typical and in line with the market. Cost is the remuneration that the parties providing the resources may expect to receive for funding the investment, i.e., the minimum acceptable returns for profitability or the decision of whether to invest. The aspects that are generally considered when the rate is chosen may be the relevant real estate market's liquidity (and, therefore, the related risk premium), the asset class/use, its location, urban planning/permit risk (particularly for real estate developments), the asset's fungibility, etc.

A proper valuation will perform/consider:

- *Market research*: identification of the relevant market, research and analysis of transactions and/or offers for assets with comparable physical and functional characteristics;
- *Analysis of leases*: rent, term, indexing, general and/or special contractual clauses;
- *Owner's costs*: administration, maintenance, insurance, building fees, taxes and other costs (vacancy and unpaid rent);
- *Any upgrade costs*: renovation, environmental clean-up, upgrades to standards, administrative updates;
- *Discount rates:* debt structure, discount rate, capitalization rate, exit value, initial yield, exit (market) yield.

The market and income approaches described above are the most frequently used in the Italian real estate market to calculate market value (typically for sales/acquisitions or for financial reporting purposes).

In particular, the market approach is the most widely used in Italy for "ordinary properties" where there is an obvious active and liquid market for the fractioned sale of properties/property units – such as homes, property units used as offices, stores, production/ artisan spaces and farmland.

On the other hand, for "commercial properties", i.e., "special assets" that are typically leased and which generate value through sale based rents on the prospective income associated with them

– e.g., shopping centres (generally large planned retail facilities), high-street properties, organized offices, logistics properties, hotels and lodging properties in general – the discounted cash flow method best corresponds with prevalent market practice in Italy (and internationally).

The cost method, described below, is used for the valuation of special assets without their own specific market (e.g., hospitals, schools and properties used for public functions, etc.), or for properties (typically industrial buildings) that are most appropriately valued at market value in continued use, therefore assuming that the assets will remain in their current location as part of the production activity, with a reasonable expectation of residual life.

- Cost approach

With this approach, an asset's market value is calculated using the "replacement principle".

This is the cost that would be incurred to replace the asset with a new asset presenting the same characteristics and utility. This cost must then be adjusted downwards to reflect the various factors of depreciation based on the observed conditions: use, condition, functional obsolescence, useful life, residual life, etc., compared to the same type of new assets.

The output is added to the value of the land, which is calculated using the market approach.

Costs are calculated at current market prices, including materials, labour, equipment, indirect costs, profits and fees, urban planning costs and borrowing costs relating to the construction period.

However, the calculation excludes the cost of overtime, employee incentives and surcharges for materials and any contributions, incentives and assistance that the property receives.

"Replacement cost" is an asset's greatest market value, since no one, under normal conditions, would pay for an asset more than it would cost to replace it with a similar asset of equal utility.

The premise on which "replacement cost" is based is that the costs are calculated and refer to an asset with the same characteristics that meets the same needs as the asset whose cost is being calculated.

There are two types of "replacement cost":

- Rebuild cost: this is the cost that would be incurred to produce an asset with the same size, structure and features, materials and layout as the subject asset;
- Substitution cost: this is the cost that would be incurred to substitute an asset with another that could replace the existing asset meeting the same economic conditions and presenting the same capacity, desirability and utility.

The development approach is typically used for the valuation of buildable land and property development projects, or whenever the highest and best use of the property being valued does not correspond with its current use, and an alternative use must be considered that would maximize the asset's value, given its market.

- Development approach: based on the discounting, at the valuation date, of the cash flows generated by the real estate transaction over the period of time corresponding to its duration.

This method can be associated with a financial valuation model (cash flow discounting) based on a development project defined in buildable quantities, use, development costs and sustainable revenue. In other words, a cost/revenue analysis is used to identify the property's market value.

The model is structured as a cash flow chart (inflows and outflows) for the real estate development project. Outflows consist of construction, demolition, urban planning, design and works oversight costs, the real estate promoter's fees and any other costs, while inflows are the revenue from sales for the intended use.

The timing of costs and revenue is used to forecast cash flows, net of the real estate promoter's fees, which are discounted at an appropriate discount rate that reflects the cost of capital.

The latter must take into account:

- the percentages of equity and debt (debt structure);
- the rates of risk-free investments with durations similar to the transaction;
- spreads adjusting these rates (illiquidity, country risk, project risk and urban planning risk);
- the cost of debt.

Costs and revenue are expressed at constant values and recognized when they arise.

In order for the value calculated using the development method to be the same as market value, the transaction relating to the development must refer to a "typical" market participant. A "typical" market participant has "normal" technical and organizational abilities, i.e., performs a transaction with costs and revenue identical or very similar to the costs and revenue that most market participants would have in the same transaction. Any other "atypical" market participant would leave space for extra income or costs, thereby contaminating market value.

The following is a summarized list of some of the information about an asset and its context that should be carefully analysed in a valuation:

<u>General context of the property subject to valuation</u>

- Macroeconomic context (GDP, consumption, investments, inflation, etc.),
- Demographic trends,
- Introduction of urban planning measures (locally and nationally) with a specific impact on the asset,
- Property tax system (e.g., municipal property taxes, registration tax, etc.),
- Lending conditions and restrictions,
- Technological innovation.

<u>Knowledge of the context and local market</u>

- Area where the asset is located ("Location, Location, Location!"),
- Urban planning situation, medium and long-term forecasts,
- Benchmark values (prices and rents) in the asset's real estate market,
- Tenants' credit ratings,
- Potential competitors.

Knowledge of the property subject to the valuation

- Building areas,
- Condition of maintenance,
- Compliance with urban planning/building/land registry regulations,
- Compliance with environmental regulations (whether there are liabilities, the need for reclamation or other),
- Potential (further building capacity, change of use, energy efficiency).

2.6. Assumptions and Special Assumptions

An assumption is a premise that is assumed to be true. Assumptions may be facts, conditions or situations concerning the asset or the valuation approach that it is generally accepted do not require verification by the valuer as part of the valuation process.

An assumption is normally formulated when the valuer does not need to conduct a specific investigation to prove that it is true.

Special Assumptions

A special assumption is an assumption that either assumes facts that differ from the actual facts existing at the valuation date or that would not be made by a typical market participant in a transaction on the valuation date. The valuation standards require adequate disclosure of special assumptions in the valuation report.

2.7. The Importance of Knowing the Specific Sector: "Special Property" Valuations

The distinction between "ordinary properties" and "special properties" is not simple. However, a quick, although simplified, method of classifying them could be to categorize as "ordinary" properties with traditional functions, like homes, offices, neighbourhood shops, production/artisan properties in general and their appurtenances.

On the other hand, "special assets" require specialized knowledge of their markets, specifically concerning their technical, income, profitability and general aspects, in addition to regulatory and operating aspects.

We have provided certain elements that valuers should consider in the valuation of certain "special assets" and that could significantly impact their market value. For the purposes of brevity, we have chosen to discuss only the most pertinent "special assets": large planned shopping centres, hotels and lodging properties in general.

a. Large planned retail facilities (shopping centres, retail parks, etc.)

Over the past 20 years, the shopping centre real estate market has progressively transformed into its own industry with such specialized characteristics that an increasingly deeper understanding of this phenomenon is needed to conduct a complete valuation of a shopping centre.

A shopping centre is an extremely complex real estate product in which many intervening variables could influence economic performance. The factors with a substantial impact on performance are: location (visibility, accessibility, dominance among its target users), the geography of competitors, merchandising mix, location of its anchor stores, its tenants' commercial attractiveness, the project's standing and other aspects related to management and marketing.

As with other commercial properties, a shopping centre's specificity lies in its ability to generate income through the lease of its lettable spaces. This income is often directly or indirectly linked to the turnover that can be withdrawn from the stores in the shopping centre, according to a sustainability threshold.

Market value is generally calculated in the event that the entire property is sold as one (rather than being divided into units), since most shopping centres have one single owner or a very small number of owners (i.e., the supermarket anchor and the centre).

Although different valuation methods and approaches abound, it is long-standing practice to use the income approach, specifically the DCF method, for the valuation of shopping centres, as this is believed to be the ideal valuation approach for the calculation of a shopping centre's market value.

The 10/15-year time period generally used to analyse the net cash flows generated by the property, not considering the strategies of opportunistic players with much shorter flip times, generally allows market players to carry out the appropriate asset management activities, which may include re-leasing the units, in addition to any capex to improve profitability, in order to substantially have the property operating at full capacity and sell it.

The valuation of a shopping centre is normally based on the property's situation in terms of lease agreements in place, its distribution layout, merchandising mix, etc., at the valuation date.

It is advisable to analyse the shopping centre's main performance indicators, such as its turnover, yield per square metre, the impact of the guaranteed minimum rent (plus shared costs) on annual turnover and/or other indicators deemed appropriate for the benchmark analyses and to assess their consistency with the assumptions and estimates underlying the valuation analysis.

The value of retail licences, without which the centre could not operate, is intrinsic to a shopping centre's market value.

The RICS Guidelines for Italy on the "Valuation of Shopping Centres", 1st edition, December 2015 define a "Retail Licence" as "The intangible asset relating to the property to be valued and consisting of all permits necessary to carry out retail operations in a permanent establishment." A retail licence for a shopping centre is typically a permit for a large sales structure arranged as a single unit (Italian Legislative Decree no. 114 of 31 March 1998)".

A listed real estate investment vehicle may be used provided that such vehicle's "main activity is property leasing" (art. 1(121) of Law no. 296 and article 1 of the Italian Decree on listed real estate investment vehicles). This implies that the vehicle does not manage the centre, as its assets and income relate solely to property leases. For tax reasons, it is therefore essential in the Italian market of commercial properties owned by listed real estate investment vehicles to value the component of lease income relating exclusively to the real estate (mostly generated by business unit leases), deducting from these inflows the intangible component referring to the licence.

Together, the legislation and regulations governing Italian real estate funds (art. 12 of Ministerial Decree no. 30 of 5 March 2015, Bank of Italy regulation of 19 January 2015, title V, chapter IV, section II, Assogestioni's guidelines of May 2010 and the joint Consob and Bank of Italy communication of July 2010) establish that these funds may invest exclusively in properties, real rights and equity investments in real estate companies. It is strategic for funds that invest in large shopping centres (whether they are planned centres or otherwise) to maintain control of the retail licences (intangible assets), without which the shopping centres could not operate. Under this legislation, the licences are the property of the SPVs, which are in turn owned by the funds. This gives rise to the need for valuers, especially when they are engaged as independent experts, to calculate the value of the licences. This is typical of the Italian market and is due to national regulations.

From a methodological perspective, valuation practices and theory diverge with respect to a generally accepted approach for the valuation of the market value of retail licences, or the only intangible component of lease flows, the licence. However, it is clear that lessors have a differential economic utility (which may be assigned a market value) if, by holding the retail licence, they can negotiate business unit leases rather than property leases, pursuant to Italian Law no. 392 of 27/07/1978. As is widely known, a business unit lease gives the owner more flexibility with tenants due to the lack of restrictions on the term of the contract, inflation rate indexing (which is otherwise set at 75% of the ISTAT cost-of-living index) and the fact that no indemnity is owed for a loss of goodwill pursuant to article 34 of the same law.

b. Hotels and Lodging Properties in General

The Italian lodging market – which presents a highly varied and fragmented supply of accommodations, mainly consists of independent, family-run businesses, with weak penetration by large hotel chains, and many different quality types and standards – increasingly requires a specific approach and specialized knowledge of the sector, in terms of both real estate and management aspects, in order to conduct a property valuation.

The value of a hotel is closely associated with the production potential of the hotel business operated within the property. A potential buyer will purchase a hotel based on the future profits that a reasonably efficient operator should be able to generate by operating the property. This is why the valuation must consider not only the property's intrinsic aspects, but also those of its hotel management and the market on which it operates.

The valuation of a hotel considers an operating unit, and generally this unit is "equipped" (i.e., it includes specific systems, equipment and furniture) and includes the permits and licences needed to operate the hotel business. The valuer must clearly state which components are considered in the valuation, i.e., the walls only or all the assets that make up the operating unit.

The method generally used to calculate the market value of a hotel is DCF analysis.

The main activities and specific considerations for hotel valuations are summarized below.

The location is a key factor in whether a hotel operation will perform well and will, accordingly, influence the property's market value. The analysis of this aspect is therefore fundamental and must take into account (i) context (both the macro context and the specific local context); (ii) accessibility, whether there is infrastructure and the relative distance; (iii) the property's visibility and recognisability and its nearness to generators of demand; (iv) the position of its main competitors to identify any competitive advantages or disadvantages; (v) whether it has or is near attractions or generators of demand (beaches, convention centres, trade fairs, office parks, ski areas, museums, theatres, etc.).

Unlike for other real estate asset classes, the market analysis for hotel properties is more specific in relation to the sector's typical management and statistical aspects, in order to examine historical trends in supply and demand and, therefore, the performance that the property can expect to generate in the medium to long-term, such as: (i) the trend in hotel demand (arrivals, visitors and segmentation by category, seasonal effects and origin); (ii) identification and performance of a competitive set (room occupancy rates, average daily rates [ADR], revenue per available room [RevPAR]); (iii) the trend in hotel supply (number of rooms, structures, segmentation by category and any new openings). In addition, any comparable transactions are analysed and verified to gather data from the hotel real estate market, where possible, on room values and returns, duly considering that the unit value in the valuation of a hotel is not surface area but room value.

The hotel sector includes a wide range of types of lodging which differ mainly according to: the location of the property (e.g., city hotels vs. resorts – sea, lakes, countryside, mountains); their market and their main source of business (e.g., business or pleasure); and their category (in terms of stars, from 1 to 5).

If they are not directly operated by their owner (direct management) lodging properties may be occupied in the ways described below, with each arrangement resulting in a different contractual situation which must be analysed to determine the correct valuation approach: (i) the property is managed by a tenant under a property lease/business lease agreement; (ii) the property is directly managed by a professional operator, which may be through a management contract or franchising agreement (in which case the owner is also the manager, i.e., directly management or vacant possession). For the purposes of the valuation, these contracts must be adequately analysed.

The valuation: first and foremost, as specified above, how the hotel is occupied and its contractual situation must be identified, as the valuation approach may vary accordingly: whether it is free and available or by vacant possession (in the event of direct management); (i) property lease or business unit lease; (ii) management contract (if the hotel is managed by third parties).

In any case, historical hotel management data must be acquired and analysed and the forecast performance of the hotel operation subject to valuation must be examined.

It is international practice in the hotel sector to prepare reclassified income statements using the US standards known as the Uniform System of Accounts for the Lodging Industry ("USALI", 11th edition). These income statements are normally used to value the property (if it is directly managed) or to analyse the sustainable rent (if it is leased or similar).

2.8. The Valuation of Mortgaged Properties in Compliance with ABI Guidelines

The 2018 edition of the guidelines for the valuation of mortgages securing credit exposure was approved on 30 November 2018. The document was prepared by a Technical Committee coordinated by ABI, the Italian Banking Association, and comprised of representatives of all the concerned institutions, with the property valuer work group carrying out the work.

The guidelines are a series of principles, rules and procedures for the valuation of mortgages securing credit exposure (collateral) with the aim of promoting transparent, high quality and correct property valuation procedures to encourage the stability of credit institutions in both lending transactions and the issue/acquisition of securities resulting from securitisation transactions and guaranteed bank bonds.

The current version (third edition) is meant to meet the principles of the current legislative framework, particularly article 120-*duodecies* of the Italian Consolidated Banking Code ("TUB"), which requires the adoption of "reliable standards for the valuation of real estate assets". The guidelines have been prepared in accordance with the International Valuation Standards, specifically the most up-to-date versions of the International Valuation Standards (IVS), the European Valuation Standards (EVS) and the RICS Global Valuation Standards (RICS Standards 2017).

The most significant changes include the appendices to the new guidelines specifically dealing with the valuation of special properties (see § 7.0 above) and details on the energy efficiency of buildings.

2.9. "Property Value"

Requirement 5 of the "Guidelines for assessing properties as collateral for credit exposures" aims at supplying the initial information indications about the "Property Value". The guidelines, published on 6 December 2024, were prepared by ABI (Italian Banking Association) and ASSOVIB (Association of Real Estate Valuation Companies), jointly with Tecnoborsa and key Italian professional associations, and with the collaboration, among others, of Confindustria Assoimmobiliare, Confedilizia and chief international valuation associations.

Regulation 575/2013/EU, as amended by Regulation (EU) 2024/1623 of 31 May 2024, of the European Parliament and European Council, under Article 4, paragraph 1, point 74bis, defines "Property Value" as "the value of a residential or non-residential property, determined pursuant to Article 229, paragraph 1".

Under Art. 229, paragraph 1, the same Regulation provides that the valuation of a property must meet all the following requirements:

a) the value is estimated independently, with respect to the procedure of the bank of the mortgage acquisition, processing and the decision regarding the loan, by an independent expert, possessing the qualifications, capacity and experience necessary to carry out a valuation;
b) the value is estimated using prudent valuation criteria that meet all the following requirements:
    I. the value excludes any expectations of price increases;
    II. the value is adjusted to take into account the possibility of the current market value being significantly higher than the value that would be sustainable for the term of the loan;
c) the value is documented in a clear, transparent manner;
d) the value is not higher than the market value of the property, where the latter might be established;

e) should the property be re-evaluated, the value of the property shall not exceed the average measured value for said property, or for a comparable property, during the last six years for residential properties, or eight years for non-residential properties or the value at the moment the loan is granted, whichever is higher.

The international valuation standards (IVS-EVS-RICS) do not include the "Property Value" among the "recognised bases of Value", which use prudently conservative valuation criteria for the purpose of supplying and monitoring loans. Hence, the "recognised bases of Value" remain the Market Value, Investment Value and Fair Value.

At this time, the "Property Value" cannot be likened to any of the recognised bases of value and, more specifically, cannot be considered coinciding with the definition of "Market Value", since:

- as indicated above, Regulation 575/2013/EU provides, under Art. 229, paragraph 1, letter b), point ii), for the value being adjusted to take into account the possibility that the current market value is significantly higher than the value that would be sustainable for a timespan equal to the term of the loan, unlike the "market value", which refers to a specific date (that coincides with that of the estimate);
- letter d) of the aforesaid Article 229, paragraph 1, states that the value shall not exceed the market value of the property, where the latter could be established, and is, therefore, by definition, methodologically different from the Market Value.

Having taken into account the provision in Art. 229, paragraph 1, letter b) point (ii), as reported above, the "Property Value" could, however, be "derived" from the market value, "where the property may be established".

Considering that the elements characterising the definition of the market value are not entirely satisfied, it appears appropriate to refer, among other things, to specific assumptions in the estimate of the "Property Value", which must be rational, objective (or at least plausible) and motivated.

In this regard, the appraiser could determine possible scenarios of evolution of the real estate cycle of the market segment, to which the property belongs, in order to express an opinion about placing the market value of the property being estimated within the cycle ascertained.

This placement could allow for determining the potential deviation between the specific "Property Value" and the "market value", taking into account that, where definable, the latter is to be considered the maximum value ("cap") that can be reached by the "Property Value" for the term of the loan.

The deviation could be calibrated on the specific property in relation to the chief areas of potential risk, both present and future, of a reduction of the market value. Among the factors that influence the risks linked to a property and, consequently, affect the sustainability of its value over time, the following could be considered:

- ESG factors of the property as regards its localisation and market segment; special attention is to be paid to the energy performance of the property and its resilience, that is, its exposure to physical and transition risks. To be taken into account among the possible variables are risks linked to the following factors: (i) Environmental (probability of hydrogeological, seismic, climatic, volcanic events, etc.), (ii) Social (safety at the workplace, levels of noise and atmospheric pollution, etc.) and (iii) Governance (logical regulations, etc.). With regard to the "Social" component, to be included are also the presence of services (both neighbourhood services and those inside the building) benefitting the residents and users of the asset;
- Location: the localisation of an asset is a fundamental component for weighing the physical and transition risk. Furthermore, the most sought-after locations usually involve a sustained demand in every phase of the property cycle; the prime positions of some properties may cause, specifically, a higher impact of the land component on the overall value of the asset, thus reducing the overall risk to it. In consideration of the specific asset class, "Prime locations" are able to reduce the perceived future risk on the asset. Lastly, good locations allow for more possibilities of converting a property, by guaranteeing multiple possible functions that can be installed in the asset being examined, or the success of any transformations, thus, increasing possible enhancements (conversions into another function and Highest and Best Use (HBU), which are more rewarding and generally reduce the perceived risk);
- Type of asset and its features (use allocation, state of preservation, building quality and installation quality);
- Compliance of the asset to all the regulatory prescriptions (including structural, environmental and safety regulations);
- Fungibility and flexibility of the asset, understood as a judgment of the capacity of a given property to be converted to several functions without radical alterations. Highly fungible assets are usually suitable for housing several functions and have a vast flexibility of the spaces, thus allowing the asset to always be in line with the needs of the market and be used by

an ample number of parties. On the contrary, specialised assets, originating for a specific function, are at a high risk of functional obsolescence, when the activity installed comes to an end;

- Analysis of the capacity to generate stable income over time, above all on "income-producing" assets: the situation of the agreements existing at the valuation date will have to be duly analysed and monitored and compared with the market. Such an analysis is essential during both the phase of supplying financing and the monitoring phase (many market segments may vary over a short time period, due to the economic and technological evolution of the particular segment). The capacity to generate income will also become increasingly important for the residential sector, through the increase in income-producing assets (student housing, senior living, multifamily, social housing, etc.).

To be of sole consideration during the work-up of the "Property Value" are the impacts of those factors that did not contribute to the forgoing determination of the "Market Value".

The deviation between "Property Value" and market value may not be determined through a mere percentage cut of the "market value", applied in the absence of a motivated analysis; it must be precisely represented in the expert opinion. Hence, the determination of the "Property Value" will only be possible by having sufficient data to describe the elements that characterise it.

2.10. Real estate appraisals and ESG factors (Environmental, Social and Governance)

The most important operational guidelines on which banks rely in order to define their own rules for the appraisal of real estate collateral for loans are contained, as already outlined, in the documents drafted by EBA (European Banking Authority), Banca d'Italia and ABI.

In particular, EBA in the document: "Orientamenti EBA in materia di concessione e monitoraggio dei prestiti – Guidelines on Loan Origination and Monitoring – (EBA LOM)" published on 29 May 2020, provides that banks should evaluate the "sustainability and the feasibility of future repayment capacity under potentially critical conditions" as well as – in Chapter 7 (Valuation of real estate and movable assets) – "should take into account the ESG factors affecting the value of the collateral, for example the energy efficiency of assets".

Both IVS and RICS (main valuation reference standards) updated to 2022 included explicit references to ESG indicators and their knowledge in the valuation practice.

At the moment, the international standards merely indicate that these issues are important today and will increasingly be so in the future; they do not give specific indications of what and how the appraisers must take into account in their job. This task is delegated to the single national / supranational entities, also since the ESG concepts are very extensive, not yet homogeneously measured, and can differ from country to country due to multiple factors (climatic, social, economic, and cultural).

Banks and valuers are expected to include ESG factors in their market analyses, as well as investors will have to consider them.

A good answer to ESG best practices will be a *conditio sine qua non* to guarantee the Market Value of a property or a specific asset class over time, because demand will increasingly value these factors; however, this condition will not be the only one and it will not be sufficient, as the value retention depends on many other factors linked to base elements of the concept of value of a real estate such as location, usefulness, its uniqueness and its ability to be “resilient” and “flexible”. The ability of an asset to adapt to the current, but also future, needs of the demand is probably the quality that will become crucial in a changing market, full of new hybridizations.

Even if included in the valuation analyses, ESG factors are unlikely to change the Bases of Value or the currently used valuation approaches; mainly because basically all valuation approaches are based on the comparison of data (prices, rents, yields and costs); if a market is mature and liquid, characterized by transactions of similar assets, for example in terms of energy, the plain comparison of assets similar for performance levels will always be the most correct approach.

A completely different theme is creating checklists dedicated to the performance definition of a given asset and its correspondence to ESG best practices (ESG rating); the above, together with a risk analysis of the value retaining over time, will probably become a side activity to the valuation process as we know it now.

The Market Value is an exact figure and reflects the market pictured at the valuation date; ESG analysis and value retention over time are more similar to compliance due diligence and risk analysis and must be integrated into the data sets banks will use in their credit granting or monitoring processes.

The Banks will have to integrate the market valuations of the collaterals with prospective analyses of the value retention risk and compliance with the best ESG practices of the specific asset category (also based on the location); These analyses will have different levels of insights based on both importance and specificity of the assets.

The related regulatory set will be fundamental as well as its application in virtuous market practices; where virtuous means shared, transparent, codified, and clear.

All the different professional associations should support the new systems implementing process by helping to outline metrics and organize databases for defining an «ESG rating».

3.
The Real Estate market in 2024 and outlook in 2025

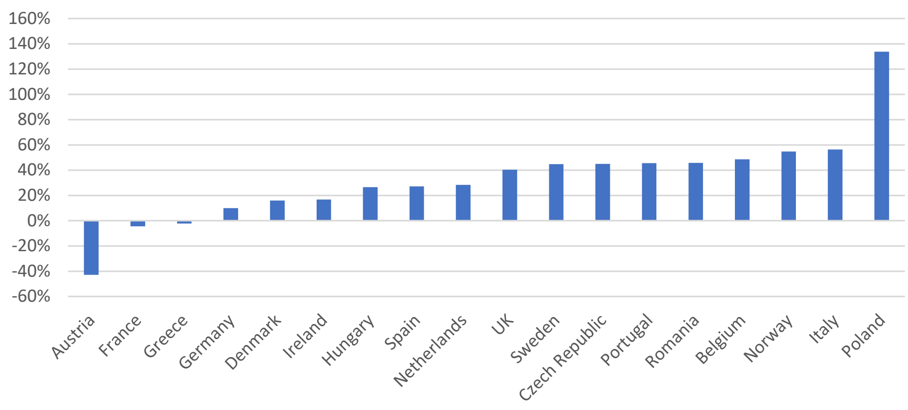
by M. Montosi and E. Zanlorenzi

3.1. European Investment Scenario

European CRE investment volumes reached approximately €191 billion in 2024, marking a 27% increase compared to 2023 and a 27% contraction on the last 5-year average. The growth recorded over four consecutive quarters brought Q4 2024 volume to around €66 billion, a level still far from the last 10-year average but reflecting a strong increase (+58% YoY). A strong final quarter across real estate capital markets is providing good momentum for the beginning of 2025.

Major institutions are back in the market, with portfolio and M&A deals rising in the final quarter. Both cross border and domestic institutional investors increased spending last year, taking back some market share from smaller private investors, who had been the most active in recent years. The recovery is also broad-based, extending beyond a particular market or region, and not concentrated in one sector. Most major markets saw year-on-year growth in investment in 2024.

Investment volume by country (% variation 2024 vs 2023)



Source: Savills Research

The global scenario is still dominated by uncertainty, but the economy showed good resilience. In the Eurozone, the economic growth remains in positive territory with wage growth slowing and energy prices likely to fall.

The pandemic accelerated certain structural changes in the market consolidating some asset classes considered more resilient, such as logistics and multifamily, which have become the second and third largest asset classes by investment volume respectively. The positive trend registered during 2024 affected all asset classes. Although challenges persist, concerns related to office sector seems overstated.

After the sharp slowdown in 2023, office investment activity returned to growth in 2024, although volumes were still far from past year standard. Office investment reached 22% of total volumes in Europe in 2024, marking the sector as the first asset class. Demand is recovering, driven by a resurgent tech sector and companies upgrading spaces to attract talent. Office take-up is forecast to rise in 2025, nearing pre-pandemic levels. Gradual recovery is anticipated, with core and core-plus investors focusing on super-prime and green certified properties, while value-add investors target secondary assets in CBDs and other strategic locations.

The logistics sector is expected to remain an attractive asset class, although capital flows are likely to moderate. In 2024, investment (€41 bln) increased by 22% YoY and was equal to 21% of investment volumes, confirming the appetite for the sector. Following the pandemic-driven surge that reshaped global supply chains, the market has entered a period of normalisation expected to stabilise further, supported by low vacancy rates and a limited development pipeline.

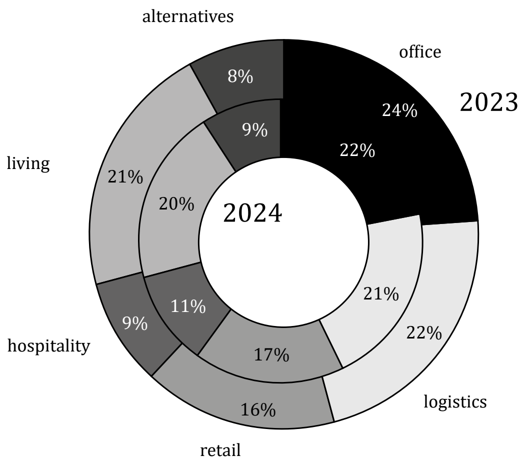
Investors‘ interest for the living sectors will continue in 2025, driven by strong demand fundamentals. Student housing will attract growing attention, supported by rising international student numbers, with continued strong activity in Spain and in the rest of southern Europe. European living investment volumes reached approximately €39 bln in 2024, marking a 21% increase YoY and a 35% contraction on the last 5-year average, after the record volumes of 2021. Rising urbanisation, affordability challenges, and tight mortgage conditions will bolster demand for rental properties, supporting stable occupancy and steady rental growth. Limited land availability and rising construction costs may constrain new supply, underpinning long-term rental growth.

Easing inflation across Europe is expected to enhance purchasing power and boost retail sales, creating a favourable outlook for the retail sector in 2025.

Retail investment turnover is anticipated to grow, underpinned by stronger investor confidence and broader economic recovery. A rising supply of assets and an expanding buyer pool should drive increased transaction activity. Grocery and convenience stores, retail warehouses, and prime high-street assets are set to stand out as particularly attractive investment opportunities.

Hotel investment is expected to remain robust, though with some moderation compared to the exceptional activity of recent years. While European RevPAR is forecasted to grow, the pace of increase will slow, exerting pressure on margins as cost growth continues, though easing. This normalisation in top-line performance is likely to prompt exit decisions from some owner-occupiers, creating opportunities for new market entrants. Transaction volumes are expected to stay high, supported by more realistic pricing expectations and a gradual decline in borrowing costs, which will enhance liquidity and activity in the market.

Investment volume by sector (2024 vs 2023)



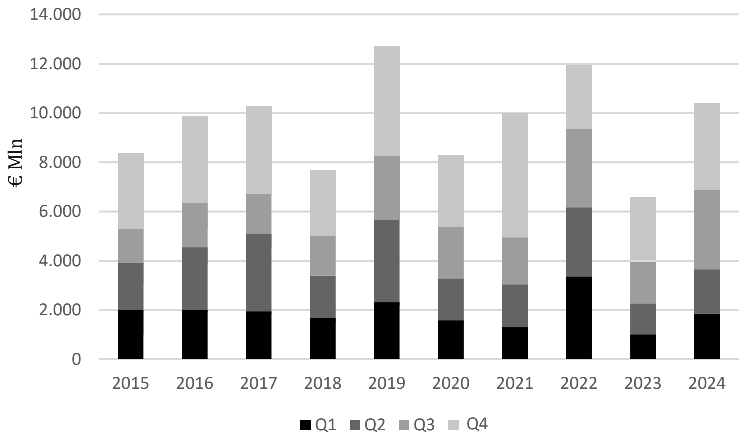
Fonte: Savills Research

3.2. Italy Investment Scenario

In 2024, around €10.3 bln was invested in the Italian commercial real estate market, registering a 56% YoY increase and confirming the positive trend that began in the second half of 2023.

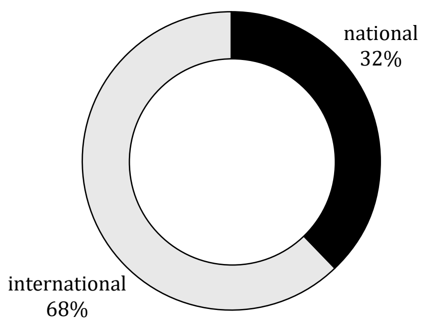
Despite some caution related to monetary policy and geopolitical risks, the market remained dynamic with 275 deals closed, well above the five-year average of 226. However, high financing costs and difficulty in securing leverage resulted in a prevalence of transactions below €50 mln but, thanks to the closing of several portfolio deals and to the largest single-asset transaction ever recorded in the Italian market, the average deal size returned to growth. The geography of the active players still report a predominance in international capital (68%), mainly European and American, a sign that the Italian market remains competitive. The share of domestic investors returned below the last 10-year average (32%), but remains close to the average in absolute value, with domestic players more active in office and mixed-use sectors.

Historical Investment Volume by quarter



Source: Savills Research

Domestic / International Capital Money 2024



Source: Savills Research

The post-Covid period saw the consolidation of interest in sectors such as the living one in all its segment, but especially in student housing and built-to-rent assets, and the consolidation of logistics and hospitality as leading sectors of Italian real estate. In 2024, on the other hand, retail and office are once again the leading asset classes.

For the first time in a decade, retail has become the leading asset class by investment volume, with around €2.3bn, fuelled by strong fundamentals in out-of-town retail, unique high-street locations opportunities, and a convergence in price expectations between buyers and sellers. Four of the largest transactions of the period were recorded in this segment. The high street component remained relevant, while shopping centres and essential retail—such as grocery and DIY stores—continued to be a key focus of investors' strategies and will keep driving the segment in the coming quarters. Out of town segment performed well, recording 22 deals for around €1.2 bln: this represents the highest value since 2019. Shopping centres drove the activity with the closing of 6 deals, two of which above €150 mln located in Rome and in Palermo. High street recorded 49% of the volumes confirming that tourist and luxury destinations are at the centre of investors and retailers' strategies.

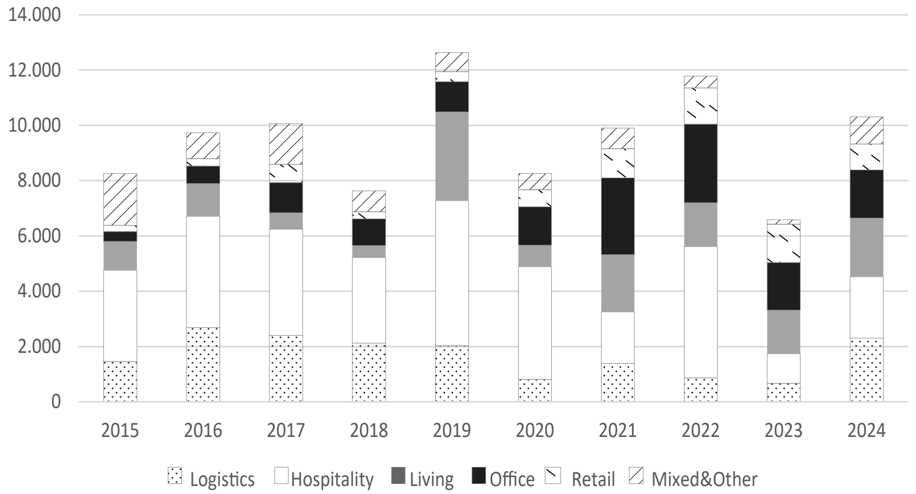
With around €2.2 bln, offices have seen a strong rebound in investment volumes in line with a market that, on the occupier side, is dynamic and points to 2024 as the year with the highest number of transactions. Activity is mainly concentrated in the Milan market (50%), with prime yield decompressing at 4.25%, whilst Rome market share returned to grow (38% of the overall volume) with prime yield at 4.75%. The sector is reaffirming its centrality in the Italian market, despite investors being more selective than in the past also in prime markets. Tenants continue to prioritise location, accessibility, and high-quality, green-certified, tech-driven buildings, while also becoming more cost-conscious about fit-out and customisation expenses. Vacancy for grade A assets remains in the region of 3.6%, while polarisation between prime and secondary office spaces is widening. As the deadline for the 2030 Agenda for Sustainable Development grows closer, companies are prioritising sustainability initiatives, with a strong emphasis on building efficiency, particularly in HVAC systems, and an effort to source renewable energy.

Hospitality continued to overperform, representing one of the most sought-after sectors. 2024 recorded a total of €2.1 bln, a figure 34% up YoY and above the last five-year average. Moreover, the sector was the most dynamic in the Italian landscape, recording the highest number of deals (75) throughout the year. Investors' strategies are shifting towards new leisure locations and asset types. Rome saw its market share increase, collecting around 25% of volumes across 10 transactions. Milan, Rome, Firenze and Venezia remained top destinations, but interest is also shifting towards regional markets such as Napoli, Bologna, Genova, Palermo and Verona. Sea and lake destinations have attracted significant interest, confirming the strong appetite for leisure locations. Value add strategy is becoming more and more recurrent, in many cases including changes of use.

Logistics confirmed its relevance in the Italian CRE scenario, representing around 17% of total investment volume. In 2024, logistics was the fourth most requested sector for a total of around € 1.75 bln (+2% YoY). After a first semester characterised by the prevalence of the industrial and light industrial components, the share of volumes absorbed by traditional logistics returned to grow again. Value add and core plus capitals are leading the market, with a potential return of core capitals in the next months. After months of decompression, prime net yields decreased by 25 bps in the Milan cluster at the end of the year and remained stable in all the other primary geographies.

The living sector bucked the trend, being the only one to experience a slowdown in volumes compared to the previous year. A total of €950 mln has been recorded, 32% down YoY. The sector continued to suffer a lack of up-and-running transactions in both student housing and residential segments, following the continued slowdown in construction and planning permits. Considering the most mature segments of PBSA, twelve student housing assets and developments were transacted in the year, for a total of around €270 mln. Interest remained high in consolidated geographies (Milan, Rome, Bologna, Torino, Firenze), but at the same time it is expanding in regional markets with a strong university presence, such as Padova and Pisa.

Investment volume by sector



Source: Savills Research
* Due to transaction type these deals are not included in the official volumes: 2017 Telecom Portfolio (€620Mln) / Diesel Store (€96 Mln) / 2019 MPS UTP Portfolio (€420mln)

3.3. Outlook 2025

2024 saw a reversal of the downward trend that characterised the previous year's market. The rebound in investment activity is partly due to some large deals that drove the market. For H1 2025 we expect a substantial stability, while a new revival is postponed until the second half of 2025. Financing costs have not yet significantly reduced, and global economy is still dominated by uncertainties. Value-add investors will predominate, but core players will also return to be active.

Like interest rates, yields will remain higher than seen in recent years of expansionary policy. A general compression is likely later in 2025, although with limited scope compared to past recoveries. Today and in the coming months, price corrections will continue to affect secondary assets, contributing to deepen the polarisation between prime and potentially stranded assets. As affordability impacts absorption, rental growth will slow down even in sectors characterised by demand constraints. Stabilising financing costs will most likely result in increased activity in H2 2025.

Living will remain one of the highly sought-after sectors, especially for the more mature PBSA segment, but volumes will remain subdued due to a lack of income producing products. Logistics will consolidate its relevance in the Italian real estate market. Office investment activity will remain subdued as rental increase and lack of grade A supply are holding back take-up. Hospitality sector is expanding thanks to new locations and formats. Selective proposition in the out-of-town market will offer appealing risk-return profile; the high street segment will attract institutional investors and see vibrant brands demand.

Decarbonising the real estate sector is an urgent and pressing need, and ESG targets are actively shaping investors and occupiers' decisions. Green certifications are no longer sufficient today, rather the minimum requirement to obtain bank financing. ESG strategies are starting to move towards the S of social.

PART I
Real Estate investment

4.
Real Estate companies

by A. Cagnani, M. C. Corno, V. Lamperti, F. Momi

4.1. Introduction (definition of the framework and main classifications: Real Estate Construction companies, Real Estate Management companies and Real Estate trading companies; "Real Estate as stock-in-trade", "operating properties used in business" and "Real Estate assets")

The contractual framework most often adopted by the industry operators in the Real Estate industry is typically a *contratto di società* (contract for the creation of a company). This chapter will deal with the most important tax issues that affect the determination of income from a tax point of view, with regard to commercial companies. The emphasis will be on Italian commercial corporations, even if the provisions of the Income Tax Code governing the determination of the income of such companies, i.e., business income (Articles 81-110 of the Income Tax Code) are applicable also to commercial partnerships (in Italy, "s.n.c." and "s.a.s."), by virtue of the reference made by Article 56 of the Income Tax Code.

Italian tax law applies the principle known as "*principio di attrattività del reddito d'impresa*" *i.e.* "*the principle of attraction of business income*". Under this principle, any income referable to partnerships and to public limited companies is deemed to be part of business income even if classified in different categories. Indeed, both income from commercial partnerships[1] and income from corporations[2], whatever its source, is considered business income and, therefore, is determined according to the relevant applicable regulations.

1 Under Article 6 (3) of the Income Tax Code, income belonging to such types of companies (s.n.c. and s.a.s.), shall be deemed to be, by non-rebuttable presumption, business income and is therefore determined according to the rules that govern this class of income.

2 Article 81 (1) of the Income Tax Code.

Under the provisions of the Income Tax Code, real property belonging to Real Estate companies can be classified into the following categories:

1. Real Estate as stock-in-trade;
2. operating property used in business: in turn subdivided into operating property by destination, by nature or on a temporary basis;
3. Real Estate assets: large residual category which includes all the property that cannot be considered as stock-in-trade nor as operating property.

Real Estate as stock-in-trade consists of property the production or exchange of which is the object of the company's business. The scope of the company's activity is identified on the basis of the by-laws or, subordinately, on the activity actually performed.

This category typically includes buildings built or renovated in order to be sold by building or development Real Estate companies or Real Estate (land and buildings) purchased for resale by Real Estate trading companies.

As a rule, these properties are shown by the Real Estate construction and/or trading company in their Balance Sheet, under item C.I of the Assets in the Italian format, as part of inventory.

Real Estate as stock-in-trade built or purchased to be sold by Real Estate companies is included in the corporate income resulting from the profit and loss account (in short "P&L account"), pursuant to Article 83 of the Income Tax Code, in particular through (the financial statements classification of the relevant items according to Italian accounting principles is given in parentheses):

- sales revenue (item A.1 of the P&L account);
- changes in inventories (items A.2 and B.11 of the P&L account);
- rental income (item A.5 of the P&L account)[3];
- construction costs (items B.6, B.7, B.9, etc. of the P&L account).

No depreciation is recognized in the financial statements in connection with Real Estate as stock-in-trade. Thus, since it is not included among fixed assets, from a tax standpoint Real Estate held as stock-in-trade forms part of corporate income as a change in closing inventories, pursuant to Article

3 Given their nature as trading assets, or assets for resale, and therefore for the production of business revenues related to the company's core activity such properties can only be rented on an occasional basis, for the short term, until completion of their sale. If this were not the case, it would indeed be appropriate to reclassify the aforementioned properties as assets, in the category of fixed assets. Once reclassified as Real Estate assets, such property, no longer inventories, would form part of the business income based on the criteria defined by Article 90 of the Income Tax Code (see below).

92 of the Income Tax Code until completed and sold or unless its intended purpose is changed.
At the time of sale of the real estate, the relevant sales revenue and the construction costs (suspended in the meantime by recording stocks) will be included in the P&L account.
Finally, if the property is rented to third parties for short periods of time and occasionally, the rental payments recorded in the P&L account constitute business income (item A.5).

With regard to the operating properties used in business, on the other hand, they are subdivided by Article 43 (2) of the Income Tax Code into three categories:

- operating property *by destination*;
- operating property *by nature*;
- property granted in use to employees (temporary operating property, limited to a maximum of three tax years).

Operating property by destination "*is used exclusively in the performance […] of business by the owner*" (article 43(2) first period of the Italian Income Tax Code). The property must therefore be used on an exclusive basis, not counting the possibility of mixed use, partly for business purposes and partly for purposes external to business.

According to the second sentence of Article 43 (2) of the Income Tax Code, operating property by nature is property which, *because of its very nature could not be used for a different purpose than it actually is without radical changes,* even if such property is not used nor rented or loaned for use.

The operating nature of such property can therefore be assessed objectively, as its use or non-use in the performance of business is not relevant: the Real Estate unit belonging to the trading company that is classified or classifiable in the land registry in one of the categories mentioned by Ministerial Resolution dated 3 February 1989 n. 3/330 is operating in nature even if it is not used directly for business operations, but is let or loaned to a third party.

The cited Ministerial Resolution No. 3/330 defines the operating nature according to cadastral records, specifying that properties that are or can be classified in the land registry under categories B (property units for use as collective accommodation), C (property units for standard, commercial and miscellaneous use), D (special-use properties) and E (properties with a particular use), as well as category A/10 (offices and private practice premises) are operating properties by nature.

Finally, buildings pertaining to a business and given in use to employees, who must have registered their residence within the same Municipality (*Comune*) where they provide their services, for business needs, are considered operating property on a temporary basis (Article 43 (2), last period, of the Income Tax Code). In this case, the rule disregards the cadastral category the building is part of. However, because of their destination (granted in use to employees), it can be inferred that they would be mostly residential buildings (cadastral categories in Group A, excluding A/10), which, normally, for commercial enterprises, would represent Real Estate assets. The nature of operating property, with regard to the buildings listed in Articles 43 (2) last period of the Income Tax Code is, however, recognized "*on a temporary basis*", that is to say only for the tax period in which the employees transfer their residence and the subsequent two. During such three tax years, the buildings in question become operating property, thereby forming part of the business income of the undertaking based on the results of the P&L account (revenues and expenses). In particular, from the point of view of the cost components, in the three tax years, the expenses shown in the P&L are allowed to be fully deducted, provided that the principles of relevance and accruals basis pursuant to Article 109 of the Income Tax Code are met. At the end of the third tax year of application of such "operating property on a temporary basis" system the property shall again be regarded as "assets", with the possibility to rent the property to another employee who will transfer his or her resident address there.

From a statutory point of view, operating properties (by destination, by nature, "*temporary*") are recorded as fixed assets, under B.II.1 of the Balance Sheet (land and buildings) and are therefore subject to depreciation.

Operating properties contribute to form the business income according to the results of the Profit and Loss Account and in particular (The financial statements classification of the relevant items according to Italian accounting principles is given in parentheses):

- through the capital gains arising from their sale (*i.e.* item A.5 of the P&L);
- through the proceeds generated from their rental (item A.5 P&L);
- through the cost components flowing into them, such as depreciation, maintenance costs, insurance, interest expense, capital losses etc.

The properties belonging to the company, other than operating property and property as stock-in-trade, are included in the residual category of Real Estate "assets", the tax treatment of which is regulated by Article 90 of the

Income Tax Code[4], i.e. are included in corporate income in accordance with the rules governing income from land and buildings rather than on the basis of the relevant costs and income (as is the case instead for operating property and property as stock-in-trade).

In general, therefore, such category consists of land which is not used directly in the performance of the business and buildings intended as private houses (cadastral categories under Group A, except A/10) not used directly on an exclusive basis in the conduct of the business (provided they are not held as stock-in-trade or as assets for resale by development and Real Estate trading companies).

In the Balance Sheet (drawn up according to Italian accounting principles), Real Estate assets are recognized as tangible assets, under B.II.1. Those assets are generally not subject to depreciation except certain types of land[5] and buildings[6].

A further classification basis adopted by legal experts, which is based on the type of activities carried out by Real Estate companies (or at least on the main type of activity it carries out), divides Real Estate companies into three main types:

1. estate development (where the activity exclusively or primarily consists of the construction/renovation of properties for resale);
2. estate trading (where the activity exclusively or predominantly consists in the purchase and resale of properties);
3. estate management (where operations exclusively or primarily consist in the management of Real Estate, performed, on a prevalent basis, by renting it out to third parties).

It should be stressed that the above classification is purely theoretical. Indeed, we are often faced with "mixed" Real Estate companies, which can deal at the same time with both construction activities for subsequent resale and Real Estate management activities (with the ultimate aim of increasing the productivity and efficiency of property with a view to prospective assignment). Certain factors generated within the company, such as the

4 Article 90 (1) of the Income Tax Code refers to Real Estate "*not consisting in assets used in business nor assets whose production or exchange is the direct object of the business*".

5 Such as land occupied by quarries or needing to be reclaimed and those subject to actual decay.

6 According to OIC document no. 16, § 59 the depreciation plan of buildings not consisting of assets used in business must meet the same conditions as that of the other tangible assets (they may not be depreciated when their remaining value is equal to or higher than the net book value).

acquisition of certain skills, or external factors, such as market opportunities, can sometimes lead management to adopt specific business strategies that differ from the type of activities undertaken up to a given time.

By close approximation, for Real Estate development and Real Estate trading companies, the Real Estate component forms part of the company's income, mostly based on the results of the profit and loss account (or, if you prefer, "costs and revenues").

Instead, for property management companies, corporate Real Estate forms part of the business income:

- in part (*e.g.* property registered with the land registry in cadastral groups B, C, D and E in the category A/10 rented or not rented to third parties, operating properties by destination) based on the results of the profit and loss account (prepared for entities adopting Italian accounting principles) in accordance with the schedule set out in Article 2425 of the Italian Civil Code);
- in part (*e.g.* residential properties – Group A except A/10 – whether rented out to third parties or not) on the basis of the criteria laid down for imputed income on the ownership from land and buildings. Expenses and other cost components related to these properties are not deductible[7]. There follows the need to make appropriate increasing or decreasing adjustments in the tax return.

4.2. Deduction of interest expense

The Italian tax system has several provisions that regulate the deductibility of interest expense. Specific regulations are in fact provided, depending on the categories of taxpayers they refer to, namely:

1. entities covered by the provisions for personal income tax (sole proprietors, s.n.c. and s.a.s.)[8];
2. entities engaged in financial activities[9];

7 Article 90(2) of the Italian Income Tax Code states that «costs and other expenses related to the real estate referred to in paragraph 1 are not deductible ».

8 For the purposes of Article 61(1) of the Income Tax Code, "*interest expense relevant to the company's business can be deducted for the part corresponding to the ratio of the amount of revenue and other proceeds which contribute to form the corporate income or that do not contribute to it because they have been excluded, to the overall amount of all revenues and proceeds*".

9 Article 96(13) of the Income Tax Code provides for a flat-rate deduction of 96% of the interest expense incurred by insurance players, as well as by the investment fund managers and securities

3. IRES taxpayers who do not carry out financial activities.

Two provisions complement the above regulations. They are contained in two paragraphs of the 2008 Finance Act[10] and regulate the deductibility of interest expense with regard to specific instances that fall within the Real Estate industry.

Legislative decree 142/2018 of 29 November 2018, transposing the ATAD Directives (Directive 1164/2016/ EU "ATAD 1" and Directive 952/2017/ EU "ATAD 2") and introducing significant changes to article 96 of the Italian Income Tax Code on interest expense deduction, was published in the Italian Official Journal on 28 December 2018. The new rules entered into force with effect from the fiscal year subsequent to that ongoing at 31 December 2018.

By operation of the new rules, some cases of full deductibility of interest expense have been abrogated[11], whereas other cases in which deductibility of interest expense is excluded *a priori* have been confirmed[12].

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brokerage companies (SIMs) referred to in legislative decree no. 58 of 24 February 1998. Until the fiscal year in progress at 31 December 2016, this rule applied also to banking and financial entities (the restriction was introduced by law 208/2015, Stability Law 2016).

10 Article 1(35 and 36) of Law no. 244 of 24 December 2007.

11 Under its prior wording, article 96(5) of the Income Tax Code allowed full deductibility of interest expense incurred:

i. by consortium companies created for the execution of all or part of the works pursuant to Article 96 of Presidential Decree of 21 December 1999, no. 554 (*i.e.* companies gathered in a consortium after the award of a public works contract under law no. 109 of 11 February 1994);
ii. by project companies incorporated under Article 156 of Legislative Decree no. 163 of 12 April 2006;
iii. by companies incorporated for the creation and operation of container terminals pursuant to law no 240 of 4 August 1990.

12 Article 96(15) of the Income Tax Code provides for the "*priority* application *of the rules providing for the absolute non-deductibility*" of the following types of interest:

i. interest expense related to Real Estate assets, with the exclusion of financing interest (Article 90(2) of the Income Tax Code);
ii. interest expense arising from transactions with non-resident group companies who are assessed at a value higher than the arms' length value (*Transfer Pricing rules contained* in Article 110(7) of the Income Tax Code).

Specific deductibility regimes apply pursuant to other rules in the following cases:

- interest on loans made by the members of cooperative companies, not deductible for the part that exceeds the interest due to holders of interest-bearing postal bonds increased by 0.90% (Article 1 (465) of Law no. 311 of 30 December 2004);
- interest on arrears, which is not deductible if not paid (Article 109 (7), of the Income Tax Code);
- interest expense on VAT quarterly settlements (Article 66 (11) of Decree no. 331 of 30 August 1993);
- interest expense related to the purchase of motor vehicles, which is subject to the terms of Article 164 of the Income Tax Code.

In this section we will attempt to outline the main features of the rules for the quantification of deductible interest expense for a given tax year contained in the Income Tax Code with reference to corporate taxpayers who do not conduct a financial activity. In consideration of the lively jurisprudential debate, following the stance taken by the Tax Authorities on the rules introduced by the 2008 Finance Act concerning the deductibility of interest expense in certain cases which involve the Real Estate sector, this subject will also be dealt with.

Before illustrating the steps for the determination of the interest expense deductible in a given tax year, it is important to describe the objective scope of the rule, that is to say identify the type of interest expense, as well as the types of interest income that may reduce the former, which remain subject to the standard restrictive rule being commented upon.

This definition is provided by the revised wording of Article 96(3) of the Italian Income Tax Code, which states that «*the provisions of this Article apply to interest expense and interest income, as well as similar financial costs and income characterized as such by the accounting principles adopted by the company […] and which derive from a transaction or contractual arrangement implemented for financial reasons or a contractual arrangement containing a significant financing element. For the purposes of this article, interest income, as identified in the first period, is relevant to the extent that it is taxable; also costs and income which – albeit deriving from financial instruments characterized as instruments representing equity pursuant to the proper application of the accounting principles adopted – are wholly taxable or deductible in the hands of the recipient or the payer respectively, are relevant as interest income or interest expense*».

It should be stressed that the objective scope outlined by Article 96(3) of the Italian Income Tax Code is the same for all types of activities carried out and will become applicable for corporate taxpayers who carry out financial activities.

Any interest (or similar charge) connected to the provision of a supply of money, securities or other assets for which there is an obligation to return and in relation to which there is specific remuneration[13] falls therefore within the scope of the provisions being examined.

Special attention shall be paid to the definition of "similar financial charge". This point has been clarified by Tax Authority Circular No. 19/2009,

13 Cf. Revenue Agency Circular of 21 April 2009, no. 19/E (§ 2.2).

according to which reference must be made to a substantive rather than merely formal notion of interest. According to the indications of the Revenue Agency and those emerged at the level of legal experts, some types of interest can be listed, which are difficult to place and would not fall within the scope of the rule being commented on:

1. credit discounts on loans obtained from banks or other financial institutions (*i.e.* excluding discounts for "ready cash" payments);
2. interest expense and other charges on bonds and debt securities issued, including issue discounts and redemption premiums (excluding the relevant substitute tax on loans);
3. the financial component of financial lease payments;
4. commission payable on loans and associated costs (*e.g.*, overdraft fee or similar fees);
5. charges related to securities repurchase agreements and those incurred by the borrower in securities lending transactions;
6. commission for guarantees aimed at obtaining funding (excluding commission on guarantees not aimed at obtaining funding);
7. derivatives to hedge the interest risk (except those for speculation purposes);
8. financial charges arising from the use of notional cash pooling systems (conversely, financial charges arising from the adoption of zero-balance cash pooling systems are not included).

Starting from FY2019, interest expense deductible to the extent indicated by Article 96 of the Italian Income Tax Code includes interest expense on trade payables[14].

By operation of the revised wording of article 96(1) of the Italian Income Tax Code, interest expense included in the cost of goods pursuant to Article 110 (1) (b) of the Income Tax Code, or interest:

- included in the cost of Real Estate the production of which is the direct object of the company's business[15];

14 Legislative decree no. 142/2018, implementing law no. 163 of 25 October 2017 (the European delegation law) which transposed Directive (EU) 2016/1164 of the Council of 12 July 2016 (the ATAD 1), included interest on trade payables among deductible interest *"provided it is entered in the accounts, since agreements for the supply of goods or the provision of services contain a loan component which is deemed to be significant under IFRS 15"*.

15 In tax law, Article 110 (1) (b) last period of the Income Tax Code allows you to include interest expense in the cost of inventories only with regard to buildings, and provided that the interest derives from "loans for their construction or renovation".

- added in the financial statements to the cost of tangible and intangible operating properties,

is taken into account in determining the amount of interest expense relevant for the purposes of the interest deductibility test.

A precise, objective definition of the scope of application is particularly important for financial statements covering the periods starting on or after 1 January 2016. Legislative Decree 139/2015 introduced significant innovations to the drafting of financial statements starting from that date, and these were later endorsed by the Italian Accounting Board (OIC), who accordingly revised Italian accounting principles. The most incisive innovations impacting on the matter under discussion include a review of the criteria for accounting financial and trade receivables and payables through the depreciated cost method, which replaced the previous methods of, respectively, presumable realizable value (for receivables) and nominal value (for payables). With the introduction of the principle of the "bolstered" derivation of corporate income tax base from financial statements, through a new formulation of Article 83 (1) of the Italian Tax Code, the qualification, time-based recognition and classification criteria provided for by the reference accounting principles became relevant for tax purposes also for entities adopting Italian accounting principles (as they were already for IAS/IFRS adopters)[16]. In application of the new Italian Civil Code provisions, parts of the revenues and costs related

Therefore, the capitalization of interest expense incurred to purchase the following assets should also be allowed for tax purposes:

- buildable land by development companies;
- property to be renovated by development companies.

As regards, however, the interest costs related to the acquisition of properties held for future sale or lease, the Revenue Agency (Circular no. 19/2009 (§ 2.2.4)) clarified that, in the absence of express regulatory provisions, the general rule applies and, according to it, the cost of the assets does not include interest expense. With regard to the interest expense incurred on the acquisition of Real Estate to be held as stock-in-trade, the limits on deductibility provided for in Article 96 of the Income Tax Code shall therefore apply.

16 The principle of "bolstered" derivation of the corporate income tax base from financial statements has various limitations which, for concision, will not be dealt with in this context (for a more exhaustive treatment, reference can be made to the many commentaries on this subject). Suffice it to say, given its absolute pertinence with the matter in point, that one of these derogations from the principle of "bolstered" derivation provided for in Ministerial Decree 3 August 2017 concerns the neutralization, for tax purposes, of the effects arising from the application of the depreciated cost method to the accounting of intragroup loans that bear no interest or that have significantly different interest rates from those available on the market.

to receivables and payables to be accounted for in accordance with the depreciated cost method are classified as financial proceeds and charges. Similarly, transaction costs (accessory charges) impacting on certain loans will no longer generate depreciation of intangible assets (or long-term charges) and therefore constitute financial charges to be recognized in the relevant Profit and loss account item.

Starting from 2016, the legislative amendments illustrated above have been producing consequences both with regard to the characterization of certain income and costs items (income and costs that become interest income and expense and depreciation that becomes interest expense), and from the point of view of time-based recognition of income components (depreciation process v. financial charges recognized for the term of the loan).

With regard to tax regulations on the deduction of interest expense, the changes have had certain effects in objective terms, as certain components of revenues have been recharacterized as financial proceeds and charges, as well as on the determination of the amount of deductible interest expense, impacting on the determination of the GOI, as will be discussed below.

It is essential, therefore, in the application of the tax provisions concerning interest expense, to identify the financial components generated from trade transactions and those arising from purely financial transactions (said interest expense being fully deductible up to the amount of financial interest income).

Article 96 of the Italian Income Tax Code provides that IRES taxable persons, other than those which carry out financial activities, may deduct net interest expense (i.e., interest expense less interest income accrued in the year and excess interest income carried out from prior fiscal years) up to an amount not exceeding 30% of the Gross Operating Income (GOI) for the year, to be used first, and, as to the remaining amount, up to 30% of the GOI accrued in the five previous fiscal years and carried over in the current fiscal year[17].

Gross operating income (article 96(4) of the Italian Income Tax Code) shall be the difference between the "value of production" (Revenue) (lett. A) of Article 2425 of the Civil Code and the "costs of production" (Expenditure) (lett. B), except amortization of tangible and intangible fixed assets and the finance lease payments for capital assets, in the amount resulting from the

17 Already in FY2019, legislative decree no. 142/2018 had limited the carryover of the excess unused GOI to the subsequent five fiscal years.

application of the provision for the determination of taxable income ("GOI for tax purposes")[18].

The excess interest expense not deducted can therefore be recovered in subsequent tax years, without time limit, provided that the financial structure of the company shows an amount of interest expense in excess of interest income lower than 30% of the GOI for the year and that carried over from the five prior fiscal years[19].

The same recovery mechanism applies in respect of excess interest income and similar financial proceeds.

In the opinion of the Revenue Agency[20] the use of the surplus GOI is mandatory in the first taxable year in which there is an excess of non-deductible interest. Failure to use the surplus GOI when there exists non-deductible net interest expense will make it impossible to use it in the subsequent years as to an amount corresponding to such interest, therefore effectively leading to the loss of the aforementioned surplus GOI available (but not actually used) for offset.

In association to these general provisions, the following are also provided:

- an authentic interpretation of Article 90 (2) of the Income Tax Code, which aims at excluding from the regime of non-deductibility costs and other expenses, referring to the "financing interest" related to Real Estate assets (Article 1 (35) of Law No. 244/2007);
- a standard "transitional" rule which provides for the full deductibility of interest expense relating to loans secured by mortgage on properties held for renting out for companies which are effectively and principally engaged in Real Estate activities (Article 1 (36) of Law No. 244/2007).

Examining the first rule above, Article 90 (2) of the Income Tax Code provides that, in relation to buildings that are not Real Estate assets for the purposes of business nor assets the production or exchange of which is the

18 This overrides the clarification provided in Revenue Agency Circular No 19/2009 (§ 2.3) according to which only statutory amounts are to be used for the purposes of the calculation.

19 It should also be noted, among other things, that the *carryover* of the non-deducted interest expense surplus is limited, in merger operations, to the same amount as carry-forwards of tax losses accrued in the accounting periods before the finalization of the extra-ordinary operation (subject to the successful completion of a "viability test" showing that the limit of the shareholder's equity, as amended by article 15 of legislative decree 192/2024, has been met).
This limitation does not seem to apply to the carryover of surplus interest income and GOI.

20 Circular no. 19/2009 (§ 2.3).

direct activity of the company (*i.e.* Real Estate assets), are not allowed to be deducted from expenses and other cost items related to this type of property.

The rule, expressly defined as an authentic rule of interpretation, introduced by Article 1 (35) of Law No. 244/2007 established that: "*expenses and other non-deductible cost items under paragraph 2 of Article 90 of the Income Tax Code, in Presidential Decree No. 917 of 22 December 1986, do not include interest expense relating to loans for the acquisition of the Real Estate listed in para. 1 of Article 90*".

The standard has been commented on by Tax Circular No. 19/2009, which established that in objective terms such interest expense should be deemed to include not only the interest expense referring to the purchase of the asset but also that incurred for its construction.

It follows that the interest paid to secure financing for the purchase or construction[21] of Real Estate assets is excluded from the regime of total non-deductibility and must comply with the limits and conditions provided for by Article 96 of the Income Tax Code.

Instead, interest expense on loans taken out to cover property operating, management and maintenance costs continues to be non-deductible.

Where the interest expense paid refers to loans secured by mortgages on properties held for renting out, the applicable rule is that contained in Article 1 (36) of Law 244/2007 (2008 Finance Act), which originally provided that "*interest expense related to loans secured by mortgages on properties held to be rented*" was not relevant for the purposes of article 96 of the Italian Income Tax Code. The Revenue Agency has also determined that this rule is applicable as long as the mortgage financing relates to the same properties subsequently rented out.

Taking due account of the underlying economic reality, however, it is necessary to consider that a loan for the purposes of financing an acquisition of Real Estate can also be raised at a later time or be renegotiated. Especially for acquisitions, in fact, it is normal to resort to short-term funding, quick to obtain, which must then be replaced and restructured in the long term, in line with the incoming flows which depend on the economic cycle of the Real Estate.

21 Circular no. 19/2009 once again stressed that the interest expense for operations, *i.e.* that incurred on loans acquired for the purposes of the management of property portfolio, as well as that incurred on loans acquired for non-routine maintenance works, remain anchored to the regime of non-deductibility provided for in Article 90 (2) of the Income Tax Code.

In a subsequent decision (legal advice n. 87555/2013 of 17 July 2013), the Revenue Agency[22] has appropriately recognized[23] that for the purposes of the deductibility of interest expense the close connection between funding and the property purchased or built should not be construed as meaning that the raising of the loan and the purchase/construction of the building must occur at the same time. So, for example, the "close connection" is found even if the property has been purchased through a "bridge" loan, to be later replaced with a "senior" loan, if it can be shown that the senior loan was used to return to shareholders the resources made available to the company for the purchase/building or to return the share premium.

Similarly, the close link exists also when the original loan is replaced by another which does not involve the deduction of higher interest, both in terms of the rate charged and extent of the borrowed capital. In this case, however, the interest in excess shall not fall within the scope of the provision in question.

Moreover, several decisions by the Italian Supreme Court over the years have extended the scope of application of the rule, which does not cover solely interest expense on loans taken out for the purchase or the construction of property to be leased. Lately, loan interest has been considered deductible also where the property was already leased at the time the loan had been taken out as well as where the interest was paid on an additional loan taken out to complete a property in respect of which another borrowing had been made[24].

It would be desirable, anyway, that the Tax Authorities extended the same conclusions to the situations where the transaction is implemented

22 Indeed, the decision being commented on, although requested by the applicant with reference to paragraph 35, appears to refer to the subsequent paragraph 36. However, the conclusions reached by the Agency may reasonably be deemed to refer only to paragraph 35, as this is the only provision which expressly requires the existence of a connection between financing and property acquired, for the deduction of the interest (as will be evident also from the subsequent discussion of paragraph 36).

23 Overriding an unfair precedent (Court of Cassation decision no. 12393 of 9 December 1998).

24 The Italian Supreme Court has repeatedly stated that «the scope of this provision, as inferred from its literal interpretation, is so broad that it does not justify limitations in terms of either the types of property considered or the purpose of the loan» (Italian Supreme Court decisions nos. 21885 and 21880 of 21 July 72023, followed by Italian Supreme Court decision no. 22191 of 24 July 2023, Italian Supreme Court decision no. 22735 of 27 July 2023, Italian Supreme Court decision no. 28804 of 8 November 2024 and, recently, Italian Supreme Court decision no. 321 of 8 January 2025).

through the purchase of a stake in the company that owns the property[25] (followed by the merger or by the option for domestic group taxation) according to the scheme of the leveraged buyout ("LBO") set out in Article 2501-*bis* ff. of the Civil Code, acknowledging that also in this case the substantive subject of the acquisition is property which constitutes a guarantee for the lender (both legally and economically) with regard to the repayment of the loan and therefore the requirements for the application of the provision are met. The full deductibility of interest expense, therefore, cannot be doubted, except in the event of an illegal LBO, somehow directed to shift taxable income to tax havens[26].

At the time, the law in question had been introduced as a transitional rule, pending a review, whose objective was the simplification and rationalization of the existing system of direct and indirect taxation of Real Estate companies by an *ad hoc* study committee. The rule, however, is gradually being perceived as final, because of the failure to implement the desired actions in matters of Real Estate taxation.

Paragraph 36 was supplemented by the "Growth and internationalization" Decree (Legislative Decree No. 147/2015). Article 4(4) of the decree expressly restricted the scope of application of the rule to companies which mainly carry out a Real Estate activity, besides defining this type of company by law.

The provision stated that the "*interest expense related to loans secured by mortgages on properties held to be rented for companies which are effectively and principally engaged in Real Estate activities, that is to say companies with balance sheet assets constituted for the most part of their market value by property to be rented out and with at least two thirds of the revenue constituted by proceeds from the lease of property or businesses whose aggregate value mainly consists of the market value of buildings*", is not relevant for the purposes of Article 96 of the Income Tax Code.

25 The matter has been dealt with by the Milan Provincial Tax Court in decision no. 2543/47/2016, which stated that "*the purchase of an equity interest in the company which owns the funded property and the direct purchase of the property cannot but be regarded as homogeneous transactions*"; therefore denying the deduction of the interest expense arising under such indirect property investment schemes would mean distorting the rationale of the beneficial rule which is designed to facilitate the investment in rental property by allowing the deductibility of interest expense.

26 R. Lupi, S. Covino, "'*Leveraged Buy-Out*': *trasformazione di profitti in interessi e fantomatiche elusioni*", in *Dialoghi Trib*., 2012, 646 ff.

The clarification provided by Legislative Decree No. 147/2015 is a direct consequence of the state of uncertainty which has characterized paragraph 36 from the outset.

It should be noted that, at the time of its initial introduction, despite its clear and unambiguous wording (full deductibility of "*interest expense on loan secured by mortgage on assets to be rented out*"), the Tax Authorities (cf. Circular No. 19/2009 and 37/2009) deemed it necessary to establish certain "subjective" and "objective" requirements which had not been expressly provided for. Such requirements are that (i) the company had to qualify as a "Real Estate management company" within the meaning of Resolution No. 323/2007[27], (ii) the mortgage had to relate to the same property "held to be rented" and (iii) interest expense had to be related to a mortgage loan for the purchase or construction of properties held to be rented.

This interpretative approach conflicted with the text of the provision, which allowed the deduction of interest on loans generally taken out to conduct the Real Estate business, with no specific reference to those taken out for the purchase of assets. The only condition was that the loans be secured by mortgages on properties held to be rented. This interpretation was substantiated by court rulings (Milan Provincial Tax Court decision no. 1876/41/2014 confirmed by Lombardy Regional Court Decision no. 1607/2015, Milan Provincial Tax Court decision no. 7086/21/2015) according to which, for the purpose of benefiting from full deductibility as provided by the 2008 Finance Act, no difference was made between persons carrying out active management of the property, and those carrying out passive management of the property.

Nevertheless, the Tax Authorities, by means of Circular 7/2013[28], had provided further clarification on the definition of "property management company". Within this category a distinction is made between companies which, next to the *passive management* of the Real Estate which consists in the mere collection of lease or rental payments, offer a "*range of complementary services which are functional to the use of the property complex as a unit*". If such services – to be evaluated from a qualitative perspective (in terms of the functional link to the properties) and a quantitative perspective (in

27 The Resolution defines a "real estate management company" as a company whose activity mainly consists in the mere rental of property to third parties; subsequently, this activity will be defined as "passive management", as opposed to "active management", characterized – in additional to rental - by the supply of "a range of complementary services conducive to the use of the property as a single whole" (Circular no. 7/E of 29 March 2013).

28 Which provided further clarification regarding the participation exemption.

terms of significant amount) – are provided, the properties concerned would be considered as assets "*used directly for the purposes of business*" pursuant to Article 87 (1) (d) of the Income Tax Code which could lead to the claim that such company is conducting a commercial enterprise. The services shall be evaluated in terms of quality (as a functional connection with the buildings themselves) and quantity (*i.e.* of significant magnitude). This new interpretation by the Revenue Agency, related to property management companies, has been implemented in several decisions on the merits[29] as part of disputes against the claims of alleged lack of the requirements for the application of the rule contained in the mentioned paragraph 36 of Article 1 of the 2008 Finance Act, which were based on the fact that the audited companies qualified as Real Estate management companies. Such decisions, referring to the most recent clarifications provided by the Tax Authorities in Circular 7/2013, have established that in the cases in question the company's business was not to be considered *active management* of Real Estate assets – since only qualitatively and quantitatively minor services ancillary to rental were provided – and conceded that the benefits introduced by the aforementioned paragraph 36 should apply.

Purpose of the new rules introduced by Legislative Decree 147/2015 was to resolve an interpretation problem which had triggered significant controversy between the Tax Authorities and taxpayers: the tax officers disputed the non-deductibility of the interest expense by Real Estate companies which in addition to renting the property (passive management) also carried out activities ancillary and accessory to the rental business, on the grounds that the provision of services in addition to rental, such as cleaning, security etc., constituted active management of the property resulting in the exclusion of these Real Estate companies from the entities subject to the application of the prior version of Article 1(36) of law no. 244/2007.

Article 4(4) of Legislative Decree 147/2015 better defines the entities subject to the provisions of the cited paragraph 1, specifying that deductibility applies to "companies which effectively and principally carry out a Real Estate business" and that in order to be defined as such, companies must concurrently meet two conditions.

The first is that balance sheet assets must mostly consist of "the arm's length value of property to be rented out". Although no express clarifica-

29 Milan provincial tax court judgments nos. 358/43/13, 212/8/13, 4299/02/14, 1876/41/14; Brescia provincial tax court judgment no. 637/15/14.

tion is available in this respect, it is believed that this condition should be checked at the year-end, based on guidance provided by the Tax Authorities on similar circumstances[30].

The second is that "at least two thirds of the revenue must consist of payments from the lease of property or businesses, whose aggregate value mainly consists of the arm's length value of buildings" derived in the fiscal year to which the interest expense refers. This is a different basis from that adopted for PEX purposes. Under the proposed rule, the amount of the lease payments and revenue from the lease of businesses is to be compared to the aggregate revenue realized. Some insightful experts[31] have pointed out the potential difficulties for companies carrying on a mixed Real Estate management and purchase and sale business if one or more properties which constitute the company's stock-in-trade are sold in the relevant year. Considering the extent of proceeds from the sale, compliance with the condition could be seriously at risk in the year of the sale.

The changes introduced by legislative decree 147/2015 entered into force, by express provision, as of the fiscal year subsequent to that in progress at the date of entry into force, *i.e.* 2016 for entities whose fiscal year coincides with the calendar year.

Since the new provision is not an interpretative rule (as substantiated by the fact that its implementation is postponed), it should not affect fiscal years prior to its entry into force, with implications on ongoing disputes focused on notices of deficiency based on the Revenue Agency's interpretation of prior legislation, leading Tax Courts to issue decisions in favor of Real Estate companies not included among Real Estate management companies.

With the publication of legislative decree no. 142 dated 29 November 2018 in the Italian Official Journal, the Government totally rephrased article 96 of the Italian Income Tax Code, which regulates the deductibility from corporate income tax (IRES) of interest expense on loans taken out by companies in the conduct of business.

30 This condition is similar to that set forth in article 87(1)(d) for the identification of commercial entities for PEX purposes. Circular 36/E of 2004 stated that the current value of the relevant property had to be compared to the "current value of the aggregate assets". In some cases, it is therefore necessary to request expert appraisals of the current value of assets. Circular 36/E of 2004, again on the matter of PEX, specifies that "both values must be taken into account after deduction of elements which may positively or negatively affect the relevant valuation" (*e.g.*, any related liabilities).

31 See G. Ferranti, "*La deduzione degli interessi passivi sui mutui ipotecari per le immobiliari di gestione*" in *Il Fisco,* n. 20/2015, page 1915.

The revised article includes in the deductibility limit – i.e., 30% of the gross operating income, GOI – all interest expense, including interest on loans specifically taken out for the construction or redevelopment of property which constitutes the company's core business, which instead, under the legislation in force until then (FY 2018), was wholly deductible.

Moreover, Legislative decree no. 142/2018 - in particular article 14(2) – provides for the abrogation of article 1(36) of law 244/2007, pursuant to which interest expense on loans secured by a mortgage on property to be leased out is wholly deductible for companies which carry out property management activities as their core business.

However, Article 1(7) of law 145/2018 145/2018 (the 2019 Finance Act) – inter alia thanks to action taken by the Italian national association of building constructors, ANCE – "temporarily" reinstated the provision by stating that: "as a result of the failure to adopt the revision of the direct and indirect tax rules for real estate companies, the provisions of article 1(36) of law no. 244 of 24 December 2007 shall apply"; therefore, full deductibility has been maintained and the abrogation determined by legislative decree 142/2018 has been overridden.

The unfortunate regulatory approach adopted by article 1(7) of Law 145/2018 did not "revitalize" the explicit suppressions made with Legislative Decree 142/2018 the previous month. Nevertheless, the rule must be deemed to be still entirely in force as amended by article 4(4) of legislative decree 147/2015.

To conclude this paragraph, we point out that it is possible that the tax deductibility of interest expense under article 96 of the Italian Income Tax Code described above may be extensively simplified, considering that article 6(1)(d) of the framework law for tax reform proposals (Law 111/2023), on business income, provides for a "revision of the rules on the deductibility of interest expense, inter alia by introducing specific exemptions, without prejudice to the fight against base erosion by multinational groups".

In particular, a threshold may be set within which interest expense would always be deductible, and companies that are not members of groups, or companies that are members of groups with total interest expense not exceeding 3 million euro, could be exempted from the limitations to interest expense deductibility[32].

32 Cf. the explanatory report to enabling bill no. 111/2023.

4.3. Depreciation of operating properties for use in business

Operating properties (by destination or by nature) are subject to the depreciation which is applied to the tax basis determined in accordance with the Income Tax Code.

To this end Article 110 of the Income Tax Code establishes the procedures for determining the tax basis of the assets relevant in the computation of business income. In particular, under paragraph 1(a) it establishes that the tax basis is the purchase cost before any depreciation charges already deducted. Under letter b) of paragraph 1 of Article 110 it is also set out that:

- the cost includes also directly attributable ancillary costs, except interest expense and overheads. However, for tangible and intangible operating assets used for the purposes of the business the cost includes interest expense added to the purchase cost itself in application of legal provisions;
- with the same criteria, costs other than those directly attributable to the product can be added to the manufacturing cost;
- for real estate the development of which constitutes the company's core activity, the costs include the interest expense on the loans taken out for RE construction or renovation.

Special attention should be paid to the possibilities granted under the aforementioned letter b) of paragraph 1 of Article 110, that the tax basis subject to depreciation could include interest expense associated with the purchase/construction of the company's Real Estate.

As a result of the changes made by legislative decree 142/2018, capitalized interest expense will be taken into account for the purposes of the interest deductibility test described in the previous paragraph and may be deducted from business income up to the amount of interest income (both accrued in the year and carried over from prior fiscal years without time limit) and, as to the amount in excess, up to 30% of the GOI for tax purposes (either for the year or carried over from the prior five fiscal years).

With regard to operating properties, the interpretation provided by Revenue Agency in Circular 19/2009 has been overridden. According to the Circular, interest expense was fully deductible (through depreciation) pursuant to the mentioned Article 110 (1) (b), under which the cost for the acquisition or construction of such Real Estate includes "interest expense shown in the financial statements as increasing the cost in application of legal provisions"[33].

33 In this regard Article 2426, no. 1) of the Italian Civil Code provides that interest expense

Therefore, whether or not it is capitalized, the interest expense paid in relation with loans raised for the purchase or development of operating property would be subject to the deductibility rules depending on the level of GOI.

Even for property classified as stock-in-trade there exists the possibility to consider interest expense as part of the cost relevant for tax purposes, in the presence of certain conditions. Article 110 (1) (b) last sentence states that "for buildings the production of which is the direct object of the company's business, the cost includes the interest expense on loans raised for their construction or renovation". It must be therefore interest connected to loans raised for the construction or renovation of properties as stock-in-trade[34]. Besides, as is the case for operating properties, also the capitalization of Real Estate as stock-in-trade must comply with the recommendations of the Italian GAAPs. OIC accounting principle No. 13 (§ 39) provides that interest expense related to loans raised for the construction or renovation of an asset can be capitalized to the cost of such asset when this requires a substantial construction period and up to the realizable value of the asset as inferred from market performance (the accounting principle refers to OIC 16 to establish the extent of and the conditions for capitalization of the financial costs in question).

With regard to the tax provisions governing the depreciation of operating assets (by destination and by nature), Article 102 (2) of the Income Tax Code provides that the deduction of the depreciation allowance shall not exceed that resulting from the application to the tax basis of the assets of the rates established by Decree of the Ministry of Economy and Finance published in the Italian Official Journal (Ministerial Decree of 31 December 1988), reduced by half in the first year. The rates are established by homogeneous classes of assets based on normal wear and tear in the various business sectors.

can be recorded to increase the cost of tangible and intangible assets which are used for business purposes, up to the time from which the property can be used. Accounting standard OIC no. 16 (§ 42) clarifies that capitalization of interest expense (to the purchase or construction cost) is possible if the following conditions are met: the interest must have been actually incurred, and must be objectively determinable, up to the recoverable value of the asset; the assets require a substantial construction period.

34 On this point the Revenue Agency, in Circular 19/2009 (§ 2.2.4), adopting a literal interpretation of the rule, has ruled out the capitalization of interest on loans for the purchase of property held as stock-in-trade.

This provision resulted in a widespread accounting practice (aimed at avoiding differences between statutory and tax values) consisting in charging to the profit and loss account depreciation allowances calculated on the basis of the rates established by the aforementioned Decree; this approach is not always correct, as the useful life of an asset may differ from that determined by tax legislation.

Buildings classified as operating assets can be depreciated[35].

With a few specific exceptions[36], land may not be depreciated, in consideration of the fact that it does not have a perishable nature and its useful life is not, therefore, limited in time (on this point see Circular No. 98/2000, repl. No. 1.1.2).

Prior to the enactment of Law Decree 223/2006, the procedure for the calculation of depreciation allowances used to take into consideration the cost of the buildings gross of the value of the areas on which the buildings stood and the relevant appurtenances. In doing so, the cost of the land beneath the building participated in the depreciation process and affected the determination of business income.

Law Decree 223/2006, with Article 36 (7, 7-*bis* and 8) has provided that, with effect from the tax period covering 4 July 2006, for the purposes of the deductibility of depreciation allowances (and the principal amount of finance lease payments), the total cost of operating buildings must be taken net of the cost of the construction areas and their appurtenances. Thus, the non-relevance for tax purposes of the cost attributable to the areas occupied by operating buildings used in business and their appurtenances has been established. Such buildings are no longer depreciable, even if acquired in previous years.

The rule in question involved the alignment of tax law with accounting policies, which provide that, where the value of a building also incorporates the value of the land on which it is built, the value of the land must be separated on the basis of estimates prior to the calculation of the depreciation to be charged to the profit and loss account. The new framework outlined by Law Decree 223/2006 has provided precise rules for the determination of

35 They include the caretaker's lodge next to an industrial building (Ministerial Resolution of 4 February 1982, no. 9/885) and buildings included in the corporate premises and used as the residence of specialized staff employed with special duties by the company (Comm. Trib. Centr., Sec. IX, sentence n. 761 of 18 March 1994).

36 Such as quarries for cement-manufacturing companies, airport runways, land used as railway grounds, land used for highways, etc.

the value of areas to be separated from the total cost of the property, in order to avoid any discretionary element in the land valuation process (which understandably would have caused disputes on the estimated values). In particular, we must distinguish the following cases:

- the areas were acquired before the construction of the building;
- the areas were acquired in connection with the building, although the deed shows a separate price for the land.

In the first case, by express provision of the law, the actual cost incurred for the purchase of the land has to be excluded from the cost of the depreciable building. The depreciable amount will therefore be equal to the actual cost incurred for the construction of the building (under contract or on a time-work basis), and the cost incurred for the acquisition of the area on which the building stands is not relevant.

In the event that the area has been acquired together with the building subject to depreciation, the value of the land that is to be deducted from the taxable value of the depreciable property is equal to the higher of:

- the value indicated separately in the financial statements for the year of purchase[37];
- and that obtained by applying to the total cost of the building, the percentage of 20%, or 30% for industrial buildings in the case of industrial buildings, that is to say buildings to be used for the manufacturing or transformation of goods.

If the land had not been recorded separately from the building, the value of the area that is not relevant for tax purposes would be always equal to the total cost of the building multiplied by 30% or 20%, as the case may be.

Such regulations are also applicable to buildings held before they entered into force. In these cases, if the land and the building have been recorded jointly, in order to determine the value of the land it shall be necessary to subtract from the total value of the property[38] the part referring to the cost of improvements and the revaluations carried out and apply the above rates to the values thus obtained. Improvement

37 Where the acquisition was finalized in a financial year prior to the entry into force of the standard it will be necessary to consider the value given in the financial statements prior to the entry into force of the same (which for those with tax period coinciding with the calendar year is the financial statements at 31 December 2005).

38 Resulting from the financial statements prior to the entry into force of the regulation (4 July 2006) corresponding to the year ended 31 December 2005, for companies using the calendar tax year.

costs and revaluations are, according to paragraph 8 of Article 36 of Law Decree 223/2006, attributable entirely to the building and therefore are fully depreciated.

The tax benefits, in the form of an increase of the tax basis of operating assets used in business solely for the purposes of deducting depreciation and finance lease payments (known in Italy as "super-depreciation", now replaced by a tax credit) or of tax credits ("Tax credit for investment in capital assets"), do not extend to buildings and constructions.

Finally, article 1(30) of the 2025 Italian Finance Act (law no. 207/2024), has introduced as a permanent measure the possibility to revalue the purchase cost or value of building or farming land owned by:

- natural persons, for transactions that fall outside the course of business;
- simple partnerships (società semplici) and entities equivalent to simple partnerships from a tax perspective, pursuant to article 5 of the Italian Income Tax Code;
- non-commercial entities, if the transaction which gives rise to the income is not carried out in the course of business;
- non-resident persons, the capital gains of which are taxable in Italy (without an Italian permanent establishment).

The rule, under which the value of the asset may be adjusted to its tax basis subject to payment of substitute tax in lieu of income taxes, was originally introduced by article 7 of law 448/2001 and over the years has been repeatedly extended. Thus, starting from 2025, the tax basis of the assets held at 1 January of each year may be adjusted by paying substitute tax at the rate of 18% of the value of the land assessed at the same date and shown in a report by a Court-appointed expert.

The expert report must be drawn up, the option to revalue the assets elected and the relevant tax paid by 30 November of the same year.

4.4. Treatment of restructuring and renovation costs ("Capex")

Restructuring and renovation costs include those related to the following:

- non-routine maintenance (Article 3(1) (b) of Presidential Decree No. 380 of 6 June 2001): these are the costs incurred *for "works and the changes necessary to renew and replace building parts, including structural ones, as well as to implement and supplement sanitation services and technology, provided they do not alter the aggregate volume of the buildings and do* *not bring about changes in the intended use of the property relevant for the purposes of zoning regulations, which result in an increased demand for infrastructure services. Non-routine maintenance includes the splitting or aggregation of property units* even if involving a change in the surface of the individual property units and of the *demand for infrastructure services, provided the aggregate volume of the buildings is not altered and no changes in the intended use of the property occur. Non-routine maintenance includes changes to the front of property which are necessary to maintain or obtain the habitability of premises or to access said premises, which do not impair the architectural decorum of the property, provided that the works are in line with current zoning and building regulations and do not concern property subject to conservation pursuant to the Italian code of cultural heritage and landscape, legislative decree no. 42 of 22 January 2004*";

- conservative restoration or renovation (Article 3 (1) (c) of Presidential Decree 6 June 2001 No. 380), defined as "*Building work aimed at preserving the building structure and to ensure functionality through a systematic set of works that might allow for uses different but at the same time compatible and conformant with those provided by the general zoning regulations and relevant implementation plans, provided they are respectful of the typological, formal and structural elements of the building organism itself. Such building interventions include the consolidation, restoration and renewal of the elements a building consists of, the insertion of accessory elements and system facilities required depending on their use, the elimination of elements which are alien to the building organism*";
- building renovation (Article 3 (1) (d) of Presidential Decree 6.6.2001 No. 380) which includes "*interventions aimed at transforming building organisms through a systematic set of works that can lead to a building organism which is entirely or partially different from the previous. These actions include the restoration or replacement of certain constituent parts of the building, the elimination, change and insertion of new elements and system facilities. Building renovations also include the demolition and reconstruction of buildings with a different shape, front, site and planivolumetric and typological characteristics compared to the pre-existing building, without prejudice to the necessary innovations for alignment to anti-seismic regulations, for the application of the rules on accessibility, for the installation of technological systems and for the purpose of improving energy efficiency. In the cases expressly provided by the law or by the municipal zoning regulations, the works may also provide for increases in volume, inter alia to*

promote urban regeneration activities. Building renovations also include works to wholly or partly reconstruct buildings which may have collapsed or been demolished, provided that it is possible to ascertain their prior size; it is understood that, with regard to the property under conservation pursuant to the Italian code of cultural heritage and landscape ("Codice dei beni culturali e del paesaggio"), legislative decree no. 42 of 22 January 2004, and without prejudice to the provisions of the law and of zoning regulations, the property located in "A" zones in accordance with decree of the Ministry of Public Works no. 1444 of 2 April 1968 or in equivalent zones in accordance with regional rules and municipal zoning regulation, in historical city centers and other prime locations from a historical and architectural perspective, the demolition and reconstruction and the repair of buildings which may have collapsed or been demolished constitute building restructuring works only if the shape, front, site and planivolumetric and typological characteristics of the pre-existing building are maintained and no increases in volume are expected"[39];

- building remodeling (Article 3 (1) (d) of Presidential Decree 6.6.2001 No. 380) which includes actions "*aimed at replacing the existing zoning – building layout with a different one, through a systematic set of building works, also by changing the layout of plots, blocks and road network*".

For tax purposes, the treatment of the costs of restructuring and renovation of the properties owned by trading companies is influenced by the type of property. The contribution of these components to the determination of income shall vary depending on whether the building works involve operating property used in business, a Real Estate asset or property which is held as stock-in-trade.

Before analyzing the tax regulations that govern this type of works, it is necessary to illustrate the cost accounting methods for the costs associated with such works. To this end it is necessary to deal separately with the work carried out on operating properties and Real Estate assets from those carried out on property held as stock-in-trade. The different treatment is due to the

39 The original version of article 3(d) of Presidential Decree 380/2001 included among building redevelopment activities the demolition and subsequent reconstruction of an identical building (in terms of volumes and shape), except for the adjustments required by anti-seismic legislation. Finally, pursuant to Decree-law no. 76 del 16/07/2020, the notion of building redevelopment is meant to include activities of demolition and subsequent reconstruction with a different shape as well as those which result in volume increases, if provided by the rules in force or by municipal zoning regulations.

fact that operating properties and Real Estate assets are considered fixed assets for statutory accounting purposes whereas property held as stock-in-trade, which is held for resale, is classified as inventory.

According to OIC 16, paragraph 32, the costs incurred to make improvements, alterations, renovations or refurbishments to plants (including Real Estate) can be capitalized provided they result in a significant and measurable increase of capacity, productivity or safety of the assets or an extension of their useful life.

Significant changes made to existing systems as a result of these transactions involve a careful assessment to determine the portion of costs to be capitalized and the complementary portion which impacts on the income for the period.

The OIC 16 gives no detailed indications about the process of depreciation of the assets which have undergone extraordinary maintenance works. A professional practice document of the Milan Accountants Association (Standard of Conduct no. 129) can be helpful in order to clarify this point. According to this document, extraordinary maintenance costs are added to the cost of the facility they relate to and, therefore, they may not be depreciated independently but only in combination with the production factor over several years. Therefore, to reformulate the depreciation plan for the facility, the effects of non-routine maintenance works must first be identified, in particular with regard to the useful life of the assets. If these effects extend the useful life of the asset, the residual value to be depreciated, plus any non-routine maintenance costs, shall be spread over the term of such longer useful life, resulting in depreciation rates that may be higher or lower than those initially planned depending on whether the higher costs to be spread or the increase in the number of depreciation charges to be computed prevails. If, on the other hand, the improvements do not affect the useful life of the asset, the depreciation process will remain the same, and the residual allowances will be higher than the original ones.

In the event that non-routine maintenance works (including the improvements described under paragraphs b), c), d) and f) of Article 3 (1) of Presidential Decree No. 380/2001) are carried out on operating property used in business, they shall contribute to the formation of taxable income through the depreciation of the property.

However, where improvements are carried out on Real Estate assets, which may not be depreciated, authoritative experts have stated that the

nature of such expenditure is likely to increase the value of the property and therefore authorize an increase of the tax basis of the property, relevant for the purposes of the determination of the capital gain (or loss) on disposal.
If maintenance work is conducted on the property referred to under legislative decree no. 42/2004 (property of historical and artistic interest subject to restrictions on use), the relevant costs will be taken into account in determining taxable income by deducting them at the time they are incurred as to the amount actually borne by the company (i.e., after deducting any subsidies received). Unless mandatory, the maintenance work will have to be expressly authorized by the Ministry for cultural heritage and activities.

Finally, when the restructuring and refurbishment works are carried out on property held as stock-in-trade, the costs incurred represent an increase in the relevant value, which at year-end will form part of item A2 ("change in inventories of work in progress and finished products") for entities adopting Italian accounting principles.

4.5. Flat-rate taxation of properties consisting in Real Estate assets

Real Estate assets are a residual category which includes properties that are not considered operating properties nor properties the production or exchange of which is the direct object of the corporate business. It mostly consists of residential land and buildings purchased by firms as an investment and not to be used for the purposes of the business.

From a tax perspective, this category is referred to in article 90(1) of the Income Tax Code, pursuant to which "*income from real estate which is not used in the regular course of business or does not constitute the company's stock-in-trade, is included in income as to the amount determined in accordance with the provisions governing property located in the Italian territory*".

Therefore, residential buildings are not included in the determination of business income on the basis of the costs and revenues related to them, but as to the amount determined based on:

- the provisions governing income from land and buildings, with regard to property located in the territory of the state and not rented to third parties;
- the provisions of Article 90 (1) of the Income Tax Code regarding residential buildings located in the territory of the state and rented out to third parties;

- Article 70 (2) of the Income Tax Code, for buildings located abroad.

The Real Estate assets that are not leased to third parties, again for the purposes of Article 90 (1) are included in the determination of business income according to criteria defined by the rules of Chapter II of the Income Tax Code (income from land and buildings). For the determination of the income produced by Real Estate assets which are not rented, the general rule establishes that such income is equal to the imputed cadastral income (revalued by 5%).

This rule may be departed from if the Real Estate asset is part of the historic and artistic heritage subject to the restrictions of Legislative Decree No. 42 of 22 January 2004. Up to the tax year covering 31 December 2011, such assets formed part of the income in an amount equal to the imputed cadastral income determined on the basis of the lowest valuation rates for dwellings in the same cadastral area. From the tax year subsequent to the one covering 31 December 2011, the imputed income on the ownership from land and buildings of these buildings has been equal to the cadastral income recorded in the land registry, revalued by 5% and decreased by 50%.

As for the Real Estate assets rented out to third parties, not subject to the constraint set out in the mentioned Legislative Decree No. 42/2004, these contribute to form the business income for an amount equal to the greater of the following two amounts:

- imputed cadastral income (revalued by 5%);
- rent agreed in the contract possibly reduced by the amount of the routine maintenance costs actually incurred on the property and borne by the company, for an amount not exceeding 15% of rent[40].
- As already established for non-rented property assets, the Income Tax Code provides an exception to the general rule for the quantification of income in respect of urban Real Estate units subject to restrictions because of their particular historic and artistic interest, pursuant to Legislative Decree N. 42/2004. Up to tax year covering 31 December 2011, the income for this type of property was to be quantified in an amount equal to the imputed cadastral income calculated on the basis of the lowest valuation rates in the same cadastral area. The beneficial treatment was equally granted to the buildings rented out and to those held for use. Beginning in the tax year following the one including 31 December 2011, the Real Estate subject to the restrictions, if rented, contributes to deter-

40 Article 90(1) third period of the Italian Income Tax Code.

mining business income as to 65% of the contractual rent, which shall not in any case be less than the average ordinary income[41].

Finally, in order to determine the contribution to the formation of the business income of Real Estate assets located abroad, reference should be made to Article 70 (2) of the Income Tax Code (referred to in Article 90 (1) of the Income Tax Code) and therefore this shall be equal to:

- the net amount resulting from the valuation made in the foreign country for the relevant tax period;
- or, for income not subject to tax in the foreign country, the amount received in the tax period reduced by a 15% lump-sum deduction of expenses.

Revenue Agency Circular No. 10/2006 clarified that if the fees are subject to foreign taxes, it is possible to benefit from the tax credit provided for in Article 165 (6) of the Income Tax Code. Under Article 70 (2) of the Income Tax Code, when the foreign and Italian fiscal years do not coincide, income shall be that assessed by the foreign state with reference to the fiscal year of the foreign country which ends during the term of the Italian fiscal year.

The positive contribution to the formation of the business income of land which is not an operating asset or stock-in-trade is determined on the basis of the following, in accordance with Article 90 (1) of the Income Tax Code:

- the provisions relating to income from land and buildings (cadastral criteria), for land located within the territory of the Italian state not used for agricultural purposes, as per Article 32 of the Income Tax Code;
- the results of the P&L account (under "costs and revenues"), for the land located in the territory of the Italian state used (by the tenant) for the performance of agricultural activities as per Article 32 of the Income Tax Code.

Non-agricultural land located in Italy shall contribute to the formation of business income as to the amount of:

- estate income, appropriately revalued (by 80%), if held for use or anyway not rented;

41 Resolution 114/2012 stated that the ordinary average income to be taken into consideration, both for properties held for use and for those rented out, must be equal to the revalued cadastral income subsequently reduced by 50%. Consequently, assuming the let property has historical and artistic significance, the values to be compared in order to determine the taxable amount for the purposes of corporate income tax, are the annual fee, reduced by 35 percent, and the revalued imputed cadastral income, reduced by 50 percent.

- the contractual rental payment, if rented out.

If, however, the land is located abroad, the determination of the relevant income follows the rules laid out by Article 70 of the Income Tax Code, also applied to buildings (to which reference can be made).

While the first paragraph of Article 90 sets the rules for determining the income related to Real Estate assets, the second paragraph provides for a closing rule which establishes the non-deductibility of expenses and other cost items referring to such assets.

On the matter, we point out that, as clarified by Revenue Agency Circular no. 6 of 13 February 2006, expenses regarding Real Estate assets, whether or not considered or considerable in the determination of the rates (tariffa d'estimo) used in the calculation of cadastral income, are not deductible.

There follows that at the time of preparation of the financial statements, it shall be necessary to make increasing and decreasing adjustments to the profit resulting from the statutory profit and loss account. In particular, it will be necessary to:

- make a decreasing adjustment to the positive components of income recognized in the profit and loss account in respect of these properties (such as rentals);
- make an increasing adjustment equal to the sum of the imputed income on the ownership from land and buildings (or, for leased buildings, the Real Estate proceeds determined on the basis of Article 90 (1) of the Income Tax Code) and the costs recognized in the profit and loss account.

However, some experts seem to go in the opposite direction, claiming that non-deductibility of the costs in respect of real estate assets pursuant to article 90(2) of the Italian Income Tax Code solely concerns the costs already included in the rate (tariffa d'estimo) used in the determination of the cadastral income of each property and not the additional costs incurred by the company which owns the property, whether for the management of its real estate assets or otherwise.

Under this approach, all costs referred to the real estate assets that were not considered or not considerable when determining the tariffe d'estimo should be deductible.

The absolute rule of the non-deductibility of expenses and other cost items related to Real Estate assets allows for a few exceptions. Among them:

- expenditure on housing units granted to employees for a limited period of time (known as temporary operating property for which reference should be made to the considerations made in the foreword to this chapter);

- the overall running costs of the company[42];
- costs incurred for the maintenance, protection and refurbishment of Real Estate assets subject to restrictions pursuant to Legislative Decree n. 42/2004 (Article 100 (2) (E) of the Income Tax Code, which are deductible when incurred, within the limits of the amount actually paid by the company);
- documented expenses for routine maintenance[43], actually borne by the company, within the limit of 15% of the agreed rent[44];
- interest expense on money borrowed for the acquisition or construction of Real Estate assets (on the conditions and limits set by Article 96 of the Income Tax Code)[45];
- interest expense related to loans secured by mortgages on properties held for renting out (full deductibility)[46].

42 According to AIDC rule of conduct no. 156 the following would be deductible:
- expenses for accounting staff, *i.e.* charges for the keeping of accounts;
- expenses for tax and corporate advice;
- fees for the control board, if any;
- directors' fees, with the exception of the specific fees for the management of property delegated to some directors.

43 The Revenue Agency Circular no. 10/2006, § 14 specified that the costs incurred for Real Estate refurbishment works other than routine maintenance, such as the costs incurred for non-routine maintenance works, restoration, conservative renovation and refurbishment, may not be deducted from the rent nor in any case from business income.

44 Only expenses incurred in connection with routine maintenance costs regarding "repairs, renewal and replacement of building finishes" and those necessary "to supplement or maintain the existing technological systems" are allowed to be deducted on an analytical basis, according to the Assonime Circular no. 54/2005.

45 On this point, please refer to the considerations relating to the deductibility of interest expense.

46 On this point, please refer to the considerations relating to the deductibility of interest expense.

4.6. Determination and restrictions on the deductibility of the unified municipal property tax (IMU)

Under Article 14 (1) of Legislative Decree No. 23/2011, as amended by subparagraph 715 of Law 147/2013 (the 2014 Stability Law), "*The single municipal property tax relating to operating properties is deductible for the purposes of the determination of the business income and the income arising from the exercise of arts and professions to the extent of 20 per cent. The same tax is not deductible for the purposes of the regional tax on productive activities*". The changes made by the quoted paragraph 715 of the 2014 Stability Law have come into effect from the year including 31 December 2013[47]. For this tax period the aforementioned deduction rate has been exceptionally raised to 30%[48].

Subsequently, article 3 of *Decreto Crescita* 2019 (Decree Law No 34 of 30 April 2019, converted with amendments into law no 58 of 28 June 2019) has been replaced by article 1(4) of law no 160 of 27 December 2019 (the 2020 Finance Act). The rule provides that in the fiscal year subsequent to that in progress at 31 December 2018, the municipal property tax is 50% deductible for the purpose of determining business income and income arising from the exercise of arts and professions.

Pursuant to paragraph 772 of the 2020 Finance Act, starting from the fiscal year subsequent to that in progress at 31 December 2021 (FY2022), the municipal property tax on assets used in the conduct of business is wholly deductible, whereas the percentage of deductibility in the fiscal years subsequent to those in progress at 31 December 2019 and at 31 December 2020 will be 60%[49]. Deductibility is limited to the tax paid for

47 The provision in force until the tax year preceding the one covering 31 December 2013 was established by Article 14 (1) of Legislative Decree no. 23/2011, where it was determined that the municipal tax is not deductible from income taxes and from the regional tax on productive activities. Practically, up to the changes made by the 2014 Stability Law, an upward adjustment of the taxable income had to be made corresponding to the full amount of the tax.

48 See paragraph 716 of Law 147/2013 (Stability Law 2014).

49 Therefore, there has been a further change to the deductibility of the municipal property tax from business income compared to the terms of law No 58 of 28 June 2019 (converting decree law 34 of 30 April 2019), which provided for full deductibility of the municipal property tax on assets used in the conduct of business starting from the fiscal year subsequent to that in progress at 31 December 2022 (in practice, from FY 2023); during the transitional period, the tax should have deductible at the following rates:
- 50% in the fiscal year subsequent to that in progress at 31 December 2018;

property used in the conduct of business (by destination and by nature).

Due to the express reference in the rule to property used in the conduct of business, the municipal property tax on real estate assets and real estate as stock-in-trade continues to be non-deductible.

To sum up, the single municipal property tax has been admitted for deductibility from business income as to 20% starting from the fiscal year 2013 (exceptionally raised to 30% for the year in progress at 31 December 2013), as to 50% in the fiscal year subsequent to that in progress at 31 December 2018, as to 60% in the fiscal years subsequent to those in progress at 31 December 2019 and 31 December 2020 and as to 100% in the fiscal years subsequent to that in progress at 31 December 2021.

Legislation	Calendar year	Percentage of deductibility
Article 14(1) of legislative decree no. 23/2011	2012	0%
Article 1(715) of law no. 147/2013	2013	30%
Article 1(715) of law no. 147/2013	From 2014 to 2018	20%
Article 1(772) and (773) of law no. 160/2019	2019	50%
Article 1(772) and (773) of law no. 160/2019	2020 and 2021	60%
Article 1(772) and (773) of law no. 160/2019	From 2022 onwards	100%

The deduction is made on a cash basis, that is to say in the year of payment, in accordance with article 99 of the Italian Income Tax Code. In this respect, it may be helpful to highlight the stance taken by the Revenue Agency during the meeting with the specialized press that took place on 30 January 2014 (reply in Circular 10/2014). Specifically, we are referring to the question as to whether any tax due in respect of an earlier period than the one of the entry into force of the new regime of deductibility (*e.g.* 2012 for companies using the calendar year) and paid late in a subsequent year (say, 2013) could be deducted pursuant to the cash basis principle applicable in this case. According to the Tax Authorities any 2012 IMU (single municipal property tax) paid in 2013 is not deductible, given that it is a cost accrued

- 60% in the fiscal years subsequent to that in progress at 31 December 2019 and 31 December 2020;
- 70% in the fiscal year subsequent to that in progress at 31 December 2021.

for tax year 2012[50]. On the other hand, the 2013 IMU paid late in 2014 is a cost accruing for tax period 2013 non-deductible in that tax period if unpaid and deductible in the next tax year, 2014, upon payment, by means of a decreasing adjustment in the income tax return. It must be said that this interpretation does not seem to be in line with previous official opinions in matters of cost deductions on a cash basis[51]. In its reply, the Revenue Agency also emphasized that "*a different interpretation, designed to ensure the deductibility of IMU for 2012 in the event of late payment, would lead to unequal treatment, penalizing those who have timely paid the IMU*".

4.7. The taxation of dividends and capital gains

The tax rules on dividends consist of the following provisions:

- Articles 44, 47, 59 and 89 of the Income Tax Code, which determine the characterization of income and the applicable legislation depending on the legal status of the receiving person;
- Articles 27 and 27-*bis* of Presidential Decree 600/73, which regulate the withholding tax to be levied on distributions of profits;
- Article 1 of Ministerial Decree 2 April 2008 and Article 1 of Ministerial Decree 26 May 2017 (depending on the period the distributed income formed) indicating the percentages at which dividend receipts form part of taxable income.

Article 89 of the Income Tax Code defines dividends as the earnings from investments in IRES taxpayers, namely:

- resident corporations and commercial entities;
- resident non-commercial entities;
- non-resident companies and entities.

For the majority of taxpayers, dividends are taxed on a cash basis, based on the actual time of receipt.

50 According to the Revenue Agency "*Article 99 (1) of the Income Tax Code does not introduce, in fact, for the purposes of determining business income, solely a cash-basis principle by way of derogation from the general accrual basis principle, but represents a precautionary rule for the revenue authorities, thus introducing a further condition for deductibility of tax which consists precisely in having made the payment*".

51 See Circulars 16/2009 and 8/2013 concerning the methods of deduction of IRAP from income tax.

Based on the combined provisions of Article 3 and Article 23 of the Income Tax Code, dividends are taxed in Italy:

- when the entity that pays the dividend is resident in Italy (or is a permanent establishment of a non-resident entity), regardless of whether or not the recipient is a resident;
- only when they are received by a resident (or by an Italian permanent establishment of a non-resident taxpayer), if the payer is a non-resident.

The tax treatment of dividends varies according to the nature of the recipient. Below we will analyze the applicable fiscal regulations according to the subjective condition of the recipient.

If the dividends are received by individuals who do not carry out business activities, the following rules apply:

- dividends from both "significant" and "non-significant" investments" (*partecipazioni qualificate e non qualificate*) are subject to withholding tax as final liability at the rate of 26% of their entire amount[52];

52 The rules were introduced by the Finance Act 2018 (paragraphs 999-1005 of Law 205/2017), with respect to capital income received as of 1 January 2018.
We set out below the tax regime in force until the fiscal year ongoing at 31 December 2017:
dividends from significant shareholdings were included in taxable income (i) as to 40% if dividends consisted of profits generated up to the year ongoing at 31 December 2007, (ii) as to 49.72% if dividends consisted of profits generated after the year ongoing at 31 December 2007 and (iii) as to 58.14% if dividends consisted of profits generated as of the fiscal year subsequent to 31 December 2016;
dividends from non-significant shareholdings were liable to withholding tax as final tax liability at the rate of 26% of the entire amount received.
As clarified in the Explanatory Report to the Budget Act 2018, the amendment had become necessary to align the tax treatment of dividends from significant and non-significant shareholdings, since as a result of developments in the taxation of financial income and the progressive reduction of the IRES rate, the taxation of dividends from significant shareholdings had become more favourable than that of dividends from non-significant shareholdings, whereas in the past the tax burden on significant shareholdings used to be higher than that on capital income from non-significant shareholdings.
However, to avoid penalizing owners of significant shareholdings in companies with earnings reserves set aside up to 31 December 2017, the law has introduced provisional rules under which profits generated before 1 January 2018 continue to be subject to the prior legislation and are therefore partly included (to a variable extent) in the taxable income of individual shareholders (other than sole proprietors) in the year in which generated. Thus, it has been established that dividends from significant shareholdings paid out of profits generated up to the fiscal year ongoing at 31 December 2017 and resolved to be distributed in the period 1 January 2018-31 December 2022, will continue to be subject to the tax treatment in force until the fiscal year ongoing at 31 December 2017.
The percentages at which profits are included in the taxable basis of individual shareholders neutralize the double taxation in the hands of both the company and the shareholder. The changes in the percentages are aligned to the reduction in the rate of corporate income tax (IRES) (33%

- dividends paid by companies located in low-tax countries or territories[53] will be fully included in aggregate taxable income.

Under Article 67(1)(c) of the Income Tax Code "significant" investments are investments which entitle their holder to:

- a percentage of the voting rights exercisable in an ordinary general meeting above 20%, or a stake in the capital or equity above 25% (for participating interests in companies that are not traded on regulated markets);
- a percentage of voting rights exercisable in an ordinary general meeting above 2%, or a stake in the capital or equity above 5% (for companies whose shares are traded on regulated markets);

The tax treatment of dividends on significant and non-significant participating interests outlined above applies also to interests held in foreign companies (resident in states other than "*black-listed*" jurisdictions). As is the case for Italian-source dividends, such dividends are subject to withholding tax as final

until 31 December 2007, 27.5% until 31 December 2016 and 24% thereafter).

53 With effect from the fiscal year subsequent to that in progress at 31 December 2015, article 1(142) of the Stability Law 2016 has reworded article 167(4) of the Italian Income Tax Code introducing (in lieu of the list contained in Ministerial Decree 21.11.2001 as replaced by Ministerial Decree 30.3.2015) a general principle according to which tax-haven countries and territories are jurisdictions where the nominal tax rate under their respective tax legislation, including any special legislation, is less than 50% the Italian applicable rate, regardless of the inclusion of any such State in a specific black list. Pursuant to the revised wording of article 47 of the Italian Income Tax Code, the following are considered low-tax regimes:
a) for entities controlled pursuant to article 2359 of the civil code, a level of *effective* tax lower than half the rate they would have been liable to had they been resident in Italy;
b) if the control requirement is not met, a level of *nominal* taxation lower than half the rate in force in Italy, having regard to special regimes under which certain persons are eligible for tax benefits.
Article 3 of the "Internationalization" Decree (legislative decree no. 209 of 27 December 2023), which entered into force on 29 December 2023, introduced some simplifications for entities subject to CFC rules. Article 3 has amended article 167(4)(a) of the Italian Income Tax Code, to the effect that now foreign entities whose financial statements are audited and certified by professionals authorized to do so in the foreign state where the controlled foreign companies are resident and the results of which are used by the controlling company's auditor for the purpose of issuing its opinion on the annual report or consolidated accounts, are no longer regarded as being resident in a tax haven country if the effective taxation of the foreign controlled companies – calculated as the ratio of the sum of the current taxes due and the deferred tax assets and liabilities recorded in the financial statements to the pre-tax profit for the year shown in the same financial statements – is not lower than 15 per cent. In all other cases the earlier rule, regarding the comparison with the effective tax rate, continues to apply. Moreover, in the event of lack of control, the new rule has no impact since reference must be made to nominal taxation.

liability at the rate of 26%, levied by the resident person involved (if applicable) in the collection of the dividends (Article 27 (4) of Presidential Decree 600/73) on 100% of the amount paid[54]. Also, under Article 27 (4-*bis*) of Presidential Decree 600/73, the Italian withholding tax on foreign-source dividends and similar income (received by individuals other than sole proprietors) must be levied by the resident withholding agent involved in the collection of the relevant amounts “net of withholdings levied by the foreign state”[55].

If the dividend is related to a significant or non-significant holding in a company resident in a low-tax country or territory, the withholding tax (on account) will be levied on 100% of the amount received (after deduction of any foreign withholding taxes).

In this regard, the Italian 2023 Finance Act (article 1(87-95), Law no. 197/2022) provided that any profits and earnings reserves in the 2021 financial statements of controlled foreign companies in low-tax jurisdictions held by taxpayers in the course of business, not distributed at 1 January 2023, may be subject to a substitute tax (at the rate of 9% or 30% depending on whether the person holding the equity interest is subject to corporate income tax – IRES – or personal income tax – IRPEF).

Under the joint provisions of Article 59 of the Income Tax Code and of Ministerial Decree 2 April 2008 and Ministerial Decree 26 May 2017, dividends received by IRPEF taxable persons (sole proprietors and partnerships – s.n.c.'s and s.a.s.'s), <u>are included in taxable income</u>, regardless of the percentage of ownership held, as follows:

54 The previous wording of article 27(4) of Presidential Decree 600/1973 provided that dividends from significant shareholdings in foreign companies which did not qualify for a beneficial tax regime were subject to an entry withholding tax at the rate of 26% on the taxable portion that constituted income for the recipient (40%; 49.72%; 58.14%), to be levied by the resident withholding tax agent, if any, involved in the collection. This rule was abrogated by article 1(1003)(c) of law no 205 of 27 December 2017 (2018 Finance Act). Instead, inbound dividends are subject to withholding tax as final liability at the rate of 26%, provided for by the new wording of article 27(1) of Presidential Decree 600/1973. Dividends directly received should be subject to self-assessed substitute tax pursuant to article 18(1) of the Italian Income Tax Code, without the possibility of opting for ordinary taxation.

55 As clarified by the Revenue Agency Circular no. 26/2004 (§ 4.3), the calculation basis for the Italian withholding taxes to be levied on collection consists of the original dividends or similar proceeds less the total amount of foreign taxes levied by the payer, including if the foreign tax levy exceeds the amount established by the applicable Double Tax Treaty signed by Italy with the foreign source State. This principle (known as “*Netto Frontiera*”) is used with reference to both Italian withholding tax as final tax liability and withholding taxes levied on account of total liability.

- as to 40%, for dividends paid out of profits earned up to the year current on 31.12.2007;
- as to 49.72%, for dividends paid out of profits earned after the tax year current on 31 December 2007
- as to 58.14% for dividends paid out of profits earned after the tax year current on 31 December 2016.

The dividends in question, whether of Italian or foreign source, are not subject to withholding tax at source.

Dividends or any equivalent proceeds from participating interests in a company resident in a low-tax jurisdiction are taxable in full.

Pursuant to Article 89 (2) of the Income Tax Code, 95% of profits earned by corporations and commercial entities do not form part of business income as they constitute income excluded from taxation. As was the case for Italian and foreign-source dividends received by IRPEF taxpayers, no withholding is levied, except for dividends from participating interests in entities resident in low-tax countries or territories, which are taxable in full.

As concerns Italian-source income paid to non-residents, reference should be made to:

- Article 27 (3) of Presidential Decree No. 600/73;
- Article 27 (3-*ter*) of Presidential Decree No. 600/73;
- Article 27-*bis* of Presidential Decree No. 600/73, if applicable;
- the double tax treaties entered into by Italy and the state of residence of the recipient.

The "ordinary" taxation regime for dividends paid by corporations to their non-resident shareholders, governed by Article 27 (3) of Presidential Decree No. 600/73, provides for the application of a 26% withholding as final tax liability (the withholding was 20% up to 30 June 2014) on the full amount of the dividends received, provided that the underlying participating interest is not related to an Italian permanent establishment of the non-resident person.

The foreign recipients to whom a 26% withholding at source is levied may apply for refund of the tax paid as final liability in their own state of residence on the same profits, up to 11/26 of the sum withheld in Italy[56],

56 Until 31 December 2011, when the applicable withholding tax was 27%, refund was granted up to 4/9 of the amount withheld. With effect from 1 July 2014, article 3 of Law Decree no. 66 of 24 April 2014 amended the refundable proportion to 11/26 as a result of the change in the applicable withholding rate, with a view to keeping the tax burden of the foreign recipient unaltered.

upon presentation of appropriate documentation issued by the foreign state Tax Authorities to the Italian Tax Authorities.

Pursuant to Article 27 (3-*ter*), withholding tax at the rate of 1.20% as final liability must be levied on profits paid to companies and entities subject to corporate income tax in EU and EEA (European Economic Area) Member States included in the list enclosed with the decree of the Minister of Economy and Finance issued for the purposes of Article 168-*bis* of the Income Tax Code[57]. The 1.20%[58] withholding tax set out in Article 27 (3-*ter*) of Presidential Decree 600/73 applies to profits earned starting from accounting periods following that current at 31 December 2016[59].

If the requirements of Article 27-bis of Presidential Decree No. 600/73, transposing the provisions of Directive 435/90/EEC (the Parent/Subsidiary Directive) into Italian legislation, are met withholding tax need not be applied on outbound dividends paid to non-residents, by way of derogation from the ordinary regime provided by Article 27 (3).

Access to the "parent/subsidiary" regime is conditional on the satisfaction of specific conditions depending both on the nature of the non-resident party (parent company) and on the participating interest in the Italian company.

57 Following the abrogation of article 168-*bis* of the Italian Income Tax Code by Legislative decree 147/2015 (the "Internationalisation Decree"), the reference to the States and territory with which adequate exchange of information procedures are in place contained therein is considered to be made to the decrees issued in accordance with article 11(4)(c) of legislative decree 239/1996 (referred to in Ministerial Decree 4 September 1996, following the changes introduced by Ministerial Decree 9 August 2016).

58 The 1.20% rate has been in force since 1 January 2017 (until 31 December 2016 the rate was 1.375%). The amendment, introduced by paragraph 62 of the Stability Law 2016 (law 208/2015) is a direct consequence of the reduction to 24% of the nominal IRES rate with effect from the fiscal year subsequent to that in progress at 31 December 2016.

59 The Tax Authorities, in Circular no. 26/2009, have also clarified that:
reduced withholdings apply to companies and entities potentially liable to corporation tax in their state of residence, regardless of the fact that the tax may not be payable as a result of tax breaks or exemptions;
non-resident recipients need to send the issuer a certificate of residence and tax "status" issued by the foreign tax authority;
no presumption of priority distribution is made under these rules. Accordingly, the payer is required to notify the recipient whether the dividends were paid out of "pre-2008" profits (which do not benefit from the reduction) or out of after 2008 profits (which, on the other hand, qualify for reduced taxation).

The parent company must meet the following conditions:

- must be incorporated in one of the legal forms listed in Directive No. 435/90/EC;
- must be resident for tax purposes in an EU Member State, with no possibility to be considered resident outside the European Union pursuant to a Double Tax Treaty in place between the state where the company has its registered office and a third State;
- must be liable to one of the taxes mentioned in Directive 435/90/EC and not benefit from any exemption or optional regime (unless limited in time or territory);
- must hold the participating interest in the Italian company for at least one year without interruption.

A further requirement for the application of the system in question is the size of the investment held by the foreign party in the Italian company. Originally a minimum threshold of 25% had been established, but this has been gradually decreased, initially to 20% for distributions made by 1 January 2005, then to 15% and finally to 10% with effect, respectively, from 1 January 2007 and 1 January 2009.

An anti-avoidance rule, aimed at countering the phenomenon of conduit companies provides that the parent/subsidiary regime may apply to a non-resident shareholder who receives an Italian-source dividend and is in turn (directly or indirectly) controlled by one or more non-EU resident persons, only if there is proof that the parent company does not hold the participating interest solely or mainly in order to benefit from the favorable regime provided for in the Directive (*i.e.* its sole function may not be to act as an intermediary between the Italian party that distributes the dividend and the non-EU beneficial owner).

Under Article 27-*bis* (2) of Presidential Decree No. 600/73, the legal status of the "parent" company, its tax residence and liability to corporation tax in the state of residence must be supported by appropriate documentation issued by the competent foreign Tax Authorities.

As an alternative to the use of the above regimes, it is possible to evaluate the effects of the provisions contained in the international double tax treaties. The treaties entered into by Italy are generally in line with the terms of Article 10 of the OECD Model Tax Convention.

Treaties generally provide for a mitigation of the withholdings at source on dividends paid by a company resident in a Contracting State to a party resident in another state who is the beneficial owner thereof (normally the applicable rates range between 10% and 15%).

Moving on now to an overview of the tax regulations for capital gains, Article 86 (1) of the Income Tax Code provides a list of proceeds which constitute capital gains. They are in connection with the company's assets "other than those indicated in Article 85 (1)"; given that Article 85 (1) of the Income Tax Code regulates assets which constitute the company's stock-in-trade and which generate revenue, it can be concluded that capital gains rules apply to assets other than assets which constitute the company's stock-in-trade and therefore to:

- operating assets used for the conduct of business, depreciable in accordance with Article 102 of the Income Tax Code;
- non-depreciable assets, provided they do constitute the company's stock-in-trade, such as, for instance, land and Real Estate held by property management companies.

The cases which give rise to capital gains also include "sales for good and valuable consideration". Capital gains realized through contributions, exchanges in kind or *datio in solutum* are also included.

Capital gains realized through a sale for good and valuable consideration consist of the difference between the consideration received (net of any directly attributable transaction costs) and the non-amortized cost[60] of the assets sold.

As regards capital gains arising from a contribution, instead, the consideration received is determined pursuant to the provisions of Article 9(2) of the Income Tax Code, according to which "in the event of transfers or contributions to companies, the consideration received shall be deemed to be the arm's length value of the assets and receivables transferred".

With regard to capital gains arising from an exchange in kind, if the consideration consists of depreciable assets and these are recorded in the transferee's accounts at the book value shown in the transferor's accounts, "only the adjustment that may have been agreed shall constitute a capital gain". If, however, the balance sheet value of the asset received is different from that of the asset transferred, the capital gain will be determined having regard to any adjustments received and any additional balance sheet values of the assets received compared to the book value of the assets transferred, whereas any lower balance sheet values and

60 In the event of differences between statutory and tax depreciation (*i.e.*, in case of a double-track statutory and tax system), the taxable capital gain is calculated having regard to the depreciation deducted for tax purposes.

adjustments paid to the other party will reduce the capital gain (or even result in a capital loss).

Where the tangible or intangible assets have been owned for at least three years, pursuant to Article 86 (4) of the Income Tax Code the taxation of the capital gains from sales and similar transactions may be spread over a maximum of five years. It is up to the taxpayer to decide the length of time over which capital gains taxation may be extended (two, three or four years), provided that capital gains are taxed on a straight-line basis; the taxpayer may not revoke or amend the election to spread capital gains taxation.

The three-year ownership period must be calculated in accordance with the provisions of Article 2963 of the Italian Civil Code, *i.e.,* on the basis of the civil calendar. For assets received as a result of a tax-neutral merger, de-merger or contribution of business (Article 176 (1) of the Income Tax Code), the three-year period will start as of the date of acquisition of the asset by the merged or the merging company, de-merged company or company making the contribution, rather than from the date of the corporate reorganization.

Under Article 86 (4) of the Income Tax Code, the election to spread capital gains taxation must be made in the tax return and, if none is filed, the capital gain will be fully included in income in the year in which the capital gain is considered realized.

As regards the taxation of capital gains from significant shareholdings realized by individuals other than sole proprietors, as is already the case for dividends, the 2018 Finance Act replaced personal income tax by bands of income pursuant to article 67 of the Italian Income Tax code with the 26% substitute tax previously applicable (pursuant to article 5 of legislative decree no 461 of 21 November 1997) only to capital gains from non-significant shareholdings.

The changes to the capital gains taxation regime applies to miscellaneous income realized as of 1 January 2019.

Before the change, capital gains realized by individuals other than sole proprietors were taxable as follows:

- significant shareholdings: up to 40%, for capital gains realized by 31 December 2008; up to 49.72% for capital gains realized between 31 January 2009 and 31 December 2017; up to 58.14% capital gains realized as of 1 January 2018;
- non-significant shareholdings: 26% substitute tax pursuant to article 5 of legislative decree No 461/1997.

Following the changes to articles 68 of the Italian Income Tax Code and article 5 of legislative decree 461/1997, also capital gains from the sale of significant shareholdings are subject to the 26% substitute tax[61].

Capital gains from the sale of a significant or a non-significant shareholding (article 68(4) of the Italian Income Tax Code) in an entity resident in a low-tax country or jurisdiction are fully taxable, without exemption.

Taxation on the entire amount can be avoided by applying the standard capital gains taxation regime if the Italian resident shareholder is able to demonstrate that ownership of the shareholdings did not result, from the start of the ownership period, in the diversion of income to a tax haven jurisdiction pursuant to article 68(4) of the Italian Income Tax Code. The latter also refers to the safe-harbor rule pursuant to article 167(5)(b) of the Italian Income Tax Code. If the resident seller is able to demonstrate that the foreign subsidiary mainly carries out an industrial or commercial activity in the foreign country:

- the capital gain will be fully taxable;
- the Italian shareholder shall be entitled to an indirect tax credit pursuant to article 68(4-bis) of the Italian Income Tax Code for the taxes paid by the foreign subsidiary on the profits accrued during the holding period of the shareholding in proportion to the shares sold and within the limit of the Italian tax thereon.

Article 87 of the Italian Income Tax Code provides for a particular taxation regime for capital gains and losses realized by companies liable to IRES from the sales of shareholdings, financial instruments and similar items ("participation exemption")[62].

If particular conditions are met, the capital gains are 95% exempt, whereas the corresponding capital losses are wholly deductible.

The conditions for exemption provided by article 87(1) of the Italian Income Tax Code are:

- uninterrupted ownership of the shareholding as of the first day of the twelfth month prior to the month of sale (letter a);
- recording of the shareholding among financial fixed assets in the first financial statements approved during the ownership period (letter b);

61 This result has been obtained by amending article 5(2) of legislative decree 461/1997 which previously mentioned capital gains in non-significant shareholdings only. Given that the notion of significant shareholdings includes also interests in partnerships, including simple partnerships, also capital gains on such interests are subject to 26% substitute tax pursuant to article 5 of legislative decree 461/1997.

62 Lower exemption percentages apply to sole entrepreneurs and to partnerships.

- tax residence of the subsidiary in states or territories other than low-tax jurisdictions (letter c);
- conduct of a commercial business by the subsidiary (letter d).

With particular regard to the last condition, which is especially significant for real estate companies, subsidiaries whose assets mainly consists of real estate other than:

- real estate the production or exchange of which constitutes the company's core business (real estate as "stock-in-trade");
- equipment;
- buildings directly used in the conduct of business ("operating property by destination "),

are presumed not to carry on a commercial business, without possibility of providing contrary proof.

Moreover, the conduct of a commercial business is not deemed to take place in all cases of passive management of assets generating passive income[63].

Also, pursuant to article 87(5) of the Italian Income Tax Code, with regard to shareholdings in holding companies, the conditions of tax residence and conduct of a commercial business:

- refer to indirectly owned companies;
- are satisfied when they are met in respect of the subsidiaries which account for most of the controlling company's shareholders' equity.

With regard to non-resident sellers, if residents of the EU or the EEA, article 1(59) of law no. 213 of 30.12.2023 (the Italian 2024 Finance Act) introduced article 68(2-bis) of the Italian Income Tax Code, which extended the PEX regime to these entities. Under this provision, capital gains on significant shareholdings realized by non-resident companies and entities without an Italian permanent establishment are included in taxable income as to 5% of their amount, if the conditions laid down in article 87(1)(a), b), c) and d) of the Italian Income Tax Code are met.

Starting from 1 January 2024, capital gains from the sale of property on which renovation works under the "Superbonus" tax credit program pursuant to article 119 of Decree Law 34/2020 were carried out and ended not earlier than 10 years before the date of the sale, are included among other income.

63 § 5 of Italian Revenue Agency circular no. 7/2013.

Pursuant to article 1(64)-(66) of the Italian 2024 Finance Act, the sale of properties is relevant for income tax purposes in the 10 years following the end of the works qualifying for the Superbonus tax credit, with the following exceptions:

- inherited property;
- property used as principal dwelling by the seller or his/her family members for most of the 10 years prior to the sale or, if less than 5 years passed between the date of purchase or construction of the property, for most of said period.

As regards the manner of determining the relevant costs for the purpose of calculating the capital gains, as a result of the amendment of article 68(1) of the Italian Income Tax Code it is established that:

- if the works under the Superbonus tax credit program ended not earlier than 5 years before the sale, no account is taken of the expenses for the works if the 110% incentive was obtained and the "tax credit assignment" or "discounted invoice" options pursuant to article 121(1)(a) and (b) of Decree Law 34/2020 were selected;
- if the works under the Superbonus tax credit program ended more than 5 years previously, but not earlier than 10 years prior to the sale, 50% of the expenses for the works will be taken into account if the 110% incentive was obtained and the "tax credit assignment" or "discounted invoice" options were selected

Needless to say, the purchase price or construction cost determined as above for the properties purchased or built for more than 5 years at the date of the sale shall be revalued at the index of consumer prices for blue and white-collar worker households.

The capital gains may be taxable at a substitute rate in lieu of IRPEF (personal income tax) at the rate of 26%, pursuant to article 1(496) of law no. 266/2005.

Finally, the 2025 Finance ACT has extended, for FY 2025 alone, the possibility for corporations and commercial partnerships (s.n.c. and s.a.s.) to allot or transfer assets (real estate or registered personal property) not used in the course of business to its shareholders or partners, charging the resulting capital gain, if any, to substitute tax in lieu of income tax and regional production tax (IRAP) at the rate of 8%[64].

64 Unless further instructions are issued, the current official guidance documents (Revenue Agency Circulars no. 112/1999, no, 40/2002, no. 26/E/2016, no. 37/E/2016 and no. 8/E/2017,

Under the incentive regime introduced by the rule, any capital gains may be determined on the basis of the land registry value, rather on the market value or sale consideration, less the tax basis of the asset.

In order to be eligible for the incentive, the shareholder will have to be registered in the shareholders' register at 30 September 2024, or by 31 January 2025 provided that the relevant asset transfer instrument is dated before 1 October 2024.

The "exclusion" of the asset from a company and its concurrent inclusion among the shareholder's assets must take place by 30 September 2025, and the relevant substitute tax will have to be paid as to 60% by the same date and as to the remaining 40% by 30 November 2025.

Payment of the substitute tax shall release the allottee from any other tax liability, limited to the additional values subject to substitute tax[65]. However, the tax basis of the shares or non-share interests held by the allottee in the company shall be reduced by the market value of the assets received, after deduction of the tax liability paid by him.

The allotment and the transfer to a shareholder are relevant for VAT, payable according to the standard procedure (if the allottee/transferee is a vatable person, the reverse-charge mechanism will apply) or, alternatively, to proportional registration tax, at a rate half the standard rate, and to fixed mortgage and land registry tax.

4.8. Taxation of Real Estate inventories, their write-off and income from sales

As already noted in the introduction, Real Estate assets which are acquired or dealt with as part of a business activity are treated as "stock-in-trade", the sale of which generates revenues and not capital gains. For these purposes, the nature of the business is identified on the basis of the by-laws or, in any case, on the activity actually carried out. Typically this involves buildings that are built

as well as Resolutions no. 93/E/2016, no. 101/E/2016 and no. 54/E/2017), issued after the introduction of the earlier versions of the incentive, should continue to apply to the "new" rules. The substitute tax rate is 10.5% if the allotting company has been regarded as a non-operating company for two out of the three fiscal years prior to the year in progress at the time of the allotment or transfer of the asset.

65 Revenue Agency Circular no. 26/E/2016, in addition to Circular no. 40/2002.

or renovated for sale by Real Estate construction or renovation companies or land and buildings purchased for resale by a company dealing in Real Estate.

Ministerial Resolution of 12 July 1982 no. 9/1730 clarified that whether an asset is shown as a current asset or as a fixed asset is not in itself a definite criterion for determining the applicable tax treatment for a particular Real Estate asset. The key criterion is, in fact, represented by the way the asset is actually used, *i.e.* whether the property is placed on the market or managed. In particular, according to the resolution, recording the property as a fixed asset and leasing the asset for a significant period represent sufficient and appropriate justification for treating the property as a capital asset, and not stock-in-trade, the disposal of which generates capital gains and not revenues. However "*in order to identify the classification of the asset* […], *it is necessary to conduct an analysis from time to time on a case by case basis*".

Article 2426 (9) of the Civil Code provides that "*Inventories, securities and financial assets other than fixed assets must be shown at the lower of purchase or production cost, calculated according to para. 1, and the net realisable market value. This lower value should not be maintained in subsequent years if the reasons for the write-down no longer apply*". Therefore the following criteria apply in determining the balance sheet value:

a. *purchase cost*: this cost, which is applicable in the case of a purchase from a third party, is formed by the actual purchase price plus incidental expenses (*e.g.* legal/notarial fees for the transfer deed, taxes on registration of the deed, etc.);
b. *cost of production*: this cost, which is to be used where the asset is produced internally, includes the purchase cost (as defined above) and the cost of production or refurbishment. All direct costs and indirect expenses reasonably attributable to the asset and relating to the period of construction up to the time after which the property may be used. General expenses must be recognized according to criteria which are in line with the specific characteristics of the production process. Abnormal or exceptional expenses should be excluded from the cost of production. The production cost may also include "*financial charges related to financing the manufacture either internally or through third parties, to be reasonably attributed to the product and up to the time from which the property may be used*"[66].

66 Cf. Article 2426 (1) of the Italian Civil Code, as expressly referred to in par. 9 of the same article.

In this regard, accounting standard no. 13[67] specifies that the general rule is to exclude financial expenses from the cost of inventories. However, in cases where a loan was clearly assumed for specific items that require a production process lasting several years before they are sold (as in the case of construction of a building) the related interest expense may be included as a cost, limited to the period of production, and provided that the interest charges have actually been incurred, this treatment is clearly indicated in the notes to the accounts and the value of the inventory does not exceed its net realisable value.

Real Estate as stock-in-trade is a component of taxable profit according to the results shown in the profit and loss account:

- income from sales;
- changes in stock-in-trade;
- construction costs.

From a tax perspective, until this type of property is completed and disposed of, it forms part of business profits, as a variation in stock as defined in Article 92 of the Income Tax Code ("ITC"), according to which it is valued on the basis of the specific costs shown in the financial statements.

Given that the inventory is valued according to a specific cost, any write-down will not be deductible for tax purposes, given the absence of any reference under Article 92 (5) to assets valued at specific cost[68]. On the other hand, any write-up will be not relevant for tax purposes, being the inventory valued according to a specific cost[69].

The costs of acquisition or construction must be treated, from a tax point of view, in accordance with the correct accounting principles[70]. Pursuant Article 83 of the ITC: "*the criteria of qualification, timely recognition and classification in the financial statements provided for in the respective accounting principles shall apply also in derogation from the provisions of the subsequent articles of this section*". In particular, the Decree of the Ministry of

67 Cf. OIC 13, par. 39.

68 Cf. Ministerial Resolution no. 78/E of 12 November 2013 and Reply to the ruling no. 60 of 19 February 2020.

69 Cf. Agenzia delle Entrate, Circular letter dated 14.5.2014, no. 10/E, par. 6.2.

70 Cf. OIC 13 (16), (17) and (18) "*16. Inventories are initially recognised at the date the risks ad benefits connected to the acquired asset are transferred. 17. Risks and benefits are usually transferred together with the ownership title in the manners set out in the contract. 18. If, in application of specific contractual clauses, the date of the transfer of risks and benefits and the date of the transfer of the ownership title are not the same, the date of the transfer of the risks and benefits shall prevail […]*".

Economy and Finance dated 3 August 2017 has extended to GAAP adopters, other than micro-enterprises which have not opted for ordinary form in financial statement draft, "*the concept of derivation of the corporate income tax basis from financial statements already provided for IAS/IFRS adopters. To this purpose, qualifications of the financial statements in application of the principle of the prevalence of substance over form*" as implemented in the new Italian GAAPs[71], "*are recognized for tax purposes also*". Therefore, the companies referred to above can also apply for exemption from the provisions of Article 109 (1 and 2) of the ITC[72].

As regards costs to be incurred in years subsequent to that in which the proceeds of Real Estate disposal are received (*e.g.* local urban development work), the Tax Authorities have repeatedly[73] stated that these costs are not relevant to the inventory valuation and can be set off against income only when the proceeds of sale are actually received.

With regard, however, to long-term works, the costs for the realisation of these kind of development works where the relevant consideration has already been received need not be deducted in the period to which the income is attributed, but they can be accounted for in the profit and loss account for the relevant accounting period, unless the liability is not yet certain or where the amount of the costs cannot be objectively determined, in which case the costs should be attributed to the tax period in which these conditions are met.

The tax cost of Real Estate held as stock-in-trade[74] also includes directly attributable costs (excluding general expenses) and interest payments on loans for construction or renovation.

The sale of Real Estate generates a component of profits treated for tax purposes as revenue, which, in the same way as for the costs involved, is treated in accordance with the policies contained in the accounting standards.

71 Cf. Presentation of the Ministerial Decree of 3 August 2017.

72 Cf. Article 109 (2) of the ITC, which provides for the costs of acquisition of Real Estate assets to be considered incurred (i) at the time of the execution of the notarial deed of sale; (ii) or, if different and subsequent, at the date of the passing of the title.

73 Reference should be made to Ministerial Resolution no. 9/2940 of 22 October 1981, Ministerial Resolution no. 14/E of 5 March 1998, Ministerial Resolution no. 52/E of 2 June 1998.

74 Article 110 (1) (b) of the ITC.

With reference to intra-annual works (i.e., with a duration equal to or less than one year) and multi-year works, computed for tax purposes, respectively, pursuant to Article 92 (6) and Article 93 of the ITC, it should be noted that the relevant tax regime has been modified by Articles 9 and 13 of Legislative Decree no. 192 of 13 December 2024 (containing the "Review of the income tax regime (IRPEF-IRES)"[75]). With the innovations introduced by the aforementioned Legislative Decree no. 192/2024, the Legislator intended to attribute tax recognition to the evaluation criteria used in the financial statements, thereby eliminating the need to make adjustments in the tax return, thus eliminating the so-called "double accounting-fiscal track". Specifically, from the tax period following the one ongoing as of 31 December 2023 (i.e., 2024 for entities with a tax period coinciding with the calendar year), companies that account for intra-annual works according to the percentage of completion method, in compliance with the correct accounting principles, apply the aforementioned method also for the purposes of determining the IRES taxable base. Conversely, companies that account for multi-year works by evaluating inventories in the financial statements with the cost method and attributing the revenues to the financial year in which the works are delivered or the services and supplies are completed (moving away from the ordinary percentage of completion criterion), in compliance with the correct accounting principles, apply this method also for the purposes of determining the IRES taxable base. Finally, it is established that the provisions in force before the Legislative Decree no. 192/2024 will continue to apply to intra-annual and multi-year works still in progress at the end of the tax period ongoing as of 31 December 2023.

75 As specified in the Explanatory Report to the Legislative Decree no. 192/2024, this intervention was intended to implement Article 9, par. 1, letter c), of Law no. 111/2203 (delegated law for the tax reform), which indicated among the guiding criteria for the review of the corporate income tax system the one of "*simplifying and rationalising the criteria for determining the business income in order to reduce administrative formalities, without prejudice to the principles of relevance, fiscal neutrality of corporate reorganisation operations and prohibition of abuse of law, through the revision of the rules on partially deductible costs and the strengthening of the process of putting near tax values to civil values, providing for the possibility of limiting the increases and decreases to be made to the results of the income statement such as, in particular, those concerning depreciation, works, supplies and services lasting more than one year, exchange rate differences for debts, credits in foreign currency and default interest*".

4.9. The participation exemption regime

The rule governing exempt shareholdings (the *"participation exemption" regime, "pex"*) set out in Article 87 of the Income Tax Code ("ITC") is a system rule since, together with the regime of the (partial) exclusion from taxation of dividends and the non-deductibility of any write-down in the value of shareholdings, it serves to avoid the double taxation of the profits produced by companies and distributed to shareholders.

Under Article 87 of the ITC, capital gains arising from the sale of investments in capital companies are exempt from the computation of taxable profits as to 95%. It should be noted that this rule – in particular, with reference to the requirement of the tax residence of the investee company, see below – has been subject to various changes, most recently made by Legislative Decree dated 29.11.2018, no. 142 (so called ATAD Decree, implementing the 2016/1164/EU and 2017/952/EU Directives) and finally by Legislative Decree dated 27.12.2023, no. 209 (implementing the tax reform in the field of international taxation). In particular, according to the tax rule in force from the tax period following the one ongoing as of 31 December 2023, for the purpose of the application of the regime the following conditions must be met (par. 1):

a. uninterrupted possession of the shareholding for twelve months (par. 1, letter a))[76];
b. classification as a financial fixed asset in the first financial statements ended during the period of ownership (par. 1, letter b));
c. tax residence of the company or a subsidiary in States or Territories different from those with a favourable tax regime identified on the basis of the criteria of Article 47 bis, par. 1[77], of the ITC (or, alternatively, successfully showing, following a request for ruling pursuant to the same Article 47 bis, par. 3, of the ITC, the existence of the condition required by par. 2, letter b), of Article 47 bis) (par. 1, letter c)). In particular, pursuant to Article 47 bis, par. 1, of the ITC, the subsidiaries are deemed to be resident in Tax heaven if:

76 A shareholding received in consideration for the transfer of a going concern is considered to be recorded as a financial fixed asset with the same period of ownership as the business assets transferred (Article 176, par. 4, of the Income Tax Code).

77 Article introduced by the Article 5, par. 1, letter b), of the ATAD Decree. This Article provides for the definition of States or Territories with a privileged tax regime and modifies the provisions concerning the taxation of dividends and capital gains for what concerns the relations with these States.

- they fulfil the condition referred to in par. 4, letter a), of Article 167 of the ITC, namely their effective level of taxation is less than 15% of the Italian one[78], for controlling participation in compliance with Article 167, par. 2, of the ITC[79] (pursuant to Article 47 bis, par. 1, letter a));

78 Regarding the criteria for the computation of the effective level of taxation, this provision has been modified in this way by the Legislative Decree 27 December 2023, no. 209, implementing the tax reform in the field of international taxation, which introduced a simplification of the regulation of the so-called "Controlled Foreign Companies" ("CFCs").
The version in force until the tax period in progress as of 31 December 2023 instead required a level of effective taxation lower than 50% of the Italian one, to be determined on the basis of the provisions contained in the Regulation of the Director of the Revenue Agency no. 376652 dated 27 December 2021 and in the Circular no. 18/E of 2021.
In more detail, Article 3 of the said Legislative Decree no. 209/2023, has made significant changes to the regulation of CFCs, in particular affecting the access conditions: indeed, the first access condition referred to in the Article 167, par. 4, letter a), of the ITC which concerns the methods for determining the tax level of the foreign subsidiary has been modified (instead, the second condition for access to the CFC regime linked to the relevance of the so-called passive income referred to in letter b) of par. 4 of Article 167 remains unchanged). Specifically, based on the new wording of the Article 167, par. 4, letter a), of the ITC, non-resident subsidiaries are now required to be subject to effective taxation of no less than 15%. The effective taxation is determined with a simplified calculation (*i.e.*, ratio between current, prepaid and deferred taxes and pre-tax profit) if the financial statements of the foreign subsidiary are subject to audit and certification and the results of this activity are used by the auditor of the controlling entity for the purposes of audit judging its annual or consolidated financial statements.
Otherwise, if the financial statements of the foreign company were not certified or the effective taxation was lower than 15%, then the regulations in place prior to the amendments made by the Legislative Decree in question apply, which regulations require having to verify the existence of the condition of effective taxation lower than half of that to which the subsidiaries would have been subject if resident in Italy (effective tax rate), to be determined on the basis of the provisions contained in the Regulation of the Director of the Revenue Agency no. 376652 dated 27 December 2021 and in the Circular no. 18/E of 2021.
For systematic reasons, the new par. 4-bis of Article 167 provides that in the calculation of the effective taxation the equivalent national minimum tax paid in application of the global minimum taxation regulation (so-called "Pillar 2") is also considered.
The new par. 4-ter of Article 167 then provides for an optional system of three-year substitute taxation with a rate equal to 15%, to be calculated on the profit of the financial statements of the foreign company without taking into account taxes, devaluations of assets and provisions for risks. The Regulation of the Director of the Revenue Agency no. 213637 dated 30 April 2024 has defined the application methods of the option provided for by par. 4-ter of Article 167 of the ITC and the Italian Tax Authority with Resolution no. 64/E of 18 December 2024 has established the tax codes for the payment, via "F24" form, of the substitute tax due pursuant to the aforementioned par. 4-ter.
Pursuant to Article 7 of Legislative Decree no. 209/2023, the new provisions apply starting from the tax period following the one in progress as of 29 December 2023 (*i.e.*, date of entry into force of this Legislative Decree pursuant to Article 63 of the Legislative Decree at hand).

79 Article 4 of the ATAD Decree amended also Article 167 of the TUIR. First of all, the "notion of control" of non-resident companies and entities has been expanded. Indeed, not only the foreign

- their nominal tax level is less than 50% of the Italian one, for those participations that do not meet the controlling requirement, also if taking into account specific tax regimes (pursuant to Article 47 bis, par. 1, letter b));
- in the new regime, due to an express regulatory provision contained in Article 47 bis, par. 1, States or Territories belonging to the European Union or to the European Economic Area are never considered privileged tax regimes;

d. the subsidiary carries on a commercial enterprise as defined in Article 55 of the ITC (the condition of "commerciality") (par. 1, letter d)). The condition of commerciality is not required for capital gains realised following the sale of shares in companies whose securities are traded on regulated markets, as well as for those gains realised pursuant to an offer of public sale.

The requirement referred to in par. 1, letter c), of Article 87 – which is the tax residence of the subsidiary – must exist uninterruptedly from the first period of holding or, for participations held by more than five tax periods and sold to entities not belonging to the seller's group, within the fifth tax periods prior to realization[80]; while the requirement of par. 1, letter d) – i.e.,

entities in which, also by means of trust or by means of a interposed person, the majority of voting rights in ordinary shareholders' meetings (Article 167, par. 2, letter a)) are deemed to be controlled, but also those where there is a participation to the profits of more than 50%, directly or indirectly, through one or more subsidiaries on the basis of Article 2359 of the Civil Code or through a trust company or a third party (Article 167, par. 2, letter b)). It is also confirmed that the notion of control is extended to the permanent establishment of the foreign subsidiaries and to the permanent establishment in branch exemption located in countries with privileged taxation for residents. At this regard, see also the clarifications provided by the Revenue Agency in Circular no. 18/E, par. 3, dated 27 December 2021.

80 According to Article 13, par. 6, of Legislative Decree no. 142/2018, the said requirements of the tax residence of the subsidiary for PEX purposes apply to the capital gain arising from tax period following the one ongoing as of 31 December 2018. In the absence of ad hoc transitional regulations governing the transition between the various regimes ratione temporis in force, many doubts have arisen regarding the frequent case of the realization of participations in long term foreign subsidiaries, namely the extension to the "monitoring periods" before 2019 of the requirements for the tax residence of the subsidiary currently in force. For a more complete analysis of the topic at hand, please refer to Assonime Guidelines no. 15/2021. In this regard, see the Reply to the ruling request no. 481/2022, containing some important principles on the topic related to the tax residence of the subsidiary for PEX purposes, with which the Revenue Agency, in relation to the criteria aimed at identifying the tax residence of the subsidiary as amended by the ATAD Decree, clarified that "*the examination of the existence of the requirement of tax residence of the subsidiary has to be conducted on the basis of the identification criteria of the privileged tax*

carrying out a business of a commercial enterprise – must be uninterrupted, at the time of realization, at least since the beginning of the third tax period prior to the realization of the same[81].

regimes in force identified by the current wording of Article 47-bis of the ITC (membership of EU/EEA States: exclusion without any verification; membership of non-EU/EEA States: verification of the nominal tax rate in the case of relayed shareholdings and of the effective tax rate in the case of controlling shareholdings) from a 'year-by-year' perspective, namely taking into account the specific situation in which the taxpayer finds himself (foreign taxation, existence or otherwise of control, etc.) in each of the tax periods being monitored".

81 According to the tax authorities' guidance (Circulars no. 36/E/2004 and no. 7/E/2013) in this regard, if the subsidiary has been incorporated for less than three years, reference must be made to the shorter period between the date of set up and the sale of the investment. However, the Tax Authorities stated that this principle does not apply to extraordinary transactions (explicitly mentioning mergers and divisions). In this case, in fact, the surviving entities inherit from predecessors also the characteristics relevant to the assessment of the requirements of residence and commerciality (called principle of continuity). With Resolution no. 227 / E of 2009, it was confirmed that this principle of continuity applies also to cases of a transfer of a business to a newly incorporated company. In this case, therefore, the requirement of "commerciality" is deemed to apply "*only if the transferee 'inherits' the trading undertaking of a company that is predominantly commercial, provided that such activity is continuously performed also by the transferee up to the date of the sale of the investment in compliance with the requirement with the holding period requirement*". Resolution no. 163/E of 2005 deals instead with the case of the rent of the only business held by the subsidiary, considering it a case of interruption of the requirement of commerciality on the grantor's side, resulting in forfeiture of the *pex* regime.
The Circular no. 7 / E of 2013 also deals with the case of interruption of the commercial activity in the three years of observation before the sale and distinguishes the case in which the interruption was temporary, while maintaining the company and its operational structure, in which case it is not relevant whether from the event of the interruption results a gradual weakening of the company, in which case an overall assessment must be made to avoid possible elusive behaviours. Therefore, the three years of observation should be verified with reference to the three fiscal years prior to the fiscal year in which starts the gradual weakening of the investee company. In this regard please see the Replies to the ruling request no. 722/2021 and no. 481/2022 (question no. 1).
With the Reply to the ruling request no. 2 of 14.09.2018, the Italian Tax Authorities provided clarifications regarding the application of PEX to the sale of shares in start-up companies. The issue derives precisely from the formulation of Article 87, par. 2, of the ITC, according to which the requirement for the subsidiary company to exercise its business must be verified uninterruptedly, at the time of realization, at least from the beginning of the third tax period prior to realization. Since, in many cases, companies in a start-up phase carry out activities that are merely preparatory to the exercise of the core business, the Italian Tax Authorities had distinguished, through the Circular no. 7 / E of 2013 (par. 2), among the following situations: (i) start-up phase which was followed by the start of commercial activity: there is a "drag" effect for which the period in which the preparatory activity takes place is calculated in the relevant three-year period for the recognition of the exemption; (ii) start-up phase still in progress: the "commercial" requirement does not yet occur; (iii) companies in the inactive phase, in which neither any preparatory nor commercial activities are carried out: this period is not included in the three-year period. With the Reply no. 2/2018 in point, the Italian Tax Authorities stated that the situation under examination would fall within the first of the three

For investments in companies whose business consists exclusively or primarily of the acquisition of shareholdings, the requirements referred to in sub par. c) and d) refer to the entities in which the investments are held, and are considered verified when they concern subsidiaries which account for most of the value of the assets of the participant.

The purpose of the *participation exemption* system is to promote the circulation – in the form of equity investments – of business complexes that have the nature of actual companies involved in the performance of business activities, with a capacity to actually conduct a productive/commercial

situations illustrated by the aforementioned Circular no. 7/E/2013, with a consequent "dragging" back the three-year period up to including in it the period in which the preparatory and auxiliary activities were carried out; the "commercial" nature of the activity carried out by the subsidiary already exists in the start-up phase, provided that the company, after completing the preparatory phases and thus having an autonomous organizational structure, then begins to carry out the activity for which it was incorporated.
In this regard, with the Reply to the ruling request no. 883 of 2021 related to a holding company with subsidiaries operating in the energy field, the Revenue Agency provided clarifications in relation to the perimeter of preparatory activities, as well as the Reply no. 418/2022 where the Revenue Agency has clarified that the activities aimed at evaluating financial sustainability and returns on investments are not included among preparatory activities.
With reference to the Italian tax case law that has stated about the existence or not of the requirement of commerciality, provided for by Article 87, par. 1, letter d), of the ITC, already in the start-up phase, please refer to the following judgements: Supreme Court of Cassation 12.12.2019, no. 32582 ("*the requirement of commerciality can be considered to exist already in the start-up phase provided that the subsidiary company, after having completed the preparatory phases and thus having equipped itself with an autonomous organizational apparatus, subsequently begins to carry out the activity for which it was established*"); Supreme Court of Cassation 02.12.2021, no. 38066 ("*in accordance with these purposes, the exercise of the commercial enterprise must be verified, not only on the basis of the indications of the corporate purpose, but also with reference to the activity actually exercised, or potentially exercisable, suitable to satisfy the market demand in technical times reasonably expected on the basis of the specific economic sector to which it belongs*"); Supreme Court of Cassation 02.28.2023, no. 6093 (with reference to the relationship between commercial activities and preparatory acts, the requirement of commerciality is present when "*the enterprise is equipped with a structure – the result of an activity of organization and preparation of the necessary resources – suitable for starting the production process in reasonable times in relation to the object of the business activity ... in other words, the requirement of commerciality can be considered as existing only when the taxpayer has equipped himself with an autonomous organizational apparatus*"); and, lastly, Tax Court II degree of Trentino-Alto Adige, 05.06.2024 no. 10/1/2024 ("*if the purpose of the PEX regime is to promote the circulation, in the form of shareholdings, of asset complexes that have the nature of actual companies functional to the exercise of business activities, this purpose is not found in the case in question where [the taxpayer] has taken a shareholding in a company that has carried out mere research activities by creating only a prototype still requiring testing. A company that has not completed the preparatory development phases, which has therefore carried out an activity far from being, even potentially, suitable to satisfy market demand in foreseeable technical times*").

activity. In other words, the regime in question applies only where the assets of the subsidiary are regarded as a business concern which is used in the performance of the company's business.

To this end, according to the clarifications of the Tax Authorities[82], it is crucial that the subsidiary's operational structure is suitable (even if only potentially so) to the implementation of the production process.

The verification of the existence of the requirement of commerciality must not be based solely on the formal content of the corporate objects, but needs to be determined in substance, based on the activity actually performed by the company[83].

With specific reference to the Real Estate sector, the provision in question raises an irrebuttable presumption that excludes the requirement of "commerciality" with regard to companies whose balance sheet assets[84] consist primarily of Real Estate other than Real Estate which is constructed or traded as the company's direct business activity (known as "stock-in-trade"), as well as by the plants and buildings used directly in business

82 Cf. Revenue Agency, Circular letter dated 29.03.2013, no. 7/E.

83 First with Circular no. 7/E of 29.3.2013 and then with the Reply to ruling request no. 502 of 28.11.2019, the Italian tax authorities clarified that "*there is a 'commercial enterprise'" for PEX purposes in the event that the investee company has an operating structure suitable for the production and/or marketing of goods or services potentially generating revenues. It is also considered that the requirement of commerciality exists if the company has the capacity, even if only potential, to satisfy market demand within the technical time frame reasonably expected in relation to the specific characteristics of the economic sectors to which it belongs*".
With reference to the requirement of commerciality provided for by letter d) of par. 1 of Article 87 of the ITC, please refer also to the Replies to ruling request no. 33/2021, no. 744/2021, no. 354/2022 and, lastly, no. 96/2024 (in particular, in this last document, the Revenue Agency reiterated that "*according to the consolidated opinion expressed by the Italian Tax Authority, the requirement of commerciality does not apply in all cases of activities aimed at the mere management of assets from which the perception of passive income derives, namely of proceeds obtainable from assets characterised by an autonomous production capacity and, therefore, not necessarily included in an organised corporate-type apparatus*". With regard to the case at hand, the Revenue Agency, after having investigated the activity carried out by Beta towards Delta, considering the fact that Beta's activity is limited to the mere commitment to assume the risk of Delta's economic-financial management, ensuring that this latter has the financial means to provide for its own operation and the pursuit of its institutional purposes, excludes that this activity can be classified as commercial activity pursuant to letter d) of par. 1) of Article 87 of the ITC, "*since it can be attributable to a mere passive management which appears to be run out, depending on the case, in the perception of a percentage of the profits and in bearing all the losses*".

84 According to the tax authorities, the valuation of assets must be carried out at fair values and not at book values; (see Circular dated 29.03.2013, no. 7/E, and Reply to ruling request no. 744/2021).

enterprises (known as "business property")[85].

In principle, therefore, the provisions of Article 87, par. 1, letter d), of the ITC exclude Real Estate management companies whose business is the mere leasing of properties to third parties, from the application of the regime in question, with no option to produce evidence to the contrary.

With Circular No. 36/E/2004, the Tax Authorities have observed that, in general, rented buildings, including those rented as part of a lease of a business, are not considered to be directly used in the conduct of a business, except for the cases in which the rental of the premises is not an independent activity but is functionally connected with a number of related services that form a significant part in determining the consideration agreed for those services.

The Tax Authorities have stated in Circular No. 7/E/2013, that the condition for commerciality required by the provisions of Article 87 of the ITC is not satisfied by property management companies whose business appears to be essentially and predominantly characterised by the mere renting of properties and the receipt of the related payments (known as "passive management"). The condition is however met when some form of "active management" of the Real Estate assets is involved, for instance through the performance of a range of complementary services and the use of functional portions of the property for purposes other than the mere enjoyment of the same. This demonstrates that the lessor has an organizational and operational structure of its own and, therefore, uses the Real Estate directly in the performance of the company's business. For example, the Circular identifies properties that are part of Real Estate complexes with functional units such as tourist resorts, sports centres, shopping malls.

In order to demonstrate that a Real Estate is actively managed, it is therefore essential to prove that complementary services are performed, both in terms of quality and quantity.

In terms of quantity, the services must be of significant magnitude. When the revenues from active management are higher than the revenues from rents/lease, the services will certainly be regarded as significant. Mere recharges or transfers of overhead costs for utilities included in the rent or charged separately, do not form part of the computation of income

85 Regarding the operational scope of this requirement and its coordination with the rules governing the contribution of going-concern, see the Italian Supreme Court of Cassation's judgment no. 12138, filed on 8.05.2019.

from active management for the purposes of assessing the requirement of commerciality.

In terms of quality, the services provided must concern the whole building complex and must be assessed depending on the destination of the whole buildings complex. By way of example, they must concern the administrative and financial management of the activities within the building complex, the management of licenses and authorizations, advertising/promotion, maintenance/cleaning, etc.

The services that are crucial in determining whether active management exists are usually those provided by the company renting out the building complex, including through business lease contracts. Such services can also be outsourced but, in this case, there must be an actual activity of coordination on the part of the renting company, that is to say that the renting company must have an internal organizational and operational structure of its own, functional to the provision of services or the coordination of outsourced services.

If the fee is determined as a whole, and covers both the letting and the integrated services rendered, the portion attributable to the property can also be identified by consulting the data published in the Public Real Estate Database ("*Osservatorio del mercato immobiliare*", "OMI"). The OMI data can also be used by the supervisory bodies to check the adequacy of the relationship between rental income and income from services rendered.

Ultimately, it is the significance of the services provided, rather than the mere rental business which determines whether a property that is part of the complex to which these services are inherent can be classified as an asset used directly in the conduct of a business, and thus permit access to the *participation exemption regime*[86].

86 On this point, it is worth noticing the Italian Tax Authority's Reply to ruling request no. 404 of 29.07.2023, in which the Revenue Agency provided clarifications, regarding VAT and registration tax, on the sale of a leased Real Estate complex. In detail, the notion of "business going-concern" relevant for the purposes at hand coincides with that one envisaged by civil law and in particular with the provisions of Article 2555 of the Civil Code which qualifies the "business going-concern" as "*the complex of assets organized by the entrepreneur for the operation of the business*". With a number of guidelines issued by the Italian Tax Authority, supporting the development of EU and national jurisprudence in relation to the notion of "business going-concern", the Financial Administration has clarified that the "business going-concern" has to be understood in a broad sense, *i.e.* also including the transfers of business complexes referred to individual branches of the business. Regarding the distinction between a transfer of a "business going-concern" and the transfer of individual assets, according to the EU judges, it is necessary to carry out

Finally, with reference to capital gains realized by non-resident entities, it is worth highlighting briefly the following tax changes.

Law 29 December 2022, no. 197 (so-called Budget Law for the financial year 2023, Article 1, par. 96 and following), amends rticle 23 of the ITC providing that the capital gain realized by non-resident individuals or companies through the sale of participations into foreign Real Estate companies is subject to taxation in Italy if in the 365 days preceding the transfer the value of the foreign participation is for the major part due to the ownership of Real Estates located in Italy.

Article 5 of Legislative Decree no. 461/1997 is also amended, where, after par. 5 (exemption from the 26% substitute tax), a new par. 5-bis is inserted which provides that the provisions of par. 5 do not apply to income deriving from the sale of shareholdings in companies and entities, not traded on regulated markets, more than half of whose value derives, at any time during the 365 days preceding their sale, directly or indirectly, from Real Estate located in the territory of the State.

For the purposes of applying the provisions in question, the immovable assets whose production or exchange the business activity is actually aimed at are not considered, as well as those used directly in the exercise of the business.

Finally, the provision at hand do not apply to capital gains realized by undertakings in collective investment ("UCI") identified by Article 1, par. 633, of Law of 30 December 2020, no. 178 (namely, UCI under foreign law compliant with Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 and UCI, not compliant with the aforementioned

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a global assessment of the factual circumstances that characterize the operation in point to determine whether it falls within the notion of transfer of a universality of goods, pursuant to the sixth Directive. In this context, particular importance must be given to the nature of the economic activity that one intends to continue. The difference between leasing a property with appurtenances and renting a business going-concern consists in the fact that in the first hypothesis the property granted for enjoyment is specifically considered, in the economy of the contract, as the main object of the agreement, according to its actual consistency and with a predominant and absorbing function compared to the other elements, which (whether they are physically linked to the property or not) take on an accessory character and remain connected to the property functionally, in a position of subordination and coordination. In the business going-concern rental, however, the property is not considered in its legal individuality, but as one of the constituent elements of the complex of movable and immovable assets, linked together by a bond of interdependence and complementarity for the achievement of a specific productive purpose, so that the object of the contract is constituted by the aforementioned unitary complex.

Directive 2009/65/EC, whose manager is subject to forms of supervision in the foreign country in which it is established pursuant to Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, established in the Member States of the European Union and in the States adhering to the Agreement on the European economic area ("EEA") which allow for an adequate exchange of information)[87].

In the end, it is worth noting that Law 30 December 2023, no. 213 (so-called Budget Law for the financial year 2024) has provided for the Participation Exemption regime for non-resident entities (Article 1, par. 59).

In more details, in Article 68 of the ITC a new paragraph 2-bis is inserted, pursuant to which the participation exemption regime ("PEX regime") is applicable also for the companies and other commercial entities tax resident in an EU State or EEA State, thus the capital gains deriving by these latter are taxable at 5% providing that: (i) the transfer concerns "qualified" participations pursuant to Article 67, par. 1, letter c), of the ITC (i.e., participations higher than 2 or 20% of voting rights exercisable at the ordinary shareholders' meeting; or an interest in the capital or assets of more than 5 or 25%, depending on whether they are securities traded on regulated markets or other holdings); and (ii) the requirements set forth by the Article 87, par. 1, letters a), b), c) and d), of the ITC are met (i.e., a) holding period of the participation since the first day of the 12th month preceding the month of the transfer; b) recognition of the participation in the financial asset in the first financial statement closed after the purchase of the participation; c) tax residence of the transferred entity in white listed State; d) business purposes of the transferred entity having a commercial nature).

The capital gains taxable for the 5% of their amount are added to the relevant capital losses, if any. If the capital losses are greater than the capital gains, such an excess can be carried forward as a deduction, up to 5% of the capital gains of the following 4 fiscal years, provided that the proper disclosure is made in the tax return of the tax period in which the capital losses were realised.

To summarizing, if the above conditions are met, the capital gains on participation sales realized as from 1 January 2024 by non-resident

87 For a more complete analysis regarding the innovations introduced by the aforementioned provisions, please refer to the clarifications provided by the Revenue Agency during the Videoconference "Telefisco 2023" held on 26 January 2023 (see question no. 10) and by Assonime with Circular no. 23/2023.

companies or other non-resident commercial entities – in case of taxability as well as in Italy – are taxed with a 26% substitute tax to be applied only on the 5% of their relevant amount[88].

4.10. The repealed ACE and the so-called "reduced IRES"

With reference to the "Allowance for Corporate Equity" ("ACE"), it should be recalled that the Legislative Decree of 30 December 2023, no. 216, implementing the first module of the reform of personal income taxes and other measures regarding income taxes, provided for the repeal of the ACE: Article 5 indeed provides that, starting from the tax period following the one in progress as of 31 December 2023, the ACE referred to in Article 1 of Law Decree no. 201/2011 is repealed. However, until the related effects are expired, the provisions relating to the amount of the notional return exceeding the total net income of the tax period in progress as of 31 December 2023 continue to apply; for this reason, with reference to the relevant regulations in force until the tax period in progress as of 31 December 2023, please refer to the prevision edition of this volume.

Always with the aim of incentivizing the reinvestment of profits within the company's economy, it should be noticed that Law no. 207 of 30 December 2024 (Budget Law for 2025, par. 436 to 444 of Article 1) introduced, only for the tax period following the one in progress as of 31 December 2024 (i.e., 2025 for entities with a tax period coinciding with the calendar year), the so-called "reduced IRES". This benefit consists of a reduction of 4 percentage points in the IRES rate providing that part of the profits are set aside to a specific reserve, that part of this is allocated to the acquisition of tangible and intangible assets that are among those that are eligible to the "Industry 4.0" and "Transition 5.0" tax credit and, finally, that new hires are made, under certain conditions and in compliance with certain safeguard clauses.

Specifically, the IRES reduced rate at 20% (instead of the ordinary rate at 24%) applies providing that both the following conditions are met:

a. a portion equal at least to 80% of the profits of the financial year in progress as of 31 December 2024 is set aside to a specific reserve;

88 Important clarifications and operating instructions regarding the innovations introduced by the aforementioned provisions have been provided by the Revenue Agency with circular no. 17/E of 29.07.2024 and by Assonime with circular no. 10 of 02.05.2024.

b. a portion equal at least to 30% of the profits set aside referred to in letter a), and in any case not less than 24% of the profits of the financial year in progress as of 31 December 2023, is allocated to investments for the purchase, also through financial lease contracts, of new assets to be located in production facilities of the territory of the State, indicated in Annexes A and B to Law no. 232/2016 (investments in assets eligible to the “Industry 4.0” tax credit) and in Article. 38 of Law Decree no. 19/2024 (investments in assets eligible to the “Transition 5.0” tax credit). The aforementioned investments have to be made from the date of entry into force of this Budget Law (i.e., 1 January 2025) and by the expiration of the deadline for submitting the tax return related to the tax period following the one in progress as of 31 December 2024. Investments must not, in any case, be less than EUR 20,000.

The Law provides for further conditions that must be met in order for taxpayers to take advantage from the IRES benefit in point, as follows:

a. in the tax period following the one in progress as of 31 December 2024: (i) the number of work units per year has not decreased compared to the average of the previous three-year period; and (ii) new hires are made of employees with open-ended employment contracts that constitute an increase in employment pursuant to Article 4 of Legislative Decree no. 216/2023, to an extent equal to at least 1% of the number of permanent employees employed on average in the tax period in progress as of 31 December 2024 and, in any case, to an extent not less than one employee with a permanent employment contract;
b. the company has not resorted to the institution of the redundancy fund (“*cassa integrazione guadagni*”) in the financial year ongoing as of 31 December 2024 or in the following one, except for the ordinary wage subsidy paid in the cases referred to in Article 11, par. 1, letter a), of Legislative Decree no. 148/2015.

The beneficiary companies lose the facilitation, with consequent recovery of the same:

a. in the event that the portion of profit set aside is distributed within the second financial year following the one in progress as of 31 December 2024;
b. in the event that invested assets are disposed of, sold to third parties, used for purposes unrelated to the operation of the business or permanently allocated to production facilities located abroad, even if belonging to the same entity, within the fifth tax period following the one in which the investment was made.

The Law provides for the application methods of the IRES rate's reduction in point also for companies participating to the national or worldwide tax consolidation regime (referred to in Articles 117 to 129 of the Income Tax Code ("ITC")): in particular, the Law sets forth that, in case the beneficiary companies participate to the tax consolidation regime, the amount on which the 20% rate is applied is used by the parent company, for the purposes of the settlement of the tax due, up to the amount of income exceeding the losses utilised to offset the said income. It is also established that, in the event of an option for the tax transparency regime referred to in Article 115 of the ITC, the amount on which the aforementioned 20% rate is applied is attributed to each shareholder in proportion to his share of the profits.

Finally, the 2025 Budget Law specifies that in determining the advance payment due for the tax period following the one in progress as of 31 December 2025, the tax for the previous period is assumed to be the tax that would have been determined by not applying the aforementioned provisions.

By decree of the Minister of Economy and Finance, the relevant implementing provisions will be adopted, also in order to introduce provisions for coordination with other rules of the tax system as well as in order to regulate the methods of recovery of the benefit in cases of forfeiture of the benefit.

4.11. The convenient companies regime

Regulations concerning "non-operating companies" – also known as "convenient companies" – was created with the aim of countering companies that, regardless of their corporate object, manage their assets mainly in the interest of shareholders without carrying out any actual business activity. Such regulations intend to prevent the proliferation and ongoing existence of companies that, though not formed for specific tax avoidance purposes, have no concrete business objectives, or do not conduct any business activity[89].

In general terms, convenient companies are corporations and partnerships resident for tax purposes in Italy and non-resident companies and organizations of all kinds having a permanent establishment in the territory of the Italian state[90] that do not actually conduct any actual

89 Cf. Revenue Agency, Circular letter no. 5/E/2007 and Circular letter no. 7/E/2013.

90 Non-resident partnerships, commercial and non-commercial organizations, cooperative firms, cooperatives and mutual insurance companies, and companies and entities without a permanent establishment in Italy do not, however, fall within the scope of application of

economic activity, but are limited to the mere enjoyment of the company's assets and their yield. A recurring example is Real Estate companies that merely possess.

Ultimately, that is an anti-avoidance rule based on the assumption that certain clearly identified assets (*e.g.* equity investments, loans, Real Estates, other tangible and intangible assets) can objectively generate a minimum level of income.

More specifically, pursuant to Article 30 of Law no. 724/1994, the parties indicated above are considered "non-operating" when the total amount of their revenues, increases in inventories and earnings, excluding extraordinary items[91], as shown in the profit and loss accounts, is lower than the sum of the amounts resulting from the application of specific percentages (known as "convenient company test" or "deemed minimum revenues test") set forth by par. 1 of Article 30 of Law no. 724/1994. In this regard, it should be noticed that Article 20 of Legislative Decree no. 192 of 13 December 2024 (containing the "Review of the income tax regime (IRPEF-IRES)") has redetermined, in relation to some categories of assets, the percentages for the computation of the convenient companies regime. Specifically, Article 20 of the aforementioned Decree halved the percentages for calculating the "deemed minimum revenues" and the "deemed minimum income" referred to Real Estates and shareholdings, effectively leading to a narrowing of the perimeter of the taxpayers considered "non-operating companies". As specified in the Explanatory Report to Legislative Decree no. 192/2024, this intervention was necessary in order to adopt the observations of the Finance Committee of the Chamber of Deputies, which – with reference to the regulations of the convenient companies –

convenient company regulations, except when fictitious relocation abroad has been proved. Cf. Revenue Agency, Circular letter no. 25/E dated 4 May 2007.

91 Legislative Decree no. 139/2015 has eliminated the "Extraordinary" section of the Profit and Loss Account. Nevertheless, the relevant regulations concerning convenient companies has not been updated and continues to mention the exclusion of extraordinary items, without indicating – despite the new layout of the Profit and Loss Account – the precise criteria for the exclusion of components that can be defined as "extraordinary" for the purposes of the regulations being examined. The only interpretative reference is contained in par. 4 of Article 13-bis of Legislative Decree no. 244/2016 (provisions for the coordination of IRES and IRAP regulations after the issuance of Legislative Decree no. 139/2015), where it is stated that "*reference in the current tax regulations to the cost and income items under points A) and B) of Article 2425 of the Italian Civil Code is to be interpreted as reference to the same cost and income items net of extraordinary cost and income arising from transfers of companies or business branches*".

requested to "*provide for the implementation of Article 9, par. 1, letter b), of Law no. 111 of 2023*[92]*, redetermining the rates of the categories of assets whose presumed profitability is not in line with the average values of market (e.g., shareholdings and Real Estates), also evaluating the introduction of a periodic review mechanism, or, alternatively, rationalizing the discipline in question with an intervention aimed at contrasting the mere enjoyment of assets made available to shareholders and their family members free of charge or against a consideration lower than the normal value*".

Therefore, starting from the tax period following the one in progress as of 31 December 2023 (i.e., 2024 for companies with a tax period coinciding with the calendar year), the following percentages apply for the purposes of the "convenient company test":

a. 1%[93] to the value of the assets indicated in Article 85, par. 1, letters c), d) and e) of the Income Tax Code ("ITC") (i.e., participations) and the shares in commercial companies referred to in Article 5 of the ITC, even if these assets and participations constitute financial fixed assets, increased by the amount of financial receivables (letter a) of par. 1);
b. 3%[94] to the value of fixed assets consisting of Real Estate[95], even in financial leasing; 2.5%[96] is applied in case of buildings classified as A/10 in the land registry; 2%[97] is applied in case of residential buildings acquired or

92 That is the delegating law for tax reform, which, in Article 9, par. 1, letter b), indicated among the guiding criteria for the review of the corporate income taxation system the one of "*revising the discipline of non-operating companies, providing: 1) the identification of new parameters, to be updated periodically, which allow to identify companies without a business, also taking into account the principles developed, in the field of value added tax, by the case law of the Supreme Court of Cassation and the Court of Justice of the European Union; 2) the determination of causes of exclusion that take into account, among other things, the existence of an adequate number of employees and the performance of activities in economic sectors subject to specific regulatory framework*".

93 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 2%.

94 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 6%.

95 As clarified by the Revenue Agency in its Reply to ruling request no. 819 of 2021, for the purpose of the " convenient company test", the 3% (before 6%) coefficient would be applied to wind farms (regardless of their classification as fixed or unfixed assets), in line with the provisions of Circular no. 36 / E of 2013 for photovoltaic systems.

96 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 5%.

97 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 4%.

revalued during the year and in the previous two years; 0.5%[98] is applied in case of properties located in municipalities with populations of less than 1,000 inhabitants (letter b) of par. 1);

c. 6%[99] to the value of fixed assets consisting of assets indicated in Article 8-bis, par. 1, letter a), of Presidential Decree no. 633/1972 (i.e., ships), even in financial leasing (letter b-bis) of par. 1);
d. 15%[100] to the value of other fixed assets, even in financial leasing (letter c) of par. 1)[101].

For the purposes of this calculation, revenues and income as well as the values of fixed assets and property should be considered in their average results for the current year and the previous two years.

If the company is not operative pursuant to aforementioned par. 1 of Article 30 of Law no. 724/1994, its income for the tax period is assumed not to be lower than the sum of the amounts deriving from the application, to the values of the assets owned during the year, of the percentages indicated in par. 3, letters a) to c) of Article 30 of Law no. 724/1994; starting from the tax period following the one in progress as of 31 December 2023, for the purposes of calculating the "deemed minimum income", the percentages are as follows:

- 0.75%[102] on the value of the assets specified under letter a) of par. 1 (letter a) of par. 3);
- 2.38%[103] on the value of fixed assets consisting of Real Estate, even in financial leasing; 2%[104] is applied in case of buildings classified as A/10

98 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 1%.

99 Same percentage as the one applicable until the tax period in progress as of 31 December 2023.

100 Same percentage as the one applicable until the tax period in progress as of 31 December 2023.

101 A residual class that includes fixed assets recorded in the financial statements other than the assets explicitly referred to in the letters a), b) and b-bis) of par. 1 of Article 30 of Law no. 724/1994 (please see the Reply to ruling request no. 636/2020 of 31 December 2020).

102 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 1.5%.

103 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 4.75%.

104 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 4%.

in the land registry; 1.5%[105] is applied in case of residential buildings acquired or revalued during the year and in the previous two years; 0.45%[106] is applied in case of properties located in municipalities with a population of less than 1,000 inhabitants (letter b) of par. 3);

- 4.75%[107] on the value of fixed assets consisting of assets indicated in Article 8-bis, par. 1, letter a), of Presidential Decree no. 633/1972 (i.e., ships), even in financial leasing (letter b-bis) of par. 3);
- 12%[108] on the overall value of other fixed assets, even in financial leasing (letter c) of par. 3).

In addition to taxation calculated on the basis of deemed minimum income, further tax restrictions apply to non-operating companies. First, tax losses from previous years can only be deducted from any income portion exceeding the minimum deemed income[109]. Secondly, it is assumed that the net value of production for IRAP purposes is no lower than the deemed minimum income, increased of staff salaries, remuneration for external co-workers on a continuous and coordinated cooperation arrangement basis and self-employed workers, and interest expense[110].

Finally, restrictions for VAT purposes are also applicable, and these latter are noteworthy in view of the particular importance they can have with regard to Real Estate companies. Indeed, companies resulting as non-operating ones are not allowed to claim refund for the VAT credit arising from the annual VAT return, or to offset such VAT credit against other taxes (known as “horizontal” compensation), or to transfer such VAT credit to third parties pursuant to Article 5, par. 4-ter, of Legislative Decree no. 70/1988. Furthermore, when for three consecutive tax periods the company does not carry out VAT relevant transactions amounting at least to the deemed minimum revenues resulting from the convenient companies test, the company loses also the possibility to bring forward for compensation in following years the excess of VAT credit

105 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 3%.

106 The percentage applicable until the tax period in progress as of 31 December 2023 was equal to 0.9%.

107 Same percentage as the one applicable until the tax period in progress as of 31 December 2023.

108 Same percentage as the one applicable until the tax period in progress as of 31 December 2023.

109 Pursuant to the second sentence of letter c) of par. 3 of Article 30 of Law no. 724/1994.

110 Pursuant to par. 3-bis of Article 30 of Law no. 724/1994.

resulting from the annual VAT return. In this regard, it is worth mentioning the judgment of the Court of Justice of the European Union ("CJEU"), case C-341/22 of 7 March 2024[111], in which the CJEU censured the Italian legislation referred to in the aforementioned par. 4 of Article 30 in the part in which it provides for the definitive loss of the VAT credit. Specifically, the CJEU considered that this latter provision is not compatible with Directive no. 2006/112/EC ("VAT Directive"), for two main reasons, such as:

1. with regard to the qualification of "taxable person" (Article 9 of the VAT Directive), the CJEU stated that "*a 'taxable person' is considered to be any person who carries out, independently and in any place, an economic activity, regardless of the purpose or results of that activity*"; the concept of "economic activity" includes "*any activity of production, marketing or provision of services*" and must be considered as such "*the exploitation of a tangible or intangible asset in order to obtain income having a nature of stability*". *Therefore, the CJEU concluded that Article 9 of the VAT Directive "must be interpreted as meaning that it cannot lead to the denial of the status of taxable person for the VAT purposes to a person who, during a given tax period, carries out VAT relevant transactions whose economic value does not reach the threshold set by a national legislation, which threshold corresponds to the revenues that can reasonably be expected from the assets which the said person has at his disposal*";
2. with regard to the right to deduct VAT, the CJEU stated that this latter "*represents … an integral part of the VAT mechanism and, in principle, cannot be restricted. […] In order to be eligible for the right of deduction, two conditions must be met. First, the person concerned must be a 'taxable person' within the meaning of the said directive. Secondly, the goods or services in respect of which that right is invoked must be used by the taxable person as outputs for the purposes of his own VAT relevant transactions and, as inputs, those goods must be sold or those services must be supplied by another taxable person*". Therefore, the CJEU concluded that Articles 167 and following of the VAT Directive "*must be interpreted as precluding a national legislation under which the taxable person is deprived of the right to deduct input VAT due to*

111 The preliminary deferment to the CJEU had been made by the Supreme Court of Cassation with the interlocutory order of 19.05.2022, no. 16091, with which the Supreme Court had referred to the CJEU the preliminary matter related to the compatibility of the internal legislation of convenient companies with EU legislation, to the extent that at national level the right to deduct VAT is denied if these companies do not carry out transactions for three consecutive years relevant for VAT purposes of an amount at least equal to the minimum deemed revenues.

the amount, considered to be insufficient, of the output transactions relevant for VAT purposes carried out by that taxable person".

Finally, the CJEU stated that *"the right to deduct VAT may be denied to the taxable person in case it is proved, on the base of objective elements, that it is invoked fraudulently or abusively*"; however, the presumption provided for by Article 30, par. 4, of Law no. 724/1994 is based on a criterion, the one related to a revenues threshold, different from those indicated by EU case law to demonstrate the existence of tax evasion or abuse of law, therefore "*it cannot be considered such as to demonstrate that the right to deduct VAT has been invoked fraudulently or abusively*".

In light of the principles enunciated by the CJEU, it should be noticed that the Italian Supreme Court of Cassation, in judgments no. 24416/2024 and no. 24442/2024 filed on 11 September 2024, disapplied the VAT penalties deriving from the regulation of convenient companies, by virtue of the interpretation provided by the CJEU in the aforementioned case C-341/22[112]. However, so far, those principles have not yet been incorporated into the national law and therefore the limitations on the VAT credit of non-operating companies continue to operate as in the past, leaving some doubts in relation to the legitimacy of the domestic rule.

Until the amendments introduced by the Legislative Decree no. 219/2023, the convenient companies regime described above could be waived by proving with the so-called "probatory" ruling that the level of "deemed minimum revenues" as well as "deemed minimum income" were not reached because of objective circumstances that made it impossible for the taxpayer to comply with the presumptive mechanism provided by the convenient companies regime. Starting from 18 January 2014, the date of entry into force of the aforementioned Legislative Decree no. 219/2023, for the majority of the taxpayers there is no longer the possibility of submitting a probatory ruling and, therefore, they have to decide independently whether, in the presence of the conditions to apply the convenient companies regime, disapply such provision[113].

112 The Tax Justice Court of II degree of Lazio expressed itself in a similar way in judgment no. 2403/17/24 of 11 April 2024, stating that the preclusion to the refund of the VAT credit provided for by Article 30, par. 4, of Law no. 724/1994 for non-operating companies is not any more applicable, by virtue of the judgment of 7 March 2024 rendered by the CJEU in case C-341/22; consequently, the Italian legislation is inapplicable and the denials of VAT refunds opposed by the Tax Authority to convenient companies are unlawful.

113 The taxpayer, who believes that the circumstances suitable for justifying the non-application of the convenient company regime exist, is required to give a specific disclosure of it in the tax

The non-application of the convenient companies regime, as well as the exclusion of the relevance of specific *assets* for the purpose of the test, is "automatic" – and therefore does not require a ruling request procedure or a specific disclosure in the relevant Income Tax Return – when any of the "causes of exclusion" set forth by the Law itself[114] or of the objective situations identified by the Regulation of the Director of the Revenue Agency dated 14 February 2008[115], are present.

It should be noticed that the convenient companies regulations have been amended by Article 2, par. from 36-*quinquies* to 36-*duodecies*, of Law Decree no. 138/2011, in force starting from 2012 (for taxpayers whose tax period coincides with the calendar year).

Firstly, the mentioned amendment has provided for an increase by 10.5 percentage points of the Italian Corporate Income Tax rate (which, therefore,

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return, otherwise a monetary penalty from EUR 1,500 to EUR 15,000 applies pursuant to Article 8, par. 3-quinquies, of Legislative Decree no. 471/1997.

114 The convenient company regime is not applicable in any of the following cases provided by Article 30 of the Law no. 724/1994: 1) taxpayers who, because of their particular activity, are mandatorily requested to be incorporated as stock companies (in this regard, see Order of the Supreme Court of Cassation no. 18337 dated 25 June 2021); 2) taxpayers in their first tax period; 3) companies in temporary receivership or extraordinary administration; 4) companies and entities that control companies and entities whose securities are traded on regulated Italian and foreign stock exchange, as well as the same listed companies and entities and their subsidiaries, including indirect subsidiaries; 5) companies providing public transport services; 6) companies with a large corporate basis (or with no less than 50 members); 7) companies that in the two previous years never had less than 10 employees; 8) companies subject to insolvency and similar proceedings (bankruptcy, compulsory liquidation, arrangement with creditors, temporary and extraordinary receivership and court liquidation); 9) companies that have a total value of production greater than the total assets of the balance sheet; 10) companies in which public authorities own at least 20% of the share capital; 11) companies that are adequate and consistent for the purposes of the Tax Authorities' sector studies.

115 The Director's Regulation allows the following taxpayers to disregard the rules in question without filing a request for a ruling: 1) companies in liquidation that request the cancellation from the enterprise register before the filing of the tax return for the following fiscal year); 2) companies subject to bankruptcy proceedings and similar; 3) companies subject to criminal proceedings; 4) company with property leased to public entities or rented with restrictions; 5) companies with investments in undertakings other than convenient companies, also as a result of the acceptance of the ruling request, and in related companies resident abroad to which the CFC rules apply (cause of partial exclusion, limited to such shareholdings); 6) companies whose ruling request has been approved in relation to previous tax years on the basis of circumstances that did not change in the following fiscal years (cause of partial exclusion, limited to the assets for which the ruling request had been submitted); 7) agricultural companies; 8) companies whose tax payments are suspended or delayed as a result of the declaration of a state of emergency.

goes up to 34.5%[116]) for the companies identified in Article 30 of Law no. 724/1994.

Secondly, Law Decree no. 138/2011 extended the number of companies covered by the convenient companies regulations and included companies which incurred in "systematic" losses; this extension was applied until fiscal year 2021 (for calendar-year companies). Subsequently, Article 9 of Legislative Decree no. 73/2022 (so-called "Simplifications Law Decree") provided for the repeal of this discipline of companies in systematic loss.

With specific reference to the Real Estate sector, it should be noticed that the following assets are not to be accounted for in the determination of deemed minimum revenues:

- property held under a lease (not financial) or loan to use;
- assets given in usufruct, providing that, however, the right is granted free of charge;
- other fixed assets in progress, which are not yet able to produce any revenue;
- "stock-in-trade", recorded under current assets, providing that such registration corresponds to the actual destination of the asset for sale and not to the durable investment[117].

With reference to Real Estate companies, some objective situations that can lead to the non-application of the rule are specified in some circular letters of the Revenue Agency[118], such as:

- the presence of buildings under construction which are not suitable for generating income;
- the demonstrated inability[119] to set rents that may be sufficient to achieve a minimum level of revenue;
- the inability to change the leases in progress[120];

116 34.5% starting with the tax period after the one ongoing as of 31 December 2016; 38% up to the tax period ongoing as of 31 December 2016. Indeed, the 2016 Stability Law provided for a reduction of the IRES rate to 24% starting with the tax period following the one ongoing as of 31 December 2016.

117 Cf., Revenue Agency, Circular letter dated 4.05.2007, no. 25/E (par. 3.2.2).

118 Cf. Revenue Agency Circular letter dated 2.02.2007, no. 5/E; Circular letter dated 9.07.2007, no. 44/E.

119 With reference to "inability" of gaining revenue, see also the Judgment of the Supreme Court of Cassation no. 23384 dated 24 August 2021.

120 Circular no. 44/E/2007 (par. 2.5) has indeed clarified that, in the case of lease of Real Estate, if the rent is lower than the market value, °*the request can be accepted on the assumption that the*

- the temporary unavailability of the property[121];
- the absence of administrative authorizations for building companies that own land;
- the presence of restrictions to the building activity in application of regional laws;
- the rental of buildings to public parties in return for modest rents but subject to the fairness opinion of the Territorial Authorities.

The underlying principle for obtaining the non-application of the regulations related to non-operating companies is that there must exist objective conditions, not arising from the company's ordinary business, and therefore not attributable to the inactivity of the company[122]. In this regard, it worth mentioning the reply to ruling request no. 53/2024, with which the Italian Revenue Agency examined the application for non-application of the rules on non-operating companies submitted by a real estate company whose corporate purpose is the rental of shops in a shopping center, rejecting its request. Specifically, the company preliminarily supports its request for disapplication by arguing, among other things, that "*the market value of the property (i.e., the*

determination of the agreed rent is not attributable to the will of the taxpayer". In this regard, see the Reply to ruling request no. 93/2024, with which the Revenue Agency rejected the request for disapplication of the rules on non-operating companies that had been submitted by a Real Estate management company that had not passed the "deemed minimum revenues" test for the 2022 tax period. The company justified this situation saying that, having not identified tenants (or buyers) for the shops owned in a shopping center due to the Covid-19 pandemic emergency, it entered into a "rent to buy" contract, agreeing on a monthly fee, part of which concerned the concession of use of the aforementioned assets and the remaining part was paid as a penitential deposit. The Revenue Agency points out that, in the context of non-operating real estate companies, it is possible to disapply the regime if the agreed rent, lower than the market value, is not attributable to the taxpayer's will (see circular no. 44/E/2007); however, in the case at hand, although the rent agreed upon in relation to the concession of the use of the assets was lower than the market value, the reasons behind the split of the rent between the amount due for the concession in use and what was due as a penitential deposit had not been explained; moreover, the taxpayer did not demonstrate that the low fee was independent of his will.

121 Cf. Reply to the ruling request no. 591 dated 15.12.2020; or the degradation of the same property according to the judgment of the Provincial Tax Court of Treviso dated 30.06.2010, no. 88/05/2010.

122 In Reply to ruling request no. 911-486/2022, the Revenue Agency of Tuscany Regional Direction regarding a company operating in Real Estate management (leasing of owned Real Estate assets) that in 2021 did not generate revenues equal to the minimum revenues required by the regulations in comment stated that, in the case in point, "*the 2021 tax period can be considered a period of non-normal performance of the activity. Indeed, the failure to achieve the minimum revenues in question appears to have depended on exogenous circumstances and independent of the company's will, such as above all the serious crisis due to the Covid-19 pandemic*"

shopping center it owns) does not correspond to the value of the historical cost". The Revenue Agency does not consider this argument to be well-founded, noticing that: (i) the simple circumstance that the market value of the property owned by the company is lower than its fiscally recognized cost cannot ex se supported the requested disapplication of the rules on non-operating companies; (ii) the company does not demonstrate how the lower market value of the property would have affected or actually affects the inadequacy of the deemed minimum revenues. Even the alleged existence of unfavourable economic conditions (i.e., "*[unfavourable] market conditions (crisis in the sector)" and "impossibility of carrying out inspections […]*") which would have prevented the achievement of revenues corresponding with the minimum ones, do not convince the Revenue Agency as no evidence supporting objective circumstances is provided by the taxpayer. Furthermore, the company – regardless of the modifiability of the lease contracts in place at the date of acquisition by the new shareholders – has not proved the impossibility of applying rents which, although not enough to pass the "deemed minimum revenues" test, are at least equal to the market rent, according to the data published in the Public Real Estate Database ("*Osservatorio del mercato immobiliare*", "OMI")[123].

4.12. IRAP regime of capital gains from sale of properties

As known, the regional tax on productive activities (IRAP) applies to the net value of production generated from business carried out in the Italian territory.

According to Article 5, par. 3, of Legislative Decree no. 446/1997 (as a result of the changes introduced by the 2008 Finance Act), the capital gains and losses from the sale of properties that are not classified as assets used in business nor goods whose production or exchange represents the main activity of the company, are always taken into account in establishing the production value (Real Estate assets).

Based on the fact that up to the tax period 2007, in application of the system of deriving the IRAP taxable base from the IRES base, the costs

123 Finally, the Revenue Agency notices that not even the alleged circumstance related to the company's general difficulty in collecting its receivables from tenants appears suitable to justifying the non-application of the rules on non-operating companies, as the company does not provide any evidence in this regard to demonstrate how this difficulty affects or has affected its inability to obtain actual revenues higher than the deemed minimum ones.

regarding Real Estate assets (including depreciation) could not be deducted (subject to certain exceptions), the statutory cost of the property purchased before 2008 rarely coincided with its tax cost. For this reason, in order to determine the capital gain (or capital loss) which is relevant for the purposes of the regional production tax, it is the tax cost of the property that should be set against the consideration received.

Following the changes introduced by the mentioned 2008 Finance Act, the provision whereby capital gains and losses related to the sale of business assets, not arising from transfers of going concerns, flowed into the IRAP taxable base, was repealed. In this regard, the doubt arose whether, as a result of this abrogation, such capital gains and losses were irrelevant for the purposes of the regional production tax. According to the Tax Authorities, such capital gains and losses still flow into the taxable base for the purposes of the regional production, because considering them totally irrelevant would not be consistent with the above provision, which established the relevance of capital gains and losses related to "Real Estate assets", nor with the deductibility from the taxable base of the depreciation of business assets (including Real Estate used only for business purposes)[124].

It should also be noticed that, under the previous legislation, any choice of instalments of the capital gain made for direct tax purposes also had an effect for IRAP purposes[125]. As a result of the repeal of Article 11-bis of Legislative Decree no. 446/1997, instead, under the current regime, capital gains related to business or patrimonial assets cannot any longer be paid in instalments pursuant to Article 86, par. 4, of the Income Tax Code. In any case, the taxability of any portion of capital gains deferred from the 2007 tax period remains confirmed.

4.13. Revaluation of properties in the context of extraordinary operations

The regulation related to the step-up of the higher values of assets that emerged as a result of extraordinary tax neutral transactions (i.e., business contribution, merger, demerger) has been deeply amended recently by Articles 12 and 13 of Legislative Decree no. 192 of 13 December 2024 (con-

124 Cf. Revenue Agency, Circular letter dated 26.05.2009, no. 27/E. Cf. Revenue Agency, Circular letter dated 14.05.2014, n. 10/E, par. 6.1.

125 Cf. Revenue Agency, Circular letter dated 4.06.1998, no. 141/E.

taining the "Review of the income tax regime (IRPEF-IRES)"). The new legislation rewrites the discipline of the so-called "ordinary" realignment set forth by par. 2-ter[126] of Article 176 of the Income Tax Code ("ITC"), which, in the context of the transfer of a business, provides for a substitute taxation regime, for the purposes of corporate income taxes (IRES) and regional tax on production activities (IRAP), which allows the transferee company to obtain the recognition on the tax level of the higher book values recorded in its balance sheet as a result of the contribution.

The above step-up can also be applied: (i) by the incorporating company or the company resulting from a merger (by express reference contained in Article 172, par. 10-bis, of the ITC); and (ii) by the beneficiary company of a demerger (by express reference contained in Article 173, par. 15-bis, of the ITC). In particular, the choice of the substitute tax regime is only up to the incorporating company or the company resulting from the merger and to the beneficiary of the demerger and no effect is produced on the tax position of the demerged company or on the shareholders of the companies involved in the transactions at hand.

With reference to the effective date (pursuant to Article 13 of Legislative Decree no. 192/2024), the new provisions apply to extraordinary transactions carried out as of 1 January 2024, specifically:

1. starting from 1 January 2024, the so-called "ordinary" realignment regime referred to in par. 2-ter of Article. 176 of the ITC according to the new provision, applies;
2. starting from the tax period following the one in progress as of 31 December 2023, it is no longer possible to exercise the options for the so-

126 More precisely, the new par. 2-ter of Article 176 of the ITC now provides that: "*2-ter. Instead of applying the provisions of paragraphs 1, 2 and 2-bis, the transferee company may opt, in the tax return referred to the tax period in which the transaction was carried out, to apply, in whole or in part, on the higher values attributed in the financial statements to the single assets constituting tangible and intangible fixed assets related to the business received, a substitute tax for income taxes and regional tax on productive activities at a rate of 18 and 3 per cent respectively, to which any additional or increased taxes must be added, as well as the difference between each of the rates referred to in Article 16, paragraph 1-bis, of Legislative Decree no. 446 of 15 December 1997 and that referred to in the same Article 16, paragraph 1. In the event of realisation of the assets before the third tax period following the one of the option, the tax cost is reduced by the higher values subject to substitute tax and any higher depreciation deducted and the substitute tax paid is correspondingly deducted from the relevant taxes. The higher values subject to substitute tax are considered recognized starting from the tax period during which the option is exercised. The amount of the substitute tax must be paid in a single instalment by the deadline for the payment of the settlement of the taxes referred to the financial year in which the transaction was carried out*".

called "derogatory" realignment regime referred to in par. 10 to 12 of Article 15 of Legislative Decree no. 185/2008; in particular, it is specified that the aforementioned provisions do not, in any case, apply to extraordinary transactions carried out as from 1 January 2024[127]; consequently, from the said date, the only regime for the realignment of the higher values recorded in the financial statements as a result of extraordinary tax neutral operations is the one provided for by Article 176, par. 2-ter, of the ITC, as amended by Article 12 of Legislative Decree no. 192/2024;
3. finally, for transactions carried out in the tax period in progress as of 31 December 2023, and with effect before 1 January 2024, the old provisions provided for by par. 2-ter of Article 176 of the ITC according to the provision in force prior to the amendments made by Legislative Decree no. 192/2024, continue to apply[128].

Specifically, the renewed par. 2-ter now provides for the following:
- the option for the step-up regime can be exercised by the company resulting from the extraordinary transaction in the tax return related to the tax period in which the transaction was carried out[129];
- the recognition for tax purposes of the higher book values may be applied, in whole or in part, in relation to the single assets constituting tangible and intangible fixed assets referred to the business received[130]. On this

127 Pursuant to Article 13, par. 1, letter b), of Legislative Decree no. 192/2024.

128 Pursuant to Article 13, par. 5, second sentence, of Legislative Decree no. 192/2024. As specified in the Explanatory Report to Legislative Decree no. 192/2024, for transactions carried out in the tax period ongoing as of 31 December 2023, prior to 1 January 2024, the exercise of the option for the substitute tax pursuant to the previous par. 2-ter of Article 176 of the ITC, if not made in the income tax return related to the 2023 tax period, can be carried out in the subsequent income tax return.

129 The new provision therefore cancels the possibility provided for by the previous provision of electing for the option also in the tax return related to the following tax period.

130 In relation to mergers, please refer to Revenue Agency's resolution no. 46/E of 24 February 2009 for any problems related to substitute tax in the event of reverse merger. The aforementioned resolution considered as possible, even for reverse mergers, to proceed to the realignment of tax and statutory values for goods coming from the parent-merged company, whereas they may not be re-evaluated (nor qualify for substitute taxation) the goods that were already part, prior to the merger, of the company's assets of the subsidiary-merging: "*The circumstance that the assets that the company intends to align by application of the substitute tax were not part of the corporate assets of the merged company but rather of that of the surviving company (the goodwill referring to the acquiring company's business and corporate structure is also to be intended as such), represents an absolute indication that the substitute tax regime may not be opted for, since the case illustrated by the applicant is in contrast with the provisions of the law pursuant to the already mentioned Article 2 of the implementing decree which allows for tax recognition 'only' in relation to the assets received,*

point, it should be noticed that the new provision introduces the word "single" in relation to the assets; in this regard, the Explanatory Report to Legislative Decree no. 192/2024 clarifies that the reference to the "single" assets means that now it is envisaged that the application of the substitute tax is no longer conditioned by the realignment for homogeneous categories of tangible fixed assets, as instead previously provided for;
- the option for the step-up regime implies the payment of a substitute tax of IRES and a substitute tax of IRAP on the higher book values for which recognition is to be obtained from a tax point of view; the substitute tax for IRES is set at 18%, while the substitute tax for IRAP is set at 3%[131], to which any additional or increased taxes may be added;
- the payment of the aforementioned substitute taxes must be made in a single instalment by the deadline for the payment of the settlement of the taxes referred to the financial year in which the transaction was carried out[132];
- the higher values subject to substitute tax are considered recognized for tax purposes (i.e., for the purposes of the computation of depreciations and of the plafond for maintenance expenses, etc.) starting from the tax period during which the option is exercised;
- with reference to the so-called monitoring period (or "recapture rule") for the purposes of determining the capital gain/loss in the event of realisation of the assets concerned by the step-up, the higher values subject to substitute tax are considered recognised for tax purposes in the event of realisation from the third tax period following the one of the option; therefore, in the event that the assets subject to realignment are realised before the third tax period following that of the option[133], the tax cost is reduced by the higher values subject to substitute tax and any higher depreciation deducted and the substitute tax paid is correspondingly deducted from the related taxes.

that is to say only for assets coming from the merged company and attributed to the acquiring company following the merger (whether direct or reverse)".

131 The previous provision, instead, provided for the application of a substitute tax for IRES and IRAP without distinction between the two taxes and with bracketed rates, *i.e.* 12% on the part of the higher values included in the limit of EUR 5 million, 14% on the part of the higher values exceeding EUR 5 million and up to EUR 10 million and 16% on the part of the higher values exceeding EUR 10 million.

132 The previous provision, instead, provided for the payment of the substitute tax for IRES and IRAP purposes compulsorily in three installments.

133 The previous provision, instead, provided that the so-called "recapture rule" applied in the event of the realisation of assets prior to the fourth tax period.

> The goods are deemed to be "realised" in the event of disposal, transfer of assets, assignment to shareholders, self-consumption or destination to other purposes, whereas transfers made within the context of tax neutral operations (merger, demerger and contribution of business pursuant to Article 176 of the ITC) have not relevance for this purposes.

In addition to the above described innovations concerning the regime for the step-up the higher values arising as a result of extraordinary transactions regulated by par. 2-ter of Article 176 of the ITC, Legislative Decree no. 192/2024 (pursuant to Article 14) provides for the reopening, on an extraordinary basis, of the terms for step-up for tax purposes the accounting reserves subject to tax constraints: in this way, all taxpayers who have reserves subject to tax constraints in the balance sheet are offered the opportunity to free them and therefore to eliminate the tax constraint, through the payment of a substitute tax of IRES and IRAP equal to 10%. The step-up "frees" the reserve subject to tax constraints, which, following the step-up, from a tax point of view acquires the nature of an ordinary reserve made up of profits or equity (depending on its original nature) and, therefore, becomes distributable to shareholders without any further burden on the distributing company. The reserves subject to tax constraints that can be stepped-up pursuant to the provision at hand are those existing in the financial statements of the financial year in progress as of 31 December 2023 that are left at the end of the financial year ongoing as of 31 December 2024.

The step-up can be carried out, according to the provisions of the law, "in whole or in part": therefore, it is possible both to step-up a reserve subject to tax constraints only for a part of its amount, and to step-up, in whole or in part, only some of the reserves subject to tax constraints booked in the financial statements.

The substitute tax for IRES and IRAP has a single rate equal to 10% and is settled in the tax return referred to the tax period in progress as of 31 December 2024. The payment must be made in four equal instalments, the first one due by the deadline for the payment of the settlement of income taxes related to the tax period ongoing as of 31 December 2024 and the other ones by the deadline for the payment of the settlement of income taxes related to subsequent fiscal years.

The new provision specifies that within 60 days of the entry into force of the law, a decree of the Minister of Economy and Finance containing the implementing rules will be issued.

A latere of the possibility to step-up the value of Real Estates in the context of extraordinary operations, the legislator from time to time has granted, pursuant to specific revaluation laws, the possibility to step-up, *una tantum*, the value of assets even outside the context of extraordinary operations.

In particular, the last measure in this sense has been provided by Article 110 of Law Decree dated 14.08.2020, no. 104 (so-called "*Decreto Agosto*"), converted by Law dated 13.10.2020, no. 126, that, extending the possibility already introduced by several Budget Laws[134] and moving from the revaluation regime introduced at the time by Article 15, par. 16-23, of Law no. 185/2008, proposed again the special provisions related to the revaluation taking as reference the revaluation rules set out by Law no. 342/2000 (Articles 11-15) and the related implementing Ministerial Decree no. 162/2001[135].

134 At this regard, see Budget Law 2020 (Law no. 160/2019), Budget Law 2019 (Law no. 145/2018), Budget Law 2017 (Law no. 232/2016) and Budget Law 2016 (Law no. 208/2015).

135 For a complete analysis of the revaluation and realignment regimes pursuant to Article 110 of Law Decree no. 104 of 14 August 2020, please refer to Assonime's circulars no. 6 of 5 March 2021 and no. 18 of 8 June 2021 and to Revenue Agency's circular no. 6/E of 1 March 2022.

5.
Partnerships and Real Estate direct investment by non-residents

by G. Strambi

5.1. The transparency regime for the partnerships (non-commercial partnerships - "società semplici" -, commercial partnerships - "società in nome collettivo" - and limited partnerships - "società in accomandita semplice). Rules for the attribution of income

5.1.1. Introduction

Commercial Partnerships and Limited Partnerships, for Income Taxes purposes (Corporate Income Tax –"imposta sul reddito delle società"- or Personal Income Tax –"imposta sul reddito delle persone fisiche"), as well as Non-commercial Partnerships, are "fiscally transparent", whereas are fully liable for the purposes of value added tax, of Regional Tax on Productive Activities – "imposta regionale sulle attività produttive" – and of Withholding agent duties.

Pursuant to the Italian Income Tax Act ("Testo Unico delle Imposte sui Redditi"[1]), income and losses[2] are considered to be gained and/or borne and taxed directly in the hands of the partners, in proportion to their shareholding (save for a limitation on losses for limited partners, as explained in the following) and regardless of their actual distribution by the partnerships[3].

Furthermore, according to the transparency regime, are deemed to be directly attributed to the partners, on the basis of the same shareholding proportion, also: i) tax credits; ii) levied withholding taxes[4]; iii) and any surplus of

1 Presidential Decree no. 917 of 22 December 1986.

2 Pursuant to Article 8, par. 2, Italian Income Tax Act.

3 Specifically, pursuant to Article 5, par. 1 and 2 of the Italian Income Tax Act.

4 Pursuant to Article 22, par. 1, of the Italian Income Tax Act; it should also be noted that the Italian Revenue has admitted the possibility of transferring any surplus of tax credits to the part-

Notional Interest Deduction[5] not used by the partnership (only to the extent that the latter adopts the ordinary accounting rules without any simplified regime).

More specifically, at the end of each calendar year (31st of December), the income or the loss borne by a partnership is allocated to each partner (at that date) regardless of any resolution to distribute the proceeds[6] and proportionally to the shareholding of the profits or losses. In case mismatch between the accounting period and the calendar year, the income/loss will be attributed to the partners at the end of the calendar year in which the accounting period closes[7].

The aforesaid shareholding is deemed proportional to the value of the contributions made by the partners, unless otherwise provided by notarial deeds or authenticated agreement (including the deed of incorporation) dated prior to the beginning of the relevant accounting period. If the value of the contributions is not determined, the shareholding is deemed equally divided amongst the partners[8].

In order to avoid any discontinuity in the application of taxes, the Italian Income Tax Act provides that distributions of profits already taxed by transparency do not concur to the partner's taxable income for the purpose of Income Taxes[9] and, accordingly, the value of the shareholding acknowledged for

ners (received as a result of the principle of transparency) to the company that is required to make payments as withholding agent (Circular letter No. 56/E of 23 December 2009). For this purpose, it is necessary i) the consent of any partners (and hopefully all partners), agreeing to the exchange of a portion of withholding taxes incurred by the partnership for a monetary counterpart and ii) comply with the provisions on the evidence of offsetting in the declaration models provided by Legislative Decree 241/1997.

5 The Notional Interest Deduction is the acknowledgement of figurative deductible interest (the applicable rate for 2019 is 1.3%) on the increase of the equity capitalization of the partnerships and repealed starting from 1st January 2024 by Article 5 of Legislative Decree no. 2016/2023.

6 According to the Italian Supreme Court judgment of 2 August 2002 no. 11569.

7 According to the principle established by Art. 7, par. 1 of the Italian Income Tax Act, which is agreed by the Italian Revenue (Resolution no. 92/E of 20 September 2011).

8 In principle, the share in the profits of partnerships may vary because of specific agreements between partners, as a result of contributions to the company and as a result of the sale and purchase of participations. For the purposes of income allocation to the partners for transparency purposes, shareholdings changes will take effect from the following fiscal year (Resolution of Ministry of Finance no. 9/1246 of 19 September 1976), with the exception of changes resulting from the entry of new partners, which will take effect from the year of entry.

9 The Italian Revenue Circular letter no. 49/E of 22 November 2004, although referring to the transparency of limited liability corporations, but whose principles can be extended to the part-

tax purposes held by each partner is increased (or decreased) by the amount of profits (or losses) allocated by transparency and is reduced by subsequent distributions of profits[10].

Notwithstanding the foregoing, for Limited Partnerships the amount of losses attributable by transparency to limited partners is capped to the value of their shareholdings, therefore any exceeding amount of losses corresponding to the quotas of limited partners is split and attributed (proportionally) to unlimited partners[11].

As of the determination of the income or loss to be attributed by transparency, for Commercial Partnerships and Limited Partnerships they are deemed in any case as "business income" to be determined on a unitary basis according to the rules provided for this income category[12], whereas for Non-commercial Partnerships the income must be determined separately for each category of income received (e.g., income from lands, buildings, etc.) according to the relevant provisions specifically provided for each category of income[13].

Finally, differently from Commercial Partnerships and Limited Partnerships, Non-commercial Partnerships are excluded from the scope of application of the "non-operating companies" regime provided by Article 30 of Law no. 724/1994, as amended, and are not subject to Regional Tax on Productive Activities when the activity carried out consists exclusively in the leasing of real estate assets[14].

nerships, specified that the distribution of profits does not contribute to forming the income at the hands of partners, even if they are distributed in excess of the income already taxed for transparency.

10 The rules regarding the cost acknowledged for tax purposes of the equity investment are set forth in the fourth sentence of Article 68, par. 6 of the Italian Income Tax Act.

11 Clarification of the operation of the tax regime set out by Art. 8, par. 2 of the Italian Income Tax Act is provided by the Italian Revenue Resolution no. 152 of 4 October 2001.

12 As described in Art. 6, paragraph 3 of the Italian Income Tax Act.

13 Given the impossibility for them to earn any "business income" (i.e. reddito appartenente alla categoria redditi d'impresa).

14 As specified by paragraph 2.2 of Ministerial Decree no. 141/E of 4 June 1998 and note 50 to Italian Notary Study no. 92-2016/T, concerning the provisions of Articles 2 and 3 of Legislative Decree no. 446/1997.

5.1.2. The determination of the tax base and the (ordinary and simplified) accounting regime for Commercial Partnerships and Limited Partnerships

Commercial Partnerships and Limited Partnerships can avail from the two different accounting regimes, the ordinary accounting regime, available to any kind of business partnerships, and a simplified accounting regime, available exclusively to commercial partnerships whose did not exceed in the former period certain thresholds[15] and have not opted for the ordinary accounting regime. As follows.

5.1.3. Ordinary accounting: exceptions to the Corporate Income Tax provisions pursuant to certain provisions applicable to entrepreneurs

For the determination of the taxable income, partnerships adopting the ordinary accounting system adopt the tax provisions applicable to persons liable to Corporate Income Tax, consisting in the adjustment of the profit or loss arising from the Management Report (i.e. income statement, as defined below) pursuant to the relevant provisions but without taking into account certain accounting policies (i.e., with the dis-application of the so called "principio di derivazione rafforzata") and with the following exceptions (set forth by Article 56 of the Italian Income Tax Act):

- the deduction of interest expenses relating to the business is not subject to the limitations set forth from the provisions of Article 96 of the Italian Income Tax Act (essentially limiting the deduction of interest expenses, net of interest received, to 30 per cent of the gross operating income of the accounting period and with certain carrying forward mechanism) and is allowed in the same proportion between the taxable income and the global income (including taxable and exempted income)[16];
- the deduction of notional interest (NID) is allowed up to the amount of

15 Up to EUR 400,000.00 for companies providing services and up to EUR 700,000.00 for companies providing other activities. For the purposes of calculating these thresholds, revenues must be assumed on an accruals basis and if the partnership is providing services or exercising other activities, reference must be made to the amount of revenues relating to the prevailing activity, provided that these are recorded separately, otherwise the service provision activity will be considered prevailing.

16 The tax regime of interest expense deduction is provided by Article 61, par. 1 of the Italian Income Tax Act.

income generated by the partnership and attributed to the partners by transparency, any exceeding amount of notional interest can be carried forward in the following years or converted into a credit for Regional Tax on Productive Activities purposes[17];
- dividends received by the partnership concur to the taxable income (to be attributed by transparency to the partners) of the period of collection limited to 58.14% of their amount[18].

5.1.4. Simplified accounting: determination of the taxable income pursuant to the provisions applicable to entrepreneurs

As clarified by the Revenue Agency with its Circular letter no. 11/E of 2017[19], in the simplified accounting system the following two criteria for determining the taxable income are available:

- a general criterion, based on both the so-called "cash" principle (for which the time of collection is relevant) and the so-called "accrual" principle (for which the of economic/legal accrual is relevant); and
- an optional criterion, based on records made for VAT accounting purposes and binding for 3 years (renewable).

A. According to the general criterion, revenues and expenses are recorded at the time of collection, except for the application of the accrual principle to the following positive and negative items of income[20]:

Items to be accounted for on an accrual basis:
revenues deriving from the assignment of assets to shareholders or their use for purposes other than those relating to business operations;
income deriving from so called "Patrimonial Properties" (i.e., as clarified in the following, real estate assets that do not constitute neither capital expenditures used for the scope and purposes of the business nor real estate asset whose construction or trade is aimed at the business activity);
capital gains and extraordinary items of income ("sopravvenienze attive"), without any possible reduction for capital gains arising from the sale of shareholdings;
income determined on a forfeiture basis for animal husbandry activities;
capital losses and contingent liabilities ("sopravvenienze passive"), provided that capital losses on the sale of financial assets are fully deductible;

17 This option is set forth in the Decree of the Ministry of Economy and Finance of 3 August 2017.

18 According to Article 59, par. 1 of the Italian Income Tax Act. For dividends deriving from profits accrued until 2017 the percentage is 49.72%.

19 That Circular letter is the document containing instructions for the determination of income for Corporate Income Tax and Regional Tax on Productive Activities purposes of minor companies.

20 Expressly mentioned by Art. 66 of the Italian Income Tax Act.

depreciation of tangible and intangible assets and financial leases;
losses on capital expenditures and losses on receivables;
provisions for retirement or pension;
expenses for workforce;
social utility charges;
expenditures relating to several financial years;
tax and social security contributions;
interest for late payments

Specifically, final and initial inventories of goods, contract work in progress (both annual and long-term) and securities do not concur to the taxable income, save for those which, jointly, concurred to the taxable income of previous period and which are fully deductible[21] (the latter circumstance occurs only in the transition from ordinary to simplified accounting). Since final inventories are no longer recorded (as an adjustment increasing the taxable income), the expenses for the purchase of goods are deductible when the cost is incurred[22].

Also expenses and negative components relating to "Patrimonial Properties" (as defined in the following) are not deductible, together with provisions other than those for pensions and remunerations due in relation to silent partnerships ("associazione in partecipazione" or "cointeressenza agli utili").

B. According to the optional criterion, for income elements subject to the "cash based" principle, it is assumed that the date of registration of the invoices matches with the date of collection/payment.

It follows that the VAT turnover also represents the amount of revenue generated, while the recorded purchase invoices represent the expenses incurred, with the exception of losses on receivables, which are deductible on an accrual basis.

As regards the accounting fulfilment common to both the above regimes, the set up of VAT registers (for invoices issued, remunerations received and depreciable assets) remains mandatory. The same registers will be used for income tax purposes, with specific recording of transactions not subject to registration for VAT purposes and of missed collections or missed payments in the year of the accounting for VAT purposes[23].

21 Pursuant to Article 1, par. 18 of Law no. 232 of 21 December 2016.

22 For companies adopting simplified accounting, the stocktaking will be only for corporate requirement and not for tax purposes.

23 The records kept for VAT purposes may replace the "registri cronologici degli incassi e dei pagamenti" (keeping however, the obligation to record separately transactions not subject to VAT). Otherwise arises the obligation to set up a special accounting book of "incassi e dei paga-

5.1.5. The tax regime of the real estate assets owned by the partnerships: depreciation and disposal

Without prejudice to the regime of the ordinary and simplified accounting described above, with regard to the procedures adopted for determining the "business income" generated by commercial partnerships, for tax purposes real estate assets can fall in one of the three following categories and be subject to the related tax regime:

- "**Available for Sale Properties**" (*i.e.* properties whose production or trades falls within the corporate purpose), concurring to the taxable revenues of the partnership and any increase or decrease in value of the same is treated as the inventories, pursuant to Article 92 of the Italian Income Tax Act;
- "**Corporate Properties**" (*i.e.*, real estate a) used exclusively for the scope of the business by the partnership, such as capex; and/or b) related to commercial enterprises that due to their characteristics are not subject to different use without any radical transformation, such as certain assets enrolled in particular cadastral categories) give the right to deduct from the taxable income the depreciation instalments[24] of the relative cost incurred for their acquisition[25], pursuant to Art. 102 of the Italian Income Tax Act, starting from the year in which they come into operation[26];

menti" in which are recorded revenue collected and costs actually incurred.

24 The depreciation rates, identified in the Ministerial Decree of 31 December 1988, are reduced by half in the first year of use.

25 For tax purposes, the depreciable cost is determined in accordance with Article 110, paragraph 1, letters a) and b) of the Italian Income Tax Act, by computing (at the historical cost of the property net of depreciation already deducted) directly attributable ancillary charges, excluding interest expense and general expenses. However, only in case of buildings used for the company's operations, the interest expense recorded in the balance sheet may be added to the cost of the property itself.
For the purpose of calculating the deductible depreciation, the cost of the Corporate Properties (and of the individual units, where portions of them exist) must be assumed net of the purchase cost of the land on which they are located. If this value is not determined, it will be assumed as the higher of: (i) the value of the land entered in the balance sheet; and (ii) 20% of the purchase cost of these buildings (30% for industrial buildings) will be adopted.
It should also be noted that extraordinary maintenance expenses relating to improvements, modifications or renovations of Corporate Properties, where they increase the cost of the property (in accordance with accounting standards), are depreciated together with the same, provided they result in a significant and measurable increase in productivity or an extension of the useful life. Conversely, ordinary maintenance expenses, including recurring charges incurred to keep the property in good working order, are deductible in the year they are incurred, up to a limit of 5% of all depreciable assets, while the excess is deductible on a straight-line basis over the following five tax periods.

26 In particular, the Supreme Court ruling no. 18082 of 21 July 2017 has recognised the essen-

- "**Patrimonial Properties**" (*i.e.*, properties other than the ones previously described), pursuant to Art. 90 of the Italian Income Tax Act, which must be treated by the partnerships according to the provisions ordinarily provided for the flat-rate determination of land income under Chapter II, Title I of the Italian Income Tax Act[27] (described in paragraph 5.2 below, concerning direct investment in real estate by foreign residents), therefore is not allowed any specific deduction of the depreciation charges relating to such properties.

The sale of Corporate Properties and Patrimonial Properties (differently from Available for Sale Properties that may generate costs, revenues and inventories) may give rise to capital gains or capital losses to be determined, respectively, in accordance with the provisions of Article 86, par. 1 (i.e., for properties owned for at least 3 years at the date of transfer, possibility to split the taxable capital gain in equal periodical instalments, in the year of collection and in subsequent years, up to the fourth), or Article 101, paragraph 1, of the Italian Income Tax Act.

From an indirect taxation standpoint, the sale and purchase of real estate by the partnerships is subject to registration tax and VAT (where applicable, depending on the characteristics of the property, the characteristics of the seller and of the purchaser, pursuant to Article 10 no. 8-bis and 8-ter of Presidential Decree no. 633/1972) as well as mortgage and cadastral taxes.

5.1.6. The management report

At the end of every accounting period, the persons responsible for the management of the partnership (usually, the general partners) are required to prepare (without any specific outlines) and submit to the approval of the non-director shareholders a management report that clearly and accurately shows the amount of assets and liabilities of the partnership and provides a numerical representation of the management of the entity (essentially, a document equivalent to the profit and loss account).

When the partners are only limited liability companies, the partnership is obliged to draft and file a financial statements (and the consolidated financial statements, when mandatory or by option)[28].

tial requirement of the buildings' usability, and therefore the deductibility of the cost.

27 Provided they are located within the territory of the State.

28 Pursuant to Art. 111-duodecies, disp. att., ICC.

In addition to the drafting of the management report (or of the financial statements), the partnership will be required to provide each partner with an additional statement for filing its own tax return. This statement must contain, inter alia: i) the details of the partnership and of the partner; ii) the shareholding of the partner; iii) the total amount of the profit or loss attributed (by transparency) to the partner; iv) the amount of the withholding taxes and of the tax credits attributed (by transparency) to the partner; v) the expenses incurred by the partnership for the building renovation and energy requalification, for the adoption of anti-seismic measures, if any; vi) the NID used by the partnership and the portion attributed to the shareholder.

5.1.7. Carrying forward of tax losses incurred by Commercial Partnerships

Business losses (which can be offset with business income only) are determined net of the portion of income exempt from Corporate Income Tax that exceeds the negative components not deducted (non deductible interest as per Articles 61 and other expenses, as per Article 109, paragraph 5, of the Italian Income Tax Act[29].

Tax losses borne during an accounting period may be carried forward without time limitations in the following accounting periods and deducted up to 80% of the taxable income of the period (according to the limitations in matter of carrying-forward tax losses provided for entities subject to Corporate Income Tax pursuant to Art. 84 of the Italian Income Tax Act[30]).

5.1.8. Foreign-resident partners: partnership's income attributed by transparency and gains deriving from the disposal of partnership shareholdings

Provided that the OECD Model Tax Convention on Income and on Capital (hereinafter, the "**OECD Model**") does not contain specific provisions dealing with the treatment of the income attributed to the partners by transparent partnerships, the taxation of partnership's income attributed by transparency should be determined making reference to the national law of the Country of residence of the partner (pursuant to general interpretative criterion set forth by Art. 3, par. 2 of the OECD Model).

29 Pursuant to Article 56, par. 2, and Article 8 of the Italian Income Tax Act.

30 Amendment introduced by Article 1, paragraphs 23-26 of Law no. 145 of 30 December 2018.

According to Italian tax provisions:

- the income attributed by transparency to foreign-resident partners by Italian (commercial and non-commercial) partnerships is relevant for Italian tax purposes as business income[31] (even if the mere participation to a partnership should not determine, *per se*, the existence of an Italian permanent establishment);
- the disposal of shareholdings into Italian partnerships could give rise to capital gains or losses.

More in details, for foreign-resident partners not holding the participation in relation to an Italian permanent establishment, said shareholdings would qualify as participations into Italian resident companies, and capital gains or losses deriving from: (i) a "qualified" participation[32], would be in any case relevant for Italian tax purposes; whereas those deriving from (ii) a "non-qualified" participation would be relevant for Italian tax purposes only when (ii.a) at any time during the three hundred and sixty-five days preceding the transfer the value of the company consisted for more than half, directly or indirectly, of immovable property located in the territory of the State other than that to the production or exchange of which the business activity is directed[33]; or (ii.b) the beneficial owner, jointly, is not resident for tax purposes into a "white list" Country[34] (i.e., a Country allowing exchange

31 Pursuant to Article 23, paragraph 1, letter g), and Article 153 of the Italian Income Tax Act.

32 When a partner holds, at a certain date, a participation exceeding 25% of participation to profits (so called "qualified shareholder"). A qualified participation is deemed to be disposed if, starting from such date, in the lapse of twelve months the partner disposes stakes of participations which, summed each other, exceed the foregoing thresholds. Also rights through which a participation can be acquired (e.g., call option) are relevant for calculation purposes. In addition, if the partner is an individual, in order to ascertain the "qualified shareholder" status also the shareholdings held by the consort, by the blood relatives up to the third degree and by the relatives by marriage up to the second degree, must be taken into account, pursuant to par. 5 of Art. 5 of Italian Income Tax Act.

33 Pursuant to Art. 5, para. 5-bis, of Legislative Decree no. 461/1997. This provision does not apply to gains realized by foreign collective investment undertakings (UCIs) that comply with Directive 2009/65/EC of the European Parliament and of the Council of July 13, 2009, and by UCIs, which do not comply with the aforementioned Directive 2009/65/EC, the manager of which is subject to forms of supervision in the foreign country in which it is established pursuant to Directive 2011/61/EU of the European Parliament and of the Council of June 8, 2011, established in the Member States of the European Union and the States party to the Agreement on the European Economic Area that allow for an adequate exchange of information, pursuant to Art. 1, para. 98 of L. n. 197/2022.

34 Pursuant to Art. 5, paragraph 5, of Legislative Decree no. 461/1997.

of information with the Italian tax authorities[35]) and is not entitled to benefit from Conventional provisions providing for the taxation in the Country of residence only.

Where relevant for Italian tax purposes, the capital gain will be subject to taxation according to the same provisions applicable to natural persons resident in Italy for tax purposes[36], therefore subject to a substitute tax on income applicable with a flat proportional rate of 26% or with the lower rate provided by the applicable Tax Convention.

The taxable amount of the capital gain is determined as positive difference between the amount collected and the cost of the shareholding acknowledged for tax purposes (the latter consisting in the purchase or subscription value, increased by expenses strictly related to the purchase, as well as the amount of income attributed by transparency and not yet taxed in the hands of the partner)[37].

When the above difference is negative, a capital loss arises and it can be offset against future capital gains realised on the disposal of qualified or non-qualified shareholdings[38].

For sake of completeness, considering that the deed of incorporation of a partnership has to be notarized, one must note that public deeds and private agreements relating to the modification of the shareholdings are subject to registration in a fixed term and with a lump sum amount.

5.1.9. Highlights on the Regional Tax on Productive Activities

For Regional Tax on Productive Activities purposes, the taxable basis of commercial partnerships is usually determined according to the so-called "tax method" ("metodo fiscale"[39]) as difference between, on one side, the amount of revenues and of changes in inventories and, on the other side, the amount of costs of raw materials, of ancillary materials, of consumables and of goods, of costs for services, of depreciation, amortization and leasing instalments, including financial instalments of tangible and intangible capital

35 In particular, reference is made to Article 67, paragraph 1, letters c) and c-bis) of the Italian Income Tax Act.

36 According to the provisions of art. 151, paragraph 3 of the Italian Income Tax Act.

37 Please refer to note 10.

38 Pursuant to Article 68, paragraph 5 of the Italian Income Tax Act.

39 Pursuant to Article 5-bis of Legislative Decree no. 446 of 15 December 1997.

goods, all to be determined according to the same rules applicable for the determination of the business income subject to Personal Income Tax.

Partnerships adopting ordinary accounting also have the possibility to opt for the determination of the tax basis according to the so-called "financial statement method" ("metodo di bilancio"[40]), therefore according to the relevant provisions for Corporate Income Tax and making generic reference to the difference between the revenues deriving from the ordinary activity and costs for the ordinary production (with the exclusion of costs for personnel, write-downs of fixed assets and of receivables, provisions for risks and other provisions) resulting from the financial statements.

5.2. Direct investment in Italian Real Estate assets by foreign-residents

In matter of foreign-resident taxpayers, one must preliminary consider that, according to Italian tax provisions, Italian real estate assets owned in relation to Italian permanent establishments located in Italy could give rise to income falling in the category of "business income", whereas other Italian real estate assets may give rise to different kind of income (namely, "income from land" or "other income", as better clarified in the following).

As regards Value Added Tax application profiles:

- taxable persons with a permanent establishment in Italy[41] have full VAT taxable *status* in Italy (although limited to transactions made or received by the permanent establishment itself). Therefore, such non-resident investors (with regard to transactions related to the Italian permanent establishment) are subject to the same fulfilments and obligations as Italian VAT taxable persons; while
- taxable persons not having a permanent establishment in Italy are required to fulfil their obligations and to exercise their rights (including the refund of VAT paid on purchases of goods and services) alternatively by: (i) appointment of a "*rappresentante fiscale*" (*i.e.* a tax representative), or

40 Pursuant to Article 5 of Legislative Decree no. 446 of 15 December 1997.

41 On the basis of EU legislation and case law (Article 11 of EU Regulation no. 282 of 15 March 2011 and Judgment C-190/95, Aero Lease BV), to trigger a permanent establishment for VAT purposes, it is necessary to have: i) a continuous presence in carrying out economic activity; ii) a proper organizational structure, characterized by the presence of human and technical elements to make it possible to carry it out autonomously and iii) the effective execution of the transactions by the non-resident party.

(ii) "direct identification" as a taxable person with an Italian VAT number.

With specific reference to real estate investments, according to the clarifications of Ministry of the Finance[42], the mere ownership and lease of a real estate property located in Italy should not per se be qualified as an Italian permanent establishment which, to the contrary, could exist when the presence on the Italian territory is also arranged with additional and different functions (such as, for example, the execution of construction activities, or the permanent presence on the Italian territory aimed at monitoring the construction/maintenance works outsourced to third party contractors and/or for the management of the properties, including market research for the maximization of their profitability).

More in detail, according to the Ministry, in order to entail a permanent establishment, it is required the effective set up of a national structure, having functional autonomy from to the foreign non-resident entity/headquarter, in terms of both management and accounting (e.g. in the case of a permanent establishment endowed with an operating economic entity with independent management at entrepreneurial level), whereas the carrying out of some kind of business activity through the simple ownership and leasing of the property should not be per se sufficient to give rise to an Italian permanent establishment (being an asset without organizational and accounting separateness with respect to the business activity carried out by the non-resident entity/headquarter).

For the purposes of income taxes, real estate investments made in connection with a permanent establishment located in Italy may generate income that will contribute to the formation of the taxable income of the permanent establishment itself (for the general application, reference is made to the paragraph on commercial partnerships).

Differently from the regimes described above, real estate investments made by foreign-resident investors not in connection with Italian permanent establishments[43] may give rise to income which (save any more favourable Convention provisions[44]) would be considered as sourced in Italy and

42 Resolution M.F. no. 460196 of 1989.

43 In order to trigger a permanent establishment of the foreign-resident investors, there must be their additional presence other than the mere holding of real estate assets and the collection of rents. Reference is made to the Supreme Court decision no. 8820/1987 and to the principle set forth in the Ministerial resolution 13.12.1989, no. 460196.

44 However since treaties provisions are drafted following the guidelines of Art. 6 of the OECD Model, which also provide (in principle) that income from real estate assets is taxable in the

there relevant for tax purposes according to Article 23, paragraph 1, letters a) and f) of the Italian Income Tax Act. More in details, it would be subject to Personal Income Tax, in case of foreign natural persons investors, and to Corporate Income Tax, in the other cases of foreign investors, whose tax base must in any case be determined in the same way as for individuals[45], and in both cases it should be determined as follows:

- as "income from land", for the ownership of Italian real estate assets which are listed in the land register or in the cadastral register with a cadastral rent attribution (in the absence of a cadastral rent, income from real estate will belong to the category of "other income"), further subdivided into "landlord income", "agricultural income" and "income from buildings", on the basis of forfeiture criteria and even if not collected[46].
- With specific reference to "income from buildings", the related income is made up of the ordinary average income ("*reddito medio ordinario*") obtainable from each real estate unit (defined as a building, a stable construction or part of it that can generate income autonomously), to be determined on a flat-rate basis equal to the higher between the cadastral rent increased of 5% and the actual rent (if any) reduced of 5%. Furthermore, (i) leases of residential properties in which the lessor is an individual may be subject, optionally, to a substitute tax (so-called "*cedolare secca*") at the ordinary rate of 21%[47], pursuant to Legislative Decree no. 23/2011; and (ii) for non-leased properties, the Municipal Tax (so-called "*Imposta Municipale Unica*") replaces the Personal Income Tax; or, in other cases,
- as "other Income", relevant for Italian tax purposes limited to the amount actually collected during the calendar year.

  In principle any disposal may give rise to capital gains or losses, determined as the difference between, on the one side, the proceeds received and, on the other side, the cost borne for the acquisition, increased of cer-

Country in which them are located (and therefore in Italy), without however excluding taxation in the Country of residence of the investors.

45 Pursuant to Article 153 of the Italian Income Tax Act.

46 Except in cases of moroseness, for which at the conclusion of the eviction proceedings a tax credit will be granted for taxes paid on uncollected rentals (Article 26, paragraph 1, Italian Income Tax Act).

47 With the exception of the so-called "canone concordato" leases (fixed by specific territorial agreements), for which a rate of 10% is applied, relating to certain cases such as the dwelling is located in municipalities with a high population density, for contracts stipulated for university students and in municipalities where calamitous events have occurred in the last 5 years.

tain other strictly related costs, provided that capital gains arising from the disposal of buildings are excluded from taxation in case of ownership of at least five years at the time of disposal and, in any other case, may be subject by option to a substitute tax regime with an applicable proportional flat rate of 26%.

6.
Real Estate Fund

by G.A. Giannantonio, G. Bighignoli

6.1. The concept of real estate fund

The real estate fund is, in brief, an investment fund whose assets consist of real estate assets as identified by the Italian law.

The legal framework is set out by the Consolidated Law on Finance[1] and by the regulatory provisions by the Ministry of Finance, Bank of Italy and the Financial Markets Authority (Consob).

An investment fund qualifies as "real estate" for legal and tax purposes if its assets consist for at least 2/3 of properties (i.e., buildings and lands) or other real estate assets identified under Article 4, paragraph 1, let. d) of Decree of the Ministry of Finance No. 30 of 5 March 2015[2].

As investment fund, the real estate fund qualifies as undertaking for collective investment (OICR).

The definitions of investment fund and undertaking for collective investment (OICR) are set out by Art. 1(1)(j) and (k) of the Consolidated Law on Finance, as amended by the Decree No. 78/2010, the Legislative Decree No. 44/2014 and the Legislative Decree No. 18/2016.

The investment fund is defined as an undertaking for collective investment (OICR) constituted as a separate pool of assets (patrimonio autonomo), divided into units, established and managed by an authorised fund manager (Art. 1(1)(j) Consolidated Law on Finance).

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1 Legislative Decree of 24 February 1998, No. 58, as amended and supplemented.

2 These are specifically: real estate, real property rights, and participations in real estate companies and other real estate AIFs, including foreign ones. This limit is reduced to 51% of the overall value of the fund if the assets are also invested, to an extent of not less than 20% of their value, in financial instruments representing securitization transactions involving real estate, real estate rights in rem, or credits secured by real estate mortgages (Art. 12 of Decree No. 30 of 5 March 2015).

The undertaking for collective investment (OICR) is defined, in turn, as the organism established for the collective asset management, whose assets are raised among a plurality of investors through the issuance and offering of units or shares, managed upstream in the interest of the investors and autonomously by the investors, and invested in financial instruments, credits, including those granted to non-individuals, out of the assets of the OICR, participations or other assets, movable or immovable, according to a predetermined investment policy (Art. 1(1)(k), Consolidated Law on Finance).

Real estate fund management constitutes an activity reserved for managers authorized by the Bank of Italy: namely, asset management companies (SGRs) authorized in Italy or, as will be seen, in another EU member state.

The real estate fund (and each sub-fund of the same fund) constitutes a "separate pool of assets", distinct for all purposes from the assets of the fund manager and those of each investor, as well as from any other assets managed by the same fund manager. Accordingly, for obligations contracted on its behalf, the fund (and each sub-fund) is liable exclusively from its own assets. No actions of the fund manager's creditors are allowed on these assets, and actions of individual investors' creditors are allowed only on the fund's (or sub-fund's) shares held by them. In addition, the fund manager may not under any circumstances, use, in its own interest or in the interest of third parties, the assets of the managed funds[3].

The fund is divided into units pertaining to a plurality of participants and is managed in the interest of these investors. The requirement of plurality of investors is intended to confer a clear separation between the fund manager (the SGR) and the individual investor, connoting the fund as an instrument of collective asset management.

Management must be in the interest of the participants but, at the same time, autonomous from them. Therefore, fund participants do not have powers such that they can directly affect the management of the fund. Real estate funds must be established in a closed form, that is, granting investors the right to redeem units only at predetermined maturity dates[4].

In a nutshell, it is a regulated investment vehicle whose activities are subject to the supervision of the Bank of Italy.

3 Art. 36, paragraph 4, last period, TUF.

4 Art. 12, paragraph 1, of Decree 5 March 2015, No. 30.

From the EU perspective, the real estate fund qualifies as alternative investment fund (AIF)[5] under the Directive 2011/61/EU ("AIFMD") on the alternative investment fund managers ("AIFM").

AIFs are, in brief, collective investment undertakings other than those regulated by Directive 2009/65/EC (UCITS IV).

The AIFMD aims to create a harmonized regulatory and supervisory framework with regard to the activities within the EU of all AIFMs (which include Italian SGRs)[6].

Interestingly, AIFMD also introduced the so-called European passport, under which AIFMs can manage funds established in other EU member States without establishing a branch in that State[7].

Thus, for example, an AIFM established in France or Luxembourg can manage, under the AIFMD passport, a real estate fund established in Italy, without necessarily establishing a branch in Italy.

The Revenue Agency has clarified that the management of a real estate fund in Italy by a foreign (e.g., French) AIFM, pursuant to the passport, does not imply, automatically, the existence of a permanent establishment in Italy of the AIFM for tax purposes. It is understood that the possible existence of a permanent establishment in Italy will have to be assessed on a case-by-case basis on the basis of the activity actually carried out in Italy.

In this regard, the Investment Management Exemption provisions introduced in Italy in 2023 should also be considered. Article 1(255) of Law No. 197 of December 29, 2022 ("Budget Law for 2023") amended the regulations on permanent establishment set forth in Article 162 of Italian Income Tax Code, introducing a specific case of exclusion effective from January 1, 2023.

If certain conditions are met, a person who in the name of or on behalf of the same vehicle or its subsidiaries habitually concludes in Italy contracts for the purchase, sale or negotiation of financial instruments and credits (so-called asset manager/investment manager) or otherwise contributes, even through preliminary transactions, to their conclusion is considered independent of the foreign investment vehicle, and therefore does not constitute a permanent establishment in Italy.

5 Art. 1, paragraph 1, let. m-*ter*), TUF.

6 Consideration No. 4 of Directive 2011/61/UE.

7 Art. 41, paragraph 1, TUF as amended by Art. 4, paragraph 6, of Legislative Decree of 4 March 2014, No. 44. Articles 32 e 33 of AIFMD.

Investment Management Exemption provisions were supplemented by the publication of the Decree of the Ministry of the Economy dated 22 February 2024 and the Provision of the Revenue Agency dated 29 February 2024.

Recently, with Circular No. 23/E of 19 November 2024, the Italian Tax Authorities provided specific clarifications. However, it has not been confirmed whether such provisions are applicable also in case of investment in Italian real estate funds.

The orientation of authoritative doctrine is in the sense that the Investment Management Exemption is also applicable in case of investment in Italian real estate funds.

6.2. Real estate fund and Supreme Court case law (overview)

According to the consistent case law of the Supreme Court, from a civil law perspective, the real estate fund would constitute a mere "separate pool of assets" of the management company (SGR) and not an autonomous legal entity. According to the Supreme Court, the real estate fund does not constitute an autonomous legal entity, but rather a pool of assets owned by the management company, albeit separate from the management company's own assets.

This thesis, which has been criticized by a part of the doctrine, has been adopted by the Revenue Agency, which in various rulings has described the legal nature of the real estate fund in the terms above.

This is an approach that can assume relevance with respect to various tax aspects pertaining to the activity of real estate funds.

6.3. Income tax aspects of the real estate fund

6.3.1. Income tax exemption

The real estate fund, as collective investment undertaking (OICR) established under Italian law, is a taxable person resident in Italy for corporate income tax purposes (IRES) under Art. (73)(1) and (3) of the Income Tax Code[8].

Consequently, the real estate fund qualifies as "person resident in a contracting State" for the purposes of Double Tax Treaties.

8 Following the amendment introduced by Art. 96, paragraph 1, let. a), of Law Decree of January 24, 2012, No. 1 converted into Law 24 March 2012, No. 27.

Although real estate funds are included among IRES taxpayers, they are exempt from the tax (24%), as well as from the local tax on productive activities (IRAP), under Article 6 of Law Decree No. 351 of 25 September 2001 ("Decree 351")[9].

The taxation system for income related to real estate funds provides for taxation at the level of the investors, with different tax regimes depending on the characteristics of the investor, against the exemption of the fund.

In such a system, as will be seen, there are then cases of investors who are exempt from tax on income derived from participation in the real estate fund.

The real estate fund is subject neither to the withholding tax on dividends distributed by companies resident in Italy nor to most withholding taxes, or substitute taxes, generally provided for income of a financial nature[10].

In this context, Article 32 of Law Decree No. 78/2010 specifies that the aforementioned tax regime specific for real estate investment funds only - i.e., exemption from IRES and IRAP of the fund and taxation in the hands of investors, except in cases of exemption - applies only if the real estate investment fund meets the requirements to qualify as an investment fund and, therefore, as an OICR under the TUF.

In this regard, the Italian Tax Authorities highlighted the following requisites, among others, "the collective management of the savings collected among a plurality of investors, and the autonomy of the SGR's management from the influence of the participants"[11].

In addition, in Resolution No. 137/E of 4 October 2005 and Circular Letter No. 33/E of 15 July 2011, the Italian Tax Authorities, even though with reference to OICRs other than real estate, affirmed that the requirement of the plurality of investors is satisfied even in the presence of a single investor,

9 Converted, with amendments, into Law No. 410 of 23 November 2001. Moreover, Article 3, paragraph 2, of Legislative Decree No. 446/1997 excludes OICRs, other than SICAVs, from the application of IRAP. The ordinary IRAP rate of 3.9% may change, pursuant to Article 16, paragraph 3, of Legislative Decree No. 446/1997.

10 Article 27(1) of Presidential Decree No. 600 of 29 September 1973; Italian Tax Authorities, Circular Letter No. 47/E, 8 August 2003, paragraph 3.3. Art. 6, paragraph 1 of Decree 351.

11 Italian Tax Authorities, Circular Letter No. 2/E of 15 February 2012, paragraph 1. In the explanatory report to Law Decree No. 78/2010, it is clarified that the tax regime applicable to real estate funds is limited to funds "that manage widespread savings and to those aimed at carrying out activities of public interest". Should the entity fail to meet the statutory and regulatory requirements to be considered an investment fund, the latter would be subject to IRES and IRAP as a commercial company.

if the investor represents a plurality of interests so as to configure a collective management.

6.3.2. The institutional real estate fund

Paragraph 3 of Article 32 of Law Decree No. 78/2010 provides that the tax regime just described applies "in any case" to real estate investment funds held exclusively by one or more "institutional investors," i.e., investors identified by the same rule. In this case, it will be referred to as an "institutional investment real estate fund" for tax purposes.

Under Article 32, paragraph 3, Law Decree No. 78/2010, institutional investors are:

- Italian State and public entities;
- OICRs (investment funds and SICAFs);
- supplementary pension schemes and compulsory social security institutions (pension funds and retirement funds);
- insurance companies, if the investment is aimed at covering technical reserves;
- banking and financial intermediaries, governed by Legislative Decree No. 385 of 1 September 1993 (TUB) and the TUF, provided they are subject to prudential supervision;
- foreign investors similar to the aforementioned entities, provided they are established in States that allow adequate exchange of information for tax purposes, included in the so-called white list (Ministerial Decree 4 September 1996, as updated on March 23, 2017)[12];
- private entities resident in Italy that carry out their activities in the non-profit sectors and cooperatives that pursue mutualistic purposes both in favor of their members and third parties;

12 Article 168-bis of TUIR, to which Article 32, paragraph 3 of Law Decree No. 78 of 31 May 2010 refers, was repealed by Article 10, paragraph 1 of Legislative Decree No. 147 of 14 September 2015 (effective as of fiscal year 2015). The aforementioned Article 10 of Legislative Decree No. 147 of 14 September 2015, in paragraph 3, moreover, introduces a coordinating provision according to which: "When laws, regulations, decrees or other rules or measures refer to the list of States and territories that allow for an adequate exchange of information referred to in paragraph 1 of Article 168-bis of the Italian Income Tax Code approved by Presidential Decree No. 917 of 22 December 1986, in force prior to the effective date of this decree, the reference shall be understood to mean the decrees issued in implementation of Article 11, paragraph 4, letter c), of Legislative Decree No. 239 of 1 April 1996". Pending the issuance of these decrees, reference should be made to the list in the Ministerial Decree of 4 September 1996 for the identification of states that allow adequate exchange of information (White-List).

- vehicles, established in corporate or contractual form, in which more than 50% of the aforementioned entities hold a stake. The Italian Tax Authorities has included among investment vehicles Cassa Depositi e Prestiti S.p.A., in which the Italian state, through the Ministry of Economy and Finance, holds about 80% of the share capital.

On the applicability of the aforementioned tax regime "in any case", the Tax Authorities clarified that the said tax regime will be applied "regardless of any assessment relating to the requirements of the autonomy of management and the plurality of the participants highlighted above"[13].

The following are some considerations, which are not exhaustive, on the category of institutional investors.

The relevant regulations do not explicitly establish the requirements that a foreign investment fund must meet in order to qualify as an "institutional investor" for the purposes of the aforementioned Article 32, paragraph 3(f), of Law Decree 78/2010.

In this regard, the Tax Administration has provided numerous clarifications over time[14].

In brief, in such a category are included foreign investment funds that (i) according to the regulations in force in the foreign State where they are established, have the substantial requirements and the same investment purposes as Italian OICRs, regardless of their legal form and even though they lack tax subjectivity, (ii) are subject to "forms of vigilance" with respect to the fund itself or the entity in charge of its management, and (iii) are established in a State included in the White List[15].

As for point (i), such an analysis requires an examination of the legislation of the foreign State governing the foreign fund, in order to assess whether it has similar substantive characteristics to those proper to a OICRs under Italian law. The reference to the investment purpose requires, in short, that the foreign fund has as the object of its activity the making and management of investments in the "interest of a plurality of investors"[16].

13 Italian Tax Authorities, Circular Letter of 15 February 2012, n. 2/E, page 10.

14 Provisions of the Italian Tax Authorities of 16 December 2011; Circular Letter of 9 March 2011, n. 11/E; Circular Letter of 15 February 2012, n. 2/E, par. 3; Resolution of 18 July 2013, No. 54/E. See also Public Answers listed below.

15 List of the States that allow an adequate exchange of information.

16 Circular Letter of 9 March 2011, No. 11/E; Circular Letter of 15 February 2012, n. 2/E, par. 3.

As for point (ii), the requirement of supervision, the Tax Authorities have initially clarified that this exists if the initiation of the activity is subject to prior authorization and the exercise of the activity itself is subject on an ongoing basis to mandatory supervision on the basis of the normative provisions in force in the foreign State of residence[17].

In addition, the Tax Authorities clarified that the existence of a form of supervision must be attested by the foreign investment fund through a certification issued by the competent foreign Authorities.

For this purpose, according to the Agency, the letter of authorization for the establishment of the fund issued by the foreign Authority can be provided, showing the regulations under which the same (or the manager) is subject to supervision. By way of example, the Tax Authorities refer to the letter of authorization for the establishment of the fund containing the specification that the body complies with the UCITS IV Directive, given that, under this EU legislation, it is expressly provided that the requirement of prudential supervision is met and that such supervision is recognized in all EU member States.

However, subsequently, the Tax Authorities provided further clarification regarding the supervisory requirement.

First, the Tax Authorities provided clarification on the vigilance requirement with respect to non-EU investment funds managed by managers supervised under U.S. regulations.

In Resolution No. 78 of 27 June 2017, the Tax Authorities examined the case of a fund established in the Cayman Islands and managed by a General Partner also established there, which qualified under U.S. regulation as a relying adviser to a Delaware management company (investment adviser).

Both the relying adviser and the investment adviser were "collectively" registered with the US Securities and Exchange Commission (SEC). Registration resulted from the online completion of a special form (Form ADV).

The Tax Authorities clarified that, in such a case, the requirement of supervision was met and that it can be demonstrated through the Form ADV available on the SEC website, thus even in the absence of a certification issued by the competent supervising authority[18].

17 Resolution of 18 July 2013, No. 54/E.

18 In the same vein: Public Answers Nos. 43/2018; 44/2018; 147/2018; 430/2019; 652/2021. See also recent Public Answer No. 265/2023, in which both the investment advisers and general partners of three investment funds established in the United States were subject to supervision

The Tax Authorities also considered relevant:

- supervision by the Cayman Islands Monetary Authority with respect to a private fund established in the Cayman Islands under the Cayman Islands Private Funds Law[19];
- supervision by the competent authority in Korea (Financial Supervisory Service FSS) with respect to two funds residing there and managed by an asset management company established and self-directed by the FSS, under the Korean Capital Markets Act (CMA)[20].

Turning to the case of the investment vehicles referred to in letter h) of mentioned Article 32, paragraph 3, it should be noted that vehicles, established in corporate or contractual form, in which more than 50% of the shares are held by institutional investors referred to in the same Article 32, qualify as institutional investors[21].

The Tax Authorities have clarified that the participation in a vehicle can be owned by the institutional investor either directly or indirectly, taking into account, in the latter case, the de-multiplication produced by the indirect participation, for the purpose of verifying that the 50% threshold is overcome.

As for the residence of the investment vehicle, the Tax Authorities[22] clarified that it must be resident in a State included in the so-called White-List. As will be seen below, partially different considerations apply to the application of the withholding exemption.

A reading of Article 32 shows that Real Estate Investment Trusts (REITs) and similar Italian entities (i.e., listed real estate investment companies - SIIQs - pursuant to Law 296/2006) are not per se included among institutional investors for tax purposes.

It follows that, as clarified by the Italian Tax Authorities, "a REIT could qualify as an institutional investor where it could be assimilated to an OICR" under Italian law, i.e., where it has the requirements proper to an Italian collective investment undertaking.

In Public Answer No. 345 of 26 August 2019, the Tax Authorities confirmed that a specific REIT established in Singapore could be considered

by the SEC.

19 Public Answer No. 409/2021.

20 Public Answer No. 169/2023.

21 Circular Letter of 15 February 2012, n. 2/E, par. 3.

22 Circular Letter of 15 February 2012, n. 2/E, par. 3.

similar to an Italian OICR based on the following elements: (a) the capital of the REIT was raised through contributions made by different parties in accordance with the terms of the deed of incorporation; (b) the investment policies were predetermined within the same deed and the management activity, entrusted to the manager, was strictly bound to what was established in that deed; (c) the investors did not participate in the management nor did they exercise any control over the investment policies; (d) the REIT manager, external to the REIT, was resident in Singapore, a Country included in the White List, and was subject to the supervision of the competent Singapore Supervisory Authority[23].

The Agency expressed the same view in Public Answer No. 655 of 4 October 2021, concerning an Australian REIT.

In summary, whether a REIT qualifies as an institutional investor for tax purposes for investment in a real estate fund requires a case-by-case analysis.

On the other hand, the Italian Tax Authorities recently considered a non-Italian investment fund wholly owned by a foreign pension fund not to be treated as equivalent to an Italian OICR because, in short, although the foreign fund was subject to supervision, it did not meet the substantive requirements to be treated as an Italian pension fund or an Italian OICR[24].

6.3.3. The "non-institutional" real estate fund

In case of real estate funds other than "institutional", i.e., real estate funds also (or only) participated in by non-institutional investors, the tax regime provided for real estate funds[25] applies provided that the fund meets the requirements established for Italian OICRs. These are, in brief, as seen, the following requirements: plurality of investors, autonomy of the SGR in the management of the fund, pre-determined investment policy of the fund[26].

23 The Italian Tax Authorities came to the same conclusions in relation to another investment fund established in Singapore, whose manager, also resident of that state, held the s.c. Capital Markets Services License under the Securities and Futures Act 2001, and was subject to the supervision of the Monetary Authority of Singapore ("MAS") (Public Answer No. 327/2022).

24 Public Answer No. 162/2022, in which the State of residence of the entities involved is not specified.

25 In short, exemption from IRES and IRAP under Article 6 of Law Decree No. 351/2001. Conversely, if the fund does not meet these requirements, it would be subject to IRES and IRAP under the ordinary rules.

26 Circular Letter of the Italian Revenue Agency of 15 February 2012, No. 2/E, par. 1.

As seen, Article 32, paragraph 3, of Law Decree No. 78 of 31 May 2010 qualifies as institutional real estate funds those exclusively participated in by institutional investors.

Therefore, the rule providing that the exemption regime applies in any case to funds having this ownership structure does not operate if the fund is also participated in by a "non-institutional" investor (e.g., a real estate company resident in Italy). This although the presence of (at least) one institutional investor should ensure compliance with the requirements established for Italian OICRs.

Of course, the exemption regime provided for real estate funds may also apply in this case: it will, however, be necessary to demonstrate the compliance with the requirements established for OICRs, since it will not be possible to rely, for tax purposes, on the presumption set forth in the aforementioned Art. 32, paragraph 3.

6.4. VAT aspects of the real estate fund

6.4.1. VAT aspects of the transactions carried out by the real estate fund

Article 8 of Law Decree No. 351/2001 establishes that the taxable person for VAT purposes for transactions carried out by the real estate fund - e.g., purchase of real estate, lease of real estate, sale of real estate - is the SGR, not the fund.

The choice of the tax legislature to attribute passive subjectivity to the manager (SGR) rather than to the body (fund) entails a number of consequences on the VAT rules of a real estate fund activity.

First, from an operational point of view, the VAT number is attributed only to the SGR and not also to the fund: this VAT number is then used for all transactions, active and passive, related to the various funds managed by the SGR.

The tax provisions reflect in the VAT rules the asset separation between fund and SGR that characterizes OICR also from a civil law point of view. In fact, pursuant to the aforementioned Article 8, the SGR must determine the VAT related to each fund separately from the tax relating to its own activity, or that of other funds managed, and then proceed to the cumulative payment of the tax after offsetting the VAT credit[27] and debit of all funds.

27 In relation to the regulations on offsetting, it should be noted that Law No. 213 of 30 De-

The separate determination of VAT for each fund and the cumulative payment at the SGR level are obligations of the SGR and not an option.

This implies, for example, that the VAT credit for one fund must be offset against the VAT payable by the other funds managed by the same SGR. Which may result in a fund being able to recover its VAT credit more quickly than if it had to offset that credit only against its own VAT debt.

In practice, a negative side effect is also noted: when refunding the VAT credit, the Agency sometimes applies the suspension of payments under Article 23 of Legislative Decree No. 472/1997 in the presence of tax debts related to other funds managed by the SGR, other than the one to which the VAT credit refers. This derives, in a nutshell, from the circumstance whereby the VAT number is unique for the SGR and all the funds managed by it, so that, with respect to pending loads, the Italian Tax Authorities sees a single entity, without distinguishing the tax positions of single real estate funds.

This is despite the fact that, from a civil law perspective, there is a clear asset separation between a single fund and the other funds managed by the same SGR, as well as between the single fund and the SGR, as provided by Article 36 of the TUF, in the mind of which only the fund itself is liable for the obligations of a fund with its own assets. In relation to the SGR's liability for tax debts attributable to one or more funds managed by it, the Supreme Court has recently clarified that in the case of termination of a fund, the management company, which managed that fund, cannot be directly liable for the failure to pay VAT unless the Italian Tax Authorities claim an independent title of liability. Therefore, the SGR is not liable with its own assets, either subsidiarily or jointly, for any VAT debts of the terminated fund. In fact, the SGR is the taxable person from a merely formal point of view while, from a substantive point of view, it is the fund with its own autonomous assets that is liable for the tax.

cember 2023 (Italian Budget Law 2024), later amended by Decree-Law No. 39 of 29 March 2024, introduced important changes to the s.c. "horizontal offsetting" (*compensazione orizzontale)* referred to in Article 17 of Legislative Decree No. 241 of 9 July 1997. As from 1 July 2024, such offsetting is precluded in the presence of debts for taxes on the tax rolls in excess of €100,000.

6.4.2. Separate determination and payment of real estate fund VAT

The SGR is required to carry out the following steps:

1. Separately determine and settle the VAT for itself and for each managed fund.
   To this end, the SGR must keep separate accounts for its own[28] and each fund's activities, i.e., autonomous registers, invoices with separate numbering series and separate records of operations. In this context, the SGR must determine for each fund the percentage of VAT deduction (s.c. pro rata), pursuant to Article 19 et seq. of Presidential Decree No. 633/1972, taking into account the transactions carried out by that fund.
2. Make a single and cumulative payment of the VAT owed by the SGR itself and by each single fund, proceeding in advance to compensation of the debit and credit balances resulting from the individual accounts;
3. File a single annual VAT return, as a unitary taxable person, filling as many forms as there are separate accounts established.

In summary, although the real estate fund is not an autonomous taxable person for VAT purposes, the determination of VAT for each fund's operation operates as if the fund were an autonomous taxable person.

The last period of Article 8 of Law Decree No. 351/2001 provides for a specific refund procedure before the Tax Authorities for VAT credits of real estate funds. First, the real estate that constitutes the fund's assets and the maintenance expenses incurred are considered depreciable assets for the purposes of Article 38-bis of Presidential Decree No. 633 of 26 October 1972, thus making applicable the discipline that allows for the annual refund of VAT related to the purchase of depreciable assets, as well as the refund of VAT credits related to periods of less than a year[29].

In addition, such refunds are made within six months without presentation of the guarantees ordinarily required. While there is no clarification from the Tax Authorities, this procedure should also apply in case the fund manager is an EU AIFM.

28 In this regard, it should be recalled that the activity of investment fund management in principle is included among transactions exempt for VAT purposes, pursuant to Article 10, paragraph, No. 1 of Presidential Decree No. 633 of 26 October 26.

29 Referred to in Article 30, paragraph 3(c) of Presidential Decree No. 633 of 26 October 1972. See Circular Letter No. 2/E, of 15 February 2012, para. 8.

In the case of a manager established in the EU (EU AIFM) who manages the Italian real estate fund through the "manager's passport," the VAT provisions relating to the SGR should refer to that manager[30]. However, it should be noted that in such a case the VAT rules relating to the SGR and real estate funds should be coordinated with the nonresident status in Italy of the EU AIFM.

6.4.3. Real estate fund and separation of activities for VAT purposes

Pursuant to Article 36(1) of Presidential Decree No. 633/1972 in respect of entities engaged in more than one activity, VAT is applied unitarily and cumulatively for all activities.

Article 19, paragraph 5, of Presidential Decree No. 633/1972 also provides that if a real estate fund operates in both activities that give rise to transactions conferring the right to deduct VAT and activities that give rise to VAT-exempt transactions (which reduce the right to deduct), the right to deduct VAT is payable proportionally to the transactions conferring the right to deduct and the amount thereof is determined applicating the percentage of deduction referred to in Article 19-bis (s.c. pro rata).

In order to mitigate the effects of pro rata, Article 36, paragraph 3, of Presidential Decree No. 633/1972, establishes that persons engaged in more than one activity have the possibility to opt for the separate application of VAT with respect to some of the activities exercised, adopting a separate accounting system. Thus, in short, the VAT deduction percentage of one activity will not be affected by exempt transactions belonging to another activity.

In this regard, the Italian Tax Authorities in Circular Letter No. 19/E of 2018 clarified that, for the separation of activities for VAT purposes, reference to ATECO codes is only one of the criteria by which separation can be made[31]. In particular, the Administration clarified that "if (...) the activities carried out present in practice a constant uniformity in their essential elements and are in any case susceptible of being distinguished on the basis of objective criteria, the condition of the existence of effectively distinct and objectively autonomous activities, even if carried out within the same business activity, must be considered fulfilled".

30 Public Answer No. 199 of 20 June 2019.

31 According to the previous approach, activities could only be separated if they were identifiable with different ATECO codes.

The Tax Authorities correctly pointed out that this interpretation is in line with the principles of the VAT Directive and with the case law of the EU Court of Justice: the latter has found the Italian VAT deduction mechanism (which provides for the application of the s.c. pro rata) to be in line with EU law, insofar as the national system offers economic operators the possibility of opting for the separation of activities, thus allowing for a more precise exercise of the right to deduct, in line with the principle of VAT neutrality[32].

In this context, the aforementioned Article 36, paragraph 3, of Presidential Decree No. 633/1972 provides a specific provision for the real estate sector under which the rules on the separation of activities for VAT purposes also apply to persons who carry out both VAT-exempt leases or sales of residential buildings (which result in the reduction of the percentage of detraction) and leases or sales of other buildings or other immovable property, with reference to each of these sectors of activity.

This provision has been the subject of some clarifications by the Tax Authorities, including with reference to the activity of real estate funds. In a nutshell, the Italian Tax Authorities, in reiterating that the criterion of ATECO codes is only one of the criteria that can be used for the separation of activities[33], also noted that:

- the wording of Article 36, paragraph 3, of Presidential Decree No. 633/1972 implies that the option for the separation of activities within the real estate sector takes place with a separation criterion based both on the VAT regime - exemption or taxability - and on the cadastral category of the building - residential or different from residential (Public Answer No. 608/2020; Circular Letter No. 22/E of 2013, paragraph 9);
- separation of activities based solely on the tax regime (of exemption or taxability) applied to the sale or leases of real estate is not permitted if the real estate is all classified as instrumental properties. Therefore, it is not possible to exercise the option for separation of activities to separate, within the transactions attributable to the real estate fund, the activity of leasing instrumental properties exempt from VAT from the activity of leasing instrumental properties subject to VAT (Public Answer No. 608/2020);

32 Circular Letter No. 19/E of 2018, pag. 60.

33 Therefore, the separation of activities for VAT purposes can also be done by criteria other than ATECO codes, even if the various activities can be traced back to the same ATECO code, as long as the separation criterion is objective and demonstrable.

- it is possible to separate the activity of disposing of real estate subject to development and redevelopment from the activity of disposing of other real estate, since they are distinct and objectively self-named activities (Public Answer No. 471/2021[34], although in this case the Tax Authorities referred, however, to the ATECO codes and cadastral category of the real estate);
- it is possible to separate the activity of lease and sale of instrumental and residential properties from the activity of development and redevelopment of properties to be converted to residential use, since the latter have a provisional cadastral classification, i.e., F/4 - units in the process of being defined (Public Answer No. 123/2022)[35].

6.4.4. The VAT regime of fees for the management of real estate funds

The management activity of investment funds is exempt for VAT purposes, pursuant to Article 10, paragraph 1, No. 1, of Presidential Decree No. 633/1972.

The definition of "management" for the purpose of applying the exemption regime is not defined by domestic legislation, but constitutes an autonomous notion of European law, the containment of which the Member States cannot change[36].

Moreover, the notion of "management of funds" developed by the Court of Justice for the purposes of VAT exemption is objective in nature and does not depend on the characteristics of the person performing the service related to the management of funds[37].

On the basis of the pronouncements of the Court of Justice of the European Union[38,] transactions that specifically pertain to the activity of collective investment undertakings fall within the objective scope of the exemption. These are the portfolio management and administration activities of collective investment undertakings indicated in Annex II of Directive No. 85/611, as amended by Directive No. 2001/107 (s.c. UCITS III Directive).

34 Concerning a pension fund.

35 Concerning an investment fund.

36 EUCJ, Decision 4 May 2006, C-169/04 ("Abbey National"), paragraph 43.

37 Italian Tax Authorities, Resolution No. 75/E, of 20 April 2007; CJEU, Decision of 4 May 2006, C-169/04 ("Abbey National"), paragraphs 66-69; CJEU, Decision of 7 March 2013, C-275/11 ("GfBK").

38 CJEU, Decision 4 May 2006, rendered in Case C-169/04 ("Abbey National"), para. 63. CJEU, Decision 19 July 2012, rendered in Case C-44/11 ("Deutsche Bank AG"), para. 31; CJEU, Decision 13 March 2014, rendered in Case C-464/12 ("ATP Pension Service"), para. 65.

This principle has been implemented by the Italian Tax Authorities[39], which have specified that the services exempt from VAT are those specific and essential to the management of funds[40].

These are, for example: control over the compliance with the regulations applicable to the fund; keeping of the register of unit holders, distribution of income, issuance and redemption of units.

The Court of Justice has ruled on the scope of the VAT exemption under consideration also with reference to the management of real estate funds[41.]

On this point, the Court affirmed that, as a rule, the effective administration of real estate (which includes, for example, the management of lease relations and the entrusting of maintenance works to third parties) does not pertain to the management of an investment fund, this being beyond the various activities related to the collective investment of the capital raised. In particular, according to the decision, since the actual administration of real estate aims to preserve and increase the invested assets (i.e., real estate), its objective does not specifically pertain to "the activity of a mutual fund" but is proper to any type of real estate investment.

6.4.5. VAT profiles of SGR substitution

In the absence of specific tax provisions on the SGR substitution operation, the Italian Tax Authorities has clarified that, for VAT purposes, the new SGR assumes the same position as the substituted SGR[42].

39 Resolution No. 75/E of 20 April 2007. In the same document, the Tax Authorities also clarified that the VAT exemption does not cover "services correspondent to the proper functions performed by the custodian bank, since these functions pertain not to the management of investment funds, but to their control and supervision". With reference to the VAT treatment of fees due to the custodian bank, see also Resolution No. 97/E of 17 December 2013. The Tax Authorities has addressed VAT exemption also with reference to specific services rendered by an external advisor, specifying that services strictly related to the management of investment funds are exempt from VAT and further clarifying that, for the purposes of the exemption, the degree of responsibility that the external advisor assumes in the provision of such services is relevant (See, inter alia, Public Answers No. 631 of 2021, No. 104 of 2022, No. 363 of 2022, No. 364 of 2022 and No. 179 of 2023).

40 *Inter alia*, Public Answer Nos. 11/2023, 206/2022 and 104/2022, which recalls clarifications issued by CJEU.

41 CJEU, Decision 9 December 2015, rendered in Case C-595/13 ("Fiscal Eenheid X NV"), paragraph 78.

42 Public Answer No. 124 of 14 May 2020.

In addition, the Agency provided clarification regarding the management of any VAT credit of the real estate fund in the event that the substitution of the manager takes place during the year[43].

6.5. The taxation of investors

6.5.1. Background

The system of taxation of income related to real estate funds provides, as noted above, for the exemption of income at the level of the fund and its taxation at the level of the investors, with different tax regimes depending on the characteristics of the investors, except in cases of exemption provided for certain investors (discussed below).

Income related to participation in a real estate fund, such as an OICR, is:

- income distributed by the fund to the holders of the fund's units in constancy of participation[44];
- positive difference between the redemption or liquidation value of the units and the subscription or purchase cost of the units[45];
- capital gains realized through the sale of units for consideration[46], as well as those realized through the conversion of units from one sub-fund to another sub-fund of the same fund (s.c. switch)[47].

6.5.2. Tax regime for resident investors

Income from participation in a real estate fund received by investors resident in Italy is subject to the following tax regime.

If the recipient is a pension fund set up in Italy or an OICR set up in Italy, proceed distributed by the real estate fund is exempt from withholding tax pursuant to Article 7(2) of Decree-Law No. 351/2001.

If the recipient is an IRES taxpayer that qualifies as an 'institutional investor' pursuant to Article 32, paragraph 3 of Decree-Law No. 78/2010, other than pension funds and OICRs (e.g., banks and financial intermediaries),

43 Public Answer No. 421 of 18 June 2021.

44 Pursuant to Article 44, paragraph 1, let. g) of TUIR.

45 Article 7, paragraph 1, of Law Decree No. 351/2001.

46 Pursuant to Article 67, paragraph 1, let. c-*ter*) of TUIR.

47 Pursuant to Article 67, paragraph 1-quater of TUIR.

the proceeds are subject to a 26% withholding tax on account of the IRES due in the tax period.

With reference to Italian resident participants that qualify as 'non-institutional investors' pursuant to Article 32(3) of Decree-Law No. 78/2010[48], the applicable tax regime depends on the units in investment fund.

If the participation is ≤ 5%[49] of the fund's assets, the investor is subject to the aforementioned withholding tax regime[50].

If, the holding is > 5% of the fund's assets, the investor is subject to the so-called "taxation by transparency" under Article 32, paragraph 3-bis, of Decree-Law No. 78/2010.

Transparency taxation provides that income earned by the real estate fund and recognised in the management statements is attributed to the participant in proportion to the percentage of participation in the fund, and taxed in the hands of the participant, regardless of the distribution of income[51].

If unitholders are individuals (and the units are not held as part of a business activity), the proceeds recognized on a look-through basis are classified as capital income from participation in an OICR[52] and contributes to the formation of the IRPEF taxable income with progressive rates (with a top rate of 43%).

The withholding tax is applied, at the time of distribution of the income, by the fund manager (SGR) or by the depositary of the units, pursuant to Article 7(1) of Decree-Law No. 351/2001.

In the case of investors subject to taxation by transparency, since the percentage of participation in the fund is verified at the end of the tax period (31 December), the withholding tax agent (e.g. the fund manager (SGR)) must

48 E.g. real estate companies and individuals.

49 As clarified by the Italian Tax Authorities, in order to determine the percentage of participation in the fund, account must also be taken of participations held indirectly through subsidiaries (within the meaning of Article 2359 of the Civil Code), trust companies, through third parties or through family members (spouse, relatives within the third degree, relatives within the second degree) (see Italian Tax Authority, Circular of 15 February 2012, No. 2/E, § 4.1.1).

50 Pursuant to Article 3-bis, last sentence, of Article 32 of Decree-Law No. 78 of 31 May 2010, the income tax regime set forth in Article 7 of Decree-Law No. 351/2001 remains unaffected for persons owning equity interests not exceeding 5%.

51 Such income is determined by excluding accrued but unrealised valuation income and expenses from the operating result. Revenue Agency Director's Order of 16 December 2011; Revenue Agency Circular of 15 February 2012, No. 2/E, § 4.1.1.

52 As perArticle 44, (1) (g) of the Income Tax Code.

in any case apply the 26%[53]withholding tax at the time of any distribution of income: this will then be deducted from the income on a look-through basis, if the participation exceeds 5%.

If the real estate fund set up in Italy is managed by an EU manager, based on the European passport regime, withholding tax on capital income arising from a participation in a Real estate fund, provided for by Article 7, (1) of Law Decree No. 351/2001, will be directly applied by the foreign AIFM. Alternatively, the foreign manager may appoint a tax representative in Italy to satisfy all the withholding taxes compliance requirements[54].

Capital gains realised through the sale of the units in the real estate fund by investors resident in Italy for tax purposes and qualifying as taxable persons for IRES purposes concur, as a rule, in forming the taxable base for IRES purposes (at the rate of 24%) under Article 86 of the Income Tax Code. The regime of partial exemption of capital gains from IRES provided for by the participation exemption (under Article 87 of the Income Tax Code) does not apply because, in short, the real estate fund does not meet the requirement of exercising a commercial business activity[55].

Such capital gains are exempt from income tax if realised by UCITS resident in Italy.

In the case of investors resident in Italy for tax purposes who do not carry on a business activity - for example, individuals who do not carry on a business activity - the capital gains in question are subject to a 26% substitute tax on income tax[56].

6.5.3. The taxation of non-resident investors in Italy

Proceeds distributed by the real estate fund to non-resident investors are subject to a 26% withholding tax (Article 7, paragraph 1, Law Decree No.

53 Article 7 (1) of Law Decree No. 351/2001.

54 Article 14(2) of Legislative Decree No. 44 of 4 March 2014, which amended Article 7 of Law Decree No. 351/2001.

55 See also Circular No. 2/E of 15 February 2012 of the Italian Tax Authorities. Paragraph 4.1.2 of that document specifies, in fact, that "in the event of the transfer of the units, the regime set forth in Article 87 of the Consolidated Income Tax Act does not apply due to the lack of the requirement set forth in Article 87(1)(d) (exercise of a commercial enterprise)".

56 As clarified by the Italian Tax Authorities in Circular No. 2/E of 15 February 2012, para. 3.1.2, in case of capital gains realised by real estate OICRs resident in Italy, the exemption regime provided for such entities applies.

351/2001), subject to the reduction of the rate on the basis of a Double Taxation Convention and the exemption from withholding provided for certain foreign investors (Article 7, paragraph 3-bis, of Law Decree No. 351/2001).

In relation to the qualification for treaty purposes of such income, the Italian Tax Authority has stated that, when there is no specific provision in the applicable Convention, said income should fall within the category of 'interest', as provided for in Article 11 of the OECD Model Convention against double taxation[57].

This position seems to follow the position supported by the Italian Tax Authority in Circular No. 74/E of 27 December 2007 in relation to Directive 2003/48/EC on the taxation of income savings resulting in the form of interest payments - the so-called Savings Directive. Indeed, in this Circular Letter, the Italian Tax Authority affirmed that the income distributed by real estate funds can be considered as interest for the purposes of the aforementioned Directive.

The interpretation provided in the above-mentioned Circular Letter No. 74/E concerns the scope of the Savings Directive, and it does not concern the categorization of income from real estate funds as interest for the purposes of the International Conventions entered into under the OECD Model.

In this regard, it should be noted that in the non-double taxation convention in force between Italy and Germany, income relating to investment funds is classified as dividends pursuant to Article 10(6)(b)[58].

In order to apply any reduced conventional rate (generally equal to 10%) the investment fund manager (SGR) must obtain[59]:

- a declaration issued by the non-resident entity, showing the identification data of the entity, the existence of the conditions to which the application of the conventional regime is subject, and the elements necessary to determine the measure of the lower rate
- a certificate issued by the tax authority of the foreign State, providing the residence of the beneficiary of the income for the purposes of the Convention.

Withholding tax is not applied if income is distributed to the following entities (Article 7, paragraph 3, of Law Decree No. 351/2001).

57 Circular Letter of the Italian Tax Authority, 9 March 2011 No. 11/E; Circular Letter of the Italian Tax Authority,15 February 2012, No. 2/E, para. 4.3.

58 Convention signed on 18 October 1989, ratified by Italy by Law No. 459 of 24 November 1992 and entered into force on 26 December 1992.

59 Circular Letter of the Italian Tax Authority, 9 March 2011 No. 11/E.

- pension funds and OICRs established in White-listed countries;
- sovereign wealth funds and central banks[60];
- international entities and bodies established under international agreements made enforceable in Italy (e.g. European Investment Bank - EIB)[61].

With reference to the possibility of applying the exemption from withholding tax even if the shareholding is indirectly held, the Italian Tax Authority initially expressed a negative opinion.

Subsequently, the Italian Tax Authority[62] has partly change its position, stating that the exemption also applies in the event that the units of the real estate fund are held by exempt entities by means of a corporate vehicle or a contractual vehicle[63] wholly owned by the party that meets the requirements for the exemption. For example, it has been clarified that, in the case of sovereign wealth funds, the exemption applies also where the investment in Italian real estate funds is made through corporate vehicles wholly owned by the foreign State.

In this regard[64], the Italian Tax Authority has further specified that the vehicle does not necessarily have to be resident in the same State as the participant, but must comply with the residency requirements established for its own participants by Article 7, paragraph 3, of Law Decree No. 351/2001.

For example, a vehicle wholly owned by a foreign OICRs must be resident in a White-List country, given that residence in a White-List State is also required for foreign OICRs to benefit from the exemption. In the different case of vehicles wholly participated by sovereign wealth funds, the vehicle

60 Measure of the Director of the Italian Tax Authority of 16 December 2011.

61 The definition of "institutional investors" for the purposes of the disapplication of the withholding tax was contained in Italian Tax Authority's Circular No. 23/E of 1 March 2002, also referred to in Revenue Agency Circular No. 11/E of 9 March 2011. According to the Italian Tax Authority, this definition included not only insurance companies, mutual investment funds, SICAVs, pension funds, asset management companies (i.e., entities subject to forms of supervision in foreign countries), but also those entities or organisations without tax subjectivity and not subject to forms of supervision but which possessed specific expertise and experience in transactions in financial instruments.

62 Circular Letter of the Italian Tax Authority,15 February 2012, No. 2/E, para. 4.3.

63 Public Answer No. 285 of 6 April 2023 concerning a Swiss pension fund holding 10% of the units of an Italian real estate fund through its total investment in a fund of a contractual nature resident in Switzerland that cannot be assimilated to an Italian OICR.

64 Resolution of the Italian Tax Authority of 18 July 2013, No. 54/E.

may reside in any foreign State, since this requirement is not required of the sovereign wealth fund for the purposes of the exemption from withholding tax[65].

The Italian Tax Authority has provided the following clarifications with respect to the requirements for exemption from withholding tax:

- in the case of an investment vehicle resident in a White-listed State and wholly owned by an institutional investor benefiting from the withholding exemption, or by several institutional investors benefiting from the exemption (e.g. pension funds and collective investment undertakings established in White-listed States), such vehicle, in addition to qualifying as an institutional investor, may also benefit from the exemption from withholding tax on income distributed by the Italian real estate fund[66];
- on the other hand, in the case of an investment vehicle resident in a White-list State and participated by institutional investors benefiting from the exemption from withholding for more than 50%, but less than 100%, such vehicle will qualify as an institutional investor, but will not be able to benefit from the exemption from withholding;
- if the unitholder is a foreign real estate investment trust (REIT), the withholding exemption is applicable provided that it is assimilated to an OICR[67].

Capital gains deriving from the sale for consideration or from the refund of quotas of real estate funds established in Italy, received by non-residents, are considered to be produced in the territory of the State pursuant to Article

65 Resolution of 18 July 2013, No. 54/E.

66 Public Answer No. 285 of 6 April 2023; Public Answer No. 385 of 18 September 2019 and Public Answer No. 430 of 25 October 2019.

67 Public Answer No. 345 of 26 August 2019; Public Answer No. 652 of 4 October 2021; Public Answer No. 655 of 4 October 2021; and Public Answer No. 169 of 26 January 2023. More recently, with Public Answer No. 104 of 13 May 2024, the Italian Tax Authority provided clarifications with respect to a Canadian management company of a Canadian pension fund supervised by the local authority. The company, through one of its vehicles, intended to acquire shares of an Italian real estate fund, asking whether the exemption from withholding tax on proceeds pursuant to Article 7(3) of Decree-Law No. 351/2001 could be applied. The Italian Tax Authority, in providing a positive answer, clarified that the exemption regime is applicable not only in the case of a 'direct' participation in the Italian real estate fund, but also when the foreign investor participates wholly in corporate vehicles that make the investment, provided that these are also resident in so-called white-list countries.

23 TUIR, provided that the quotas are not traded on regulated markets[68].

Consequently, such income is taxable in Italy, through a 26% substitute tax on income tax, except as discussed below.

If the investor holding the unit in the fund resides in a country that has entered into a double tax treaty with Italy, the capital gain may be taxable only in the investor's State of residence and not in Italy due to the effect of the treaty[69].

On this point, it is worth noting that Italy has opted for the application of Article 9(4) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) with respect to the Conventions to which it is a signatory: this is the rule that attracts to the source country the taxation of capital gains from the transfer of participations in companies and entities whose value derives mainly from real estate.

Once the MLI enters into force with respect to Italy, Article 9(4) will apply to the Conventions signed by Italy only if the other Contracting State has also chosen to apply the same provision.

In this context, domestic provisions must also be considered.

Article 5, paragraph 5, of Legislative Decree No. 461 of 21 November 1997 provides for the exemption from taxation in Italy of capital gains realised by non-Italian resident persons referred to in Article 6, par. 1, of Legislative Decree No. 239 of 1 April 1996. Namely:

- entities resident in States and territories that allow an adequate exchange of information[70]. The residency requirement is verified on the basis of the domestic rules of the country where the foreign entity is established[71];
- foreign institutional investors established in States and territories that allow an adequate exchange of information;
- sovereign wealth funds and central banks;
- international entities or bodies set up under international agreements made enforceable in Italy.

68 Art. 23, (1), (f), of the Italian Tax Code.

69 If the Convention gives exclusive taxing power to the State of residence instead of the source State (Italy). Such capital gains are normally regulated in the Article of the Convention based on Art. 13 of the OECD Model.

70 Please note that the first sentence of Article 6(1) of Legislative Decree No. 239 of 1 April 1996 was amended by Article 10(2)(a) of Legislative Decree No. 147 of 14 September 2015.

71 Circular Letter of the Italian Tax Authority of 27 March 2003, No. 20/E, para. 1.1.

The tax regime described above is independent of the percentage of units held in the real estate fund.

Article 1, paragraphs 96-99 of Law No. 197 of 29 December 2022 ("Budget Law for 2023") made certain amendments to the tax regime described above.

In summary, as a result of these amendments, capital gains from the sale of direct or indirect participations in companies and entities the value of which derives, for more than 50%, in any of the 365 days preceding the sale, from real estate located in Italy other than merchandise real estate and instrumental real estate, are taxable in Italy under certain conditions.

By Resolution No. 76 of 22 December 2023, the Italian Tax Authority clarified that these amendments do not apply to capital gains deriving from the transfer of participations in Italian real estate OICRs: therefore, the tax regime described above will continue to apply to such capital gains.

Similarly, Article 1(99) of the Budget Law for 2023 provides that the above changes do not apply either to capital gains realised by investment funds established in the EU and compliant with the UCITS Directive or non-compliant with that Directive where the manager is subject to supervision under the AIFMD.

Table 1 – Tax regime applicable to income distributed by real estate funds

	Units ≤ 5%	Units > 5%
Institutional resident investors (other than pension funds and OICRs)	26% withholding tax (Article 7 of Law Decree No. 351/2001)	26% withholding tax (Article 7 of Law Decree No. 351/2001)
Italian non-istitutional investors	26% withholding tax (Article 7 of Law Decree No. 351/2001)	Transparency taxation
Italian pension funds and OICRs	Exemption	Exemption
Non-resident investors as per Article 7 para. 3 Law Decree No. 351/2001	Exemption	Exemption
Non-resident institutional investors (other than those referred to in Article 7 para 3 Decree No. 351/2001)	26% withholding tax (Article 7 Decree No. 351/2001) or lower conventional rate	26% withholding tax (Article 7 Decree No. 351/2001) or lower conventional rate
Non-resident and non istitutional investors	26% withholding tax (Article 7 Decree No. 351/2001) or lower conventional rate	26% withholding tax (Article 32(4) of Law Decree No. 78 of 31 May 2020) or lower conventional rate

6.6. Contribution and sale of real estate properties to a real estate fund

6.6.1. Income taxes

For income tax purposes, the contribution and the sale of real estate are deemed to generate a capital gain and as such they are subject to the ordinary rules governing sales of goods for consideration[72].

Examining the case where the party making the contribution/selling the real estate is a company (S.p.A. or S.r.l.) resident in Italy that transfers real estate located in the territory of the State, the following is observed.

The contribution/sale to the fund of real estate properties (held for trading or for investment purposes) generate a capital gain or a capital loss, calculated as the difference between (a) the tax cost of the assets and (b) the consideration received. The latter consist of the fair value of the units received by the contributor, determined pursuant to Article 9 of the TUIR[73]. This value, in any case, takes into account the market value of the real estate.

Capital gains[74] constitute corporate income pursuant to Article 86 of the Income Tax Code and are in principle subject to IRES at 24%[75] in the financial year in which they are realise.

If the real estate has been recognised in the balance sheet of the contributor/vendor for at least three years, the capital gains are taxable, at the company's choice, (i) entirely in the year of realisation or (ii) on a straight-line basis in the period of realisation and in the four subsequent accounting periods.

Such capital gains also contribute to the formation of the taxable base for IRAP purposes - which provides for a basic rate of 3.9% [76].

If the transaction concerns real estate that qualifies as goods-for goods in

72 Circular Letter of the Italian Tax Authority of 8 August 2003, No. 47/E, para. 3.4.

73 Pursuant to Article 9(4) of the Italian Tax Code, the normal value is the arithmetic mean of the prices recorded in the last month if the units are traded on regulated markets, while it is to be determined in proportion to the net worth in the opposite case.

74 Indeed, it appears to be of no practical relevance if the contribution of real estate to the fund results in a capital loss for the contributor.

75 The ordinary tax rate of 24% has been in force since 1 January 2017 (Art. 1, paragraphs 61-64 of Law No. 208 of 28 December 2015). The previous ordinary rate was 27.5%. Note that banks and certain financial entities are subject to a 3.5% IRES rate surcharge, so that the overall rate is 27.5% (Article 1, Paragraph 65 of Law No. 208 of 28 December 2015).

76 Pursuant to Art. 5, par. 3, Legislative Decree No. 446 of 15 December 1997. Circular Letter of the Italian Tax Authority No. 27/E of 26 May 2009 (para. 1.1).

the balance sheet of the contributor/vendor, a revenue will be realised, rather than a capital gain, which will nevertheless contribute to the formation of the taxable base for both IRES and IRAP purposes[77].

As an alternative to the tax regime described above, it is possible to apply, at the option of the company making the contribution, a 20% substitute tax to both IRES and IRAP on the income deriving from the contribution[78].

The substitute tax is applied irrespective of the type of property contributed. Therefore, it is applied, in the respect of buildings (instrumental, capital or goods) and land[79].

The Italian Tax Authority has clarified that, although the text of the rule uses the term capital gains, this does not have a technical meaning in this context, so that the substitute tax may also be applied to revenues from the contribution of real estate-goods [80].

Substitute tax does not apply if the property is sold to the fund.

For the purposes of the application of the substitute tax, it is not required that the real estate be rented at the time of the contribution; it will be seen below that this requirement is, on the contrary, necessary for the reliefs for the purposes of indirect taxes.

6.6.2. VAT and other indirect tax

If the contributor/vendor is a VAT taxable person resident in Italy (e.g., S.p.A. or S.r.l.), the contribution and sale of real estate properties to a fund constitute a transfer of goods for VAT purposes pursuant to Article 2(1) of Presidential Decree No. 633 of 26 October 1972, according to which the supply of goods is any transaction for consideration involving the transfer of ownership of goods of any kind - unless the special tax regime applicable to contributions of a plurality of real assets is applicable (discussed below).

Where such transactions relate to buildings and their appurtenances, Article 10(1) (8-bis) and (8-ter) of Presidential Decree No. 633 of 26 October 1972 will apply.

77 Pursuant to Articles 5, 5-bis and 8 of Legislative Decree No. 446 of 15 December 1997.

78 Pursuant to Article 1, paragraphs 137 and 140 of Law No. 296 of 27 December 2006. The substitute tax may be paid in annual instalments (maximum 5 of equal amount), plus interest. The first instalment must be paid by the deadline for the payment of the balance of income tax relating to the tax period in which the contribution takes place.

79 Resolution of the Italian Tax Authority No. 186/E of 5 May 2008.

80 Resolution of the Italian Tax Authority No. 186/E of 5 May 2008.

This rule, as is well known, provides, as a general rule, an exemption from VAT and then regulates the hypotheses of taxation ex lege and the hypotheses of taxation at the option of the transferor with consequent application of the reverse charge.

For these purposes, the qualification of 'construction or refurbishment company' for VAT purposes, developed by the practice of the Italian Tax Authority, is relevant.

In this regard, it should be noted that, in an unpublished Public Answer of 2021, the Italian Tax Authority confirmed that the real estate investment fund may be qualifies as a "construction or refurbishment company" for the purposes of the aforementioned Article 10.

With reference to "unfinished" buildings or buildings classified in the Land Registry in one of the 'F' categories, it will be necessary to verify the applicable regime for VAT purposes in light of the positions of the Supreme Court of Cassation and the Tax Administration[81].

If the supply relates to buildable land, it will be subject to VAT at the rate of 22%, without reverse charge, pursuant to Article 2(1) of 26 October 1972, No. 633[82].

With reference to registration, mortgage and cadastral taxes, it is necessary to examine separately the contribution and sale of real estate properties to the fund.

A deed of contribution for real estate properties to a real estate fund must be stipulated by means of a notarial deed[83] for the purpose of transcription of the transfer of ownership of the property in the land register (Article 2657 of the Civil Code).

81 The Italian Tax Authority has clarified that buildings in cadastral category 'F' must be considered excluded from the scope of Article 10 of Presidential Decree No. 633 of 1972 (nos. 8-bis) and 8-ter), being goods 'still in the productive cycle' ordinarily subject to VAT (Circular No. 18/E of 2013 (§ 3.3.4) referring to the principles already expressed in Circular No. 12/E/2007; Public Answers No. 241 of 4 August 2020 and No. 554 of 7 November 2022.
The Supreme Court has clarified that the sale of buildings under construction is subject to VAT only if the property remains in the ''productive cycle ''. On the contrary, if the building under construction is sold to a final consumer (Supreme Court, Decisions No. 23499 of 18 November 2016 and no 22138 of 22 September 2017) or to a leasing company (Supreme Court, Decision No. 34734 of 25 November 2022) the sale falls within the scope of Article 10 of Presidential Decree No. 633 of 1972 nos. 8-bis) and 8-ter).

82 The transfer of land that cannot be used for building purposes under the applicable provisions is excluded from the scope of VAT pursuant to Article 2(3)(c) of Presidential Decree No. 633 of 26 October 1972.

83 Public deed or private agreements with notarized signature.

For the purposes of registration tax, this deed is subject to compulsory registration within 30 days from entering into[84].

If the contribution concerns properties used in the conduct of business and are subject to VAT, including under an exemption or taxable regime, pursuant to Article 10, paragraph 1, No. 8-ter) of Presidential Decree 633/1972, or residential properties under a VAT tax regime pursuant to Article 10, paragraph 1, No. 8-bis) of Presidential Decree 633/1972, the contribution is subject to fixed registration tax (€ 200), rather than a proportional one (9%), by virtue of the principle of alternation application of VAT and registration tax established by Article 40 of Presidential Decree 131/1986.

On the other hand, if the contribution concerns residential property exempt from VAT pursuant to Article 10, paragraph 1, No. 8-bis) of Presidential Decree No. 633/1972 or is made by a person not acting as a VAT taxable person, the principle of alternativeness does not apply.

In this second hypothesis, the registration tax should be applied as a fixed amount (€200) pursuant to the combined provisions of Article 7 of the Schedule of Presidential Decree No. 131 of 26 April 1986 and Article 11, Tariff Part I, of Presidential Decree No. 131 of 26 April 1986.

In particular, for the purposes of Article 11 of the Tariff, public deeds and authenticated private agreements are subject to registration at the rate of €200 for which there is no obligation to apply for registration pursuant to the Schedule of Presidential Decree No. 131 of 26 April 1986.

The latter includes, in Article 7 of the Table, documents concerning the establishment of mutual investment funds and the subscription of their units.

This provision is applicable also to Real Estate funds in compliance with Article 9(1) of Law Decree No. 351/2001.

In this regard, the Italian Tax Authority has specified that the notion of deeds concerning the establishment or subscription of Real Estate funds also includes deeds related to the subscription made by means of contributions of real estate.

84 Since this is a notarial deed, the registration is performed by the notary electronically pursuant to Presidential Decree No. 308 of 18 August 2000. Pursuant to Article 3-ter of Presidential Decree No. 463 of 18 December 1997, the Italian Tax Authority controls the self-assessment of the tax executed at the time of registration and, within 60 days following registration, may serve on the notary a notice of assessment of additional registration tax, if, on the basis of the elements deducible from the deed, an additional tax is due. After 60 days from the registration of the deed, the notice of liquidation, if any, must be served on the contracting parties, who are jointly and severally liable to the Italian Tax Authority.

However, it should be noted that in 2011 the legislator made provision to repeal the tax benefits and the tax exemption regarding registration tax on the deeds pursuant to Article 1 of the Tariff, Part I, in Presidential Decree No. 131 of 26 April 1986, i.e. transfers of real estate for consideration[85], and such abrogation has raised some interpretational uncertainties.

In particular, Article 10(4) of Legislative Decree No. 23 of 14 March 2011 established in relation to deeds of transfer of property for consideration, all the exemptions and tax benefits were abolished, even if provided for under special laws.

In Circular Letter of the Italian Tax Authority No. 2/E of 21 February 2014, it has clarified that, as a result of this law, as from 1 January 2014, the rules providing the registration tax relief such as reductions in rates, fixed taxes or exemptions from the tax, for deeds transferring property for a consideration, shall no longer apply.

In the same Circular Letter, the Italian Tax Authority has specified that the tax relief referring to deeds other than those attributable to the transfer of ownership of real estate, i.e. deeds not included in Article 1 of the Tariff, Part I, of Presidential Decree No. 131 of 26 April 1986, will continue to apply.

In this regard, pursuant to Article 7 of the Table, the contribution of real estate to a Real Estate fund is not one of the deeds subject to mandatory registration of a fixed amount; from this perspective, the contribution of Real Estate to a Real Estate fund is not within the scope of Article 1 of the Tariff(deeds subject to mandatory registration in a fixed amount).

The Italian Tax Authority then indicated, in Circular Letter No. 2/E of 2014, certain tax benefit provisions that must considered repealed, from 1 January 2014, and a list of tax benefits that are instead considered to be still in force.

Among the rules reviewed by the Italian Tax Authority article 7 of the Table as cited above was not included.

Moreover, in the aforementioned Circular No. 2/E of 2014, the Italian Tax Authority stated that the abrogation provided by Article 10, paragraph 4, of Legislative Decree No. 23 of 14 March 2011 does not apply to tax rules that are functional to the regulation of particular institutions, which have a broad application, than can only potentially be referred to Real estate transfers, whether or not a consideration is paid.

85 Article 1 of the Tariff, Part One, of Presidential Decree No. 131 of 26 April 1986 refers to 'Deeds of transfer for consideration of ownership of immovable property in general'.

In view of the above, the exclusion from the obligation to register the contribution of real estate properties to a real estate fund, provided for by Article 7, should still be deemed applicable. Such exclusion, as mentioned above, according to Article 11 of the Tariff, implies that the notarial deed of contribution is subject to registration tax at a fixed rate (€ 200) rather than proportional one (usually 9%).

On this point, it should be noted that there are some tax disputes concerning the question whether Article 7 of the Table should be considered repealed.

In this regard, the Supreme Court in its recent judgment No. 3218 of 5 February 2024 stated, in summary, that Article 7 of the Table is still in force. This is the first pronouncement of the Supreme Court on the subject.

With regard to the mortgage and cadastral taxes on the contribution of real estate to the fund, the following is noted.

The mortgage tax is due for the transcription of the contribution deed in the real estate registers. Cadastral tax is due on cadastral registrations, to be made for each real estate property object of transfer.

In the case of deeds of contribution of instrumental real estate, the rates of the mortgage and cadastral taxes are respectively 1.5% and 0.5%, i.e. half of the ordinary rates[86] .

On the contrary, in the case of the contribution of residential property, if the transaction is exempt from VAT, the mortgage and cadastral taxes remain applicable according to the ordinary proportional rates (2% and 1%).

On the other hand, if the contribution of residential real estate is made under a VAT taxable regime, the mortgage and cadastral taxes will be applied at the fixed rate of € 200 each.

As regards the sale of real estate to the fund, the following is noted.

Generally, the sale of buildings to the fund is subject to registration tax at the fixed rate of €200, by virtue of the alternation application between VAT and registration established by Article 40, paragraph 1, of Presidential Decree No. 131 of 26 April 1986. Consequently, the notarial deed of sale will be registered at the Italian Tax Authority by paying the registration tax in a fixed amount.

86 Pursuant to Article 35, paragraph 10-ter, of Decree-Law No. 223 of 4 July 2006. In Circular Letter of the Italian Tax Authority No. 2/E, para. 9.6 of February 2014, it was clarified that the application of such provision must be deemed to be confirmed also following the entry into force of Article 10, paragraph 4, of Legislative Decree No. 23 of 14 March 2011, which, as noted above, established the abolition of the tax reliefs relating to certain types of deeds subject to registration tax.

The mortgage and cadastral taxes in the case of a sale of buildings for commercial use are proportionally applied: 1.5% (mortgage) and 0.5% (cadastral)[87].

In the case of residential buildings, mortgage and cadastral taxes are applied (except as described below) of a fixed amount of € 200 each (according to the note to Article 1 of the Tariff attached to Legislative Decree No. 347 of 31 October 1990 and Article 10(2) of Legislative Decree No. 347 of 31 October 1990).

However, if residential buildings are sold under a VAT exemption regime, the registration tax is applied at the rate of 9%[88] and the mortgage and cadastral taxes are applied at the fixed rate of €50 each[89].

Finally, in the case of 'unfinished buildings' at the time of contribution, it is necessary to consider the clarifications provided by the Italian Tax Authority and on the recent decisions of the Supreme Court. In light of the VAT regime applicable to such buildings (see above), the Italian Tax Authority[90] has clarified that, considering the alternative application between VAT and registration tax, registration, mortgage and cadastral taxes are due in a fixed amount (Euro 200 each) rather than on proportional basis[91]. On the contrary, if the sale of the 'unfinished building' were to be made to a final consumer or in any case resulted in the removal from the 'productive cycle', mortgage and cadastral taxes would be due at the proportional rate of 3% and 1%[92].

87 On such a point, it should be noted that the Court of Justice of the European Union, in its judgments in Joined Cases C-478/19 and C-479/19, affirmed that reduced transfer taxes would also apply to purchases and sales made by a real estate fund established in an EU Member State, regardless of whether the fund is of the closed or open-ended type, in light of the principle of free movement of capital set forth in Article 63, TFEU. This principle has also been implemented in the Court of Cassation's Judgements Nos. 28595 and 28810 of 3 October 2022.

88 Article 1 of the Tariff(I), attached to Presidential Decree 26 April 1986, No. 131.

89 Article 10 (3) Legislative Decree 14 March 2011, No. 23.

90 Circular Letter of the Italian Tax Authority No. 12/E of 12 March 2010, para 3.9; Circular Letter of the Italian Tax Authority No. 18/E of 29 May 2013, para. 3.3.3.

91 Circular Letter of the Italian Tax Authority No. 12/E of 12 March 2010, para 3.9. Public Answers No. 241 of 4 August 2020 and No. 554 of 7 November 2022.

92 See the aforementioned Decisions of the Supreme Court No. 23499 of 18 November 2016 and No. 22138 of 22 September 2017. On this point, it is also worth mentioning Public Answer No. 167/2022 regarding the sale between real estate AIFs of buildings originally intended for instrumental use, subject to renovation works already started by the transferor AIF aimed at converting such buildings from instrumental use to residential use. Due to the registration in the cadastral category F/4 ("*units under definition*"), the Tax Authorities clarified that '*the property maintains the nature it had before such provisional cadastral classification, i.e., instrumental na-*

The Italian Tax Authority has not expressly clarified whether such considerations are also applicable to 'buildings under renovation in particular with respect to buildings already enrolling the cadastre (other than cadastral category 'F').

6.6.3. VAT and transfer taxes in case of contribution of a plurality of mainly rented properties

A special tax regime is provided for contributions[93] to real estate funds of a plurality of real estate mainly rented at the time of the contribution. Pursuant to Article 8, paragraph 1-bis of Law Decree No. 351/2001, such contributions are treated for VAT purposes as contributions to companies having as their object a business[94] and, consequently, are excluded from the scope of application of VAT[95].

Such contributions are also subject to other indirect taxes (registration, mortgage and cadastral taxes) at the fixed rate of Euro 200 each[96].

The rule does not provide the criteria for verifying the existence of the requirements of 'plurality of properties' and 'prevalence of rental'.

The Italian Tax Authority has specified that the plurality exists if the contribution relates to two or more real estate units from the cadastral point of view[97].

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ture'. In this context, it held applicable the mortgage and cadastral taxes in the proportional rates of 3% and 1%.

93 Not for the sale.

94 See Italian Tax Authority's Circular No. 22/E of 19 June 2006, section 2.2; Studio del Consiglio Nazionale del Notariato n. 46-2015/T, section No. 4.3; Assonime, Circular 1 March 2005, No. 10.

95 Pursuant to Art. 2, paragraph 3, letter b) of Presidential Decree no 633/1972.

96 Pursuant to Article 8 (1-bis) of Decree-Law No. 351/2001, which refers to Article 4(1)(a)(3) of the Tariff, part I, of Presidential Decree No. 131/1986; to Article 10(2) of Legislative Decree No. 347/1990 and to Article 4 of the Tariff annexed to the same Legislative Decree. It should be noted that Article 10, paragraph 4, of Legislative Decree No. 23/2011, as amended by Article 1, paragraph 608, of Law No. 147/2013, and subsequently, by Article 13, paragraph 3 of Decree-Law No. 47/2014, converted with amendments by Law No. 80/2014, provided for the abolition of all tax exemptions and tax reliefs, even if provided for in special laws, concerning the deeds subject to registration tax. In this regard, the Circular of the Italian Tax Authority dated 21 February 2014, No. 2/E, section 9.6, clarified that, with reference to Article 8, paragraph 1-bis, of Decree-Law No. 351/2001, the abolition repealing Article 10, paragraph 4, of Legislative Decree No. 23/2011 does not apply.

97 Circular of the Italian Tax Authority of 19 June 2006, No. 22/E, section 2.2.1.

The Italian Tax Authority has also clarified that *'the requirement of multiple properties also applies to a single building for special use which, although registered in the Land Register as a single property unit, is composed of several portions capable of producing income independently*[98]*, as in the case of a building used as a shopping centre and classified at the Land Registry in category D/8 - considering that the individual portions of the building are leased separately'*.

On the prevalence requirement, the Italian Tax Authority clarified that this exists if the ratio of the actual value of the leased real estate units to the total value of the contributed real estate units is more than 50 per cent[99].

It should also be noted that, for the purposes of the rental requirement, it is not required that the real estate shall be leased to several tenants: the requirement is deemed to be met even if the real estate is leased to only one tenant.

In relation to the contribution of a plurality of mainly leased real estate, the Italian Tax Authority confirmed the transferability to the fund of the VAT credit related to the transferred real estate and accrued before the contribution[100].

As mentioned above, in 2011 a rule was introduced that abrogated the tax benefits in respect of the registration tax on the deeds referred to in Article 1 of the Tariff, Part I, of Presidential Decree No. 131 of 26 April 1986, i.e. transfers of real estate for consideration. The Revenue Agency has confirmed that this repeal does not concern the regime set forth in Article 8, Paragraph 1-bis of Decree-Law No. 351/2001, relating to the contribution to real estate funds of a plurality of mainly leased properties[101].

In its decision No. 15319 of 2013[102], the Supreme Court addressed the indirect taxes applicable to a transaction involving the contribution to a real estate fund of a plurality of mainly leased properties, with the simultaneous assumption of a financing debt amounting to approximately 9/10 of the val-

98 Circular of the Italian Tax Authority of 19 June 2006, No. 22/E.

99 Therefore, for the purposes of the prevalence requirement, the ratio of leased to non-leased area would not be relevant per se.

100 Public Answer No. 71/2018.

101 Circular No. 2/E of 21 February 2014, section 9.6.

102 Supreme Court of 19 June 2013, No. 15319.

ue of the properties[103], followed by the sale of the totality of the fund's shares resulting from the contribution.

The decision concerned the reclassification of the transaction as the sale of real estate, with the consequent disallowance of the mortgage and cadastral taxes at a fixed rate and the application of the same at a pro-rata rate - moreover, at the ordinary rates of 3% and 1% instead of the reduced rates of half (1.5% and 0.5%) provided for real estate fund transactions.

It should be noted that this decision concerns rules that differ, at least in part, from those in force.

The requalification was carried out by the Italian Tax Authority by virtue of Article 20 of Presidential Decree No. 131/1986 on registration tax, also applicable to mortgage and cadastral taxes, concerning the interpretation of deeds[104].

According to the Supreme Court, Article 20, as interpreted at the time of the litigation, allowed the tax authorities to examine all the contracts in the transaction and to re-qualify the transaction as a whole on the basis of the real cause and the interests pursued by the parties.

Based on this approach, the deed was reclassified as a 'sale of real estate'.

The Supreme Court upheld the conclusions reached by the Italian Tax Authority, except for granting the reduction to half of the mortgage and cadastral tax rates provided for transactions in which real estate funds are a party.

The decision notes the circumstance that the bank loan with the banks was signed by both the contributing company and the SGR that managed the fund.

The relevant debt was then transferred to the real estate fund by way of assumption at the same time as the contribution of the real estate.

The Supreme Court highlights the fact that the debt arising from the financing and assumed by the fund was equal to 9/10 of the contribution value of the real estate.

Thus, according to the decision, the contributor immediately received consideration in cash for the transfer of the real estate to the fund. In this regard, the decision also notes that the shares obtained for the contribution

103 The SGR was part of the financing agreement.

104 As discussed below, the interpretation of this rule was changed by an intervention of the legislature at the end of 2017.

were immediately transferred to third parties on the basis of previous contractual agreements.

The decision states, in particular, that the contributing limited liability company "always remained outside the Fund and never became a 'participant', since it immediately obtained, as consideration for the transfer of the assets, the discharging assumption ("accollo liberatorio") of the financing (for an amount equal to more than nine-tenths of the entire value of the real estate transferred) and only in a much smaller percentage, shares in the fund, moreover, immediately disbursed, according to previous commitments, to other participants in the Fund and investors".

In this regard, it should be noted that Article 20 (on which the Supreme Court ruled in the decision under comment) was amended between 2017 and 2018[105]. In a nutshell, it is now confirmed that the registration tax applies to the legal effects of the deed submitted for registration, irrespective of elements external to the deed and any related contracts - contrary to what was held in the decision under review.

In a nutshell, Art. 20 does not permit the reclassification of a deed on the basis of elements not related to that deed or on the basis of related contracts.

This does not affect the Italian Tax Authority's power to challenge complex economic transactions on the basis of the general anti-abuse rule set out in Article 10-bis of Law No. 212/2000.

It should be noted that a constitutional legitimacy question was raised in 2020 concerning such a provision: however, this was later declared groundless by the Constitutional Court[106]. In addition, the Supreme Court made a preliminary reference to the Court of Justice pursuant to Article 267 TFEU with Order No. 10283 of 31 March 2022, submitting the question whether this provision is compatible with the rules of the European Union. This proceeding was declared inadmissible by the Court of Justice. Such a decision should have definitively settled the dispute on the interpretation of deeds for registration tax purposes under Art. 20.

105 The amendment to Article 20 was made by Article 1, Paragraph 87(a)(1) and (2) of Law No. 205/2017 (Budget Law 2018) and is effective as of 1 January 2018. Pursuant to Article 1, paragraph 1084, L. 145/2018 (Budget Law 2019), the above-mentioned provision constitutes a rule of authentic interpretation of Article 20.

106 Constitutional Court, Decision No. 158 of 21 July 2020. See also the subsequent Constitutional Court Judgment No. 39 of 16 March 2021.

6.7. Reorganization of real estate funds

The Italian Tax Authority provided some guidelines on the tax regime applicable to a transaction of "aggregation" of real estate alternative investment funds. In the case examined, relating to funds established in Italy and managed by the same fund manager (SGR), the Tax Authority confirmed the tax neutrality of the transaction both for income tax purposes (for the funds and the investors) and for transfer taxes (registration tax, mortgage tax and cadastral tax).

For the purposes of direct taxes, the Italian Tax Authority confirmed that the transaction is not subject to taxation, neither at the level of the real estate funds participating in the "aggregation", given the exemption of the fund from income taxes, nor at the level of the investors, as they do not realize any of the income provided by the Income Tax Code in the case of participation in investment funds.

For VAT purposes, the Italian Tax Authority stated that the transaction of aggregating the assets of different real estate funds, managed by the same SGR, involves an "internal transfer of assets" between separate businesses. This is because, in the case of real estate funds, the taxable person for VAT purposes is the SGR and not the individual fund. As a result, such a transfer would be excluded from the scope of the VAT, except in the case where the properties are transferred to a fund having a right to deduct VAT lower than the original fund (under the so-called pro-rata rule).

On this point, however, the Italian Tax Authority did not provide any further considerations.

The Tax Authority, moreover, confirmed the applicability of the transfer taxes (registration, mortgage and cadastral taxes) in the fixed amount of 200 euros each, as the "aggregation" of real estate funds managed by the same SGR represents a "merely organizational transaction".

Although the Italian Tax Authority's clarifications concern an aggregation transaction between real estate funds, the same tax considerations should be relevant, if certain conditions are met, also for aggregation transactions of compartments of the same fund and for the "spin off" of real estate funds.

7.
Real Estate SICAF

by G.A. Giannantonio, G. Bighignoli

7.1. Overview

The investment company with fixed capital (SICAF) is defined by Legislative the Consolidated Law on Finance as the closed-end undertaking for collective Investment (OICR) established in the form of a joint-stock company (società per azioni) with fixed capital, with its registered office and place of management in Italy, having as its exclusive purpose the collective investment of the funds raised through the offer of its shares[1], which , as will be explained in more detail below, can directly manage its own assets (qualifying, at the same time, both as an AIF and an asset manager), or entrust their management to an asset management company (SGR) or EU alternative investment fund manager (GEFIA).

The SICAF was introduced in Italy with Legislative Decree No. 44 of 4 March 2014, which transposed Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ('**AIFMD**'), amending the Consolidated Law on Finance[2]. The SICAF qualifies, for the purposes of that Directive, an alternative investment fund (AIF)[3].

1 And other participatory financial instruments. Regarding the definition of "SICAF" and "externally-managed SICAF" see Article 1(1)(*i-bis*) and (i-bis.1), TUF as respectively amended and inserted by Article 16 of Law No. 21/2024.

2 On this subject, see F. Annunziata, *La Sicaf nel quadro degli schemi organizzativi degli Oicr*, tra disciplina interna e UE, in F. Annunziata-M. Notari (ed.), *Le SICAF. Profili societari e regolamentari,* Egea, Milan, 2021, pp. 26 ff.

3 With regard to the criteria for preparing the financial statements of SICAFs, please refer to the following publications: Bank of Italy, Regulation on Collective Investment Management, Annex IV.6.3-bis "Financial statements of investment companies with fixed capital (SICAFs)"; Bank of Italy, Regulation on Collective Investment Management, Title IV, Chapter V "Financial statements of UCITS"; S.P. Rossi-G. Strampelli, Il bilancio delle Sicaf (multi comparto), in F. Annunziata-M.

The SICAF provisions were introduced to align the Italian jurisdiction with the practice of other European jurisdictions, where the company scheme is used in *private equity* and real estate sectors[4].

Under the Legislative Decree No. 44/2014, the SICAF qualifies as "real estate SICAF" if it invests '*in real estate assets in the measures indicated by* civil *law provisions*'[5].

As in the case of mutual funds, reference should be made to Article 12 of Decree No. 30 of the Ministry of Economy and Finance of 5 March 2015[6].

In terms of asset management, the SICAF may be, alternatively, self-managed (if authorised by the Bank of Italy to carry out this activity directly) or externally-managed (in which case the SICAF will appoint an external manager authorised to provide collective management services, i.e., in brief, an SGR[7] or an EU AIFM[8]).

Certain changes to the SICAF regime were introduced by the s.c. Capital Law (Legge Capitali), which provides for measures to support the competitiveness of capital[9], and which, in Article 16, provides for the "*simplification of the supervisory regime for SICAVs and SICAFs externally managed*".

These provisions have amended the Consolidated Law on Finance (TUF) in order to simplify the regulations applicable to these entities. In particular, the "Capital Law" has clarified that externally-managed SICAFs are not included among the entities authorised to carry out collective asset management and has therefore aligned the regulations applicable to these entities with the (simpler) regulations provided for mutual funds.

Among the most important changes, it should be noted that the provisions governing the authorisation for the establishment of SICAFs and the related requirements - also in terms of the qualifications of company representatives and shareholders - no longer apply to externally-managed SICAFs. The establishment of reserved externally managed SICAFs may therefore occur - similarly to what happens to joint-stock companies - regardless

Notari (ed.), op. cit., pp. 191 ff; P. De Biasi, Appunti sulla redazione del bilancio da parte di una Sicaf, in Le Società, 7/2018, pp. 885 ff.

4 F. Annunziata, *La disciplina del mercato mobiliare,* Giappichelli, Turin, 2016, p. 245.

5 Art. 9, Legislative Decree No. 44 of 4 March 2014.

6 See Chapter 6, Section 6.1.

7 Article 1(1)(o), TUF.

8 Article 1(1)(p), TUF.

9 Law No. 21 of 5 March 2024.

of any scrutiny by the supervisory authorities, with a substantial reduction of the time needed for these vehicles to become fully operative. The only exception regards non-reserved externally managed SICAFs, for which, notwithstanding the non-applicability of the authorisation procedure, a preliminary screening of the statute by the Bank of Italy continues to be carried out, as is generally the case for non-reserved funds.

With particular reference to self-managed multi-compartment SICAFs, the Capital Law clearly sets forth the principle of asset separation between the SICAFs' compartments, introducing a limitation of the company's liability for obligations incurred on behalf of the various compartments, provided that the activities carried out in relation to the management of the different compartments expressly mention the compartment concerned. In this regard, it is expressly stated that the distribution of income relating to a single compartment could take place even in the absence of overall corporate profits, with the consequence that losses relating to a compartment are exclusively attributed to the assets of the same compartment and within the limits of the value of the same.

Conversely, with regard to multi-compartment externally managed SICAFs, the amended Article 38 of the TUF merely specifies that each "*compartment constitutes an autonomous patrimony, distinct in all respects from that of the other compartments*", without providing a detailed regulation of the liability regime for the obligations of the compartments.

Further amendments to the regulations governing SICAFs as provided for by the TUF are currently under discussion.

7.2. The tax framework regarding the real estate SICAF framework

The tax regime of real estate SICAFs is outlined in Article 9 of Legislative Decree No. 44/2014, by way of reference to the tax rules on real estate investment funds established under Italian law.

Under Article 9(1) of Legislative Decree No. 44/2014, the following apply to real estate SICAFs:

- Articles 6 et seq. of Decree-Law No 351 of 25 September 2001 on the tax regime for real estate funds and their investors;
- Article 32 of Decree-Law No. 78 of 31 May 2010, which regulates the distinction for tax purposes between 'institutional' and 'non-institutional' real estate funds and the tax treatment of the Investors;

- Article 35(*10-ter)* of Decree-Law No. 223 of 4 July 2006, which provides for the reduction to half (2%) of the mortgage and cadastral taxes for transactions involving non-residential properties if a real estate fund is a party of the transaction;
- Article 1(140) of Law No 296 of 27 December 2006, on the substitute tax on capital gains realised upon the contribution of real estate assets Into a fund;
- Article *14-bis* of Law No. 86 of 25 January 1994, which provides for the application of a fixed transfer tax of €516.46 for transfers of public properties in lieu of ordinary registration, mortgage and cadastral taxes.

7.3. The real estate SICAF's income tax regime

7.3.1. Corporate income tax exemption

The real estate SICAF, as a collective investment undertaking (i.e. OICR) established in Italy, qualifies as a person resident in Italy for the purposes of the corporate income tax ("IRES"), pursuant to Article 73, paragraph 1, letter c) and paragraph 3 of the Income Tax Code[10] - like the real estate investment fund.

As noted in Chapter 6, the inclusion of OICRs among IRES taxpayers has made it possible to overcome the interpretative doubts, which had arisen in the past, on the applicability to OICRs of double tax treaties, given that these apply to persons that are considered resident for tax purposes in one of the two contracting states[11].

Although the real estate SICAF is a taxable entity for IRES purposes, it is exempt from the tax (24%) pursuant to the abovementioned Article 6 of Legislative Decree No. 351 of 25 September 2001 ("Decree 351")[12] - like real estate investment funds established in contractual form.

As discussed below, for the purposes of the regional tax on productive activities ("IRAP"), however, the SICAF differs from the real estate fund.

10 Following the amendment introduced by Article 96(1)(a) of Decree-Law No. 1 of 24 January 2012, converted into Law No. 27 of 24 March 2012.

11 A. Ballancin, *Riflessioni sull' acquisita soggettività tributaria degli OICR*, in *Diritto e pratica tributaria internazionale,* No. 3/2013, pp. 707 ff.

12 Converted, with amendments, into Law No. 410 of 23 November 2001. However, Article 3(2) of Legislative Decree No. 446/1997 excludes UCITs, other than SICAVs, from the group of persons subject to IRAP. The ordinary IRAP rate of 3.9 per cent may be subject to change, pursuant to Article 16(3) of Legislative Decree No. 446/1997.

Moreover, real estate SICAFs are not subject to most withholding taxes generally applicable to financial income (e.g., dividends) - again pursuant to Article 6(1) of Decree-Law No. 351/2001 on real estate funds.

The Tax Authority has confirmed that real estate OICRs - therefore, also the SICAF - are not subject to withholding tax on dividends distributed by companies resident in Italy for tax purposes[13].

7.3.2. The institutional real estate SICAF

The IRES exemption applies "in any event", under Italian tax law, if the real estate SICAF is participated exclusively by investors that qualify as "institutional" for tax purposes pursuant to paragraph 3 of Article 32 of Decree-Law No. 78/2010; the latter rule is provided for the real estate funds and is applicable to real estate SICAFs by virtue of the reference made by Article 9 of Legislative Decree No. 44/2014.

'In any event' means, in brief, '*regardless of any assessment of the legal requirements of management autonomy [of the fund manager] and plurality of participants [in the SICAF]*' as clarified by the Tax Authority in Circular No. 2/E of 2012 with reference to real estate funds.

Institutional investors for the purposes of this tax regime are identified in Article 32(3) of Decree-Law No. 78/2010 (see Chapter 6, Section 6.3.2):

- State and Italian public entities;
- undertakings for collective investment (OICRs under Italian law: investment funds and SICAFs);
- pension schemes and pension funds;
- insurance undertakings, if the investment is intended to cover technical provisions;
- banking and financial intermediaries established under Italian law, provided that they are subject to supervision;
- foreign investors, under certain circumstances. In particular, investors comparable to one of the entities above and established in a State that allows an adequate exchange of information for tax purposes ("*White-List*" - Ministerial Decree of 4 September 1996, as updated on 23 March 2017)[14] ;

13 Revenue Agency Circular No. 47/E of 8 August 2003, paragraph 3.3. See Part I, paragraph 2.1.

14 Article *168-bis* of the Consolidated Income Tax Law (TUIR), to which Article 32, Paragraph 3

- investment vehicles, established in corporate or contractual form, in which the above-mentioned entities hold an interest of more than 50%.

Institutional investors include, for example, foreign investment funds on the dual condition that they are established in a *White-List* State *and have the same substantive characteristics* as Italian OICRs.

The Tax Authority has provided guidelines regarding the requirements for qualifying a foreign investment fund as an institutional investor for tax purposes: in this regard, please refer to paragraph 6.3.2 of Chapter 6.

In short, this category includes foreign funds that (i) according to the law in force in the foreign State where they are established, have the same substantive characteristics and investment purposes as Italian OICRs, regardless of their legal form and their tax status in the State of establishment, (ii) are subject to supervision, either on the fund or the fund manager, and (iii) are established in a White List State[15].

7.3.3. The 'non-institutional' real estate SICAF

For SICAFs that are also (or only) participated in by non-institutional investors, the above-mentioned rule providing for IRES exemption 'in any case' will not apply.

However, the SICAF will be still exempt from IRES, provided that it meets the legal requirements for qualification as an OICR for regulatory purposes.

The Tax Authority has provided guidelines on such requirements with reference to real estate funds, while no specific guidelines have been provided with respect to real estate SICAFs[16] .

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of Decree-Law No. 78 of 31 May 2010 refers, was repealed by Article 10, Paragraph 1 of Legislative Decree No. 147 of 14 September 2015 (effective as of the 2015 financial year). The aforementioned Article 10 of Legislative Decree No. 147/2015 in paragraph 3 dictates, moreover, a coordinating provision by providing that: "When laws, regulations, decrees or other rules or measures refer to the list of States and territories that allow an adequate exchange of information referred to in paragraph 1 of Article *168-bis* of the Income Tax Consolidation Act approved by Presidential Decree No. 917 of 22 December 1986, in force prior to the date of entry into force of this Decree, the reference shall be construed as referring to the decrees issued in implementation of Article 11, paragraph 4, letter c), of Legislative Decree No. 239 of 1 April 1996". Pending the issuance of such decrees, reference must be made to the list contained in the Ministerial Decree of 4 September 1996 for the identification of the States permitting an adequate exchange of information (*White List*).

15 Revenue Agency Order of 16 December 2011; Revenue Agency Circular of 9 March 2011, No. 11/E; Revenue Agency Circular of 15 February 2012, No. 2/E, par. 3; Revenue Agency Resolution of 18 July 2013, No. 54/E.

16 Revenue Agency Circular No. 2/E, par. 1 of 15 February 2012 issued before the introduction

7.3.4. The real estate SICAF and IRAP

For IRAP purposes, real estate SICAFs, unlike real estate funds, are persons subject to tax according to the rules provided for non-real estate OICR (i.e. SICAVs), pursuant to Article 9(3) of Legislative Decree No. 44/2014.

In a nutshell, the tax base consists of the difference between *underwriting commissions* and *commission expenses payable* to placement agents, net of specific deductible charges[17].

The rate is, as a rule, 4.65%[18], given the reference to the SICAV rules.

It is interesting to note that, while Article 9(1) of Legislative Decree No. 44/2014 recalls the entire Article 6 of Decree-Law No. 351/2001, which provides that real estate funds - and therefore real estate SICAFs - are not subject to IRAP, on the other hand, under Article 9(3) the SICAFs are subject to IRAP.

Therefore, with respect to IRAP, there is a potential difference between a real estate fund and a real estate SICAF, since the latter may be subject to IRAP if it realizes the tax base above.

7.4. VAT aspects of the real estate SICAF

7.4.1. VAT aspects of the real estate SICAF's activities

The real estate SICAF, as a joint-stock company carrying out an economic activity, qualifies for VAT purposes as an autonomous taxable person, distinct from the fund manager (i.e. the SGR or the EU AIFM) that manages it, pursuant to Article 9 of Directive 2006/112/EC and Article 4 of Presidential Decree No. 633 of 26 October 1972.

This is a clear difference with respect to the VAT regime of the real estate fund established as contractual fund (fondo comune d'investimento): in fact, the real estate fund is not an autonomous taxable person for VAT purposes and the fund manager (e.g. SGR) qualifies as the taxable person for the fund's transactions (see Chapter 6, paragraph 6.4).

of the SICAF in the Italian legal system. Should the SICAF not meet the statutory and regulatory requirements to be qualified as an OICR, it would be subject to IRES and IRAP as a commercial joint-stock company.

17 Pursuant to Article 3(2)(a) and Article 6(4) of Legislative Decree No. 446 of 15 December 1997.

18 Art. 16, paragraph *1-bis*, letter b) of Legislative Decree No. 446/1997 and Art. 2, paragraph 1, letter b), No. 2), Decree-Law No. 66 of 24 April 2014 and Art. 1, paragraph 22, Law No. 190 of 23 December 2014. It being understood that each Region may provide for a different rate.

And this is even if the aforementioned Article 9 of Legislative Decree No. 44/2014 extends to the real estate SICAF Article 8 of Legislative Decree No. 351/2001, according to which the fund manager, rather than the fund, is the taxable person for VAT purposes.

This is also confirmed by the guidelines of the Tax Authority[19], where it has been noted that the real estate SICAF is an independent taxable person for VAT purposes even in the presence of an SGR acting as external fund manager. Therefore, the tax liability of the SICAF for VAT purposes exists both in the case of a self-managed SICAF and in the case of an externally managed SICAF[20].

Consequently, for VAT purposes, the transactions of the externally managed SICAF are not included in the fund manager VAT return, unlike in the case of a contractual real estate fund.

The last sentence of Article 8 of Decree-Law No. 351/2001 provides for special rules for the refund of VAT credits of real estate funds, applicable also to real estate SICAFs by virtue of the reference contained in Article 9(1) of Decree-Law No. 44/2014[21].

The rules described above will apply irrespective of the management model adopted by the real estate SICAF, since, as noted above, for VAT purposes the SICAF is a separate taxable person from the manager.

Therefore, these rules will apply in the case of a self-managed real estate SICAF, in the case of a real estate SICAF managed by an Italian fund manager (SGR) and in the case of a real estate SICAF managed by an EU fund manager (EU AIFM).

The SICAF, as a VAT taxable person, may in principle alternatively opt for the VAT group settlement regime as consolidating entity[22] or adhere to the VAT group regime, pursuant to Article *70-bis* et seq. of Presidential Decree No. 633/1972, if the relevant requirements are met[23].

19 Reply to Interrogation No. 74 of 24 February 2020.

20 This qualification is, moreover, consistent with the absolute presumption of liability for VAT purposes laid down for public limited companies in Article 4(2) of Presidential Decree No 633/1972.

21 As referred to in Article 30(3)(c) of Presidential Decree No. 633/1972. See Revenue Agency Circular No. 2/E of 15 February 2012, par. 8; Revenue Agency Circular No. 47/E of 8 August 2003.

22 Although there is no public practice clarification on this point.

23 With its Reply to Interrogation No. 374 of 17 September 2020, the Revenue Agency provided clarifications on the participation of a real estate SICAF in a VAT Group, ruling on a case concerning the transformation of a limited liability company participating in a VAT Group into a

7.4.2. Considerations on the SICAF as VAT taxable person

Recognition of the real estate SICAF's liability for VAT, which excludes the fund manager's liability for the transactions of the SICAF managed by it, implies, inter alia, that any VAT credit of the externally managed SICAF cannot be recovered by offsetting it against the VAT payable - or other tax debts, under certain conditions - of the real estate funds managed by the same fund manager of the SICAF.

Similarly, any VAT credit of a sub-fund of an externally managed SICAF may be recovered by offsetting it against the VAT payable by the other sub-funds of the same SICAF, while it may not be recovered by offsetting it against the VAT payable by the real estate funds managed by such fund manager.

In addition, tax proceedings relating to real estate funds managed by the fund manager which manages the SICAF do not affect the reimbursement of VAT (or other taxes) to the SICAF, since in its relations with the Tax Authority the SICAF will have its own VAT registration number different from that of the fund manager, unlike real estate funds (see Chapter 6, paragraph 6.4.1).

From another point of view, it is interesting to note that in the current national VAT system there coexist a real estate undertaking for collective investment that qualifies as an autonomous taxable person (the SICAF) and a real estate undertaking for collective investment that does not qualify as an autonomous taxable person (the contractual fund). As noted briefly in Chapter 6, the issue of the qualification of the funds as taxable persons for VAT purposes had been discussed by the scholars at the time of the introduction of funds into Italian law by Law No. 77 of 23 March 1983: at the time, the thesis that excluded the Inclusion of the funds among the taxable persons for VAT purposes prevailed[24] .

7.4.3. Real estate SICAF and separation of activities for VAT purposes

With reference to the separation of activities for VAT purposes pursuant to Article 36(1) of VAT Law, reference can be made, first of all, to the considerations regarding real estate funds (see Chapter 6, Section 6.4.3).

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multi-compartment real estate SICAF.

24 See, *ex multis,* F. Gallo, *Il problema della soggettività ai fini IVA dei fondi comuni di investimento*, in *Riv. Dir. Fin.*, 1987, p. 502 ff. On this point, see also A. Giovannini, *Soggettività tributaria e fattispecie impositiva*, Padua, 1996, p. 411 ff.

Moreover, it should be noted that, with reference to the case of the multi-compartment real estate SICAF, the Tax Authority[25] has stated that the SICAF must opt for each sub-fund for the regime of segregation of activities under Article 36, paragraph 3, of VAT Law: VAT is determined for each compartment independently, through separate accounting for VAT purposes, while the SICAF, as the sole taxable person, will determine cumulatively the VAT to be paid or the VAT credit after having offset the VAT position of the compartments.

In fact, the separate determination of VAT for each compartment should derive, first of all, from Article 8 of Decree-Law No. 351/2001 - also applicable to real estate SICAFs - which provides for the 'separate determination' of VAT for each fund or compartment, since they are separate and autonomous pool of assets.

Therefore, the multi-compartment real estate SICAF, as a VAT taxable person, is required to fulfil the following obligations:

- determining and settling VAT separately for itself and for each compartment set up, keeping separate accounts, i.e. separate registers, invoices with separate numbering series and separate records of transactions;
- make a single cumulative payment of the VAT due by the company itself and by the individual subdivisions, first offsetting the debit and credit balances resulting from the individual accounts;
- submit a single annual VAT return, as a single taxable person, by completing as many forms as there are separate accounts set up.

7.4.4. The VAT regime of the management fees of real estate SICAFs

In principle, the management activity of the SICAF is exempt for VAT purposes, pursuant to Article 10(1)(1) of VAT Law.

In this regard, it should be recalled that the management activity may be carried out either by an external manager (SGR or EU AIFM) or by the SICAF itself if authorised as fund manager.

The tax considerations outlined in Chapter 6 on this matter are applicable also to the SICAF.

25 Reply to Interrogation No. 74 of 24 February 2020.

7.5. The taxation of the investors (shareholders)

7.5.1. Overview

The income taxation system for real estate SICAFs provides, as for real estate funds, for the exemption of income at the level of the SICAF and the taxation of the same at the level of the shareholders, i.e. the investors, with different tax regimes depending on the characteristics of each shareholder - except for the cases of tax exemption provided for certain investors (discussed below).

Income related to the participation in the real estate SICAF, as an undertaking for collective investment, is:

- income from participation in the SICAF[26];
- capital gains realised through the sale of shares[27], as well as those realised through the conversion (*switch*) of shares from one compartment to another compartment of the same SICAF[28] .

7.5.2. The taxation of dividends distributed to shareholders resident in Italy

Dividends distributed by the real estate SICAF to investors resident in Italy that qualify as 'institutional investors' pursuant to Article 32(3) of Decree-Law No. 78/2010 are generally subject to a 26% withholding tax, regardless of the percentage of participation in the SICAF.

The withholding tax does not apply to pension funds and undertakings for collective investment (OICR) established in Italy, pursuant to Article 7, paragraph 2, of Decree-Law No. 351/2001, applicable to the SICAF under Article 9 of Decree-Law No. 44/2014.

In the case of 'institutional investors' that qualify as persons resident in Italy for IRES purposes (other than undertakings for collective investment-OICR), such as, for example, banks and financial intermediaries, the withholding tax is levied as an advance with respect to IRES (which has a rate of 24%).

26 Referred to in Article 44(1)(*g)* of the TUIR.

27 Referred to in Article 67(1)(*c-ter*) of the TUIR.

28 Pursuant to Article 67(*1-quater)* of the TUIR.

The withholding tax is applied, at the time of distribution of the proceeds, by the SICAF[29] or by the entity with which the shares are deposited[30] , pursuant to Article 7(1) of Decree-Law No. 351/2001.

If the real estate SICAF established in Italy is managed by an EU fund manager (EU AIFM), under the 'passport' regime, the withholding tax under review is applied directly by the foreign fund manager. Alternatively, the foreign manager may appoint a tax representative in Italy for compliance with the withholding tax obligations[31].

Dividends distributed by the real estate SICAF to investors resident in Italy who do not qualify as "institutional investors" within the meaning of Article 32, paragraph 3, of Decree-Law No. 78/2010 are subject to taxation as if the SICAF was fiscally transparent, if the participation is higher than 5%, or to the 26% withholding tax, if the participation is equal to or less than 5%.

In brief, dividends distributed by the real estate SICAF to shareholders resident for tax purposes in Italy are subject to the same tax regime provided for income from participation in real estate contractual funds (see Chapter 6, paragraph 6.5.2).

7.5.3. The taxation of dividends distributed to non-Italian resident shareholders

Dividends distributed by the real estate SICAF to non-italian resident investors are subject to the following tax regime:

- in principle, such dividends are subject to a 26% withholding tax (Article 7(1) of Decree-Law No. 351/2001);

29 See Article 7(1) of Decree-Law No. 351/2001, to which Article 9 of Decree-Law No. 44/2014 refers. Moreover, with reference to OICRs, Article *26-quinquies*, paragraph 1 of Presidential Decree No. 600/1973 expressly identifies, as withholding agents required to apply the withholding tax on capital income deriving from participation in OICRs, *inter alia,* SICAFs, in their capacity as issuers of the securities subscribed.

30 In the event that the shares of the SICAF are placed in a centralised deposit system managed by a company authorised pursuant to Article 80 of the TUF, the withholding tax is instead applied by the intermediaries with whom the shares are deposited, directly or indirectly members of such centralised deposit system, as well as by non-resident entities (typically intermediaries) members of such centralised deposit system or foreign centralised deposit systems, which are in turn members of the same system. In the latter case, non-resident intermediaries are required to appoint a so-called 'tax representative' in Italy, who is responsible for fulfilling the obligations of substitute tax.

31 Article 14(2) of Legislative Decree No. 44/2014, amending Article 7 of Legislative Decree No. 351/2001.

- the rate of the withholding tax may be reduced under a Double Tax Treaty between Italy and the State of residence of the investor, if applicable (Article 7, paragraph 3-bis, Decree-Law No. 351/2001)[32];
- the withholding tax does not apply in the case of income distributed to the following parties (these are the same investors who benefit from the exemption from withholding on income distributed by real estate funds pursuant to Article 7, Paragraph 3 of Decree-Law No. 351/2001):
  - pension funds and collective investment undertakings established in a *White-List* State;
  - sovereign wealth funds;
  - international bodies or organisations set up under international agreements made enforceable in Italy (e.g. the European Investment Bank[33];
  - central banks.

For non-resident shareholders, on the other hand, the SICAF is not considered fiscally transparent (while this could be the case for certain shareholders resident in Italy).

In brief, dividends distributed by the real estate SICAF to non-resident investors are subject to the same tax regime of the profits distributed by real estate funds.

For further details on the requirements for the withholding tax exemption see Section 6.5.3 of Chapter 6.

With respect to the qualification for tax treaty purposes of the income distributed by the real estate SICAF, the Revenue Agency has not provided any clarification. With respect to the income distributed by a real estate fund, the Tax Authority has stated that, in the absence of a specific provision in the applicable Double Tax Treaty[34], such income falls within the category

32 For the purposes of applying any reduced conventional rate, the SICAF or its manager must acquire (Revenue Agency Circular No. 11/E of 9 March 2011):

- a declaration issued by the non-resident party indicating the identification data of the party, the existence of the conditions to which the application of the conventional regime is subject and the elements necessary to determine the extent of the lower rate;
- a certificate from the tax authority of the foreign State certifying the residence of the income recipient for the purposes of the Convention.

33 For a list of these entities, see the annex to the Note of the Ministry of Finance prot. No. 14/942925 of 1 June 1994 and Circular No. 11/E of 28 March 2012, par. 2.1.

34 For example, pursuant to Article 10(6)(b) of the Convention between Italy and Germany signed on 18 October 1989, ratified by Italy by Law 459 of 24 November 1992 and entered into Law No. 459 force on 26 December 1992, income relating to investment funds qualifies as "dividends".

of 'interest' (Article 11 of the OECD Model Convention)[35].

In the case of the SICAF, it must be considered that it is both an OICR, like the fund, and a company which distributes dividends, unlike the fund.

Following the Tax Authority's thesis, the income distributed by the real estate SICAF should be qualified as interest for the purposes of the Double Tax Treaties, not as dividends, given that it is income from participation in an undertaking for collective investment (OICR) in the same way as that distributed by real estate funds - subject to any different qualification provided for by a Treaty.

Table 5 - Tax regime applicable to income distributed by real estate SICAFs

	Participation ≤ 5%.	Participation > 5%.
Institutional resident investors (other than pension funds and OICRs)	Withholding tax 26% (Art. 7, Decree-Law No. 351/2001)	Withholding tax 26% (Art. 7, Decree-Law No. 351/2001)
Non-institutional resident investors	Withholding tax 26% (Art. 7, Decree-Law No. 351/2001)	Transparency taxation
Italian pension funds and OICRs	Exemption	Exemption
Non-resident investors referred to in Article 7(3) of Decree-Law No. 351/2001	Exemption	Exemption
Non-resident institutional investors (other than those referred to in Art. 7(3), Decree-Law No 351/2001)	Withholding tax 26% (Art. 7, Decree-Law No 351/2001) or lower conventional rate	Withholding tax 26% (Art. 7, Decree-Law No 351/2001) or lower conventional rate
Non-resident non-institutional investors	Withholding tax 26% (Art. 7, Decree-Law No 351/2001) or lower conventional rate	Withholding tax 26% (Art. 32, par. 4, Decree-Law No. 78/2010) or lower conventional rate

7.5.4. Capital gains on sale of participations in real estate SICAFs

Capital gains realised through the sale of shares of the real estate SICAF by investors resident in Italy for tax purposes that qualify as taxable persons for IRES purposes - e.g. real estate companies and banks - generally concur in determining the taxable base for IRES purposes (at a 24% rate) pursuant

35 Revenue Agency Circular of 9 March 2011, No. 11/E; Revenue Agency Circular of 15 February 2012, No. 2/E, par. 4.3. See F. Brunelli, *Real Estate Funds. Note di commento al regime fiscale dei partecipanti non residenti*, in *Bollettino Tributario,* 2011, fasc. 18, pp. 1371-1377.

to Article 86 of the Income Tax Code. In such a case, the regime of partial exemption of the capital gain from IRES provided for by the *participation exemption* (under Article 87 of the Income Tax Code) does not apply because, in short, the real estate SICAF does not meet the requirement of carrying on a commercial business activity for tax purposes[36].

Such capital gains are exempt from income tax if realised by Italian resident undertakings for collective Investment (OICR)[37].

In the case of investors resident in Italy for tax purposes - e.g., Individuals not conducting business activities - the capital gains under analysis are subject to a 26% tax in lieu of the personal income tax[38].

Non-resident investors are subject to the following tax regime.

Article 5(5) of Legislative Decree No. 461/1997 provides for a tax exemption in respect of such capital gains for certain non-resident investors (identified by Article 6(1) of Legislative Decree No. 239 of 1 April 1996):

- persons resident in a State that allows an adequate exchange of information[39];
- foreign institutional investors established in a State that allows an adequate exchange of information[40];
- sovereign wealth funds;
- international bodies or organisations established under international agreements made enforceable in Italy;
- central banks.

36 As a result of the application of the same tax regime of real estate funds, the considerations made by the Revenue Agency in the Circular No. 2/E of 15 February 2012 are deemed extensible to real estate SICAFs. Paragraph 4.1.2 of that document specifies, in fact, that *"in the event of the transfer of the share, the regime set forth in Article 87 of the TUIR does not apply due to the lack of the requirement set forth in paragraph 1, letter d) of the same article (exercise of commercial enterprise)".*

37 As clarified by the Revenue Agency in Circular No. 2/E of 15 February 2012, para. 3.1.2, in the case of capital gains realised by real estate OICRs resident in Italy, the exemption regime provided for such entities applies.

38 Article 5 of Legislative Decree No. 461 of 21 November 1997.

39 Please note that the first sentence of Article 6(1) of Legislative Decree No. 239 of 1 April 1996 was amended by Article 10(2)(a) of Legislative Decree No. 147 of 14 September 2015.

40 As clarified in the Revenue Agency Circular of 15 February 2012, No. 2/E, Preamble, foreign institutional investors are understood to be entities that, irrespective of their legal status and the tax treatment to which their income is subject in the country where they are incorporated, have as the object of their activity the making and management of investments on their own behalf or on behalf of third parties. To this end, please refer to what was specified by the Revenue Agency in Circular No. 23/E of 1 March 2002.

The subsequent paragraph 5-bis of Article 5 of Legislative Decree No. 461 of 21 November 1997, introduced by Law No. 197 of 29 December 2022 ("Budget Law 2023")[41], provides that, as of 1st January 2023, this exemption regime will no longer apply with reference to capital gains deriving from the sale of 'non-qualified' and un-listed participations in real estate 'companies and entities'[42].

Instead, the exemption continues to apply with respect to capital gains (qualified and non-qualified) realised by funds established in the EU that comply with the UCITs Directive (2009/65/EC) or are subject to supervision under the AIFMD (2011/61/EU).

As better described in Chapter 6, paragraph 6.1.4.2., the Tax Authority provided some important clarifications as to the objective scope of application of this new provision with the Resolution No. 76/E of 22 December 2023, ruling out its application in the case of capital gains deriving from the sale of participations in Italian real estate undertakings for collective investment (OICR)[43].

In addition, Article 1, Paragraph 96 of the Budget Law 2023 also amended Article 23 of the TUIR, introducing a new Paragraph *1-bis*.

This rule entails that capital gains realised by non-residents and deriving from the disposal of participations in non-resident 'companies or entities', the value of which derives, for more than half at any time during the 365 days preceding the disposal, from the direct or indirect investment in real estate located in Italy[44], may be taxed In Italy (at the rate of 26%)[45].

41 Article 1, paragraphs 97-99 of the Budget Law 2023, which provides for the introduction of a new paragraph 5-bis to Article 5 of Legislative Decree No. 461 of 21 November 1997.

42 The rule identifies such persons as companies and entities the value of which derives, for more than half, at any time during the 365 days preceding the transfer, directly or indirectly, from immovable property situated in the territory of the State. For this purpose, immovable property to the production or exchange of which the business activity is actually directed, as well as that used directly in the exercise of the business, is not taken into account.

43 In this regard, it is worth noting that the clarifications provided by the Revenue Agency in the aforementioned Resolution relate to a case concerning the transfer of shares of an Italian real estate fund. Conversely, the Revenue Agency has not expressed its opinion to date with respect to the transfer of shares of a real estate SICAF.

44 As for paragraph 5-bis of Article 5 of Legislative Decree No. 461 of 21 November 1997, No. 461 of 21 November 1997, the Budget Law 2023 provides that (i) real estate to the production or exchange of which the business activity is actually directed as well as real estate used directly in the exercise of the business activity is not considered, and that (ii) the same does not apply with reference to capital gains realised by funds established in the EU compliant with the UCITs Directive (2009/65/EC) or subject to supervision pursuant to the AIFMD Directive (2011/61/EU) - both for qualified and non-qualified participations.

45 Pursuant to Article 5(2) of Legislative Decree No. 461 of 21 November 1997.

The Tax Authority has not provided guidelines to date on the latter rule.

Therefore, apart from the specific exceptions provided for by the Budget Law 2023, it will be necessary an analysis, on a case-by-case basis, to verify whether the applicable Double Taxation Treaty provides for the exclusive power of the State of residence of the Investor or allows for taxation in Italy (with the recognition of a tax credit in the investor's State of residence for the taxes paid in Italy).

7.6. The acquisition of real estate assets by the SICAF

The acquisition of properties (lands or buildings) by the real estate SICAF is subject to the same tax regime applicable to the acquisition of real estate assets by the real estate contractual fund, discussed in Chapter 6 (to which reference is made).

It should be noted, in particular, that also the contribution of properties to the real estate SICAF may be subject to the special regime provided for the contribution of a plurality of mainly rented properties[46].

7.7. The conversion of a company into a real estate SICAF

The tax regime of the conversion of a commercial real estate company into a real estate SICAF is not explicitly regulated by tax law, unlike in the case of other company reorganizations.

The Revenue Agency provided guidelines on this point in the Ruling No. 370 of 24 May 2021.

According to the Tax Authority, the conversion of a commercial company into a real estate SICAF is subject, for income tax purposes, to the *so-called heterogeneous regressive transformation regime, i.e. to* the regime provided for the transformation of a commercial company into a non-commercial entity, as per Article 171 of the Income Tax Code.

Accordingly, in summary, latent capital gains relating to the company's assets are deemed realised on the basis of the assets fair value, pursuant to Article 9 of the TUIR, and consequently taxed with the corporate income tax.

Therefore, for IRES purposes, the commercial company will have to determine its income, according to the ordinary rules, for the period between

46 Under Article 9(1) of Legislative Decree No. 44/2014 and Article 8(1-bis) of Decree-Law No 351/2001.

(i) the beginning of the fiscal year and (ii) the date of the conversion into a SICAF.

For IRAP purposes, the conversion will not entail per se a taxable income.

As regards the IRAP rules for determining the tax base, before the conversion, the rules provided for commercial entities will apply (Article 5 of Legislative Decree No. 446/1997), while, after the conversion, the rules provided for the SICAFs will apply (Article 6(4) of Legislative Decree No. 446/1997).

For VAT purposes, the transfer of immovable properties from the commercial company to the SICAF as a result of the conversion is outside the scope of application of the tax, pursuant to Article 2(3)(f) and Article 3(4)(d) of Presidential Decree No 633/1972, according to which '*transfers of goods* or services *in connection with (...) transformations of companies and similar transactions carried out by other entities*' do not constitute supplies of goods or services.

The deed of conversion into a real estate SICAF is subject to registration tax of € 200[47]. In addition, mortgage and cadastral taxes apply at the fixed amount of € 200 each[48].

The analysis regarding the conversion of a commercial company into a real estate SICAF, as opposed to the establishment of a new SICAF with the subsequent acquisition of the real estate assets, must consider also the SICAF authorisation *procedure* under Italian law.

On this point, please refer to section 7.8 below on the potential changes in the SICAF authorisation procedure.

47 Article 4(1)(c) of the Tariff Part I, Presidential Decree No. 131 of 26 April 1986.

48 Articles 4 and 10(2) of the Tariff annexed to Legislative Decree No 347 of 31 October 1990.

8.
SIIQs and SIINQs

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8.1. Introduction

The Italian SIIQs ("Società di investimento immobiliare quotata" – "Listed Real Estate Investment Companies") and SIINQs ("Società di investimento immobiliare non quotate", "Unlisted Real Estate Investment Companies") are institutions provided for by the Italian tax system to promote the development of the national real estate market, particularly with respect to the business of leasing. The goal is to increase the transparency and attractiveness of the market by creating investment instruments addressed to a wide range of investors, managed by professionals and that, above all, benefit from particularly favourable tax regulations. The legal concept of SIIQs has been introduced in the Italian system in 2006. So far, it has had limited use compared to the experience that similar institutions have in other countries (e.g. the French SIIC and the US REITs).

The reasons for this limited development were mainly the result of the sternness and inconsistency of certain aspects in the legislation and these were largely mitigated with the issuing of Law Decree No. 133 of 12 September 2014, enacted by Law No. 164/2014.

However, some further (significant) issues still deserve to be addressed by the legislator in order to make the regulations more consistent with its purposes and with the EU principles (above all with the freedom of establishment and non-discrimination principles); one of these has been dealt with by the recent Budget Law for 2022, which has innovated the provisions on SIINQs, thus allowing the creation of SIIQ-led joint ventures (see below), while others although widely shared at a technical level – have not yet been implemented at a regulatory level (see below)

That said in general terms, to appreciate the relevance of the 2014 amendments, it is enough to remember that the tax system in question is fundamentally based on the exemption from tax (at the level of the vehicle) and on the deferral of taxation (for "non SIIQ/SIINQ" shareholders) relating to the profits derived from the business of property leasing (so-called "exempt management") and that, nevertheless, in the former regulatory framework, capital gains deriving from the sale of real estate properties subject to rental activities, as well as those deriving from investments in real estate funds (which should instead constitute a typical investment of the SIIQ, where the fund invests in rented properties) were not included in this exempt management.

Another strongly demotivating aspect related to the requirements provided for as to ensure that SIIQs were adequately spread in the market. Indeed, it was prescribed that no shareholder could hold more than 51% of the voting and profit participating rights and also that a significant portion of the share capital (at least 35%) was sufficiently "distributed" in the market (so that no shareholder held more than 2%). Furthermore, in order to prevent that the exemption of the leasing business from tax could lead to an open-ended deferment of the taxation, an obligation to distribute the majority (85%) of the profits attributable to such activities was also provided.

These were all reasonable provisions, taking into account the aims pursued, but due to the excessive severity of the limits imposed, they risked leading (albeit only ideally) to possible critical elements in the ordinary and extraordinary life of the listed companies (for which the exceeding of the aforesaid thresholds, that were indeed extremely "strict", is absolutely physiological) and also, because of the obligation regarding profits distribution, to issues related to financial management and limitations in the reinvestment of profits.

Another element that significantly slowed the inflow of foreign capital into SIIQs was the lack of clarity concerning the right of non-resident participants to benefit from the Conventions against double taxation.

Given the small number of SIIQs, however, the Tax Authorities paid little attention to them in the past (up to Circular Letter No. 32/E/2015): very little information and few explanatory remarks have been provided in standard procedures, with particular reference to delicate issues that could have considerable consequences on taxation, such as the grounds for revoking the special regime.

Conversely, the debate among professionals and experts on fiscal law (who have identified the inefficiencies of the system and proposed the appropriate corrections also before the Italian Parliament) has consistently been of considerable intensity.

The Italian Law Decree No. 133/2014 (known as "Unfreeze Italy Decree") was introduced in order to overcome (with Article 20) most of the difficulties and rigidities described above and make further changes to the special regime that are explained in greater detail below.

Moreover, the mentioned Law Decree uniformed as far as possible the taxation regime of SIIQs to the one of ("qualifying") Real Estate Funds by introducing provisions aimed at making neutral, from a tax perspective, the choice between the two institutions. The provision aims at promoting the interdependence and complementarity between the two forms of investment, making it easier to pass from one to the other (see Circular Letter No. 32/E/2015).

Although important changes were made in 2014, practical experience in subsequent years has highlighted additional inefficiencies in the regulatory system that are worthy of removal in order to foster real estate market development.

One of these inefficiencies has been resolved by the recent Italian Law No. 234/2021 (Budget Law for 2022), which has significantly amended the regulations governing SIINQs, the unlisted corporate vehicles in which SIIQs hold a stake, now making it possible for investors other than SIIQs to participate in the capital of these flexible corporate instruments, even for significant, albeit not controlling, shareholdings.

Other amendments have not yet been drafted and implemented in the Italian legislation, although they are considered necessary in order to overcome the illegitimacy of the regulatory framework due to violation of the EU non-discrimination and freedom of movement principles, as well as to update the regulatory framework to reflect changes made in the meantime.

In particular, reference is made to the need to allow companies from other European Union (EU) or European Economic Area (EEA) countries that are subject to a regime that is substantially similar to that of Italian SIIQs (so-called "EU/EEA REITs") to be able to invest in SIINQs, being fully equivalent to Italian SIIQs, as well as to be able to use the SIIQ branch and be subject to taxation, albeit at a flat rate, that is substantially similar to that which they would incur if they invested directly in a SIIQ or a subsidiary SIINQ.

The measures already adopted and those at the moment only hoped for, on which however the professional operators through the trade associations (first and foremost Assoimmobiliare) are working, will be described in the paragraphs below in which the discipline profiles that are affected are described.

8.1.1. Legal framework

The regime of SIIQs and SIINQs is governed by the provisions of paragraphs 119 to 141-bis of Article 1 of Italian Law No. 296/2006(2007 Budget), as amended by Article 1 (374) of Italian Law No. 244/2007 (2008 Budget) and the aforementioned Law Decree No.133/2014, which has amended some substantial aspects of the governing rules of those entities, with reference to the requirements ofaccess to the regime and the taxation rules (both for SIIQs/SIINQs and their shareholders), as well as, most recently, Article 1 (718) of Italian Law No. 234/2021 (Budget Law for 2022) which modified the subjective and participation requirements of the SIINQs. In addition, the provisions contained in Ministerial Decree No. 174/2007 and the regulations of the Director of the Revenue Agency dated 28 November 2007 and 18 December 2015, which established the procedures for exercising theelection for the special regime, also acquire a certain importance. The legal framework is rounded off by the Rules of the markets that are organized and managed by Borsa Italiana S.p.A. and by therelated instructions, which indicate the requirements for the listingof the real estate companies in question[1].

Finally, the instructions issued by the Tax Authorities in Circular Letters No. 8/E/2008 and No. 32/E/2015 are of enormous importance.

8.1.2. The SIIQ and SIINQ regime in brief

SIIQs and SIINQs are are corporations (SIIQ necessarily takes the form of a joint-stock companies, SIINQ also a limited liability company or a limited partnership) that are predominant-ly engaged in the business of leasing real estate properties according to certain (economic and financial) regulatory parameters, and which may opt for a special tax regime as regards direct taxation. It provides for an exemption to IRES and IRAP with regard to income from the real estate leasing activities (known as "exempt activity"). The entire taxation of such income is postponed until the income is (mandatory) distributed to shareholders that are not SIIQs, by applying an advanced withholding tax of 26% on the corresponding profit in the balance sheet, for

1 With particular reference to the special regime, the assumption of the SIIQ status, the loss of the requirements to benefit from tax relief and on termination of the regime, there are stringent obligations regarding disclosures to Borsa Italiana S.p.A and the market (cfr. art. 2.6.4 of the Regulations). There are also stringent obligations regarding the minimum value of the real estate portfolio and the management control (cfr. 2.2.38).

entrepreneurs (that are subject to IRPEF and IRES), and by way of taxes in relation to the other parties.

Conversely, income arising from business other than leasing, falls into the category of operations designated as "taxable activities", which is already ordinarily subject to IRES and IRAP for companies, as well as for shareholders at the time of (non-mandatory) distribution of the related profits, in accordance with the ordinary rules.

The access to the special regime is subject to the payment of an "entry tax" of 20% on the positive differences (net capital gains) between the "fair" value[2] and the fiscally-recognised value of the properties that are rented out.

In order to take advantage of the special regime, moreover, the company must meet specific requirements of a subjective nature, of (statutory and distribution) governance, as well as with regard to shareholding percentages and characteristics of the investment. From a subjective point of view, for SIIQs the special regime applies to joint-stock companies with listed shares that are resident for tax purposes in Italy as well as, with certain differences, to permanent establishments of EU resident companies.

The election may also be exercised by resident unlisted corporations ("SIINQs"), dealing mainly with the activity of real estate leasing, provided that they are mainly participated by SIIQs or other SIINQs. More specifically, there could be two different schemes in which it is necessary to be owned, alternatively:

1. for more than 50% of the voting rights in the ordinary shareholders' meeting and profit-sharing rights, by a SIIQ (or by another SIINQ) which has the legal control, the remaining participation being free for the investment of any other investor ("Open SIINQ"), or
2. for more than 50% of voting rights and profit-sharing rights, by one or more SIIQs or SIINQs, in this case also without the need for legal control, and for the rest exclusively by "qualified" real estate funds ("Reserved SIINQ")[3].

2 Under Article 1, letter g) of Ministerial Decree no. 174/2007, "normal value" means the Fair Value of a property held by way of ownership, usufruct or other real rights, determined in accordance with the International Accounting Standards.

3 As already mentioned, the original provision according to which the SIINQ had to be at least 95% owned by a SIIQ, eventually together with other SIIQs, provided that the former had to have more than 50% of the voting rights in the ordinary shareholders' meeting and profit-sharing rights, so as to consolidate it for tax purposes, has been amended as from 1st January 2022 by Article 1 (718) of Italian Law No. 234/2021 (Budget Law for 2022).

In the first case, the condition that the participating SIIQ (or SIINQ) also qualifies as a "parent company" and have exercised the option for national tax consolidation together with the same subsidiary is also relevant.

The by-laws of SIIQs (and SIINQs) must ensure the protection of investors through adequate rules concerning the investment, establishing limits on the concentration of risks and maximum limits on the use of leverage (both on an individual company level and on a group level).

In terms of shareholding percentages, no shareholder must hold, directly or indirectly, more than 60% of the voting rights at the Annual General Meeting and more than 60% of the profit participating rights of a SIIQ[4].

Furthermore, in case of SIIQs, the share capital must be adequately distributed and divided up: at least 25% of shares must be held by shareholders who do not hold directly or indirectly – at the "time of the option" – more than 2% of the voting rights at the Annual General Meeting and more than 2% of the profit participating rights[5]. Moreover, it is worth considering that according to the Regulations of Markets Organized and Managed by Borsa Italiana S.p.A. (Art. 2.2.1), irrelevant shareholdings for the purpose of calculating the 35% free float are those equal to or greater than 5%.. Finally, as regards the type of investment, the prevailing business performed by SIIQs (as well as SIINQs) must be that of properties' leasing. This requirement must be assessed retrospectively, based on the data of each annual financial statement, in relation to capital and income parameters: in fact, on the one hand, the property intended for leasing must represent at least 80% of the assets, on the other hand, the revenues from the property leasing activity must constitute at least 80% of the positive items in the Income Statement.

The application of the special tax regime involves, as a counter-balance to the benefit of exemption, the obligation for the company to distribute at least 70%[6] of profits derived from the Exempt Activity. Otherwise, a number of strategies that would lead to indeterminate deferral of taxes would take

4 These thresholds, that initially stood at 51%, were modified by Article 20 of Law Decree no. 133/2014.

5 This threshold, that initially stood at 35%, was modified by Article 20 of Law Decree no. 133/2014.

6 This threshold, that initially stood at 85%, was modified by Article 20 of Law Decree no. 133/2014. The recent legislative changes, however, have introduced a differentiated regime as regards the profit earned from capital gains on the sale of properties held for renting for leasing, of equity investments in SIIQs/SIINQs or units held in Real Estate Funds; for these proceeds, the obligation of distribution is set at 50% and can be fulfilled within two years from realization.

place and this would not only contrast with the interests of the Treasury in promptly collecting taxes, but also with the nature of the investment instrument, directed to a "widespread" range of shareholders, given its role of collector of savings, which characterizes the model of the SIIQ.

8.2. Requirements for access to the regime

8.2.1. Subjective requirements

In order to be able to exercise the election for the SIIQ regime, the companies concerned must meet the following subjective requirements, since the first tax year in which the special regime applies:

- the company must be incorporated as a joint-stock company;
- the company must be resident in Italy for tax purposes.

In this regard, pursuant to Article 73 (3) of the TUIR (Income Tax Code), companies are deemed resident when, for the majority of the tax period, they have their registered office, administrative office or their principal purpose located in Italy.

Therefore, foreign companies or permanent establishments of foreign companies cannot have access to the regime. However, as a result of a procedure for infringement initiated by the European Commission against Italy, with the aim of preventing discrimination against entities resident in other EU Member States, Article 12 of Law Decree No. 135/2009 introduced a provision (paragraph 141-bis of Article 1 of Italian Law No. 296/2006) which extends the SIIQ regime to companies resident in EU Member States and in signatory States of the Agreement on the European Economic Area (EEA) included in the White List, with reference to permanent establishments in Italy whose main business is real estate leasing. Also, as a result of the recent legislative changes introduced by Law Decree No. 133/2014, this activity may be carried out through equity investments in companies that have expressed the joint option for the special regime referred to in paragraph 125 (SIINQ)[7].

7 In order to include SIINQs within the area of exemption, in principle – and for the sole case of Open SIINQs – the permanent establishment needs to have the requirements to be able to opt, together with the subsidiary SIINQ(s), for the national consolidated tax regime pursuant to Article 117 (2)of the Income Tax Code (unless the SIINQ is a minority subsidiary and already has, therefore, an ongoing fiscal consolidation with another SIIQ). On the other hand, the requirement of tax consolidation is no longer required as a necessary condition for the different case of the Reserved SIINQ (therefore, participated only by SIIQs or SIINQs, which have the majority of rights and possibly by "qualified" real estate funds).

As far foreign investors are concerned, however, there is a particular regime with respect to the permanent establishments having the SIIQs requirements; starting from the tax period in which the option for the special regime takes effect, the company income arising from the leasing of properties is subject to substitute tax at a rate of 20% in place of IRES and IRAP, as opposed to the exemption regime reserved for resident subsidiary companies, according to which the taxation occurs on distribution of the profits at a standard rate of 26% (unless reduced by the application of Conventions against double taxation on income)[8].

The current regulations do not appear to allow to equalize this substitute tax to the withholding tax on dividends, thus obstructing the possibility of a (partial) compensation in application of the double tax provisions set out in international Conventions. It would be desirable that regulatory changes were implemented, so as to eliminate such disadvantage and remove one of the obstacles to potential investments by foreign REITs wishing to invest in Italy through a SIIQs/SIINQs[9] instrument, as it is possible and, indeed, regulated, in other European countries.

The SIIQs' shares must be traded on regulated markets.

In particular, pursuant to the paragraph 141-bis of Article 1 of Italian Law No. 296/2006, companies whose securities are traded on Italian regulated

8 The need for a substitute tax imposed on permanent establishments is necessary because the transfers of profits of a permanent establishment to its parent company are not subject to taxation in Italy, since they do not constitute distribution of dividends. For permanent establishments, therefore, the exemption regime has been envisaged by means of a fiction, applying to the income of the branch a substitute tax in an amount (20%) equal to the withholding tax that in 2009 would have been applied to the dividend that a wholly owned subsidiary would have distributed to the foreign parent company. Subsequent legislation, however, did not consider that the measure of withholding taxes on dividends could be reduced as a result of the applicability of treaties against double taxation on income, as confirmed by the express regulatory provision inserted in paragraph 134 of the Italian Law No. 296/2006 by Article 20 of Decree Law No. 133/2014, which clarified the issue by indicating the modalities for obtaining the conventional reductions, essentially taking up the similar provisions set out for real estate UCITs. As a result, it becomes clear that a consequent update is needed to restore consistency to the regulations, as will be further clarified in the following footnote.

9 The need to eliminate this obstacle to the establishment in Italy of companies resident in other EU/EEA countries is strongly supported by professional operators in the real estate market and subject to specific legislative initiatives promoted by Assoimmobiliare. In this regard, the government has discussed the possibility of reducing the substitute tax rate in order to make it consistent with the rate envisaged by the most important treaties against double taxation for significant shareholdings (5%), so as to remove possible infringements of the freedom of establishment to the detriment of EU/EEA companies that are similar to SIIQs (so-called EU/EEA REITs).

markets[10] or on regulated markets in the EU Member States and in the signatory States of the Agreement on the European Economic Area included in the White List provided for by the article 168-bis of the Income Tax Code[11], can exercise the option.

8.2.2. Statutory requirements

The by-laws of SIIQs or SIINQs need to specify:

- the rules adopted by the company in the field of investments;
- the specified limits in terms of the concentration of investment risks and counterparty risks;
- the maximum permitted financial leverage, at an individual and group level.

The interim report and the management report must give account of the actual choices made and effectively represent the current level of the single parameters of potential criticality.

The legislation has not set specific benchmarks for the observance of the aforementioned limitations, since a clear indication in the by-laws of the rules which the company must follow is considered sufficient, on the assumption that this will enable a control by the market.

The provisions specify[12] that SIIQs are subject to the supervision of the Bank of Italy and CONSOB, each within the sphere of its powers, as provided for in the relevant legislation. The minimum content of information in the by-laws must be satisfactory according to the instructions given by the administrative supervisory authorities of the market where the company's securities are listed.

10 As clarified by Ruling No. 682/2021, listing on the AIM Italia market (or the "Professional" Segment devoted to professional investors) also allows access to the optional regime provided for SIIQs.

11 Article 168-bis, paragraph 1 of the Income Tax Code provided for a White List to be issued by the Ministerial Decree. Article 168-bis was revoked by the article 10 of the Legislative Decree n. 147/2015 and now all the references to the article 168-bis list shall be made to the White List (of the countries that grant an adequate exchange of information) to be issued pursuant to the article 11 of the Legislative Decree n. 239/1996. All the reference shall be made to the White List provided for by the Ministerial Decree of September 4, 1996 and subsequent amendments or additions.

12 From Article 1 (141) (a) of Italian Law no. 296/2006 and Article 3 (2), of Ministerial Decree no. 174/2007.

8.2.3. Requirements related to the participation structure

In order to qualify for the special regime, the following requirements related to the participation structure must also be met:

- control requirement: no shareholder shall hold, directly or indirectly, more than 60% of the voting rights at the Annual General Meeting and more than 60% of the profit participation rights of the SIIQ.
- floating requirement: at least 25% of shares must be held by shareholders who do not hold directly or indirectly, at the "time of the option", more than 2% of the voting rights at the Annual General Meeting and more than 2% of the profit participation rights.

As stated by the Tax Authorities[13], in order to calculate the percentage of voting rights and profit-participating rights, also any shares given in pledge must be included, if it is agreed that the holder is entitled to the right to vote in the Annual General Meeting and to the profit participation right thereof (unless any events occur that dissolve this attribution, in coherence with the aims of the guarantee).

The control requirement must be considered satisfied if none of the shareholders holds at the same time voting rights and profit participating rights in excess of 60%; in other words, the option can reasonably be regarded as available (and the regime maintained) even when a shareholder exceeds just one of the two limits above. In fact, according to the text of the rule, a shareholder is precluded from having access to the special scheme (or such access is terminated) if both limits are exceeded at the same time.

In order to check that the floating shares requirement is met, account must be taken of the provisions included in the Rules of the markets that are organized and managed by Borsa Italiana S.p.A., with reference to Real Estate Investment Companies ("REIC"), in whose genus SIIQs are included. In this regard, Article 2.2.1 of the aforesaid Regulations sets out that, in the calculation of the portion of share capital (at least 25%) which must be sufficiently "widespread", the shares held by institutional investors (provided that is lower than 10%), shares bound by shareholders' agreements and those subject to restrictions on the transferability of shares (lock-up) lasting more than 6 months, must always be taken into account. The equity investments held by the special-purpose assets set up pursuant to Article 27 of Italian Legislative Decree

13 Circular no. 8/E of 2008, confirmed by the Italian Tax Authorities in Circular Letter No. 32/E of 2015.

No. 34/2020 are taken into account, except for controlling equity investments, those bound by shareholders' agreements and those subject to restrictions on the transferability of shares (lock-up) lasting more than 6 months.

Due to the changes to Article 1 (119) of Italian Law No. 296/2006, that were introduced by Law Decree No. 133/2014, the ownership requirement of 25% does not apply in any case to companies whose capital is already listed; such derogation is justified by the fact that in such cases the floating shares requirement has to be necessarily satisfied at the time of the listing (see Circular No. 32/E of 2015).

Pursuant to paragraph 119-bis, the requirements in question (regarding the participation structure) must be met within the first tax year for which the option is exercised; in this case the special regime applies from the beginning of that period.

However, companies that, at the end of the first tax year for which the option was exercised, have satisfied only the floating shares requirement are allowed to confirm the additional control requirement during the two subsequent tax years ("grace period"). In this case, the special regime applies from the beginning of the tax period in which the control requirement is confirmed, so the company applies the ordinary IRES and IRAP until then. In other words, if, during a given tax period, both the floating and control requirements are met, the special regime shall apply from the first day of that tax year. As specified by the Tax Authorities (see Circular No. 32/E of 2015), art. 2, paragraph 2, of Ministerial Decree No. 174/2007 must be considered abrogated. The latter provision required that the subjective requirements had to be met at the beginning of the first tax period from which the company that exercises the option intends to benefit from the special regime. Moreover, art. 2, paragraph 4, of the Decree of the Director of the Italian Tax Authorities of 28 November 2007 must be considered abrogated[14].

This clarification helps understanding that this "grace period" of one year (for the floating shares requirement), that can be extended to three years for the control requirement, prevail over the provision, which still formally exists (at least in the regulations) and provides that the listing requirement must exist at the time of the option and the option must be prior to the first

14 According to which "the possession of such requirements at a later date whit respect to the exercise of the option takes effect and allows the access to the special regime only when communicated to the Tax Authorities, as provided for by paragraph 1 of this Article, within thirty days from the beginning of the same tax period".

period of application of the special regime. The same Tax Authorities stated (in Circ. No. 32/E of 2015) that the participation requirements must be met within the first tax year in which the company requests the access to special and that "This time frame allows the company that has opted for SIIQ regime to list by exploiting the listing windows during the whole year". It could to be reasonably inferred that also the provision of Article 1 (119) of Italian Law No. 296/2006, that establishes that the floating share requirement must be met when the option is exercised, can be considered revoked; in any cases, a clarification by the Tax Authorities would be highly helpful.

8.2.4. Objective requirements

8.2.4.1. Renting out of Real Estate properties as prevalent activity

The special regime may only be applied when the prevalent business performed by the company is the renting out of property. In this regard, according to Article 1 (1) of Ministerial Decree No. 174/2007, the following activities fall into the category of renting operations that are exempt operations:

- the renting out of properties held by way of ownership, usufruct or other real property rights, as well as on the basis of financial leasing contracts;
- the renting activity resulting from the development of real estate assets;
- the possession of shareholdings, represented by long-term investments in other SIIQs or SIINQs, in accordance with international accounting standards.

As a result of the changes made by Law Decree No. 133/2014, the ownership of investments in Real Estate Funds that are "significant" under Italian law (i.e. real estate funds that have invested at least 80% of their assets in properties intended to be rented out or in investments in real estate companies such as SIIQs or SIINQs – as specified also in Circ. No. 32/E of 2015) alsoconstitutes tax exempt real estate business, as explained in greater detail in the following paragraph. Ministerial regulations, therefore, need to be updated in the light of these changes in the primary legislation.

The term "properties" refers to assets in any cadastral category, wherever located (even abroad). Exempt business will be the one concerning the buildings and the areas on which they stand, including appurtenances and building plots.

The activity of real estate leasing also includes the leasing of companies, limited to the real estate properties that are part of the company's assets. The Exempt Activity (which would thus be exempt from both IRES and IRAP) would thus include the rent attributable to rented properties, as agreed in the company leasing contract (if indicated separately) or, in its absence, as determined on the basis of the current market rent[15].

Moreover, in accordance with the definition of Article 1 (1) of Ministerial Decree No. 174/2007, exempt operations can also include the direct construction and renovation, carried out directly or through third-party contractors, of properties intended for leasing (including development work carried out on building land, provided that the final destination of the buildings to be constructed is still to be leased).

In consideration of the above, in order for the business of real estate leasing to be considered prevalent business, certain asset and income parameters need to be complied with. In order to confirm these parameters, one must look closely at the data from the financial statements of each year, starting from the first year of application of the special regime. Therefore, it is possible to confirm the prevalence of the leasing business only ex post, by referring to the financial statements of the year in which the company intends to take advantage of the special regime.

Newly established companies, possessing all the other requirements, may validly exercise the option, provided that, in the financial statement for the first period of application of the regime, the above-mentioned asset and income parameters are complied with.

8.2.4.2. Asset Test

Pursuant to Article 1 (121) of Law No. 296/2006, for the asset test to be satisfied, the properties owned or held under other real rights, and those held under financial leasing, intended for the business of real estate leasing must represent at least 80% of assets.

The properties relevant for the asset test include those covered by the development of real estate assets, i.e. properties (held to be rented) that are under construction and those subject to direct renovation which, as noted above, are included among the Exempt Activity. In addition, the assets subject to verification should also take account, at numerator of the ratio, of investments in other SIIQs or SIINQs that constitute long-term investments. On this point, long-term investments shall mean financial instruments other than those held for trading,

15 For this purpose, reference may be made to the quotations of real estate properties and rents as indicated by the Property Market Observatory.

Due to the amendments of 2014 to Article 1 (121) of Law No. 296/2006, the Asset Test may be integrated (at the numerator of the ratio) by participations in Closed Real Estate Investment Funds (as above defined). To this end, as put in evidence by the Tax authorities in Circular No. 32/E of 2015 the investments in real estate SICAF are also relevant, being these investment instruments entirely similar to Real Estate Funds, especially with regard to the tax treatment. This interpretation allows to overcome the lack of an express provision that, even if adopted after the establishment of a real estate SICAF, had already been formulated in the preparatory work, without taking into account this new type of investment fund; a systematic reading of the complex regulatory framework makes it possible to argue that "qualified" real estate funds must be treated in the same way, regardless of their "contractual" (Funds) or "corporate" (SICAF) legal form.

As specified by the Tax Authorities[16], when verifying the asset parameter, the value of real estate properties intended for renting and of investments in SIIQs or SIINQs (as well as equity investments in "qualified" real estate funds) must be compared with the overall value of the assets, without taking into account the following elements:

- the value of real estate properties or of the real rights on real estate properties used as registered office of a SIIQ or SIINQ or directly used by the same as offices;
- cash and cash equivalents;
- loans to group companies;
- receivables for fees from Exempt Activity not yet received, as well as any VAT credits associated with the same Exempt Activity.

Ministerial Decree No. 174/2007, as interpreted by Circular Letter No. 8/E 2008, excludes the items mentioned above from the calculation. The rationale behind these provisions is intended to exclude items that are not actually attributable to (taxable or exempt) activities performed by a SIIQ/SIINQ. Following this line, one can therefore exclude any further items (though not expressly contemplated by the relevant provisions and practice) that cannot be considered as part of the Taxable or Tax-exempt Activity. Such items, that are in fact quite common in carrying out of the normal activity, would be liable, if taken into consideration, to distort the results of the checks on the prevalence ratio, that is designed to measure the relative weight of the two

16 Circular no. 8/E of 2008.

activities (see the clarifications provided by the Circular Letter no. 32/E of 2015)[17].

8.2.4.3. Profit Test

The "profit test" is satisfied if the revenues from property rents represent at least 80% of the positive items in the Income Statement.

The concept of revenue from property rents also includes dividends from investments in SIIQs and SIINQs. Dividends must be received in the tax period for which the checks on the income requirement are made and must be related to profits derived from activities relating to the Exempt Activity carried out by subsidiaries with SIIQ or SIINQ status.

Therefore, any dividends paid by a SIIQ or SIINQ subsidiary coming from activities related to the Taxable Activity and those deriving from the distribution of reserves formed prior to the access to the special regime are excluded.

Due to the changes to Article 1 (121) of Law No. 296/2006, the Profit Test is also integrated by profits distributed by participated Qualified Real Estate Funds. Also for this purpose, as clarified in Circ. No. 32/E of 2015, the participations in real estate SICAF are also relevant, for the same reasons above illustrated.

The ratio (which must be greater than 80%) does not take into account the numerator or the denominator of the increases in value of properties under construction intended for rent.

Before the recent legislative changes in 2014, capital gains from the sale of properties and from real rights of properties intended for rent – although included in the Taxable Activity and, therefore, ordinarily subject to taxation – were relevant for the sole effects of the checks on the income requirement, if and to the extent in which, in a given year, the total profits from the aforesaid sales were higher than the amount reinvested in property or in real rights on properties intended for rent or in investments constituting

17 As illustrated in the Circular No. 32/E of 2015, further elements shall be excluded both from the numerator and denominator of the ratio: a) activities related to hedging contracts, as they are related to risk hedging policies, very volatile in consideration of the underlying variables; b) credits for deferred tax assets, as they represent an equity component not related to the activity carried out, but to tax rules of taxation deferral; c) tax credits (including those required for reimbursement), as they also do not express the different activities carried out; d) prepaid expenses, as not representative of the activity, but of the costs that have already had a numerical value and have been indicated the income statement for reasons of competence.

longterm investments, according to international accounting standards, in other SIIQs or SIINQs[18].

Following the amendment to paragraph 121 made by Law Decree No. 133/2014, as clarified in Circ. No. 32/E of 2015, however, the capital gains realized in relation to these properties contribute towards the determination of the profit test.

Conversely, capital gains recorded on real estate properties intended for rent due to accounting revaluations (performed with the allocation of the surplus value to the Income Statement as a result of the valuation of the properties using the fair value method) are irrelevant for the purposes of checking the profit test, since they are positive items in the Income Statement that do not derive from the Exempt Activity or from the Taxable Activity.

According to the Explanatory Notes to the Implementing Regulation, the increases related to properties under construction intended for rent and the increase in the others inventories must not be considered in the composition of the denominator, since such increases already affect the numerator of the asset ratio. In line with this, the increases relating to properties under construction other than those intended for rent must not be considered in the denominator.

For the same reasons already pointed out in relation to the asset test, it can be considered that the identification of positive items included in the numerator and the denominator of the ratio must not be affected by items that are not actually expression of the (Taxable or Exempt) Activity performed by the SIIQ/SIINQ. Consequently, the numerator must be made up of (i) the revenues from the rent business, (ii) dividends coming from SIIQs/SIINQS, (iii) income from “qualifying” Real Estate Funds and (iv) the increases in value of real estate properties relating to assets held for rent (elements of the Exempt Activity); the denominator must be composed of (i) the sum of the numerator and of (ii) revenues coming from activities other than rent and (iii) dividends coming from non-SIIQ/ SIINQ companies or from the distribution of reserves formed before the access to the regime (elements of the Taxable Activity). In ordinary conduct of the business a number of

18 According to the example contained in Circular 8/E of 2008, if the consideration for the sale of a property is equal to 2,000 and the capital gains is equal to 1,000 and an amount equal to 1.500 is reinvested, the amount of capital gains significant for the purposes of calculating the income requirement is 500.

items arise whose exclusion the interpreter may evaluate, on the basis of the rationale of the regime, – albeit with all the points of sensitivity required in the case – despite the fact that the legislative regulation refers, in a broad and general sense, to the entire category of positive items in the Income Statement as the denominator in the ratio. In Circular No. 32/E of 2015 the Italian Tax Authorities have clarified that the following items are not to be considered: revenues that represent cost adjustments (for example, the income from hedging the risks of changes in interest rates), extraordinary income and income deriving from the release of exuberant risks and charges provisions (including bad debt) provisions, deferred taxes, income deriving from mere chargebacks (such as those carried out against tenants), the proceeds derived from insurance reimbursements (if those are not a replacement of rent income, or other corporate income) and income from insurance active adjustments.

8.3. The tax regime of SIIQs and SIINQs

8.3.1. Exercise and effects of the option for the regime

The option for the regime must be exercised before the end of the tax period prior to the one for which the taxpayer intends to take advantage thereof.

Moreover, with specific reference to the "special" tax conditions for the purposes of the indirect taxation of properties, according to one authoritative interpretation[19], the option probably already has effect, for some purposes, in the tax period in which it is exercised. The option is irrevocable and means that the company acquires the status of SIIQ – "Società di Investimento Immobiliare Quotata" ("Listed Real Estate Investment Company") – which must be included, even in abbreviated form, in the company name and in all the documents of the company.

At the time of the option, the company must declare its possession of the requirements described above, from the beginning of the first tax year in which it is applied.

However, if one or more requirements are not met at the time the option is exercised, the company is allowed to give notice thereof in its communi-

19 See Studio Tributario no. 98-2012/T by the Commissione Studi Tributari del Consiglio Nazionale del Notariato (on this point, see below in section 8.4.2). The hypothesis regarding the advanced effects of the option, moreover, is founded on the grounds that once it is manifested the option becomes irrevocable.

cation. In such cases, the exercised option does not produce effects if the possession of the requirements is not satisfied by the beginning of the first tax period in which the special regime applies. The subsequent existence of the requirements (in a time, nevertheless, prior to the beginning of the tax period) produces its effect and allows access to the special regime only if the Revenue Agency is notified thereof within 30 days from the beginning of the same tax period. Even this aspect of the regime, however, must be put into context, through appropriate explanations in the secondary level legislation and administrative practice, which more clearly defines its combination with the innovative provision of the one-year and three-year periods of grace for the requirements relating to the participation structure.

8.3.2. SIINQs

As mentioned, the special regime may be extended to corporations, resident in Italy, mainly participated by SIIQs or other SIINQs, whose shares are not traded on regulatedmarkets (SIINQs).

In this regard, as a result of the amendment introduced by Article 1, (718) of the Budget Law for 2022[20], the following conditions must be met:

- the company takes the form of a joint-stock company, a limited partnership or a limited liability company, since it must in any case have a share capital of no less than the minimum (50,000 Euros) laid down by Article 2327 of the Italian Civil Code for joint-stock companies;
- the prevalent business performed by the company must be that of property leasing according to the quantitative parameters already examined (see § 8.2.4.2. and 8.2.4.3);
- the company's shares are owned by a SIIQ or SIINQ according to one of the two following alternatives:
  - more than 50% of the voting rights and of the profits participation rights is owned by a SIIQs or SIINQs and the remaining 49.99% of the capital available for <u>any type of investor (Open SIINQs)</u>;
  - all share capital is <u>exclusively owned by SIIQs, SIINQs and/or "qualified" real estate funds</u>, provided that the participating SIIQs or SIINQs hold at

20 Previously, the SIINQs necessarily had to be participated by one or more SIIQs for at least 95% in terms of voting rights in the ordinary shareholders' meeting and profits participation rights, provided that one SIIQ exercised the legal control. In this way, the possibility of setting up joint ventures with parties other than SIIQs was substantially impeded, thus severely limiting the development of the sector.

least 50% of the voting rights and of the profit participation rights, without the need for a tax consolidation relationship (Reserved SIINQs");
- In case of an Open SIINQs, the company must exercise the option for the special regime in conjunction with the controlling SIIQs or SIINQs;
- In that case, the controlling SIIQs or SIINQs must possess the required control pursuant to Articles 117 and 120 of the Income Tax Code as regards the application of the regime of group taxation (known as "tax consolidation")[21]. In this regard, the existence of these requirements is not enough: the option for national tax consolidation must actually be exercised so that the companies participate in the same national tax consolidation scheme.
- in the case of an Reserved SIINQ, the requirement of legal control by an SIIQ or SIINQ is not required as a necessary condition (should it exist, it would fall under the previous hypothesis), although a majority shareholding by several SIIQs or SIINQs is necessary. Consequently, the tax consolidation requirement is not required.

The accession of a SIINQ to the special regime involves the obligation for the SIINQ to draw up its financial statements in accordance with the international accounting standards.

8.3.3. The entry tax

The option for the special regime involves the realization of the real estate properties at fair value as well as the real rights over the real estate properties intended for rent held on the closing date of the last tax period using the ordinary regime.

Any capital gains that may have been realized must be subject to a substitute tax for IRES and IRAP with a rate of 20% (known as "entry tax").

Entry tax is applied to the total amount of capital gains, net of any capital losses, which is determined by the comparison between the fair value (in accordance with the international accounting standards) of the real estate properties and real rights of real estate at the end of the last tax period under the ordinary regime and their fiscally-recognised cost.

21 In this regard, pursuant to Article 117 of the Income Tax Code, the parent company must have control as referred to in Article 2359 (1) of the Italian Civil Code. Moreover, under Article 120 of the Income Tax Code, the parent company must have a direct or indirect stake in the share capital and balance sheet profits at a percentage higher than 50% (taking into account the effect of scaling and excluding shares without voting rights).

Properties intended for rent and held on the basis of a leasing contract are also subject to the entry tax (the capital gain is given by the difference between the fair value of the fixed asset and the residual capital quota specified in the contract).

The capital gains relating to properties held for rent, but also those relating to real property held for sale can also be subject to substitute tax, under the condition that they are reclassified in the balance sheet as tangible fixed assets, as a result of the changed functional destination.

Real estate properties subject to substitute tax not only include the buildings in their strict sense but also the land (plots) on which they stand, their appurtenances and any building plots, provided that, in the latter case, their intended use is changed.

The capital gains related to real estate properties included in the "development of real estate assets", i.e. the buildings under construction and those subject to direct renovation intended for the business of real estate leasing, that are part of the Exempt Activity, are also relevant in terms of the application of entry tax.

The fair value to be taken as the basis for the determination of the capital gains subject to entry tax consists of the new fiscally-recognised value of the properties themselves, only from the fourth tax period subsequent to the period prior to the entry into the special regime. Therefore, any sales made before that moment – that would be liable to generate taxable gains in terms of income tax – are subject to the tax based on the fiscally-recognised value before entering the special regime, and the proportionally attributable substitute tax on the properties or real rights that have been sold constitutes a tax credit. The failure to comply with the holding requirement, based on the new wording of the provision as amended in 2014, entails the consequences mentioned above both in the case of properties already owned by the company before the access to the special regime and in the case of property contributed to companies that have opted for the special regime.

In the first case, the difference between the market value of the property (on which the substitute tax was determined) and its fiscally recognized cost (net of amortization) before entering the special regime shall be subject to ordinary taxation; any difference between the selling price and the market value is considered income of the Exempt Activity. In the second case, the transferee company is obliged to tax the difference between the market value of the property subject to the substitute tax by the transferor and the transferor's recognized tax cost of the property; also in this case, the difference between the tax cost and the market value is considered income of the Exempt Activity.

As an alternative to the application of entry tax, the company may choose to include the total amount of capital gains, net of any capital losses, in the calculation of company income according to the ordinary tax regime of the tax year prior to the commencement of the special regime or, for constant quotas, of the income of that period and of the subsequent periods but not beyond the fourth period. In this case, the deferred capital gain amounts contribute towards the income coming from activities other than real estate renting (Taxable Activity) in the subsequent periods.

If ordinary taxation is opted for instead of the entry tax, the new tax cost of the real estate properties and of the real rights on real estate properties is relevant from the tax year following the one in which the same are deemed to have been realized. If the choice is to attribute the capital gains to the company income in constant quotas, the increased tax cost will be recognised gradually and in proportion to the quota of fair value which is subject to ordinary taxation in each immediately preceding tax period.

8.3.4. The exemption regime for income deriving from the business of Real Estate leasing and assimilated activities

The main effect of the special regime is the exemption from IRES and IRAP of the profits derived from the Exempt Activity. In particular, the exemption concerns revenues coming from the renting out of real estate properties (mainly rent instalments). In addition, the special regime of company income exemption includes income on dividends received on equity investments in other SIIQs and SIINQs, if such dividends are made up of profits from the business of real estate leasing.

Before Law Decree No. 133/2014, some income items arising from assets or rights instrumental for the renting activity did not benefit from the exemption regime (in a manner that was barely consistent with the rationale of the scheme). In particular, capital gains and losses, realized as a result of the contribution of real estate properties held for the purposes of running a business of leasing or of shareholding investments in other SIIQs or SIINQs, contributed towards the determination of income of the Taxable Activity, since they were subject to tax in line with the ordinary rules set forth by the Income Tax Code or by Italian Legislative Decree No. 446/1997, concerning IRAP.

Due to the legislative changes in 2014 (to Article 1 (131) of Law No. 296/2006), in addition to revenues from rents and dividends coming from SIIQs/SIINQs, the following are also included in tax-exempt income:

1. capital gains or losses related to properties intended for renting and investments in SIIQs or SIINQs;
2. revenues and capital gains or losses relating to investments in Real Estate Funds, that are "significant" under Italian law (i.e. at least 80% of their assets are invested in real estate, real property rights, including those arising from concessionary relationships or financial leasing agreements on properties by way of negotiated settlement, and in participations in real estate companies or other real estate funds held for the purpose of real estate leasing, including funds held for investment in real estate mainly used for social purposes or in participations in SIIQs and SIINQs). As clarified in Circular No. 32/E of 2015, for the reasons outlined in paragraphs regarding the asset and profit test, the profits deriving from investments in real estate SICAF can be treated as income from Real Estate Funds. With reference to the distribution of these profits, however, the SIIQ receives them "gross", since the withholding taxes referred to in Article 7 of Law Decree No. 351/2001 do not apply.

The inclusion of all proceeds within the Exempt Activity, moreover, is consistent with their inclusion in the calculation of the asset and income parameters regarding the prevalence of renting activities (see sections 3.2.4.2 and 3.2.4.3).

As noted by the Tax Authorities[22], the exemption is not, in one sense, "definitive", given that taxation (albeit limited) takes place at the time of distribution. In other words, instead of tax the profits at the time of production, the taxation occurs only at the time of distribution. It is in fact a reversal of the taxation principle introduced by the Tremonti Reform under which company income is taxed at the time of its production, while distributed dividends are (partially) excluded from taxation.

The company income attributable to the exercise of activities other than real estate renting (i.e. "Taxable Activities") remains, conversely, subject to ordinary taxation (IRES and IRAP) according to the ordinary rules. It should be noted that the positive items within the Exempt Activity are defined in express and analytical terms, so that the operations related to the Taxable Activity are defined in a residual manner and fall into the category of "all other" revenues within the Income Statement.

22 Circular no. 8/E of 2008.

It is also important to note that Law Decree No. 133/2014 included paragraph 119-ter within Article 1 of Italian Law No. 296/2006, pursuant to which SIIQs/SIINQs are not considered to be OICRs (UCIs). This provision – that was probably issued in order to clarify, in terms of regulatory law, the non-applicability of the AIFMD Directive for the aforementioned companies and, therefore, the relevance for tax purposes of the ordinary taxation regime of the business income, even with the application of the SIIQs' special regime with regard to the exempt activity (Circ. No. 32/E of 2015) – has also an important effect in terms of taxation since SIIQs/SIINQs cannot be considered "institutional investors" pursuant to Article 32 of Law Decree No. 32/2010 (since they are not UCIs). However, as clarified in Circular No. 32/E of 2015, even if a SIIQ/SIINQ held a stake in a "qualified" real estate Fund exceeding 5%, it would still not be subject to taxation of the operating profit accrued by the Fund attributed pursuant to art. 32 (as regards a permanent establishment that has opted for the SIIQ regime, such profit concurs to the exempt activity income subject to a 20% substitute tax).

In terms of IRAP, the production value relating to exempt operations is deemed exempt. In order to determine the proportion of the production value attributable to exempt operations, a flat-rate criterion applies, which is made by the ratio between the positive items in terms of IRAP attributable to the Exempt Activity and the overall total amount of positive items that are relevant in terms of IRAP.

The overall total of production value, on which this flat-rate criterion applies, must be determined according to the ordinary rules for calculating the taxable amount in terms of IRAP.

As mentioned above in Sect. II.1, with regard to companies resident in other EU Member States or in signatory States of the Agreement on the European Economic Area included in the White List with permanent establishments in Italy, whose main business is the real estate leasing, the regime provides for the application of a substitute tax in place of income tax and IRAP, at a rate of 20%, instead of exemption on income from rents. This is because, in this case, it would not be possible to apply the system of deferred taxation for the shareholders presenting the issues previously analysed. Law Decree No. 133/2014 expanded the range of permanent establishments admitted to the special regime, having added that the business of real estate rents can also be performed through investments in companies that have expressed the joint option for the SIINQ regime.

8.3.5. Obligation of distributing the profits of the Exempt Activity

As noted, the distinguishing feature of the special regime is the exemption of income from the renting out of property from both IRES and IRAP and the deferral of direct taxation until the time the profits are distributed to the shareholders.

In order to avoid the regime being used instrumentally to suspend taxation by deferring the distribution of dividends indefinitely (which would also be to the detriment of many minority shareholders, who would be frustrated in their expectations of receiving returns on their investments), the rules governing the SIIQ specify that at least 70% (85% in the legislation prior to Law Decree No. 133/2014) of the net profits coming from property rentals and dividends coming from investments in SIIQs or SIINQs must be distributed.

For the purposes of the obligatory distribution in question – following the inclusion among the exempt operations of capital gains/ losses from the sale of properties held for leasing and equity investments in SIIQs/SIINQs, as well as income from "qualifying" Real Estate Funds – these income items also gain relevance. However, the recent legislative changes from 2014 established that the proceeds coming from net capital gains realized on properties intended for leasing as well as those coming from the sale of investments in SIIQs/SIINQs or of shares in qualifying Real Estate Funds, are subject to obligatory distribution solely for 50% and in the two years subsequent to the year of realization. These capital gains, therefore, benefit from a lower requirement of distribution, which can, moreover, be performed within a longer term. The total amount of profits distributed is obtained for each period, by applying to each of the income categories the percentage of the corresponding distribution (70% or 50%) and then adding the two results obtained. As noted in the Circular No. 32/E of 2015, the respect of the distribution obligation must be considered in its entirety, as one obligation, even if the total amount of profit to be distributed is to be determined through a calculation based on two different coefficients. In order to calculate the total amount of profits to be distributed, it is necessary to check the impact of the two different categories of profits (rents and dividends, on the one hand, and capital gains on disposal of properties and participations in SIIQs and real estate funds, on the other) on the total profits which contributed to the net profit attributable to the exempt activity of one and the other of these categories of income; finally, after applying to each category of profit the corresponding distribution coefficient, the two results must be summed. The obligation of distribution refers to the net profit in the Income Statement that comes from the Exempt Activity and which is made available for distribution to shareholders, increased by the amount of the reserves formed during the term of the special regime deriving from the valuation of rent properties and become available after the disposal of these assets.

Therefore, this obligation is not extended to that part of the profits which is subject to statutory obligations and cannot therefore be distributed, as in the case of profits that must be set aside for the mandatory legal reserve or those coming from the revaluation of assets due to a valuation based on fair value.

If the obligation of distribution (specified in general at 70% of the available Exempt Activity's profits) is not observed, the option for the special regime ceases to have effect from the tax year in which the profits are not distributed.

In order to identify the object of the distribution obligation, the legislation provides that the profits and related reserves formed during the term of the special regime must be indicated separately in the income tax return, stating which relate to taxable operations and which to exempt operations.

The distribution of profits other than those coming from the Exempt Activity, and extraordinary distributions performed with resolutions subsequent to the approval of the financial statements are not relevant for the purposes of complying with the obligation. If the total amount of profits of the year, available for distribution, is less than the amount coming from the Exempt Activity, due to operating losses relating to taxable operations, the percentage of 70% is applied to this lower amount.

With regard to the distribution obligation concerning "net realized capital gains on properties held for leasing", according to the Tax Administration's interpretation (Circular No. 32/E of 2015), from a logical and systematic perspective, such gains shall be determined taking into account not only the amount included in the income statement in the year of realization, but also of the gains deriving from valuations recognized – during the application of the SIIQ regime – in the income statement in prior tax years to that of the sale of the property, and set aside in a specific reserve provided for in the said Article 6 of the Legislative Decree No. 38 of 2005, which became available as a result of the aforementioned disposal. It is understood that in the event of application of the recapture rule provided for by Article 4 of the SIIQ Decree, the distribution requirement must take into account the variations of the reserve recorded before entering the special SIIQ regime[23].

23 With reference to the criteria used to determine the net capital gains subject to the 50%

Moreover, if the loss arising from the Taxable Activity reduces the profits from the Exempt Activity, the subsequent positive result from the Taxable Activity must be considered as being formed by profits from the Exempt Activity until the amount of the aforementioned reduction is covered, on which the obligatory distribution applies. Conversely, if the loss resulting from the Exempt Activity reduces the profit from Taxable Activity, the subsequent positive result of the Exempt Activity must be considered net of the aforesaid reduction, in order to comply with the obligation under examination, (so called "carry forward").

8.3.6. Obligation to keep separate accounts

In order to keep track of the operations relating to the renting out of real estate (and similar activities) and those related to any other activities that may be performed and thus to apply the different relevant tax regimes, it is obligatory to keep separate accounts for the Exempt Activity and the Taxable Activity. There is also an obligation to provide separate information on the profits coming from the different kinds of activity when completing income tax returns. For the same purposes, it is also compulsory, with reference to profits and reserves from the Exempt Activity, to make a separate report for the "portion, as can be verified through appropriate documentation, attributable to rent agreements on properties for residential use concluded pursuant to Article 2 (3) of Italian Law No. 431 of 9 December 1998" (renting out of real estate properties for residential use with "special rent payments"). The reason for this distinction lies in the fact that the profits distributed to shareholders that come from such rent agreements were subject to a reduced withholding tax of 15% instead of the rate of 26%, until 31 December 31 2011. From 1 January 2012 to 30 June 2014, as a result of the harmonization

distribution obligation, it is to be considered that the SIIQs – that must adopt the international accounting standards – account the investment in real estate properties according to the IAS principles, which provide that real estate investments are accounted in the balance sheet also using the "fair value method" (i.e. at the market value at the balance sheet date), with the allocation in the income statement of the "valuation" gains or losses in the period in which the variation itself occurs. As a result, the application of the fair value method involves, in fact, the systematic recognition in the income statement of gains (or losses) in advance with respect of the cash realization. As noted by the Italian Tax Authorities, the sale of a real estate investment involves the ending of any restrictions on the related reserves in which the fair value increases in value are recorded (which, in fact, is reduced due to the capital gains actually realized or have become non-existent as a result of impairment).

of taxation on financial income[24] and in the absence of a specific exception with reference to the case in question[25], a withholding tax of 20% is also applied to such proceeds. Moreover, as a result of the further increase introduced by Article 3 of Law Decree No. 66/2014, the tax rate is 26% on all dividends payable from 1 July 2014.

However, Law Decree No. 133/2014 has intervened on this field (by modifying paragraph 134 of Law No. 296/2006), providing that for dividends (distributed since September 13, 2014) arising from the rent instalments in question, including those concluded with special social welfare conditions (also called “social housing”[26]) the original 15% rate is reintroduced in place of the 26% rate.

In the light of the different ways, over recent years, of dealing with profits attributable to such rental fees (at the time of distribution), the separate accounting requirement is particularly important with a view to accurately identifying the period of their formation and hence the correct rate of taxation.

Separate accounting also serves to allow tax losses arising from the Exempt Activity to be managed correctly and the residual tax value of assets to be identified in the event of termination of the regime.

It is considered, in accordance with the correct accounting standards, that all the typical revenues and costs of the activity of real estate rentals must converge within the accounts of the Exempt Activity, as well as all the other financial, administrative and tax charges relating to that same activity. Financial charges can be considered related to The Exempt Activity if they refer to loans raised specifically for running the leasing business.

The same principle applies for allocating costs and revenues relating to taxable operations which refer to the running of activities other than those included in Exempt Activity.

The (“shared”) general costs, on the other hand, will be charged to the exempt activity and Taxable Activity bearing in mind the characteristics of the specific activity carried out. There is no specific criterion for the division

24 Article 2 (da 6 a 34), of Law Decree no. 138/2011.

25 See Circ. no. 11/E of the Revenue Agency dated 28 March 2012.

26 Rent agreements relating to social housing that was built or recovered in accordance with Article 11 of Law Decree no. 112 of 25 June 2008, enacted, with amendments, by Italian Law no. 133 of 6 August 2008, and Article 11 of the Annex to the Decree of the Chairman of the Council of Ministers of 16 July 2009, published in Official Gazette of the Republic of Italy no. 191 dated 19 August 2009.

of costs or the other common items between the different activities. One suitable, valid criterion that could be used for this division may be that of attributing the shared costs to the exempt activity or Taxable Activity on the basis of the ratio between the revenues and other income coming from the Exempt Activity or Taxable Activity and the overall total of all revenues and income (known as “economic ratio”).

The application of the special regime, however, does not exempt the SIIQ from the duty of determining, in line with the ordinary rules governing IRES, the income coming from the Exempt Activity which, despite the exemption regime, must be indicated in the tax return.

8.3.7. The treatment of tax losses

Any tax losses generated in the tax periods prior to the one in which the special regime started to apply, can be used to reduce the taxable amount of the substitute entry tax and/or as compensation of the taxable income coming from any activities related to the Taxable Activity.

Accumulated losses must be used, as clarified by the Italian Tax Autorities, in the following years within the limits of 80% of the taxable income for each tax period pursuant to Article 84 (1) of the Income Tax Code (TUIR), as amended by Law Decree No. 98/2011 (except for those losses incurred during the first three tax periods of the company that, conversely, can be used without quantitative limits up to the total income amount).

The two separate tax results, one relating to the Taxable Activity and the other to the Exempt Activity, are clearly divided, so that income from Taxable Activity cannot be offset by tax losses from the Exempt Activity.

Losses relating to the Exempt Activity are used (in virtual terms, since it is an exempt income) to reduce the income relating to the Exempt Activity of the future tax periods in line with the ordinary rules. If a company leaves the special regime, the principle of separating the accounting and taxation relating to the result of Taxable Activity from that of the Exempt Activity is no longer necessary: if the right to the special regime is lost, any losses related to the Exempt Activity that have not been offset with the income from the same Exempt Activity can be used to offset the taxable income produced from the tax year following the last year in which the special regime was applied.

8.3.8. The rules governing reserves

The rules governing SIIQs include the obligation to indicate in the tax return the origin of the reserves that have been formed during the application of the special regime. The following kinds of reserves may be included:

- reserves formed from profits coming from the Exempt Activity;
- reserves formed from profits from years prior to the start of the special regime;
- reserves coming from the Taxable Activity during the special regime.

The distinction is important, since dividends relating to reserves referred to in (ii) and (iii) above, at the time of their distribution, are subject to the ordinary tax treatment of the dividends for those who receive them.

As regards the criteria for the use of reserves, in the absence of any express provision to the contrary by the Shareholders' Meeting, the accumulated earnings formed prior to the beginning of the special regime and those formed during the period of application of this regime together with profits from the Taxable Activity are deemed to take priority in being distributed.

If a resolution is passed for the distribution of capital reserves, the ordinary presumption laid down in relation to income taxation is to be applied, whereby profits and reserves that are not capital reserves are deemed to take priority in distribution; during the period that the special regime is in force, one should presumably give priority to the distribution of reserves coming from profits from Taxable Activity.

If reserves are used to cover losses, accumulated earnings formed prior to the beginning of the special regime and those formed during the period of application of this special regime together with profits from the Taxable Activity are deemed to be used with priority.

The presumptions referred to remain valid in the tax periods in which the option is effective and in the tax periods after the loss of the special regime (if this occurs).

8.3.9. Option for the national consolidated tax regime

With regard to other special regimes provided for in the sphere of direct taxation, it should be noted that SIIQs can take part in the national consolidated tax regime as consolidating parties or as consolidated parties (provided that the consolidating party is also a SIIQ, which exercises control over the former).

SIIQs can also participate in a national consolidated tax regime as the consolidating company, also by consolidating companies which do not apply the special regime.

If a SIIQ opts for a group taxation regime as the consolidating company, it must calculate the total overall income by considering solely the result of the Taxable Activity, in particular by adding up its own net taxable income with the net taxable incomes of the subsidiaries, participating in the consolidated tax regime. As already mentioned, other SIIQs or SIINQs can also be included as controlled subsidiaries and their income, for the part referring to the Taxable Activity will be included in the total income of the group.

The loss of the special tax regime by one of the consolidated SIIQs or SIINQs does not automatically lead to discontinuation of the group taxation.

8.3.10. Extraordinary operations

A company which has opted for the SIIQ/SIINQ regime may be involved in company reorganization operations.

In this regard, the general principle is that mergers, demergers, contribution of companies or business units, of which SIIQs or SIINQs are party, do not automatically lead to a loss of the right to the special regime under examination. Therefore, if this kind of reorganization occurs, the special tax regime may continue to apply to the entities that are the result of such operations if all the conditions and requirements above specified by the laws and regulations are nevertheless satisfied.

In other cases where, on the contrary, the merger, demerger or company contribution has also involved companies that do not qualify for the special SIIQ/SIINQ special regime, the continuation of the special regime depends on whether the entity resulting from the reorganization operation satisfies the requirements provided for by the regulations in question.

8.3.11. Events leading to a loss of the right to the special regime

The loss of the requirements established in order to have access to the SIIQ regime (except for the floating shares requirement) leads to loss of the right to the special regime.

In fact, the requirements outlined above must be met, not only at the beginning of the first tax year of application of the special regime (subject to the referred to one-year or three-year “grace period”), but also subsequently, for all the tax periods in which the special regime is effective.

Given the above, with regard to the requirements which must exist at the time of the option, the following events represent causes for the immediate loss of the special regime from the same tax period in which they occur:

- the loss of residency for tax purposes within the territory of the State[27];
- the company loses its juridical status as joint-stock company;
- the authorisation for being listed on regulated markets is revoked. A temporary suspension from being listed in the regulated markets is not, however, a cause for termination of the regime.
- one shareholder exceeds the threshold of possessing directly or indirectly 60% of the voting rights at the Annual General Meeting and of the profits participating rights[28]. Moreover, as a result of recent legislative changes in Law Decree No. 133/2014, where the ownership requirement of 60% was exceeded as a result of extraordinary corporate operations or operations on the capital market, the special regime is suspended until the above participation requirement is restored, within the limits imposed by the present rule. In such cases, if the participation requirement is overcome only for a limited period of time, the same will be considered met, without discontinuity, for the entire tax year; it is understood that the requirement must be met at the end of the relevant tax year.

The only requirement that must be present at the time of the option (except for any new provisions regarding the annual "grace period"), but that may later be absent, without this causing the loss of the right to the special regime, is the floating requirement.

Conversely, the immediate termination of the special regime will be determined by the failure to comply with the obligation to distribute at least 70% of profits arising from real estate rental activities and from the possession of investments in SIIQs and SIINQs (as specified by the Italian Tax Authorities, the same effect is obtained from the failure to comply with the 50% distribution obligation, with regard to the net capital gains deriving from

27 It would need to be clarified whether the loss of residency constitutes grounds for immediate termination of the special regime, if a permanent establishment were to remain within the State, which deals primarily in the renting out of real estate and therefore possesses the right to exercise the option for the special regime.

28 In order for the loss of the regime to be actual – based on the legislative provision as it stands – both limits need to be surpassed at the same time (60% of rights to profits and 60% of the voting rights); therefore, it would seem reasonable to argue, despite the lack of official clarification on the point, that the surpassing of just one of the two requirements is not in itself adequate cause for revocation.

the transfer of real estate properties held for lease and of interest in SIIQs/SIINQs or in "qualifying" SICAF/Real Estate funds).

If one of the two above mentioned parameters of prevalence (income and assets) from the Exempt Activity is not complied with for three[29] consecutive tax periods, there is automatic loss of the right to the special regime with effect from the second tax period of non-compliance. If, on the other hand, neither of the two parameters is satisfied at the end of a tax period, the termination of the special regime comes into effect from that same tax period.

With regard to SIINQs, the causes of immediate loss of the special regime, in addition to those causes of loss of the regime indicated for SIIQs, insofar as they are applicable[30], also include the loss of the minimum shareholding requirements foreseen for SIIQs or other SIINQs, to different extents, by the two regulatory schemes introduced from 2022, respectively for Open SIINQs and Reserved SIINQs (see above § 8.3.2).

If one of the situations causing the loss of the special regime occurs, from a civil law point of view, this would imply the loss of the status of SIIQ (which would no longer need to be indicated in the company name and company documents), but it may continue to be listed on the regulated markets. In addition, there would no longer be an obligation to perform annual distribution of profits and to keep separate accounts and the provisions on supervision and statutory requirements would become inapplicable.

From a tax point of view, the consequences of the loss of the option can be summarized mainly in the loss of the tax exemption on income from the renting out of property (and similar activities) and the consequent restoration of the ordinary taxation rules in terms of IRES and IRAP, with the obligation to pay, in addition to the taxes due, also the default interests; on the contrary, penalties are not applicable.

Moreover, as previously explained, the losses derived from the Exempt Activity, produced during the special regime and not offset in virtual terms with the incomes from such Activity, may be used according to the ordinary

29 The tolerance towards non-fulfilment of one of the parameters of prevalence was extended from two to three tax periods by Article 20 of Law Decree no. 133/2014. However, the consequence of the loss of the regime, as with the previous governing rules, comes into effect from the second period of non-compliance.

30 It should be noted that from 2022 SIINQs may also take the form of limited liability companies or limited partnerships with shares, as well as joint-stock companies, provided that the minimum capital requirement for the latter (50,000 euros) is met.

rules of company income – to reduce the income produced under the ordinary regime.

With regard to the fiscal cost of investments held in a SIIQ or SIINQ, these must be decreased by the value of the reserves consisting of profits from the Taxable Activity and accumulated earnings (created prior to the application of the special regime) and subjected to ordinary taxation.

Nevertheless, after leaving the special regime, a company is still required to provide separate disclosure in the tax return of accumulated earnings from the Exempt Activity.

If the loss of the special regime occurs before the end of the three-year-period – during which the recognition of the capital appreciation of real estate properties and real property rights subject to entry tax is suspended – the original fiscal cost of the assets is restored (i.e. the recognized fiscal cost before opting for the special regime, minus the depreciation quotas calculated on that cost) and the entry tax paid constitutes a tax credit that can be deducted from IRES.

It is worth pointing out that the afore-mentioned presumptions (see sect. 3.3.8) regarding the distribution of reserves of accumulated earnings.

One should also mention the case where, pursuant to the provisions of Article 1 (119-bis), the company only satisfies the floating share requirement at the time of the option but not that of control. In this case, the entry tax, the substitute tax on capital gains from contributions and the mortgage and cadastral taxes (explained in the sections 3.4.1 and 3.4.2 below) are applied on a provisional basis until access to the special tax regime is achieved. If access to this special tax regime is not achieved, the taxes in question are recalculated and become due in the ordinary way by the end of the fourth tax year following the submission of the option. Taxes paid on a provisional basis constitute tax credits.

8.4. The regime of contributions

8.4.1. Direct taxes

The contribution of real estate properties or real rights over real estate properties to a SIIQ or SIINQ may generate forms of taxation against the contributor (whether a non-entrepreneurial natural person, an entrepreneur, or commercial company) in terms of direct taxation.

In this respect, the capital gains realised upon the contribution may be subject, at the choice of the contributor, to ordinary taxation or to a substitute tax in respect of income taxes (IRPEF and IRES) and IRAP at a rate of 20%.

The substitute tax regime is applicable irrespective of the nature of the contributor and of the fact that the capital gains are realized in the course of company business or by a non-entrepreneur. The substitute tax – as with the entry tax – may be paid in up to a maximum of five instalments of the same amount and is applied to capital gains arising from a contribution without taking account of any capital losses.

It should be noted that, for contributions made by companies, the application of substitute tax may also cover real estate properties that were intended for sale by the contributor. These properties need to be reclassified in the balance sheet of the transferee company as intended for leasing. As specified by the Tax Authorities[31], there are no specific penalties for failing to reclassify and it is confirmed on this point that any possible abuses of the favourable rules governing contributions may still be considered absorbed by the obligation to retain the properties that are being contributed for three years.

In fact, as established by Article 1 (137) of Italian Law No. 296/2006, the application of the substitute tax is subject to the retention by the transferee company of the property or other acquired real rights over the property for at least three years. If, before the expiry of the term of three years, the transferee company, even though in the meantime it has fallen from its special regime status, proceeds with the realization of the real estate properties or real rights received as a capital contribution, the fiscal cost of such property is assumed to be the fiscal acknowledged value applied to the contributor (namely the old tax value) and the substitute tax paid by the contributor is deemed a deductible tax credit for the transferee. Therefore, disposal prior to the end of the three-year period has consequences solely for the transferee company and has no significance for the contributor.

The advantage between ordinary taxation and substitute tax must be assessed in practice based on the nature of the contributor and the actual circumstances. By way of example and without limitation, if the contributor is a natural person who has owned the property being contributed for over five years, the ordinary tax regime would be more advantageous, since the aforesaid capital gains would not lead to taxation on the basis of the ordinary rules. With regard to companies, the ordinary tax regime is in general more

31 Circular no. 8/E of 2008.

advantageous in case of tax losses for the period or accumulated losses that can be used to offset the taxable capital gains.

8.4.2. VAT and indirect taxes

For VAT purposes, contributions in favour of SIIQs or SIINQs consisting of a number of properties that are mainly being rented out are considered similar to operations for the transfer of a company or of business units and are therefore excluded from the scope of the tax.

In order to verify compliance with the requirement of prevalence, it is necessary to analyse the use of the real estate properties owned by the contributor and the ratio between the actual value of the property units being rented out compared to the total value of real estate units that are the subject of the single transfer. The requirement is considered satisfied if the ratio is greater than 50%.

The prevalence of the properties being rented out must be verified on the date the deed of contribution becomes effective.

Contributions of properties that are primarily being rented out, performed by any party ("private" persons or entrepreneurs), are also subject to registration, mortgage and cadastral tax, at a fixed rate[32].

As regards contributions – other than those involving a number of properties that are mainly being rented out – as well as the sales of properties to SIIQs or SIINQs, the regime of VAT and registration, mortgage and cadastral taxes depends on the nature of the contributor and type of property (land, or residential building or building used in business operations). One should refer to the general comments made in Chapter 6 on the treatment of real estate contributions with regard to VAT and registration, mortgage and cadastral taxes.

In the event of sales/contributions of commercial/business buildings by parties subject to VAT, regardless of the kind of VAT applied (exempt or taxable), the mortgage and cadastral taxes are reduced by half and are applied, therefore, at a rate of 1.5% and 0.5%[33] respectively.

32 The comments expressed by the Tax Authorities in Circular no. 2/E para. 9.6 of 21 February 2014 are also considered extendible to SIIQs and SIINQs, with regard to the continuance of this treatment also in light of the recent removal of favourable conditions relating to real estate transfers.

33 See the previous note. See also note 107of the previous Chapter 5.

As already mentioned when discussing the effectiveness of the option for the SIIQ/SIINQ status, according to certain authoritative opinions[34], the rules governing indirect taxation on the contributions in question are immediately applicable for any contribution to a company that has made the option in the same tax period, even if this – which is revocable – produces its effects, as regards direct taxation, from the following year.

8.4.3. Contributions made by Real Estate Funds

In order to encourage the use of the institute in question and, in more general terms, to address the issues relating to Real Estate Funds "reaching maturity"[35], Law Decree No. 133/2014 provided for rules (with the inclusion of paragraphs 140-*bis*, 140-*ter* and 140-*quater* into Article 1 of Law No. 296/2006) introducing two different kinds of tax benefits, in order to promote the contribution of properties of Real Estate Funds into SIIQs.

The first concerns the contribution (in the act of total or partial liquidation) of the real estate assets by the Fund followed by the allocation to the Fund unit-holders of the shares of the SIIQ transferee (in exchange for the Fund units):

- though producing realization, this contribution operation will not involve income tax for the Fund (since it is exempt from direct taxes);
- the SIIQ will attribute a tax value to the contributed real estate properties that is the same as that found in the accounting records;

34 See Studio Tributario no. 98-2012/T by the Commissione Studi Tributari del Consiglio Nazionale del Notariato. This interpretation is based primarily on the legislative provision, which does not provide for a specific initial term for the rules governing indirect taxation on contributions, but only the actual exercising of the option and not its effectiveness. Even the instructions provided with the Circular 8/E of 2008 seem consistent with this view, which, with reference to contributions made at the time of constitution, has the advantage of not penalizing those companies in the startup phase that have opted for the special tax regime right from the initial tax period.

35 The real estate sector has, in fact, found itself in the situation of having to cope with the issue of the impending contract expiry and the concomitant obligation of liquidation of a large number of listed Investment funds. The expected flooding in the market (of about EUR 5 billion of real estate assets, according to Assoimmobiliare) could generate an excess in supply that would not be easy for the market to absorb, with probable adverse effects on the final performance of the Trust and on the redemption value of the equity invested. In order to facilitate the process of liquidation and transfer to similar instruments of property investment (as an alternative to the extended duration of the Trusts established by Article 22 (5-bis) of Law Decree no. 91/2014 enacted by Law no. 116/2014 of 20 August 2014) the system under examination here was introduced by the Legislators.

- the subsequent exchange of the units of the Fund with the shares of the SIIQ will not constitute realization for the purposes of income tax for the investors of the Fund, who may attribute to the SIIQ shares the same tax value as the exchanged units. In this way, the realization of a capital gain or loss relevant for tax purposes is postponed to the following event of realization of the participation in the SIIQ.

The Legislation also specified that the sale of shares and units performed during liquidation should be considered, for the purposes of Article 19-bis (2) of Presidential Decree No. 633/72, operations that do not form part of the normal business of the taxpaying party; this implies that these transactions, even if exempt from VAT, do not have a negative effect on the calculation of the extent of the contributor's right to the ("pro-rata") deduction.

In addition, when a contribution operation involves real estate properties that are for the most part rented out, this requires the application of the rules examined above governing the exclusion from VAT provided for in Article 2 (3) (b) of Presidential Decree No. 633/72, while the mortgage and cadastral taxes will be due in a fixed amount.

The favourable tax regime, as just described, will then apply also with respect to the second tax allowance rule, consisting of the liquidation of the Real Estate Fund through the allocation to the SIIQ of real estate properties that are for the most part rented out.

8.4.4. Effective date of the special regime for contributions

With regard to the effectiveness of the special regime provided for contributions, for direct and indirect taxes purposes, by paragraphs from 137 to 140-ter, the exercise of the option is relevant, or, in some cases, simply the fact that the exercise of the option has occurred "by the closing of the tax year of the transferor, during which the contribution is made", as clarified in Circular Letter No. 32/E of 2015. In this respect, it shall be considered that, in particular, the provision of paragraph 140, according to which the regime provided for by paragraphs 137 and 138, concerning direct and indirect taxes, is also applicable to contributions made in companies not yet listed, namely "companies that have not yet become SIIQs or SIINQ" (cf. paragraph 7.1 of Circular No. 8/E of 2008), provided that the stocks are admitted to trading "by the closing of the reporting tax period of the transferor, during which the allocation is made and provided that, by the same date, the same company opt for the application of the special regime". In conclusion, in the cases of contribution of real estate properties and real estate rights, the provision states that the requirement of listing, to be met by the transferor company for the purpose of the application of the regime by the transferee company, does not necessarily have to be verified before the contribution, provided that it is satisfied "by the end of the tax year of the transferor in which the contribution is made"[36].

8.5. The tax regime of shareholders

8.5.1. Distributions from SIIQs and SIINQs

Dividends distributed by SIIQs and SIINQs involve a differentiated tax regime depending on whether they derive from the distribution of profits relating to the Exempt Activity or the distribution of profits relating to the Taxable Activity.

When profits relating to the Exempt Activity are distributed and paid to shareholders other than SIIQs, a withholding tax of 26% is applied.

As already mentioned above in section 3.3.6, the level of withholding tax is reduced to 20% on the portion of income for the period attributable to rent agreements on residential properties stipulated pursuant to Article 2 (3) of Italian Law No. 431 of 9 December 1998, including the rent agreements on social housing[37]; as established by Art. 134 (1) of Italian Law No. 296/2006, this provision constitutes a waiver of the unification of the rate (to 26%) on the subject of investment income referred to in Article 3 (1) of Law Decree No. 66/2014.

The lower taxation, enjoyed by shareholders, on the dividends attributable to these special types of rent agreements was originally provided for

36 The provision was introduced in 2014 to deal with the issue, urgent at the time, The rule was introduced in 2014 to deal with the issue of the imminent contractual termination, with the simultaneous obligation to liquidate, of a large number of listed Investment Funds. This is an issue that is still topical despite the elapsed time, as demonstrated by the recent, further, extension provision introduced by Article 3, (1-bis) of Italian Law Decree no. 228/2021, enacted with amendments by Italian Law no. 15/2022, so-called "milleproroghe". Anyway, beyond the temporary needs for which they have been introduced, the provisions at issue constitute important system regulations, that facilitate the complementarity and permeability between real estate funds and SIIQs, as players in a single supply chain.

37 With regard to social housing that was built or recovered in accordance with Article 11 of Law Decree no. 112 of 25 June 2008, enacted with amendments, by Italian Law no. 133 of 6 August 2008, and Article 11 of the Annex to the Decree of the Chairman of the Council of Ministers of 16 July 2009 published in Official Gazette of the Republic of Italy no. 191 dated 19 August 2009.

in 2006 with the introduction of the legislation, but was repealed by the increases in the financial rates (first to 20% and then to 26%) provided for by Law Decree No. 138/2011 and Law Decree No. 66/2014. The lower taxation, as clarified in Circular Letter No. 32/E of 2015, is a derogation to the ordinary applicable rate provided for financial income; such a derogation applies on dividends received from the entry into force of the Decree No. 164/2014, that is 13 September 2014.

The withholding tax is applied as a provisional tax when the income is related to investments held in connection with the running of a business.

So, for those who hold investments in connection with the running of a business[38], the withholding tax of 26% does not complete the taxation of the dividends in question but is merely a down payment that will be deducted from the income tax payable on the basis of the tax return. Dividends, therefore, contribute fully towards one's taxable income and are subject to the reference tax rate for the perceiver in overall terms.

With regard to cases other than those examined, however, the withholding tax is applied by way of the actual tax and concludes the direct taxation on dividends received.

Withholding taxes are not applied to dividends distributed to other SIIQs, or by SIINQs to SIIQs holding investments in them.

Moreover, withholding tax is not applied for the following parties:

- supplementary pension funds pursuant to Legislative Decree No. 252/2005;
- collective investment undertakings established in Italy[39];
- individual portfolio management entities pursuant to Legislative Decree No. 461/1997.

It is also worth considering that Article 1 (631) of Italian Law No. 178/2020 provided for the non-application of the "ordinary" withholding tax on dividends under Art. 27 of Presidential Decree No. 600/1973 for foreign UCIs complying with Directive 2009/65/EC and for UCIs not complying with the aforementioned directive whose manager is subject to forms of supervision in the foreign country in which it is established pursuant to Directive 2011/61/EU, established in the EU Member States or

38 Individual entrepreneurs (if the investments are related to a commercial company); unlimited partnerships, limited partnerships and similar companies; companies and business entities; permanent establishments of non-resident companies and entities within the State.

39 As confirmed recently by Circular no. 11/E of 2012.

EEA Member States that allow an adequate exchange of information. The withholding tax repeal aims to eliminate discrimination with respect to domestic investment funds (in compliance with infringement procedure No. 8105/15/TAXU). However, the amendment in question did not intervene with reference to dividends related to the exempt management of SIIQs and SIINQs referred to in Article 1 (134) Italian Law No. 296/2006, despite the fact that even in this case a self-evident (and unreasonable) discrimination in favor of Italian pension funds and UCIs compared to their foreign counterparts may be involved. It is expected that legislative measures or clarification from the Italian Revenue Agency, in order to confirm the disapplication of withholding tax also with reference to Paragraph 134, will be provided.

When profits relating to taxable operations are distributed (with taxes already deducted from SIIQs or SIINQs), the ordinary rules provided for by the Income Tax Code apply. Consequently, while the exclusion from taxation of 95% is valid in general for parties subject to IRES (joint-stock companies, business entities, non-commercial entities, non-resident companies), for parties subject to IRPEF (non-entrepreneurial natural persons, sole proprietors, partnerships), the dividends received constitute their income at a rate of 58.14%[40], except in the case of dividends relating to non-significant investments not held in the running of one's business that are subject to a final withholding tax of 26% on the distributed amount. However, according to Law No. 205/2017, dividends paid out of profits earned up after the year current on 31 December 2017 – both relating to non-significant investments and relating to significant investments – are subject to the 26% withholding tax[41].

40 This rate is applicable only to the dividends deriving from profits earned up after the year current on 31.12.2016 to the year current on 31.12.2017. Dividends paid out of profits earned up after the year current on 31.12.2007 to the year current on 31.12.2016 are included in taxable income as to 49.72%. Dividends paid out of profits earned up to the year current on 31.12.2007 are included in taxable income as to 40%.

41 According to the transitional regime, with respect to non-significant investments, the dividends paid out from 1.1.2018 to 31.12.2022 deriving from profits earned up before 1.1.2018 are included in taxable base at the rates set out in the footnote no. 37.

8.5.2. Capital gains from the sale of investments in SIIQs or SIINQs realized by non-resident investors

The disposal of equity investments held in SIIQs and SIINQs can give rise to positive differences (capital gains) that are relevant for income tax purposes.

In general, the taxation of such capital gains does not benefit from the partial exemption regime applied on capital gains arising from the disposal of equity investments. Symmetrically, the general system of non-deductibility of negative differences (capital losses) does not apply for these investments. Therefore, capital gains generated from the sale of investments in SIIQs or SIINQS, as well as any capital losses, contribute towards the calculation of taxable income in terms of IRES and IRPEF of the transferor shareholder.

In consideration of the above, as regards the investments held as part of corporate business, since the regime of participation exemption cannot be applied to the capital gains under examination, it should be noted that the implementing measure, that is currently in force (Ministerial Decree No. 174/2007), includes provisions intended to make the exclusion from the exemption regime coherent even when the SIIQ or SIINQ carries out activities that fall into the category of the Taxable Activity. In fact, capital gains from investments in SIIQs and SIINQs which also perform taxable operations could reflect the advanced payment to the contributor of profits already taxed through the investee company (as they refer to the Taxable Activity) though not distributed yet[42].

To this end, the fiscal cost of investments is deemed to be increased by the proportion of profits from the Taxable Activity of the participated company, as well as the accumulated earnings set aside prior to access to the special regime and decreased by the proportion of such profits or reserves that are actually distributed. It was also established that, as a result of the subjection to capital gains taxation arising from the realization at fair value of real estate properties and real property rights on entry to the special tax regime, the fiscal cost of investments in SIIQs/SIINQs is deemed to be proportionately increased by the amount of capital gains (net of any capital losses) subject to entry tax.

42 As shown in section 3.3.4, however, it should be noted that since 2014 taxable operations have consisted of quite residual items (given that real estate capital gains and income from "qualified" Real Estate Funds, which once accounted for the typical and main income items from taxable operations for SIIQs and SIINQs, are now included among exempt operations); this is why the need for this provision remains valid in particular in relation to profits from tax periods prior to the recent legislative changes.

With regard to equity investments held by individuals outside the realm of company operations, the related capital gains are subject to the ordinary tax regime of the 26% substitute tax according to Article 5 (2) of Legislative Decree No. 461/1997.

8.5.3. Non-resident shareholders

The way the distribution of dividends to non-resident shareholders was handled – together with the recognition of capital gains arising from the sale of properties intended for leasing being classed as revenue from taxable operations – was one of the critical elements that hindered the success of SIIQs and SIINQs, especially with regard to the goal of attracting foreign investors, until the new legislative changes in 2014.

As a result of the provision in Article 1 (374) (d) of Italian Law No. 244/2007 which introduced paragraph 134-bis[43] of Article 1 of Italian Law No. 296/2006 and as clarified by the tax authorities[44], the dividends paid by SIIQs or SIINQs to companies resident in one of the EU Member States or European Economic Area relating to the profits from exempt operations – precisely as a result of this regime of income tax exemption – cannot take advantage of the regime of exemption from withholding tax, provided for by Community legislation (also called "Parent-subsidiary" Directive). On the contrary, however, they can take advantage of the "Parent-subsidiary" regime for dividends arising from the Taxable Activity.

The penalizing element arising from the impossibility of applying the Parent-Subsidiary Directive could be partly mitigated through the withholding applicability to dividend distributions drawn from the profit of exempt operations of the reductions provided for in Conventions against double taxation; an issue on which Decree Law No. 134/2014 intervened to settle possible application doubts, as shown in greater detail in the following paragraph.

43 According to that provision, for the purposes of the application of withholding tax, one must apply mutatis mutandis the provisions of Article 27-ter of Italian Presidential Decree no. 600/1973 (withholding tax regime on dividends relating to shares on deposit at Monte Titoli S.p.A.) with the exception of paragraph 6 (containing the reference to Article 27-bis of Italian Presidential Decree no. 600/1973, the regulation implementing the provisions of the "Parent-subsidiary" Directive that provides for the exemption, under certain conditions, from the withholding tax on dividends distributed by Italian companies to EU companies).

44 Circular no. 8/E of 2008.

8.6. Aspects relating to international relations

8.6.1. International conventions against double taxation

As is well known, the international Conventions against double taxation aim at regulating tax jurisdiction, typically in the context of income tax, in circumstances where two jurisdictions come into contact with a single event that produces income and they can potentially have both the right to tax.

In general terms, the Conventions apply to taxable persons resident in one of the two Contracting States. In this regard, therefore, for the purposes of applying a specific Convention, it is absolutely essential that the taxable person in question indicates itself as "resident" in one of the two Contracting States. According to Article 4 (1) of the Convention Model drafted by the OECD (which, as is well-known, was the model used to design almost all the Conventions against double taxation signed by Italy), a person shall be deemed to be "resident" in one of the two contracting countries if, according to the internal rules of that State, it is a taxable person by virtue of its domicile, residence or administrative headquarters or similar criterion. In accordance with the information contained in the Commentary to the aforesaid Article 4 of the Model Convention, a person is considered "resident" when it is "subject to taxation" in that State. Therefore, persons exempt from income taxes cannot be considered "resident" and cannot therefore benefit from the provisions of the Convention.

With reference to SIIQs and SIINQs, the issue of "residence" for the purpose of the Conventions was raised, since they benefit from an exemption regime with regard to their typical income. In that regard, it was believed that that SIIQs and SIINQs may be considered "resident" for tax purposes in Italy as they are subject to a form of partial exemption, of an objective nature and subject to conditions (which if not met render the exemption inapplicable) as well as they are ordinarily subject to IRES and IRAP on all proceeds that are not part of their Exempt Activity, in a similar manner to equity investment holdings that are (in some jurisdictions) fully exempt on their income from investments and are typically considered as "resident" entities for the purposes of the Conventions.

The lack of official clarification, however, had always been an issue regarding the applicability of such treaties. In this sense, Law Decree No. 133/2014 amended paragraph 134 of Article 1 of Italian Law No. 296/2006 by inserting the express provision that the Conventions against double taxations apply in case of taxation of profit distributions made to non-resident, when the other required conditions are met.

Thus, for our purposes, the regime of SIIQs is equated to that of Real Estate Funds[45].

In the case of SIIQs, moreover, the issue (addressed in Chapter 6) referred to income distributed by Real Estate Investment Funds, which, according to the Tax Authorities, should be included in the category of "interest", should not arise. In this case, there is no doubt about the statutory and fiscal nature of the "dividends" distributed by SIIQs (joint-stock companies).

With regard to the specific cases in which an issue regarding the application of the Conventions against double taxation to SIIQs may be raised, the following general situations may be considered:

- direct investment by a SIIQ or SIINQ in a real estate property located abroad.
- On this point, in concrete terms, the application (or otherwise) of the Convention would not lead to specific differences (and therefore becomes irrelevant) since, according to the OECD Model Convention and the Conventions signed by Italy, the right to impose tax on income relating to real estate properties is attributed to the country in which the property is situated;
- purchase of a stake in a foreign real estate company.

The legislative clarification on the applicability of the Conventions against double taxation is undoubtedly an important element in providing certainty regarding foreign investors' rights to this benefit, which enhances the attractiveness of the instrument. As specified in Circ. No. 32/E of 2015, the "new procedural rules" apply on dividends received from the date of entry into force of Law Decree No. 164/2014, that is from 13 September 2014. However, the tax authorities also affirmed that the application of the conventional rate, for the taxation of dividends received before 13 September 2014, depends on the date of the entry into force of the relevant Convention and not on the Italian legislation. This seems an acknowledgment about the purely declaratory and clarifying scope of the new provision, potentially applicable also for the past.

45 One remaining element of discrimination, however, may be found in the different treatment accorded to foreign "institutional" investors, namely pension funds and foreign UCIs, international entities (constituted on the basis of international agreements made enforceable in Italy), as well as central banks and agencies that manage official state reserves. While these entities are exempted from the application of withholding tax (pursuant to Article 7 (3) of Law Decree no. 351/2001) with reference to income from Real Estate Investment funds, they do not enjoy the same preferential treatment with regard to SIIQ dividends.

However, there are still certain elements of inconsistency, principally the one concerning the treatment of foreign investors who decide to establish a real estate business in Italy through a permanent establishment, rather than hold a stake in a SIIQ (legal entity/subsidiary). In this situation, an investor receives its dividends and incurs a straight 20% taxation (which is not deferred) as illustrated above – instead of being taxed at the time they are distributed through the application of a withholding tax of 26% and the possibility of significant reductions resulting from the application of the Conventions against double taxation.

8.6.2. Dividends paid by SIIQs

As already mentioned, dividends received by the members of a SIIQ are subject to a different tax treatment depending on whether they arise from profits generated by exempt operations or profits generated by taxable operations.

However, all the dividends paid to non-resident investors without a permanent establishment in Italy are generally subject to the withholding of tax by 26% on the distributed amount, whether they derive from profits generated by[46] tax exempt or by taxable operations[47].

The origin of the profits from taxable operations or from exempt operations is relevant in terms of the applicability of special provisions.

Dividends deriving from taxable operations paid to companies resident in the European Union may benefit from the following treatments (in lieu of 26% withholdings), under certain conditions:

- Withholding at source reduced to 1.20%[48];

46 Article 1 (134) of Law 296/2006. Pursuant to Article 1 (134-bis), of said Law, withholding tax is applied pursuant to the provisions of Article 27-ter of Presidential Decree 600 of 29 September 1973, which govern the application of substitute tax on the dividends paid to listed companies. Articles 3 and 4 of Law Decree no. 66/2014, converted and amended by Law no. 89/2014 provided for anincrease ofthe tax rate of financial returns from 20% to 26% from 1 July 2014. Circular 19/E dated 27 June 2014 of the Italian Revenue Agency has clarified that a 26% tax rate also applies to dividends paid by SIIQ and arising from real-estate leases (paragraph 3.1.1).

47 Article 27-ter of Presidential Decree 600 of 29 September 1973.

48 Based on Article 27 (3 ter) of Presidential Decree no. 600 of 29 September 1973, a withholding tax of 1.20% is applied on the dividends paid by a company resident in Italy to companies subject to corporate income tax and resident in a EU member State or in one of the States party to the Agreement on the European Economic Area included in the list set out in the Ministerial Decree issued pursuant toArticle 168-bis of the Consolidated Income Tax Code. In this regard,pursuant to Article 10 (3) of Legislative Decree no. 147 of 14 September 2015 any reference to the list of the States and territories that allow an adequate exchange of information pursuant to para. 1 of Arti-

- Exemption from withholding tax under the Parent-Subsidiary Directive[49].

If these beneficial treatments are not applicable, the standard 26% withholding tax rate may be reduced by applying (if existing) the Convention stipulated between Italy (State of the source) and the foreign State of residence of the investor. Treaty provisions are particularly relevant when the investors are not resident in the European Union.

The dividends deriving from exempt operations paid to companies resident in the European Union are not eligible for withholding tax exemption under the Parent-Subsidiary Directive (Article 1 (134) of Law 296 of 27 December 2006)[50].

They are however eligible for the benefits provided for in the treaty between Italy and the investor's foreign State of residence (Article 1 (134) of Law 296 of 27 December 2006)[51].

Finally, it should be noted that the dividends paid by SIIQs, whether derived from exempt or taxable operations, are not subject to any exemptions from the application of the withholdings at source under domestic regulations if such dividends are distributed to foreign institutional investors, as for instance real-estate funds (further details can be found in Chapter 6) thus also creating an unreasonable asymmetry of treatment with respect to real estate UCIs that is not very reasonable from the point of view of the tendency to assimilate investment instruments. It is desirable that also on this point the Legislator may intervene shortly, so as to reduce unjustified different treatment with respect to instruments that should, in essence, be subject to similar disciplines.

The treaties entered into by Italy do not make specific provisions concerning the income distributed by SIIQs.

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cle 168-bis of the Income Tax Code is to be understood as reference to the decrees issued in implementation ofArticle 11 (4 - c) of Legislative Decree no. 239 of 1 April 1996. Pending the enactment of these decrees, the States allowing an appropriate exchange of information ("white-listed") are to be identified with reference to the Ministerial Decree dated 4 September 1996, and subsequent additions and amendments.

49 Adopted in Italy through Article 27-bis of Presidential Decree no. 600 of 29 September 1973.

50 Circular of the Italian Revenue Agency no. 8/E of 31 January 2008, Para. 6.1. According to the Revenue Agency, SIIQs do not qualify as "subsidiaries" within the meanings of Directive 435/90/EEC, since they benefit from exemption from corporate income tax for the portion of income deriving from exempt operations.

51 Article 1 (134), of Law 296/2006, as amended by Article 20 of Law Decree no. 133/2014 clarified that the treaties for the avoidance of double taxation entered into by Italy also applied to the distribution of dividends derived from exempt operations.

The Italian Revenue Agency has not provided clarification regarding the reference rule of the OECD Model to be applied to distributions by SIIQs. Nonetheless, it is reasonable to conclude that such distributions are subject to Article 10 of the OECD Model concerning dividends. As discussed above, that provision indicates that dividends may be taxed in both the State of the source of the income (Italy) and the State of residence of the beneficiary. In any event, taxation in the source State may not exceed the limit established by treaty if the person who receives the income is also its "beneficial owner".

8.6.3. Capital gains on disposal of a SIIQ's shares

In the case of gains from realization of interests in a SIIQ, a distinction must be drawn between qualifying and non-qualifying holdings for the purposes of Article 67 (1) (c) and (c-bis) respectively of the Consolidated Income Tax Act.

Capital gains realized by non-residents from non-qualifying interests in a SIIQ are not generally subject to taxation in Italy under Article 23 (1) (f) No. 1 of the Consolidated Income Tax Code. Accordingly, in such cases no double-taxation issues arise for the non-resident.

Capital gains from the transfer of qualifying holdings in a SIIQ are counted entirely[52] as income for the non-resident investor and are fully taxed in Italy with the possibility of applying double taxation treaties[53].

These rules are confirmed also following the changes introduced by Law No. 197/2022 (Budget Law 2023)[54], according to which:

- capital gains arising from the transfer of shares in non-resident companies and entities, more than half of the value of which derives, at any time during the 365 days preceding their transfer, directly or indirectly, from immovable property located in Italy, are considered to have been produced in the territory of the State[55];

52 Article 1 (135), of Law 296 of 27 December 2006.

53 Please note that according to Article 1 (61) Law no. 208 of 28 December 2015, starting from 1 January 2017, the previous IRES rate of 27.5% was reduced to 24%

54 Which introduced paragraph 1-bis into Article 23 of the Consolidated Income Tax Act and paragraph 5-bis into Article 5 of Legislative Decree No. 461/1997.

55 Real estate to the production or exchange of which the business activity is effectively directed, as well as real estate used directly in the conduct of the business, are not considered to be taxable in Italy. In addition, the taxability in Italy does not apply to capital gains realised by foreign UCITs complying with Directive 2009/65/EC of the European Parliament and of the Council of

- the tax exemption no longer applies to capital gains deriving from the sale of non-qualified participations in resident companies and entities held by non-residents established in ‘white-listed’ States if the relative assets are prevalently constituted by real estate located in Italy[56].

Such new rules are not applicable to the transfer of securities traded on regulated markets, which therefore preserves the non-taxability in Italy of the transfer of non-qualified participations in SIIQs (necessarily listed).

On the other hand, with regard to the transfer of shares/units in SIIQs (as they are unlisted) effected as of 1.1.2023 by non-residents, even where the participation is non-qualified and even if the transferor resides in a “white-listed” State, as a result of the aforementioned regulatory changes, the related capital gains are taxable in Italy.

Anyway, there still remains the possibility to such tax capital gains in accordance with the regulations of double tax treaties where they provide, pursuant to Article 13(1) of the OECD Model, for exclusive taxation in the country in which the SIIQ/SIINQ participation transferor is resident and do not have special provisions for companies with a predominantly real estate content (so-called land-rich clause)[57].

It is also necessary to take into consideration the signing of the Multilateral Convention to amend double tax treaties, signed on 7 June 2017 as part of the BEPS Project, currently not yet in force in Italy (as the ratification procedure has not yet been completed) the implementation of which

13 July 2009 and by foreign UCITs, not complying with the aforementioned Directive 2009/65/EC, whose manager is subject to forms of supervision in the foreign country in which it is established pursuant to Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, established in the Member States of the European Union and in the States party to the Agreement on the European Economic Area which allow an adequate exchange of information.

56 Pursuant to Article 5, paragraph 5, of Legislative Decree No. 461/1997, capital gains and capital losses, as well as income and losses referred to in subparagraphs c-bis) to c-quinquies) of paragraph 1 of Article 67 of the Consolidated Income Tax Act, received or incurred by: a) persons resident abroad, referred to in Article 6, paragraph 1, of Legislative Decree No. 239 of 1 April 1996, as amended;[insert reference to how the amendment operates]. 239, and subsequent amendments;[insert reference to how the amendment operates]. By effect of paragraph 5 bis below, with effect from 1.1.2023, the provisions of paragraph 5 shall not apply to income deriving from the disposal of participations in companies and entities, not traded in regulated markets, more than half of the value of which is derived, at any time during the three hundred and sixty-five days preceding their disposal, directly or indirectly, from immovable property situated in the territory of the State.

57 In which case the actual application of the treaty rules will have to be assessed on the basis of the (not always homogeneous) content of these clauses.

will entail significant changes in the criteria for taxation of capital gains[58]. Specifically, pursuant to Article 9 (4) of the Multilateral Convention, capital gains accruing to a resident of a contracting State following the transfer of shares (or equity interests considered similar to shares) will be taxable in the contracting State if, at any time during the 365 days preceding the sale, such shares or equity investments comparable to shares have derived more than 50% of their value directly or indirectly from real estate located in that contracting State. Therefore, foreign investors in Italian SIIQ (with reference to qualifying holdings) and SIINQ, when the Multilateral Convention will be in force, they will lose, will lose the benefit of tax exemption in Italy on the capital gains realized at the time of the divestment, as is currently granted in compliance with Article 13 of most double taxation treaties[59][60].

8.6.4. Credit for taxes paid abroad

A tax credit equal to the tax that would have been creditable in the absence of the special tax regime is attributed for income taxes paid abroad by a SIIQ or SIINQ, in relation to real estate properties owned in that country and that come within its Exempt Activity. The legislative provisions relate to real estate properties located abroad, included in the Exempt Activity and held by way of ownership, usufruct or other real property rights, as well as on the basis of financial leasing contracts.

In addition, according to the provisions of Article 165 of the Income Tax Code, the taxes paid Wabroad must have been paid "definitively".

58 On the contrary, the Multilateral Convention should not require any change to the agreements signed by Italy with regard to the dividend regime. In fact, Italy has reserved the right not to apply Article 8 of the Convention which makes provisions regarding that income.

59 The concrete applicability of Para. 4 of Article 9 of the Multilateral Convention depends on reciprocity. The meaning to be attributed to the term "reciprocity" is indicated by the same Multilateral Convention. In particular, as highlighted in Article 9 (8) "each party that opts to apply paragraph 4 shall notify the Depositary (the other Contracting State) of its choice. Paragraph 4 applies to a covered tax agreement only if all the contracting jurisdictions have made such a notification".

60 Unless the applicable convention already contains a provision derogating from taxation in the State of the (residence) transferor in favour of the State where the immovable property held by the entity is located (source State).

9.
The "real estate" companies established under Law 130/1999 within the context of securitization transactions

by L. Dal Cerro, V. Mileto

9.1. Foreword

Securitization is a process through which one or more assets, usually financial, undivided and illiquid but capable of generating cash flows – such as bank receivables – are "transformed" into securities, *i.e.* assets easier to divide and transfer.

Due to their connection with the underlying securitized assets, these securities are called asset-backed securities (ABS), and can be of various kinds: mortgage-backed securities (MBS), whose under- lying are mortgages, collateralized debt obligations (CDOs), whose underlying are public or private bonds, asset-backed commercial papers *(*ABCPs), whose underlying are represented by short-termreceivables.

An *ad hoc* vehicle incorporated for the transaction – so called special purpose vehicle (SPV) – plays the primary role in the securitization process: purchasing illiquid assets and issuing securities representing the underlying asset.

In Italian law, the transaction described above is regulated by Law No. 130 of 30 April 1999. It is certainly a capital market transaction with financing purpose. However, as a result of the measures that over time have updated the securitization law to the market practice, securitization has lost its financial nature and has taken on an abstract, or rather "variable",nature. Indeed, as an example, and as better analysed below, it is possible to use the securitization vehicle as a pure real estate investment vehicle in the real estate industry. For this reason, the chapters describing the role of the securitization vehicle and more generally of the "real estate" vehicles set up in the context of Law No. 130, quoted, have been included in the broader section dealing with real estate tax regulation in the context of real estate investment instruments.

In particular, the following chapters deal with the tax issues ofcompanies that purchase real estate assets or real estate rights, having in common their incorporation pursuant to Law No. 130, quoted, on securitizations.

More in detail, there are three such figures introduced starting from 2017:

- the SPV securitizing real estate assets and related rights, *i.e.* thecompany incorporated for "securitization transactions of proceeds deriving from the ownership, by the same company, of real estate assets, registered movable assets and rights *in rem* orpersonal rights relating to the same assets", originally includedin the securitization law by the L. No. 145 of December 30, 2018 (the "**2018 Financial Statements Law**"), which was then better regulated due to the changes made by the *Decreto Crescita* withthe amendment to Article 7, paragraph 1, letter b-*bis*) of Law No. 130, quoted, and with the introduction of Article 7.2 of LawNo. 130, quoted.
- the vehicle supporting the SPV securitizing mortgage receivables (better known in the market practice as real estate operating company or "**ReOCo**"), so renamed following the amendments made by Decree Law No. 34 of 30 April 2019 (the "**Decreto Crescita**") to Article 7.1, paragraph 4 of Law No. 130, quoted;
- the vehicle supporting the SPV securitizing leasing receivables (known in the market practice as "*LeaseCo*"), so renamed following the amendments made by the *Decreto Crescita* to Article 7.1, paragraph 4-*ter* of Law No. 130, quoted.

As for the first real estate company, regulated by the Law No. 130, quoted, the placement of such investment vehicle in the chapter of "real estate investment instruments" seems the most appropriate, considering that is a an "ordinary" real estate company with the special segregation regime of securitization companies. However, it should be noted that the latter is also able to carry out transactions with a prevalent financial function, albeit through the purchase of real estate assets (e.g. sale and lease back transactions).

Such considerations cannot be extended to the other two real estate companies, which act as transferees of the real estate assets precisely in the default phase of the financing relationship.

9.2. Structure of securitization transactions (of receivables). Notes about asset separation

As mentioned above, the securitization is a complex financial technique aimed at achieving a process through which receivablesor other non-negotiable financial assets generating periodic cash flows are converted into financial products represented by negotiable securities, which can be placed on the markets through theirsale to a specialized entity.

With the securitization transaction, the future cash flows deriving from a company's portfolio of assets are sold to a specialized entity that "repackages" them and presents them on the market in the form of securities with return and risk consistent with the prevailing market conditions, and can be placed with investors. Thus,the cash flow is shifted from the market to which the securitized assets belong to the capital market.

One of the essential aspects for determining the accountingand tax regime of the companies analyzed in this chapter is the so-called "separation" or "segregation" of assets generated by the securitization vehicle with regard to the securitized assets.

As mentioned above, the securitization transaction normally requires the incorporation of a specialized intermediary (*i.e.* the securitization vehicle) which issues the securities and, through the funds collected from the subscription of the securities, acquires the assets object of the transaction. The purpose of setting up an "intermediate" vehicle is to ensure the complete independence of the securitized assets from the assets and events affecting both the transferor's assets (the so-called originator) and the general assets of the acquiring vehicle (creating the so-called bankruptcy remoteness). In any case, the securities are issued with the "limited recourse" clause, according to which the payment of interest and the reimbursement of the sums given at the time of subscription can only happen on condition that the collection relating to the assets purchased with the sums collected through the issue of the securities takes place. Therefore, the issuer is not liable *vis* à *vis* the holders of the securities except within the limits of the separate portfolio and the actual amount of assets purchased.

The segregation of assets and related flows is the most important aspect of the process. In order to achieve segregation, it is necessary that the vehicle is not influenced by the events of the transferor (and in particular by the risk of bankruptcy of the transferor).To this end, it becomes necessary that:

- the vehicle is completely independent of the originator in legal,economic and financial terms;
- the vehicle's activity is limited and it turns its activity exclusively to the purchase of assets subject to securitization, without carrying out other different transactions;
- the transfer is made without recourse.

Thus, in order for the acquired portfolio of assets to be exclusively intended to secure the payment of income to the subscribersof the securities issued, it is also necessary to "isolate" the portfolio from events that concern the securitization vehicle but which are extraneous to the portfolio itself. This purpose is obtained by preventing actions against the portfolio by creditors outside the portfolio.

From a regulatory perspective, the separation of assets is guaranteed by paragraphs 1 and 2 of Article 3 of Law No. 130 of 1999.The first paragraph states that the exclusive object of the vehicle is to carry out one or more securitization transactions. The second paragraph specifies that "*the receivables relating to each transaction constitute assets separate in all respects from those ofthe company and from those relating to other transactions*" and that "*no claims on the assets are admitted by creditors other thanthe holders of the securities issued to finance the purchase of the receivables*".

In essence, each issue of notes has as its basis one or more receivables – in fact "segregated" or "separated" – purchased by thespecial purpose vehicle, well defined, not modifiable and referringexclusively to each specific issue of notes. The provisions of the second paragraph of Article 3 implies the impossibility of aggressionof the separate assets by parties other than the holders of the specific notes issued to finance the purchase of the receivables that constitute that relevant assets. In other words, each securitization transaction shall remain distinct from the others since the individual assets cannot be directly claimed, neither by the so-called personal creditors of the assignee/issuer company or by those whohave claims against a different asset, even though they are managedby the same company. The segregation of the portfolio is only intended to avoid the risk of a dispersion of collections or the possibility for such assets to be claimed by third parties but it does not solve the problem of a possible insolvency of the debtors of the relevant portfolio.

Moving on from the effects of the separation/segregation process summarized herein, the Italian tax authority had the opportunity to clarify the tax regime applicable to securitization vehicles for income tax purposes with Circular No. 8 of 6 February 2003[1]. In this document, the Italian tax authority admits that, "*since the restriction on the allocation of the segregated assets continues to apply,the securitization vehicle is not the recipient of any income or interestby itself that may be relevant from a tax point of view in the individual tax periods in which each securitization transaction takes place*".In essence, due to the fact that the economic results deriving from the management of the securitized assets, in the course of carrying out the securitization transactions, do not enter into the availability of the special purpose vehicle, receiving them in the exclusiveinterest of the holders of securities, the Italian Tax Administration states that any income element deriving from the transaction is nottaxable in

1 In accordance, resolution No. 222/E of 5 December 2003 and resolution No. 77/E of 4 August 2010.

the hands of the vehicle. In other words, the restriction on the destination of segregated assets excludes *a priori* that the securitization vehicle holds an income relevant for tax purposes[2].

In confirmation of this, the Italian Tax Administration refers tothe Bank of Italy's measures[3], according to which the securitized receivables and the income components deriving from them are not indicated in the balance sheet and income statement of the securitization vehicle, according to the so-called "under the line" accounting regime but are shown separately in the notes to the statements.

The separation of the assets relating to the securitization transaction and the tax regime deriving from it, as clarified by the Italiantax authorities, is the fundamental and common feature of all the vehicles examined in this chapter.

The similarity in this context between the various securitization vehicles has been confirmed by the Italian tax authority in itsrecent ruling No. 132 of 2 March 2021. This document of practice,although specifically aimed at analyzing the various tax profiles ofproceeds deriving from the ownership of real estate property and registered movable property in the hands of securitization companies (which will be discussed in greater detail below in 9.3), has confirmed once again the principle of "fiscal neutrality" applicablebecause of the separation of assets, firstly, to the so-called "vehicle supporting" the ordinary Securitization Vehicles, securitizing mortgage loans (already defined as ReOCo or SVA), and then extended it to the real estate securitization companies referred to in 9.3. Correctly, the Tax Authority has reiterated what had already been argued in 2003 in a very explicit and clear manner but this time with specific reference to the vehicles dealt with in this chapter: "*the presence of a restriction on the destination of the 'segregated'assets excludes a priori a possession of the relevant income for taxpurposes, pursuant to article 83*

2 According to the Italian Tax Administration, any residual net income from the re ceivables portfolio remaining once all the creditors of the segregated assets have been satisfied, and of which the securitization vehicle is the beneficiary, must be attracted for taxation when it comes into the possession of the beneficiary, i.e. at the end of each securitization transaction. It is only at this point in time that the "certainty" necessary for an income component to be able to contribute to taxable income for income tax purposes are created.

3 At that time, the measure of 29 March 2000, gradually updated and replaced in subsequent years also with significant amendments. Such amendments have raised perplexities regarding the fact that the so called "under the line" accounting is still correct for securitization vehicles. Such perplexities did not have any consequence in the market practice, but have created doubts between scholars. See Paragraph 4-*bis* of Article 7.1 of Law No. 130 of 1999.

of the Italian tax code". This document of practice together with other recent ones that will be mentioned below, outlines the position of the Tax Authority in relationto ReOCo, LeaseCo and real estate securitization companies, and will be referred to several times during the course of this chapter.

9.3. The securitization company of the proceeds from ownership of real estate (and registered movables) and related real and personal rights

Law no. 15 of 30 December 2018 ("**Legge di Bilancio 2019**") deserves credit for having set up the securitization of "real estate proceeds" in the private sector[4], by adding letter b-bis) to the first paragraph of Article 7 of Law No. 130 of 1999. As a result, the legislation on securitization was applicable, as compatible, to "securitization transactions of income deriving from the ownership of real estate, registered movable property and right in rem or personal rights relating to the same assets". The Decreto Crescita then enriched this wording, giving greater completeness to the regulatory framework on the subject by introducing the new article 7.2 of Law No. 130, quoted, entitled "securitization of real estate and registered movable property" in order to foster the provisions introduced by the Legge di Bilancio 2019 with a minimum regulation.

Article 7.2 establishes some fundamental principles applicable to real estate securitizations:

- firstly, special purpose vehicles can only be used for the securitization of real estate proceeds and cannot also carry out moretraditional (receivables) securitizations;
- also with respect to real estate proceeds securitization, the principle of capital segregation and so-called bankruptcy remoteness characterizing the operations of securitization vehicles is applicable. It is clear from the second paragraph of the rule thatthe object of the segregated assets is not only the object of the securitization, i.e. the "proceeds" that derive from

4 The securitization of real estate proceeds was in fact a technique adopted for the privatization of public real estate assets in the early 2000s. For these purposes, public real estate securitization companies (so-called SCIPs) were introduced into the system by means of special regulations. In fact, Article 2 of Decree Law No. 351 of 2001 authorized the Ministry of Economy and Finance "to set up or promote the setting up, also through third parties, of several limited liability companies, with the exclusive purpose of carrying out one or more securitization transactions of the proceeds deriving from the disposal of the real estate assets of the State and other public bodies".

the ownership of real estate assets and related rights, but also the same assets and rights on such assets.

- It is now fair to say that the intention of the legislator was to introduce a new securitization scheme (the one of the proceeds deriving from the ownership of registered immovable and movableassets and certain rights on the same assets) completely detached from other more traditional transactions and different from the operation of the recent amendments to the law, aimed at making the securitization law a more versatile instrument in the contextof securitization transactions of non performing loans having as underlying immovable assets or leasing relationships.

The measure, initially welcomed by the market with moderate enthusiasm, has recently been validated by the Italian Tax Authority with the clarifications provided by the ruling No. 132 of 2 March 2021.

The Italian Tax Authority has actually provided confirmation of the tax regimes applicable to the vehicle and to the securities issued by it, for the purposes of direct taxation (rectius, IRES, IRAP), the application of substitute tax and (in part) also of the applicable VAT regime, thus definitively clearing this instrument.

9.3.1. Separation of assets and direct taxes in the securitization of real estate income

The second paragraph of Article 7.2, quoted, on the securitization of real estate proceeds borrows from the regulations on the securitization of loans (Article 3, paragraph 2, Law No. 130, quoted) the same wording adopted to provide for the capital separation between, on the one hand, the assets subject to the securitization and, on the other hand, the assets of the securitization vehicle and the assets subject to other securitization transactions. In other words, the allocation restriction in favour of the holders of the securities issued by the vehicle is stated with the same words already used for the securitization of the receivables. The use of the same words therefore gives rise to the same accounting and tax considerations for real estate securitization vehicles as those already mentioned with regard to receivable securitization vehicles (paragraph 9.2).

In this regard, the report on the first version of the draft decree (dated 2 April 2019) which would later become the Decreto Crescita explained that "the provision provides for the application to real estate securitization companies of a homogeneous tax neutrality regime with respect to that applicable to companies for the securitization of receivables, as well as to securities issued by them”. This clarification, which was certainly very explicit, was then rewritten in the report to the subsequent (and final) version of the draft Decreto Crescita (dated 23 April 2019): “the article sets the characteristics of such companies in line with the provisions for securitization and backing companies”. Any reference to securities disappears and reference is made in a generic manner to the characteristics, without mentioning tax neutrality. Nevertheless, since the content of the first and the second version of the draft decree has not changed in any way, it seems reasonable to consider that what has already been argued with regard to asset segregation and tax neutrality of receivable securitization vehicles, the SVA and the SVA of Leasing is also true with regard to real estate securitization vehicles governed by Article 7.2 of Law No. 130, quoted.

Precisely with regard to the securities issued by the real estate securitization vehicle, mentioned in the report but not by the amendments to the Decreto Crescita, it is fair to say that the tax treatment provided for by Article 6 of Law No. 130, quoted, which refers to Legislative Decree No. 239 of 1996 (applicable to bonds issued by banks and listed companies) can also apply to these securities. It is true, however, that, from a literal point of view, Article 6, quoted, refers (by reference to Article 5 of the same Law No. 130) only to securities issued to finance the purchase of receivables and would be applicable only by reason of Article 7, Paragraph 1 of Law No. 130, quoted. The latter provision extends the application to real estate securitization (as well as to the other securitizations mentioned therein) of all the provisions of Law No. 130 “insofar as compatible” and therefore also Article 6 on the tax treatment of securities. Such interpretation makes sense not only for reasons of consistency with the regulatory system dedicated to securitization, but also because, reasoning otherwise, the application of Article 6, quoted, should be excluded to all those securitizations that do not provide for the issue of securities against the purchase of receivables (e.g. synthetic securitizations pursuant to Article 7, paragraph 1, letter b) of Law No. 130, quoted, or securitization for the disbursement of receivables pursuant to Article 1, paragraph 1-ter of the same Lawn No. 130). Something that has never found any confirmation by the Italian tax authority and in the market practice.

All of the foregoing, both with regard to the separation of assets and with regard to the securities regime, has also been confirmed by the Tax Authority in ruling No. 132 of 2 March 2021, already mentioned several times.

9.3.2. Real estate proceeds' securitization company regime for indirect tax purposes

The regulation on the securitization of real estate proceeds does not contain any provisions on indirect taxes. In the absence of specific references in this regard, there are no regulatory elements to extend to the securitization company the application of the relief rules reserved for ReOCo and LeaseCo that will be described in the following sections. Neither it seems that there are grounded reasons to justify an extensive reading of these rules, also because of the different function (mentioned in the introduction) that the securitization special purpose vehicle company plays compared to the other "new" real estate companies created with the *Decreto Crescita*[5].

The only indication of any usefulness arising from the set of laws and interpretations relating to the ReOCo is the confirmation by the Italian Tax Authority that apply the ordinary provisions on indirect taxes in the absence of specific tax relieves. In the ruling No. 18 and 56 of 2019, commenting on Article 7.1, quoted, preceding the amendments of the *Decreto Crescita*, the Italian Tax Administration appears to reach this conclusion considering the real estate nature of the activity actually carried out by the ReOCo, although within the particular function of the same. In a similar way, it seems reasonable to give importance to the *de facto* activity carried out by the vehicle companies for the securitization of real estate proceeds, despite the peculiarities of these companies.

In this sense, the Tax Authority confirmed, for VAT purposes, the tax subjectivity of a securitization vehicle for real estate proceeds and, consequently, the application of the ordinary regime by reason of the (real estate) activity carried out. Similarly, for the registration, mortgage and cadastral taxes purposes, the Italian Tax Authority validated the rules generally applicable to companies carrying out real estate activities and, as a result, correctly excluded, as noted above, the extension of the benefits provided for ReOCo and LeaseCo.

However, it is worth noting something about VAT. In its answer to the abovementioned ruling, the Authority stated that "The Company carries

5 A confirmation of this, in a negative sense, is a passage from the explanatory report to the first version of the draft decree-law that would later become the Decreto Crescita. In the explanatory part of Art. 7.2, quoted, there is an explicit reference to a third paragraph-which was not later confirmed in the final version of the provision-that would have stated the fixed amount for deed taxes applicable to the purchase of real estate by the special purpose vehicle.

out a management activity of its ‘separate’ assets similar to that of ReO-Co, the revenues of which, however, are not transferred to a securitisation company, but kept for its own account as it is used for its other activity, which is securitisation. In the end, the property management activity of the Vehicle is functional and instrumental to the securitisation activity carried out by it”. In this statement they seem to want to confine the real estate activity carried out by the vehicle to a “merely instrumental” activity and that this activity cannot therefore be qualified as principal, without going to the extreme of denying the real estate nature of the activity of the securitisation vehicle (real estate) – as happened with reference to public securitisation companies[6]. In fact, it would only be instrumental to the securitisation, which is the main activity. If this excessively restrictive interpretation were to be confirmed, it might be more difficult to apply those rules which expressly require that the taxpayer’s exclusive or principal object be, for example, the activity of construction company (including, among others, Article 19-bis.1, let- i) of Presidential Decree No. 633 of 1972[7] concerning deductions on purchases of residential buildings and the connected services).

Another issue under discussion is the possibility for a real estate securitization company to access the refund of the VAT credit resulting from the annual return under Article 30, paragraph 3(c) of Presidential Decree No. 633 of 1972, i.e. limited to the tax related to the purchase of depreciable assets. More specifically, there is a debate as to whether, because of the “below-the-line”

6 Please refer to Italian Tax Authority, rulings No. 215/E of 2002 and No. 69 of 2009.

7 According to which, by way of derogation from the ordinary rules governing the deduction of VAT, where VAT relating to the purchase of buildings, or parts thereof, for residential use or the VAT relating to the rental or maintenance, renovation or management of those buildings, is not deductible unless the company carries as its corporate object the exclusive or principal purpose of construction of such buildings or parts. Regarding this rule, please refer to the considerations made, in this volume, by Mantegazza, Galli, *La tassazione degli immobili residenziali*: in a nutshell, on the basis of an interpretation focused on the safeguard of the provision in the EU context (elaborated by the judges of the Italian Supreme Court), the rule should provide not a case of objective non-deductibility, but rather a condition of enhanced deductibility, in the sense that the deduction on the purchase of residential buildings is not per se precluded, but for these purposes the demonstration of inherence and instrumentality to the taxpayer’s business activity on the basis of concrete and objective elements is required. However, this is a theory that has been accepted by the tax authorities only with reference to residential buildings used by the taxpayer in the context of a hospitality-type activity, in a practice document (in particular, Resolution No. 58/E of 2008) that in any case moves from the general consideration that “the non-deductibility of the tax concerns residential buildings that have been found to be such by the cadastral results and, in general, is irrespective of their actual use”.

accounting representation of the real estate purchased, the aforementioned refund is generally precluded for a securitization company, regardless of the concrete use of the asset; or whether, on the other hand, it is necessary to assess on a case-by-case basis what the function of the asset is in relation to the activity concretely carried out by the vehicle (e.g. pure real estate trading activity, development activity, management activity) and the nature of the asset (which must be of durable use and subject to progressive wear and tear). In this regard, without dealing exhaustively with all the extensive case law on the subject, it is worth noting that, none of the positions expressed with regard to the notion of "depreciable asset" by the tax authorities[8] and the case law[9] give relevance to the accounting representation adopted in practice by the taxpayer. All of these positions look at the nature and concrete use of the asset within the scope of the taxpayer's business. In line with this approach, considering that today there is not an explicit position in relation to the entitlement of this type of refund to a securitization company, it would make sense therefore, not to preclude per se a securitization vehicle from accessing the refund of the excess VAT credit resulting from the annual return, but to proceed on a case-by-case basis with the analysis in relation to the nature and use of the asset.

9.4. ReOCo: the vehicle supporting mortgage securitization transactions

This section goes into the main aspects relating to the operation of a so-called "support vehicle" also to the securitization company of receivables backed by mortgages (referred to as ReOCo or SVA), as renamed following the amendments made by the *Decreto Crescita*to Article 7.1 of Law No. 130 of 30 April 1999 on securitizations,with particular consideration to the main relevant tax implications.

8 Inter alia, see Resolution No. 179/E of 2005, in relation to the VAT refund paid on the down payment paid on the preliminary purchase of real estate and on the expenses on third-party real estate, and No. 147/E of 2009, for which the reference criterion for identifying depreciable assets should be the rules of the TUIR (thus only capital assets are considered depreciable, i.e., those assets that are used in the production process directly by the entrepreneur who has possession of them by way of ownership or other right in rem).

9 *Inter alia* see Italian Supreme Court, judgements No. 13315/2013 and No. 24779/2015 (basically in line with the positions of the Italian Revenue Agency). See also judgement No. 19481/2016, which ruled out the conditions for refund in the case of land, and judgement No. 24518/2020, which ruled that the denial of refund was legitimate with regard to extension works carried out on third-party property on loan.

Pursuant to paragraph 4 of Article 7.1, quoted above, ReOCo is the joint-stock company whose exclusive corporate purpose is to acquire, manage and enhance, in the exclusive interest of the securitization transaction, registered movable assets and real estateassets as well as other assets and rights in any form pledged as collateral for the securitized loans.

The existence of a parallel vehicle to the securitization company to maximize the value of the underlying real estate in the loan portfolio is nothing new in the market practice. In fact, the above regulation is the effort to render typical and to regulate structures already present in the market for years, developed by the creativity of operators to overcome the investment limits of "traditional" credit securitization companies. In essence, the main function ofa ReOCo is to avoid that, during execution, assets pledged as collateral for receivables purchased by a securitization vehicle, alternatively, (i) remain unsold for a long time or (ii) are sold at a low price. In these cases, ReOCo, in agreement with, and in the interestof, the securitization vehicle, intervenes in the enforcement proceedings in a "defensive" manner. That is to say, either with the purpose that the real estate is sold at a "fair" price or, in the absence of bidders who buy a satisfactory price, with the purpose of purchasing the assets, give value to them and retransferring them to the market in order to allow a better performance of the receivables ofthe securitization vehicle. Nothing precludes ReOCo from operating with a different, more speculative or "aggressive" purpose, and from concluding agreements with debtors outside of enforcement proceedings with the specific purpose to pursue an investment opportunity. The newly introduced legislation does not impose any restriction to the fact that the ReOCo operates within both scenarios described, and indeed admits – although in an incidental - this dual role when extending the tax benefits (in the field of indirect taxes to the purchase of the underlying assets) to acquisitionmade "for any reason, even in court or insolvency proceedings"[10]. In fact, the sentence quoted makes explicit the possibility to act "inside and outside" auctions.

The only real restriction imposed by the regulation is making sure that ReOCo conducts its business "in the exclusive interest" of a securitization transaction of receivables "qualified as non performing according to the provisions of the competent authority, sold by banks and financial intermediaries"[11] having their registeredoffice in Italy. This implies the following:

10 See Paragraph 4-*bis* of Article 7.1 of Law No. 130 of 1999.

11 The scope of application of Article 7.1, paragraph 4 is in fact limited by the previous Article

- it does not seem likely, due to the ReOCo's instrumental role in a securitization transaction, that it will be promoted by parties other than those who invest in the securitized receivables portfolio[12]. This follows from the fact that ReOCo, as it is set up exclusively in the interests of the securitization transaction, shall act in favor of the holders of securities issued by securitizationvehicles. In other words, it cannot intervene, on an occasional or systematic basis, in auctions and real estate transactions relating to "third party's" loans;
- a ReOCo is not allowed to operate in the interest of securitization transactions involving receivables that do not qualifyas "non performing" within the meaning of the classification adopted by the Bank of Italy[13]. The possibility of adopting the new structure in the case of performing securitizations is therefore excluded (in situations where however, there should be noauctions, as the debtor is duly fulfilling its obligations);
- the possibility of setting up a ReOCo is reserved for portfoliosof receivables sold by a bank or financial intermediaries basedin Italy. This limitation is the most difficult to interpret, since a restrictive reading would unreasonably exclude the use of ReOCofor receivables originated – *i.e.* sold to the securitization vehicle –by a foreign banks with a secondary office in Italy, with potentialconsequences as regards the compatibility of the restriction withEuropean law. Moreover, it is questionable whether the literal wording of the provision allows for the application of the regulation at hand to the case of transfer in the "secondary" i.e., for example, when the transferor of the impaired portfolio is in turn a securitization company to which the portfolio was previously transferred by a bank: on this point, the Italian Revenue Agency, in tax ruling no. 304 of 2021, has expressed a negative opinion, stating that the special rules on securitization set forth

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7.1, paragraph 1 of Law No. 130, cited above.

12 It does not detract from the fact that, since there are no restrictions whatsoever, anyone can be a (formal) partner of ReOCo and constitute the company. From an economic point of view, it tends to be irrelevant who has a stake in the share capital of ReOCo, given that the proceeds from it are in any case allocated to the securitization vehicle for which ReOCo is instrumental. If it is possible to find orphan structures in the market, ReOCo constituted by the promoters or still 100% owned by the servicer, the possibility that the same securitization vehicle may hold shares in a ReOCo remains excluded, due to the regulatory limitations dictated by Law No. 130 of 1999.

13 See Bank of Italy Circular No. 272 of 30 July 2008 (and subsequent updates), par. B.1.1, which provides for three subcategories: non-performing loans, probable defaults (*unlikely to pay* or UTP) and past due and/or impaired exposures.

in Article 7.1 of Law No. 130, quoted (in particular, but not only, the tax benefits in favor of ReoCo), apply only if the loans are sold to the securitization vehicle by a bank or financial intermediary[14].

Obviously, the limitations described above are only specific to the new case regulated by Article 7.1, quoted above, to which therelevant discipline is attributable. In the absence of express prohibitions, there is no reason to disregard the principle of freedom or,more properly, the negotiating autonomy of the parties[15]. In other words, in the absence of the conditions set out in paragraph 1 of Article 7.1, quoted[16], operators in the market can use or can continue to use structures similar to a ReOCo but to which the advantages and the regulations provided for ReOCo will not apply.

9.4.1. Relevant regulations

The Decree-Law No. 50 of 24 April 2017 (the so-called “**Manovra correttiva**” of 2017) introduced ReOCo in Law No. 130 of 1999, as part of measures specifically aimed at the securitization of non performing loans. The *Decreto Crescita* enriches the provisions ofthe first version of article 7.1 of Law No. 130, quoted, by introducing regulatory and fiscal innovations:

- it is envisaged that more than one SVA may be set up to supportthe same securitization vehicle. These SVAs may take over (byway of assumption)

14 However, it is possible to better define the scope of application of the legislation, respecting this position of the Italian Revenue Agency: what seems to be relevant is exclusively the nature of the originator of the impaired loans; on the other hand, it does not matter whether or not the loans were originally disbursed by the bank or the intermediary that makes the transfer to securitization. Although this is statistically the most frequent case, the sale on the so-called primary market is not an essential feature of the regulatory case. In other words, securitizations of loans by banks that have in turn purchased them from other banks or financial intermediaries are not precluded by the letter of the rule, and indeed would fall within the scope of application (on this point, cf. Giannelli - *Per un mercato secondario dei crediti deteriorati*, in Sole24Ore of May 24, 2021 - who also analyzed the application of the regulation to loans assigned by more peculiar structures, such as self-securitizations carried out by banks with the aim of segregating impaired loans).

15 As is well known, this principle is set forth in Article 1322 of the Civil Code, which expressly admits the possibility of “entering into contracts that do not belong to the types having a particular regulation, provided that they are aimed at achieving interests worthy of protection under the legal system”.

16 Another matter (perhaps only theoretical) is to assess whether, in the presence of the conditions set out in Paragraph 1 of Article 7, quoted, the market operators remain - or not - free to use a structure other than the typed ReOCo, even if it operates as such. However, in this case it should not be possible to trace back to this structure the legal regulation reserved for ReOCo.

all or part of the original debt when purchasing the assets and rights securing the receivables;

- the transfer of the assets and the rights provided as security for the receivables (including in the case of transfer of leased assetsand related legal rights) may be carried out in accordance withArticle 58 of the consolidated banking act, and may therefore benefit from the simplified formalities provided for therein, even if the assets and relationships purchased cannot be identified as a "block";
- it was also specified that all assets, rights and sums deriving from the assets and rights acquired by the SVA constitute assetsseparate from those of the SVA itself and from those relating to other securitization transactions. Consequently, no executiveactions are allowed on the assets of each SVA by parties other than the securitization vehicle acquiring the receivables and theholders of the securities issued by the latter;
- finally, the regime for indirect taxes on deeds of purchase and resale of real estate assets by the SVA is specifically outlined.

Lastly, Law No. 178 of 30 December 2020 (the "**Legge di Bilancio 2021"**), by means of an authentic interpretation[17], has specified that the acquisition by the SVA of assets having the function of guaranteeing the receivables object of a securitization may alsotake place as a result of a demerger or other "aggregation" transactions. This specification regarding ReOCo – differently from whatwe will note in paragraph 5.1 relating to LeaseCo – is not easy to understand given that ReOCo operates in the context of judicial auctions where there will be no possibility of having a demerger or other "aggregation" transactions as a mean to acquiring the relevant assets.

9.4.2. Asset separation and direct taxes in ReOCo

The version originally introduced by Article 7.1 of Law No. 130, quoted, did not provide for any specific rule for direct taxation purposes. There was, however, a part of paragraph 4 of the provision that, according to certain interpretation, was aimed at introducing a "destination restriction", and thus establish a kind of tax neutrality similar to the one operating for securitization vehicles: "any sums arising in any way from the holding, management or disposal of such assets and rights, due by the special purpose vehicle to the securitization company, for the purposes of this law shall be treated as

17 Article 1, Paragraph 215 of Legge di Bilancio 2021.

payments made by the assigned debtors and shall be used exclusively to satisfy the rights incorporated in the notes issued and to pay the costs of the transaction". In this regard, the Italian tax authority took a stand in 2019, before the issuance of the Decreto Crescita, analyzing the regulation in the version just mentioned in two responses to the request for ruling[18]. According to the Italian tax authority, the economic results of the activity carried out by a ReOCo should ordinarily have been subject to IRES and IRAP. In fact, the principle of non-relevance of the receivables purchased and the cash flows deriving with regard to the securitization vehicle during the securitization transaction, already stated by the tax authority in Circular No. 8/E of 6 February 2003, would not be applicable to ReOCo, since, in the Italian tax authority's opinion, the assets purchased by the company were not be subject to a full "destination restriction" similar to that envisaged for the receivables and related flows of ordinary securitization companies under article 3.2 of Law No. 130, quoted. In fact, the wording adopted in paragraph 4 of Article 7.1, quoted above, which is quite different from that adopted for the purposes of capital separation of securitizations vehicles, referred (only) to "amounts" and certainly not (also) to the relevant "assets" purchased by the ReOCo.

As already mentioned, the *Decreto Crescita* has rewritten the rule in this specific point, with the same wording adopted for credit securitization vehicles in Article 3, paragraph 2, of Law No. No.130, quoted above. Thus, the *Decreto Crescita* specified that all assets, rights and sums deriving from the assets and rights acquired by the SVA constitute assets separate from those of the SVA itselfand from those relating to other securitization transactions. Therefore, it is now clear, in the new wording, that the Italian tax authority's position in the above mentioned responses to the question is outdated, and it is reasonable now to argue that the economic results deriving from the activity carried out by an SVA in the course of securitization transactions are by law intended for (or rather, segregated in favour of) the securitization vehicle and the holders ofthe relevant securitization notes. The argument according to which the tax regime similar to the one of a securitization company, as outlined in Circular No 8/E, cited above, is applicable to the SVA has been confirmed by the same Italian tax authority, in the aforementioned ruling No. 132 of 2021. Albeit relating to an issue regarding the taxation of a "real estate securitization" vehicle. In this response, the Italian tax authority ex-

18 See the answers to ruling No. 18 of 2019 and No. 59 of 2019.

pressly referred to its previous position on ReOCo *i.e.* and confirmed that the newversion of the law following the *Decreto Crescita* now exclude "possession/availability" of the income which is the basis for taxation pursuant to art. 72 of Presidential Decree No. 917/1986).

In this regard, the explanatory report to the *Decreto Crescita* clarifies that the specification relating to the creation of separate assets allows "*to remove any doubts about the applicability also tothe supporting vehicle companies of the accounting approach and, with it, the tax neutrality regime applicable to securitization companies during the securitization operation*". This paragraph in thereport clarifies, quite explicitly,

- on the one hand, the confirmation of tax neutrality – and indirectly – correctness of the so-called "under the line" accountingapproach for securitization vehicles, also following the amendments that have affected the financial statements of these vehicles since the Italian tax authority expressed its opinion in Circular No. 8/E, quoted, and
- on the other hand, that the non-relevance (or rather, tax neutrality) of the income received by the receivables securitizationvehicles is also applicable to the SVA in the course of the securitization transaction for which it was set up.

9.4.3. ReOCo regime for indirect taxation purposes

The *Decreto Crescita* also regulated the indirect taxes regime on deeds (registration, mortgage and cadastral taxes) on the purchaseand re-sale by the SVA of the assets used as securities for the securitized receivables. In particular, it provides for,

- fixed amount of indirect taxes on acts and transactions relating to the transfer of the assets and rights which are the subjectof their operations (including real estate property)[19];
- fixed amount of indirect taxes on deeds and transactions deedsrelating to the subsequent transfer of the assets purchased to persons carrying out business activities, provided that the purchaser transfers them within five years from the date of purchase. In the event of failure to transfer within the five-year period, ordinary duties, as well as interest and penalties shall applyat the rate of 30%[20];

19 Article 7.1, Paragraph 4-*bis*, of Law No. 130, quoted.

20 Article 7.1, Paragraph 4-*quater*, of Law No. 130, quoted.

- fixed amount of taxes on the deeds relating to the subsequent transfer in favour of individuals of the assets purchased, where the conditions relating to the so-called "first home" tax advantage are met. In the event of incorrect application of the advantage, reference shall be made to the detailed rules for the application of the advantage, as laid down in the consolidated text of the registration tax[21].

It is particularly relevant the extension of the fixed amount of tax to include debt assumption and "securities of any kind, by anyone and at any time given, in favour of the securitization company or other lender":

- as far as debt assumption is concerned, it remains to be clarified whether the facility reserved for acceptance can also be extended to cases of assumption of debts by the successful tendered pursuant to Article 508 of the Code of Civil Procedure. This is, in essence, the transfer of the debt to the vehicle (with effects very similar to those of a release clause) ordered by the enforcement judge at auction, better known in commercial practice as a *credit bid*;
- as far as securities are concerned, the particularly broad wording of the provision leads to a rather broad reading of its scope, which adopts wording similar to that provided for in Article 15 et seq. of Presidential Decree No. 601 of 1973. In fact, the regime not only concerns the guarantees, but also the related "subrogation, postponement, splitting and cancellation, even partial, including the related assignments of credit". The only limit of the advantage concerns the object of the securities (the assets and rights acquired by ReOCo as part of its operations) and that they must be provided "in relation to the securitization transaction". This last, rather obscure wording seems to suggest the need, for the purposes of applying the fixed taxation, for some criterion of functionality and connection between the secured obligation and the securitization transaction.

No provision has been introduced for VAT, so the ordinary regime for real estate companies is applicable, as clarified by the Italian tax authority in its answers[22].

21 Article 7.1, Paragraph 4-*quinquies*, of Law No. 130, quoted.

22 Please see what is outlined below on the subject of VAT with regard to real estate securitization companies, particularly with reference to the potential limitations (with regard to both deductions on purchases of residential buildings due to the object of ReOCo's typical activity and "expedited" refunds). While structurally applicable, these limitations should not, in practice, impact ReOCo because of its peculiar operation.

9.5. LeaseCo: the special purpose vehicle company supporting securitization transactions of receivablesarising from leasing relationships

This section explores the main aspects relating to the operations and the related tax profiles of the so-called "supporting vehicle company assignee of leasing contracts and relationships, and assets deriving from such activity", *i.e.* the type of vehicle known as LeaseCo in commercial practice (hereinafter also referred to as SVA of Leasing). In the context of non performing portfolios this company assumes a function similar to a ReOCo but, as it operates in support of securitization operations of receivables deriving from leasing relationships, has certain characteristics that differentiate it from the typical ReOCo model, both in terms of functions and operations.

Paragraphs 4-*ter* and 5 of Article 7.1, quoted, contain specific rules reserved to LeaseCo but there is no definition of the case similar to the one with reference to ReOCo in paragraph 4. On the other hand, considering these paragraphs, it is clear that LeaseCo is just a different kind of ReOCo and that in terms of identification its only peculiarity is the type of assets to be purchased. In fact, if ReOCo is a "support vehicle company with the exclusive corporate purpose of acquiring, managing and maximising the value, in the exclusive interest of the securitization operation, … real estate… to guarantee the securitized receivables" (as *per* paragraph 4), Lease- Co is a "support vehicle company as *per* paragraph 4" (as *per* paragraph 5), "if the transfer has as its object, together with the assets subject to finance lease, the related finance lease contracts or the legal relationships arising from the termination of such contracts" (again, as *per* paragraph 5). From a regulatory point of view Lease-Co is a sub-species of ReOCo, and this aspect has a significant impact regarding the relevant regulation giving that it is subject to all the benefits and limitations specific to ReOCo.

Thus, what has been analysed in relation to ReOCo in paragraphs 4.2 and 4.3 above, it is also relevant for the purposes of LeaseCo without prejudice to the "special" content of the above mentioned paragraphs 4-ter and 5 of Article 7.1. Moreover, both paragraph 4 – in the part concerning asset separation – and paragraph 4-*bis*, concerning the fixed amount of indirect taxes in purchase transactions, explicitly extend the rules set forth therein to transfers and transactions pursuant to paragraph 5 (*i.e.* those carried out by LeaseCo).

Before analysing the content of LeaseCo's own regulation it is worth representing the economic *rationale* behind its existence. In fact, the rules regulate a structure already existent on the market, which was created in principle to meet the investment limits of ordinary existing securitization transactions. In a "traditional" securitization operation of secured receivables (for example, those arising from mortgage loan agreements), all securities, real and personal, liens of pre-emption assisting the assigned loans are also transferred to the securitization vehicle. However, by virtue of the peculiar negotiating scheme that characterizes financial leasing, due to its nature, receivables are not formally backed by securities, since the protection of the creditor (*i.e.* the leasing company's) is achieved by retaining the right of ownership of the asset object of the contract. Therefore, in the case of the assignment of receivables arising from financial leasing contracts, the mechanism provided for in Article 1263 of the Civil Code does not operate by law; generally, it does not constitute a problem in the context of a traditional securitization scheme of receivables arising from leasing contracts, as the role of lessor and owner of the relevant assets normally continues to be fulfilled by the transferor/originator. However, in all those cases where it is necessary to fully disengage the originator (as usually in the case with non performing loans), in order to achieve the same economic and legal effect as a securitization scheme, based on capital separation and bankruptcy remoteness, the transfer of receivables arising from leasing relationships also requires the transfer of the related contracts, and accordingly of the underlying assets. Since it was not possible – at least until the last legislative changes – for the securitization company to purchase assets other than receivables, customarily it was necessary to segregate the ownership of the assets (functioning as guarantee) in favour of the purchaser of the leasing receivables (the securitization vehicle) pursuant to a specific scheme provided for the transfer of the leasing contracts and of the underlying assets to a parallel and instrumental structure to the securitization company. This structure was already known as LeaseCo in the market.

To sum up, the reasons behind LeaseCo lie in the need to realize, with regard to a portfolio of receivables arising from leasing relationships, the typical effects of a securitization of receivables backed by securities *in rem*. To this aim, the peculiarity of leasing contracts, in which the assets owned by the creditor assume the economic function of collateralizing the credit exposure, makes it necessary to adopt a parallel structure owing all assets, rights and obligations, except receivables, derived from the leasing contracts from which the said receivables originate.

In the context of portfolios of non performing loans, LeaseCo assumes the additional function – quite similar to the ReOCo's one - of managing and enhancing the value of the underlying real estate assets, in order to maximize the values recovered by the securitization vehicle. Instead of acquiring the real estate assets (at or outside auction), LeaseCo, already owner of the underlying asset, will limit itself to managing the relationship with the user under the leasing contract from time to time by terminating the contract and carrying out the so-called repossessment (*i.e.* obtaining full control over the asset), and again through the possible valorization and sale of the asset. It is clear that what has been realized during the sale of a real estate (in full possession as a result of the termination of the related leasing contract) will be transferred to the securitization vehicle and, for the surplus, will be returned to the user subject to the conclusion of appropriate settlement agreements with the user.

9.5.1. Relevant legislation

Similarly to ReOCo, LeaseCo was introduced by the "*Manovra correttiva*" in 2017 as part of the same measures aimed at facilitating the securitization of non performing loans. The *Decreto Crescita* enriched the provisions of the first version of article 7.1 of Law No. 130, hereinabove, by introducing – in addition to the new provisions for ReOCo, which has already been mentioned in paragraph 4.1 of this chapter and which also can be referred to LeaseCo – the following specific new provisions:

- The entities allowed to be the mandatory consolidating entity of the SVA of Leasing in its balance sheet has been broadened byalso adding financial intermediaries authorized to lend to the public pursuant to Article 106 of the Italian legislation on banking activities and not only banks (as originally provided for in the first version of the rule);
- a new paragraph 4-*ter* is introduced, which, however, merely duplicates the provisions of the already existing paragraph 5 clarifying in particular that (i) the tax provisions applicable to companies carrying out financial leasing activities apply to the SVA of Leasing (paragraph 5 uses, in addition to the new version, the adverb "in full"), (ii) the tax relief introduced by the 2011 leasing reform for the sale of real estate resulting from leasing contracts terminated for default of the user (pursuant to Article 35, paragraph 10-ter.1, of Decree Law No. 225 of 2006) applies to the SVA of Leasing, clarifying that indirect taxes on deeds are due in a fixed amount (in this case, however, the wording differs slightly from that adopted in paragraph 5). In addition, paragraph 4-*ter* repeats the provisions of paragraph 4-*bis* on the

application of the application in a fixed amount of taxes on the purchase of assets and relationships deriving from leasing contracts.

It is not clear why paragraph 4-*ter* exists. All what is in this provision, is already expressly provided for by other paragraphs, introduced *ex novo* by *Decreto Crescita* or already present in the first version of the same Article 7.1, above mentioned. The different wording of some paragraphs does not add any real content, nor does it reveal any antinomy that could in any way justify the application by specialty or the implicit abrogation of one or the other rule. The only rewording worthy of note is in the reference to paragraph 10-*ter*.1 about the taxes applicable to the sale of real estate covered by leasing contracts “terminated or otherwise ceased by the user”. Contrary to the other rule, this last wording seems to extend, for LeaseCo only, the tax relief also to those properties whose full possession in the hands of LeaseCo is not the result of the user’s default.

Finally, the *Legge di Bilancio* 2021, by means of a provision of authentic interpretation[23], has specified that the acquisition by the SVA (and therefore also by the SVA of Leasing) of the assets having the function of guaranteeing the securitized receivables can also take place as a result of a demerger or other aggregation transactions. This specification is crucial in the context of transactions carried out on portfolios with real estate properties not yet “repossessed” in relation to which in recent cases certain transfers of the leasing contracts and the underlying real estate properties, took place by means of company demerger/merger rather than by a straight forward purchase and sale transaction. In those cases, the choice of the demerger derived from the circumstance that the “*necessary verification of the conformity of the property to the cadastral land registry*”[24], applicable to straight forward sale and purchase transactions or contribution, do not apply to mergers or demergers. In fact, in the context of operations of purchase of leasing portfolios, it is frequent that the real estate properties, even if related to leasing contracts already terminated, have not (yet) been repossessed by the leasing company (i.e. they are still in the possession of the user). The consequence being that it is not easy for the leasing company to carry out conformity verifications of the actual status of the property with the one deposited with the relevant cadastral land registry. These verifications are necessary in real estate deeds of transfer in order to be able to validly issue declarations within the notarial deed, without which the relative deeds are invalid and void.

23 Article 1, Paragraph 215 of *Legge di Bilancio* 2021.

24 Article 29, Paragraph 1-*bis* of Law No. 52 of 27 February 1985.

9.5.2. Separation of assets and direct taxes in LeaseCo

The original version introduced by Article 7.1 of Law No. 130, quoted, with regard to the tax regime applicable to LeaseCo, only provided for the full application of the tax provisions applicable to the company exercising the leasing activity. Despite this reference – which can be read with reference to both direct and indirect taxation – there remained the same doubts about the separation of assets that had led some taxpayers to submit an appeal to the Italian Tax Administration with regard to the tax regime applicable to LeaseCo (see paragraph 2 of this chapter). In fact, already in the first version of Article 7.1, quoted, LeaseCo represented a "sub- type" of ReOCo. The existence of a specific provision extending to Leasco the tax regime of any other ordinarily taxable leasing company originated the doubt that LeaseCo was subject to full taxation in relation to any income received by LeaseCo as part of its activity.

The new wording, as modified by the *Decreto Crescita*, explicitly states that the capital separation regime applies "*in the context of the transaction referred to in paragraph [4], or in paragraph 5 below*"[25], and so extending it to LeaseCo as well. Although there remains a need to coordinate the content of paragraph 5 (on the full application of the tax provisions applicable to leasing companies) with that of the new paragraph 4 just mentioned, there is no doubt that what has already been argued with regard to ReOCo in the field of direct taxes is also true with regard to LeaseCo. From the above, it follows that the reasoning on "tax neutrality" developed, with regard to ReOCo in the ruling No. 132/2021, issued by the Italian Tax Authority, is now unquestionably applicable to LeaseCo. For these purposes, please refer again to paragraph 4.2 of this chapter. The reference to the tax provisions applicable to leasing companies can only be read in the sense that they must be applied to all those components of income that are not deducted from taxation as a result of the *de facto* tax neutrality achieved as consequence of the destination restriction in favor of the securitization vehicle and the holders of the securitization securities. This would regard income components that may result (since they are left in LeaseCo's possession) at the end of the securitization transaction or item of income relating to amounts withheld by LeaseCo to cover its current expenses.

25 As follows paragraph 4: "The assets, rights and sums in any way deriving from them, as well as any other rights acquired in the context of the transaction referred to in this paragraph, or in paragraph 5 …, constitute assets separate in all respects from those of the companies themselves and from those relating to other transactions".

9.5.3. LeaseCo scheme for indirect taxation purposes

As mentioned above, LeaseCo is the assignee of legal relationships arising from a portfolio of leasing contracts but not of receivables arising from them, which are generally acquired by the securitization vehicle (for which LeaseCo is established). Prior to the most recent regulatory changes, the purchase of such relationships – and the related indirect tax regime – was the main tax problem of this type of transaction. In fact, what value should be given to a set of legal relationships already substantially valued when assigning receivables? The attribution – or not – of a value and, therefore, of a consideration to the transfer of leasing contracts has obviously repercussions in terms of VAT and, consequently, due to the principle of alternation, in terms of registration taxes. The analysis of the issue, even though it is of interest and importance for all those structures that cannot benefit from the discipline of Article 7.1 of Law No. 130, quoted (e.g. transactions on leasing performing loans)[26], is useless here, since the new version allows to achieve full clarity on the tax regime applicable for the purposes of indirect taxes. Without wishing to go into too many details of the issues related to the valuation of the relationships of which LeaseCo is the assignee, it is enough to note here that:

- if a transfer is completed, such that a consideration is paid for the transfer to LeaseCo of the ownership of the legal relationships deriving from leasing contracts, the transaction will be a supply of services relevant for VAT purposes pursuant to Article3, paragraph 5) of Presidential Decree No. 633 of 1972, subjectto the ordinary rate of 22%,
- in the absence of a consideration, the purchase transaction willbe outside the scope of VAT.

26 See rulings No. 954-166/2018 and No. 954-82/2017, never published, concerning respectively the transfer of complex leasing portfolios (terminated and unresolved) and performing leasing portfolios. In those rulings, the Italian tax authority had occasion to clarify that "the transfer as a whole... of leasing contracts in ... is relevant to the effects of VAT as a supply of services within the meaning of Article 24 of Directive 2006/112/EC and the corresponding provision of domestic law, namely Article 3 of Presidential Decree No 633 of 1972". And again "that the transfer of ownership of the goods underlying the leasing contracts in question, the economic consideration for which is included in the consideration for the contracts in question, qualifies, for VAT purposes - because of the peculiarities linked to the leasing sector, in which such properties perform, in fact, a mere guarantee function of the underlying contract - as a supply of goods referred to in Article 2, paragraph 1, of Presidential Decree No. 633 of 1972, ancillary to the transaction in question, on the basis of Article 12 of the same Presidential Decree. In short, it seems fair to assume that the consideration for the supply of the underlying goods is included in the consideration for the contracts, following the VAT regime of the contracts themselves".

- for the purposes of indirect taxes on deeds, registration, mortgage and cadastral taxes will in any case be due in a fixedamount, in accordance with the provisions of paragraph 4-*bis*and the "not necessary" paragraph 4-*ter* of Article 7.1, quoted.With regard to real estate divestments/sales operations by LeaseCo, all the tax relieves provided for ReOCo, which have already been mentioned in paragraph 3.3 of this chapter, are applicable for the reasons already stated. In addition to these, paragraph 4-ter of Article 7.1, quoted, and with it paragraph 5 of the same Article 7.1, extend to LeaseCo the relief introduced by the 2011 leasing reform for the transfer of real estate resulting from leasing contracts terminated due to default of the user (pursuant to Article 35, paragraph 10-ter.1, of Decree Law No. 223 of 2006)[27]. These transfers are subject to registration, mortgage and cadastral taxes at a fixed rate. In this regard, it is worth noting that the newly introduced paragraph 4-ter has adopted a different formulation in duplicating the provisions of paragraph 5 and (re)extending to LeaseCo the tax relief in question. The mere reference to paragraph 5 is in paragraph 4-*ter* reworded in a more articulated manner, since it says that the relief applies "to the sale of real estate subject to leasing contracts terminated or otherwise ceased by action of the user". The general reference to the "action of the user" and not to the more specific default seems to admit the extension of the tax incentive to all those cases in which the full possession of the property is realized also for facts other than termination for default (e.g. early termination at the will of the user, in the absence of prior default) – a circumstance which inpractice has been considered outside the scope of the tax incentive referred to in paragraph 10-*ter*.1 in question[28].

27 According to this rule "*In the case of transfers, carried out by banks and authorized financial intermediaries referred to in Article 106 of the Consolidated Law on Banking and Credit, as set out in Legislative Decree No. 385 of 1 September 1993, as amended, in the event of exercise by the user of the option to purchase the leased property, or in the case of property resulting from financial leasing contracts terminated due to default by the user, registration, mortgage and cadastral taxes are due at a fixed rate*".

28 With respect to this tax incentive, the Italian tax administration has provided a (very questionable) clarification in the ruling No. 59/2020: in cases where the possession of the property is achieved following the default of the user, the application of the relief would be subject to the fact that the termination of the leasing contract (following the default) must have been taken place on the initiative of the same intermediary re- questing the relief. In other words, if the termination (of the leasing contract) was carried out by a leasing company other than the one which then disposes of the property, the relief would not apply. Having a seller of the real estate asset different

9.6. Conclusion

At the beginning of this chapter, we wanted to justify the joint treatment of the three real estate vehicles analyzed (i.e.the vehicle for securitization of real estate proceeds, ReOCo and LeaseCo) because of their placement in Law No. 130 of 1999 on securitizations. Moreover, each of the three vehicles plays a different role from the others, which varies according to the function that investors want to pursue.

The real estate proceeds securitization vehicle represents the real revolution in recent regulatory amendments, as it not only broadens the scope of assets that can be purchased as part of a securitization, but it also provides for a real alternative investment vehicle to those currently available on the market. It does not have the regulatory-fiscal restrictions of a real estate AIF (such as the multi-investor and third-party management requirements, or the lengthy authorization procedures of a SICAF), but retains its tax advantages (at least for IRES and IRAP purposes) and is in some respects even

from the one (leasing company) that has actually terminated the contract, would only be would only be possible in cases where the position vis-à-vis the user has been assigned (or otherwise transferred) to another intermediary, e.g. in the case of a block sale of leasing portfolios. Therefore, in the opinion of the Italian tax administration, if a leasing company termi nates the contract due to nonperformance, transfers the contractual position and the transferee intermediary disposes of the property, the relief would not be applicable and registration, mortgage and cadastral taxes would be applied on a proportional rate. If read another way, the transfer from intermediary to intermediary would "exhaust" the relief and the subsequent transfer should be treated as an ordinary transfer. Beyond the non acceptable tendency to always read the relief measures in such a way as to restrict their scope of application instead of sticking to the literal interpretation (which is what the Court of Cassation really required when it adopted a "restrictive" reading of a relief: please note the judgment No. 11106/2008, which is now always often misquoted by the Italian Tax Authority in its answers to ruling), the Tax Authority's standpoint is questionable for a number of reasons. On the other hand, the Italian Tax Authority does not take into account that, even if as a result of the termination of the leasing contract, the property is transferred to another intermediary within the context of the transfer of the entire legal position that survives by law the termination (these are the rules set out in paragraphs 138 and 139 of Law No. 124 of 4 August 2017) and which bind the intermediary transferee to the divestment procedures provided for in the legislation. In other words, in the context of the transfer of the legal position (the terminated contract) along with the property, the latter remains bound by a series of obligations under the lease, which, although terminated, continues to be binding. Only at the time of the "final" disposal to a third party of (only) the real estate property, without the legal position and any other binding effects, the property would be "freed" from any said obligations. Until that time, the relationship maintains its unity, and it is clear that the transfer from the leasing company to the intermediary is only an intermediate step in the relationship and that the special relief for leasing contract must also be ensured for the disposal by the last financial intermediary who is the final transferee of the leasing contract and of the leasing relationship.

more advantageous (with regard to the outflow of proceeds). The real diffusion of this instrument as an alternative to the real estate vehicles already used will depend on the ability of the operators in the sector to make clear the main (non-tax) doubts: the suitability of these instruments to invest in real estate opportunities that are not yet existing or already profitable (e.g. green field purchases or those under development), the need to comply with securitization regulations in case of securities tranching, or the actual need to register a mortgage for a lender participating in the transaction as a senior holder of securities rather than direct lender under a loan contract. These are doubts and issues that only market practice can resolve and are unlikely to be clarified by the relevant regulatory authorities.

The ReOCo is in fact an "optional" instrument, within a receivable securitization operation, which aims at maximizing the recovery of the value of the securitized portfolio. LeaseCo, although it is also an internal instrument of a receivable securitization operation, is instead a "necessary" instrument because of the legal-formal peculiarities of the financial leasing contract. A vehicle parallel to the securitization vehicle (a LeaseCo or a dedicated leasing company) is in fact essential to the success of the securitization transaction, since the substantial guarantee of the loan portfolio circulates only with the ownership of the underlying asset.

In conclusion, each of the instruments outlined fits into a specific area and fulfils a specific purpose. On a closer inspection, beyond the mere regulatory reference, there is a substantial feature that distinguishes this group of new instruments: the fact that each of them has formal ownership of (real estate) assets, but does so in the interest of third parties, i.e. investors in notes issued to finance an interest in the same assets. And that the system links to this "intermediate" role a peculiar legal effect, i.e. the separation of assets, which in turn has consequences also for tax purposes. In other words, the real common characteristic of the three vehicles analysed in this chapter is the asset segregation and the *de facto* tax neutrality that its effects produce.

PART II

Focus on tax aspects of the real estate investment

10.
The municipal property tax (so-called "IMU")

by E. Gnech, N. Bottino

10.1. Introduction

The Municipal Tax has always been a debated topic, having been the focus of heated debates in the halls of power since its inception. Its aim of targeting wealth that cannot be concealed from the eyes of the treasury has produced, and continues to produce, considerable revenue. This unquestioned prominence on the agenda of every governmental body has aroused constant interest shaped by various facets over the years: from administrative decentralisation to tax autonomy to the bulwark of fiscal federalism.

In this chapter, we aim to examine, first of all, the historical genesis of the IMU. This is followed by a careful analysis of the fundamental assumptions on which this tax is based and finally concluding with a survey of plausible assumptions projected into the future.

10.2. Origin and history of the tax

The genealogical roots of the Municipal Tax can be traced back to a multitude of forerunners, bearing witness to the interest and prosperity that this tax has generated over time. The predecessor of the IMU, in chronological order, was the INVIM[1] (tax on the increase in the value of property), a tax that was levied on the acts of transfer of the right of ownership or enjoyment of real estate (ordinary INVIM) and limited to

1 It was introduced by Presidential Decree no. 643 of 26 October 1972. Art. 17 para. 6 of Ministerial Decree no. 504 of 30 December 1992, published in the Official Gazette no. 305 of 30 December 1992, Ordinary Supplement no. 137, abolished, with effect from 1 January 1993, the municipal tax on the increase in value of property.

the property of companies and entities, at the end of each decade from the date of purchase (ten-year INVIM). The INVIM was initially a tax intended to raise the revenue of local governments, but within a short time, the expected revenue poured into the state coffers. Its introduction came at a time marked by fervent speculation in the building sector, aimed at tempering its excesses and implementing a tax system capable of returning a tangible economic income to the community. The evolution of the INVIM[2] has been a long and winding path, during which the tax has undergone many transformations before taking on its familiar final traits. Its calculation mechanism, however, did not take into account the nature of the different increases implemented, assuming a purely dynamic differential value (between two static moments: the initial and the final) as the object of taxation, regardless of the economic reasons from which they derive[3]. In any case, the method of calculation brought uncertainty of revenue for the country.

Within the framework of the 1983 Finance Act, Parliament granted the government a delegation to establish a municipal tax on buildings. This tax would be levied not on the intrinsic value of property, but on its actual or potential income[4]. However, the draft legislation in question, although outlined with this perspective, did not see the light of day. They opted, in fact, for the surtax on income from buildings[5], in a move aimed at meeting the inescapable financial needs of the municipalities, thus taking the initial project away from its actual implementation.

Nevertheless, this project did not fall into oblivion. Over the course of a decade, it again became the subject of discussion and proposals, through the various Finance Ministers who followed one another from

2 Following the issuance of the Presidential Decree no. 643 of 26 October 1972, the structure of the taxation underwent radical innovations again, first with Presidential Decree no. 688 of 23 December 1974, which reinterpreted the will of the delegating legislator, and subsequently by Law no. 594 of 22 December 1975, followed by Presidential Decree no. 959 of 13 December 1977, and by Decree-Law no. 571 of 12 November 1979, converted with amendments into Law no. 2 of 12 January 1980, which defines the profile of the tax. The Constitutional Court's ruling no. 126 of 7 November 1979, from which the current structure of the tax and its more straightforward theoretical justifications derive, also contributed to this development.

3 The taxation was levied on entirely nominal values that had no real increase of the taxpayer's ability to pay.

4 With a minimum limit of 5 percent and a maximum of 20 percent.

5 With Decree-Law no 55 of 28 February 1983, converted into Law no 131 of 26 April 1983.

1982 to 1992, thus highlighting the persistence of and continued interest in a tax reform to regulate the tax on buildings.

In 1992, the application of an extraordinary property tax in favour of the Treasury was born (the ISI)[6] limited to the 1992 tax year. The extraordinary tax, as the same provision stated, concerned buildings and building areas identified in the town planning tools, for whatever use. The persons liable for the extraordinary tax were the owners of the property or the holder of the right of enjoyment, use or dwelling thereon, even if not resident in the State territory, and the tax was due - as is still the case today - in proportion to the share of ownership.

By enacting the extraordinary property tax, the legislature established a prelude to the municipal property tax, commonly known as ICI, which was to come into force as of 1993[7].

Since 1993, with the simultaneous abolition of INVIM, a taxation on real estate was outlined, similar to ISI. This taxation was levied not on the occupier of the property, but on the owner or holder of the right in rem, regardless of his or her residence, even if it was located outside the country. This tax, calculated on the basis of the value of the property, was applied by means of a variable rate, left to the discretion of the individual municipalities, with a range between 4 and 6 per mille. This percentage could be increased by an additional one point in exceptional situations of municipal financial need.

The taxable premise of the ICI was identified - as it is for the IMU - as the 'possession' of property,[8] which made the tax a wealth tax. Thus, the fact that the property was entirely unproductive of income, or that it was directly and strictly used for the production of income specifically taxed by other taxes, was of no relevance; the model was the same as that already tried and tested for the ISI.

6 See Art. 7 of Decree-Law no. 333 of 11 July 1992, replaced by Conversion Act no. 359 of 8 August 1992.

7 Introduced by Legislative Decree. no. 504 of 30 December 1992

8 Art. 3 of Legislative Decree. no. 504 of 30 December 1992 identified the persons liable for ICI as the owner of property, or the holder of enjoyment, use or dwelling thereon, i.e. rights in rem over property, pursuant to Articles 832, 978, 1021 and 1022 of the Civil Code. It should be noted that, in the case of property granted by surface rights, emphyteusis or leasehold, the debtor with respect to the taxpaying municipality is formally always the grantor, who, however, is recognised by law as having the right to reclaim the amount paid by way of ICI against the surface rights holder, emphyteuta or leaseholder.

Possession related to the following properties:

a. buildings
b. building areas
c. agricultural land
d. sites within the country, regardless of their intended use, including those that are instrumental to either the production or exchange of the undertaking's activities.

Without delving into the intrinsic mechanism of the "*Imposta Comunale sugli Immobili*" (ICI), it is sufficient to consider the estimates provided at the time by the Ministry of the Treasury, which estimated the revenue from this tax at around 12 billion lire[9]. The increase in income is derived from the capitalisation of the annuity, obtained from the revalued annuity multiplied by predetermined coefficients[10].

This tax, by virtue of its economic relevance, immediately aroused considerable interest and sought protection at all institutional levels, despite the numerous objections raised against it regarding its alleged unconstitutionality.

However, the turning point came in 2012, when the Monti Decree[11] was enacted, which was designed to address an extremely critical economic situation that called for the need to reduce the public debt, which had accumulated over time, and to ensure the nation's solvency. Faced with such a tense situation, where the goal was as ambitious as the margin of manoeuvre was limited, the government, in addition to the cuts in public spending traditionally employed to achieve a balanced budget, used and subsequently maintained a series of measures focused on increasing the tax burden on citizens. Against this backdrop, the executive's shrewd gaze turned, in particular, towards the taxation of real estate, which was considered to be less easily disguised from the watchful eye of the treasury, designating it as the main target for increasing the tax burden[12].

9 Only a small part of this went to the municipalities.

10 *It was then increased by the Monti Decree, Decree-Law no. 201 of 6 December 2011.*

11 Decree-Law no. 201 of 6 December 2011.

12 The increase was also due to a significant increase in coefficients.

Within this framework, there was the intensification and anticipation in 2012 of the entry into force of the IMU, which had been previously envisaged and regulated in March 2011, and which, in its original provisions, was only supposed to make its tax debut in 2014. However, it took the place of ICI early on, acting as its rapid replacement. It was introduced 'on an experimental basis' and initially also covered the main dwelling, albeit at a reduced rate. The prerequisite for IMU was - in the initial phase - the possession of property, including the main house and its appurtenances. The Monti Decree defined basic rates, which can be changed by individual municipalities by resolution of the municipal council. In particular, it was established that the basic rate was 0.76 per cent (i.e. 7.6 per mille) and that the municipalities, by resolution, could change the basic rate up or down by up to 0.3 percentage points.

The most recent changes were introduced through law number 160 dated 27 December 2019, known as the Budget Law 2020, which brings with it important changes to the local taxation landscape, most notably the unification of IMU and TASI[13].

Without elaborating further on what has previously been said about IMU (ICI, INVIM), in the following section, we will shift our attention to the fiscal premise on which this tax is based and the rates associated with it.

10.3. Taxation basis and rates

The municipal tax is based on "*the ownership of property other than the main dwelling*"[14].

13 TASI was intended as a tax for indivisible services. As of 1 January 2020, TASI was abolished by Art.1 Paragraph 738 of Law no. 160/2019 (Budget Law 2020). Until 31 December 2019, TASI was payable by anyone who owned or held, in any capacity, buildings (including the main dwelling if classified in cadastral categories A/1, A/8 and A/9) and building areas subject to the tax.

14 Art. 8 of Legislative Decree no. 23/2011 and Art. 13 paragraph 2 of Decree-Law no. 201/2011.

In fact, municipal tax does not apply to the ownership of the main dwelling[15] and its appurtenances, with some exceptions[16].

- Persons liable to pay the tax[17] are:

15 According to Art. 1, paragraph 741(b) of Law no. 160/2019, a main dwelling is defined as: *"the immovable property, registered or registrable in the urban building registry as a single building unit, in which the owner and the members of his or her household habitually reside and are registered residents. In the event that the members of the household have established their habitual abode and registered residence in different properties located within the municipal territory or in different municipalities, the allowances for the main dwelling and its appurtenances in relation to the household apply for only one property, chosen by the members of the household.*
Appurtenances to the main dwelling are exclusively those classified in cadastral categories C/2, C/6 and C/7, to the extent of a maximum of one appurtenance unit for each of the cadastral categories indicated, even if they are registered in the Cadastre together with the dwelling unit;
c) the following are also considered to be principal residences:

a. *building units belonging to building cooperatives with indivisible ownership used as the main dwelling and its related appurtenances by the assignee members;*
b. *building units belonging to building cooperatives with indivisible ownership intended for university student members, even in the absence of registered residence;*
c. *residential buildings intended for low income housing as defined by the decree of the Minister of Infrastructure of 22 April 2008, published in the Official Gazette no. 146 of 24 June 2008, used as main dwelling;*
d. *the family home assigned to the parent with custody of the children, following a court order, which also constitutes, solely for the purposes of applying the tax, the right of habitation of the custodial parent;*
e. *a single property, registered or registerable in the urban land register as a single building unit, owned and not leased by personnel on permanent service belonging to the Armed Forces and the Military Police Forces and by employees of the Civil Police Forces, as well as by personnel of the National Fire Brigade Corps and, without prejudice to the provisions of Article 28(1) of Legislative Decree no. 139 of 19 May 2000, by personnel belonging to the Prefectural Career, for whom the conditions of habitual abode and registered residence are not required;*
f. *by decision of the individual municipality, the building unit owned by elderly or disabled persons who take up residence in a hospice or health institution as a result of permanent hospitalisation, provided that it is not rented. In the case of several building units, the aforementioned relief may be applied to one building unit only'.*

16 Possession of the main dwelling or assimilated dwelling, as defined in letters b) and c) of paragraph 741 of Law no. 160/2019, does not constitute a prerequisite for the tax, unless it is a dwelling unit classified in cadastral categories A/1, A/8 or A/9.

17 Art. 1, paragraph 743 of Law no. 160/2019: *"The persons liable to pay the tax are the owners of real estate, meaning the owner or holder of the right in rem of enjoyment, use, dwelling, emphyteusis, or surface rights over the same. The parent assigned the family home following a court order, which also constitutes the right of habitation for the parent with custody of the children, is liable for the tax. In the case of the concession of state land, the taxable person is the concession holder. In the case of real estate, including property to be built or under construction, leased under a finance lease, the taxable person is the lessee from the date of conclusion and for the entire duration of the contract. In the presence of several taxable persons with reference to the same property, each is the holder of an autonomous tax obligation and in the application of the tax the subjective and objective elements*

- the owner;
- the holder of rights in rem relating to real estate[18];
- the concession holder[19];
- the tenant of real estate (also under construction or in the course of construction) granted under a lease[20].

Each calendar year corresponds to an autonomous tax liability, and taxpayers must pay the tax in proportion to the share and months of the year in which possession lasted. In this respect, possession for at least fifteen days in a month determines the obligation to count it in full.

The party liable for the tax is the municipality in whose territorial area the immovable property itself is situated, wholly or predominantly, on the 1st January of the year to which the tax relates.

Before moving on to the discussion of rates, it is first necessary to clarify the scope of the municipalities in this regard. Municipalities are recognised as having the power to intervene in certain aspects of IMU, but the regulatory power of municipalities in matters of revenue, including tax revenues, is not absolute; rather, it has precise limits.

Recently, the IMU rates have been defined by the legislature[21] and municipalities are authorised to diversify the rates with respect to the cases identified by the Ministry of Economy and Finance in a specific decree[22]. The cases identified by the aforementioned Ministerial Decree may also be amended or supplemented by a subsequent Ministerial Decree.

The cases for which IMU rates may be varied are as follows[23]:

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referring to each individual share of ownership are taken into account, even in cases of application of exemptions or concessions".

18 Enjoyment, use, dwelling, emphyteusis, surface.

19 In the case of the concession of state-owned areas.

20 From the date of conclusion and for the entire duration of the contract.

21 See paragraphs 748 - 757 of Art. 1 of Law no. 160/2019. Previously, the rates were set by Art. 13 Paragraphs 6 - 8 of Decree-Law no. 201/2011, converted into Law no. 214/2011.

22 See Ministerial Decree 7 July 2023 (published in the Official Gazette Law no. 172 of 25 July 2023)

23 See Art. 2 para. 1 of the Ministerial Decree of 7 July 2023.
Paragraph 2 below also recognises the municipality's right, within the scope of its regulatory autonomy pursuant to Article 52 of Legislative Decree no. 446/97, to introduce further differentiations within each of the cases listed above, provided that the following applies:
- exclusively with reference to the conditions identified in Annex A to the Ministerial Decree of 7 July 2023;
- in compliance with the general criteria of reasonableness, adequacy, proportionality and non-discrimination.

- main dwelling in cadastral categories A/1, A/8 and A/9;
- rural buildings for operational use;
- buildings belonging to cadastral group D;
- agricultural land;
- buildable areas;
- other buildings (buildings other than the main dwelling and buildings belonging to cadastral group D).

The table below shows the rates.

IMU rates defined by paragraphs 748 - 757 of art. 1 of Law no. 160/2019		
Type of property	Basic rate	Municipal discretionary margin
Main dwelling A/1, A/8 and A/9 and its appurtenances	0.5% (with deduction of 200 euros)	- 0.1% increase - decrease to zero.
Operational rural buildings (Art. 9 paragraph 3-bis of Decree-Law no. 557/93)	0.10%	- decrease to zero.
Commodity real estate	From 2022 exemption from IMU	
Agricultural land	0.76%	- increase by 1.06% - decrease to zero.
Group 'D' Production Buildings	0.86%, of which: 0.76% to the State, the remainder to the municipalities.	- increase up to 1.06%; - decrease up to 0.76%.
Other properties	0.86%	- increase up to 1.06% (in some cases up to 1.14%) - decrease up to zero.

Representation of minimum and maximum rates to be decided by municipalities			
Type of property	Basic rate	Minimum rate	Maximum rate
Principal dwelling A/1, A/8 and A/9 and related appurtenances	0.5%	0%	0.6%
Operational rural buildings (Art. 9 paragraph 3-bis of Decree-Law No. 557/93)	0.1%	0%	0.1%
Agricultural land	0.76%	0%	0.25%
Group 'D' Production Buildings	0.86%	0%	1.06%
Other properties	0.86%	0%	1.06%

10.4. Coordination with cadastral annuities[24]

The Cadastre represents a detailed register of real estate in a specific territory and, in its essence, was initially conceived with the primary purpose of determining the income tax to be levied on the owners of said property. The Cadastre, depending on the real estate it covers, is divided into:

- Land Cadastre, also known as the New Land Cadastre[25],
- Urban Cadastre, also known as the New Urban Building Cadastre.

The New Land Cadastre is of the geometric and parcel type, based on the measurement and estimation of individual parcels. Geometric cadastre means the set of information used to identify the geometry of parcels of land on the basis of the coordinates of its vertices, which were originally only recorded on paper maps.

The minimum inventory element is the parcel of land and the cadastral identifier of agricultural land is the following data:

- name of the municipality where it is located;
- section code;
- map sheet number;
- parcel number;
- sub-plot number.

24 For the sake of completeness, it is worth mentioning that the revision of the Cadastre has [been] constantly in the spotlight, aiming to achieve greater fairness and simplicity than its current configuration, which dates back many years. The new estimation system of the Cadastre of Buildings will not refer to predetermined estimation rates, but will independently determine for each building unit both the patrimonial value and the cadastral annuity on the basis of specific calculation algorithms. The revision of asset values will make use of an estimation process that uses, instead of the old (and still applicable) criterion of the number of 'useful' rooms, the square metre as the unit of consistency, and uses statistical functions to express the relationship between market value, location and building characteristics of assets for each territorial area even within the same municipality. Where, on the other hand, asset values cannot be determined on the basis of such statistical functions, one should proceed by direct estimation, either by reference to market values (for special-purpose building units), or by the cost criterion (for operational buildings), or by the income criterion (when profitability is the prevailing element).
The focus on this revision aims, in particular, at adapting the Cadastre to the dynamics of urban development, with consequent appreciation or depreciation of value on the territory. This approach goes hand in hand with the consideration of the evolving concept of 'value' of property in the current context. However, as yet, no concrete steps have been taken, and the reform remains a work in progress.

25 The formation of the Land Cadastre was provided for by Law no. 3682/1886, which was subsequently replaced by the Consolidated Text of Laws on the New Land Cadastre approved by Royal Decree no. 1572/1931.

The following incomes are attributed to each parcel of land, which, as will be seen in the following chapter, are relevant for tax purposes:

- the income from land, relating to the ownership of the land;
- agricultural income, relating to the exercise of agricultural activity on the land.

In order to attribute the income from land and agricultural income to the individual parcels, the following operations were carried out, dictated by the Regulations for the execution of the Consolidated Text of the laws on the new Cadastre[26]:

- qualification operations (consisting of the division of land, in each municipality, according to crop quality);
- classification operations (which consist of subdividing land, belonging to the same crop quality, into many classes according to the level of productivity);
- appraisal operations (consisting of the determination of appraisal rates, which represent the income from land and agricultural income of land, for each quality and class, per unit of area, i.e. per hectare).

Following the aforementioned operations, the classification was carried out, i.e. each identified parcel was assigned its quality and class, and thus its income from land and agricultural income (given by multiplying the surface area of the parcel expressed in hectares by the corresponding tariff).

In this cadastral system, the crop quality is affected by the presence of rural buildings.

The tax legislation requires the taxpayer to notify the Land Agency of the events that determine variations[27] in the income from land and agricultural income.

The New Urban Building Cadastre consists of the buildings included in the municipal territory and the urban building units are identified for each municipality by a sheet number, map number and a sub-plot number. The

26 Royal Decree no. 1539/1933.

27 In particular, Article 29 of Presidential Decree no. 917/1986 divides the variation into two types:

- increased income variations: given by the substitution of the crop quality recorded in the land register with another of higher income;
- decreased income variations: given by the substitution of the crop quality entered in the land register with another of lower income; and by the decrease in the productive capacity of the land due to natural exhaustion or other force majeure, even if there has been no change of crop, or due to phytopathological and entomological events affecting the plantations.

urban building unit is associated with metric data expressing consistency (for dwellings, consistency is measured in rooms), profitability data (the annuity, which is useful for tax reporting purposes) and the holders of real rights to the building unit. For the Urban Cadastre, the evidentiary function is also lost, in the sense that it does not certify the ownership of real estate.

As anticipated, each building unit acquires an annuity according to the provisions laid down in cadastral legislation, which, as we will discuss in more detail in the following chapter, is the primary basis for determining both the income and asset value of the unit in question.

For the purpose of assigning annuities, building units are categorised into five distinct category groups.

The first three category groups are aimed at properties with an ordinary and specific use[28]:

- Group A includes all dwellings as well as offices;
- Group B includes buildings intended for use by several persons or for collective housing (colleges, convents, schools, hospitals, prisons);
- Group C includes shops, workshops and the like.

The last two groups, on the other hand, include properties for special and specific purpose, namely, in a nutshell:

- Group D includes industrial buildings and, in general, buildings intended for production activities and not susceptible of being put to a different use without radical transformation;
- Group E is residual and includes properties that cannot be classified in the previous groups of categories due to their special characteristics (railway stations, ports and airports, fortifications, lighthouses).

For the first three category groups, cadastral annuities are assigned by means of a prior classification procedure, consisting of the *following stages:*

28 For the first three category groups, cadastral annuities are assigned by means of a prior classification procedure, consisting of the following stages:
- subdivision of the territory into census zones, each having uniform environmental and typological building characteristics;
- in each census area, subdivision of each category (e.g. A/2, 'Dwellings of civil type') into classes having, principally, similar extrinsic conditions and, secondarily, similar intrinsic conditions;
- calculation of the consistency of building units;
- identification of model units and determination of their rates;
- classification of individual building units;
- calculation of the cadastral income.

- subdivision of the territory into census zones, each having uniform environmental and typological building characteristics;
- in each census area, subdivision of each category (e.g. A/2, 'Civil dwellings') into classes having, principally, similar conditions;
- calculation of the consistency[29] of building units;
- identification of model units and determination of their rates;
- classification of individual building units;
- calculation of the cadastral income.

On the other hand, in the case of the groups of categories D and E, which include properties for special or particular use, the attribution of the annuity is made 'a posteriori', on the basis of direct appraisal, precisely because of the peculiarities that characterise buildings classifiable in this category.

Other types of property may be registered in the Cadastre of Buildings, for the sole purpose of identification (necessary, for example, in deeds of transfer of ownership), with a description of the specific features and purpose and without attribution of cadastral income[30]. These are the virtual or notional 'F' categories, which include units under construction, urban areas, collaborating units, units in the process of being defined, solar terraces, buildings awaiting declaration, and public communication network infrastructures.

Table 1 - CADASTRAL CLASSIFICATION OF BUILDINGS

I. PROPERTIES FOR ORDINARY USE

Group A

A/1 - Dwelling of stately type
A/2 - Civil dwelling
A/3 - Economic housing
A/4 - Low income housing
A/5 - Very low income housing
A/6 - Rural dwelling
A/7 - Dwellings in cottages

29 The consistency of building units is determined differently for the aforementioned first three groups of cadastral categories: for group A, consistency is determined with reference to rooms; for group B with reference to cubic metres; for group C with reference to square metres. The methods for calculating the consistency are specified in the regulation for the formation of the new urban building cadastre approved by Presidential Decree. no. 1142. of 1 December 1949.

30 Art. 2, para 2 of Ministerial Decree 28/98.

A/8 - Dwellings in villas
A/9 - Castles and palaces of eminent artistic and historical value
A/10 - Offices and private offices
A/11 - Dwellings and accommodation typical of the area

Group B

B/1 - Boarding schools and boarding houses; boarding schools, shelters, orphanages, hospices, convents, seminaries and barracks
B/2 - Nursing homes and hospitals (including those built or adapted for such purposes and not susceptible of being put to a different use without radical transformation, if they are not for profit)
B/3 - Prisons and reformation centres
B/4 - Public offices
B/5 - Schools, scientific laboratories
B/6 - Libraries, art galleries, museums, galleries, academies, not located in buildings belonging to category A/9
B/7 - Chapels and oratories not intended for public worship
B/8 - Underground warehouses for food storage

Group C

C/1 - Shops and workshops
C/2 - Warehouses and storage rooms
C/3 - Workshops for arts and crafts
C/4 - Buildings and premises for sporting activities (including those built or adapted for such purposes and not susceptible of being put to a different use without radical transformation, if they are not for profit)
C/5 - Bathing and therapeutic water establishments (including those built or adapted for such purposes and not susceptible of being put to a different use without radical transformation, if they are not for profit)
C/6 - Barns, stables, garages
C/7 - Closed and open canopies

II. PROPERTIES FOR SPECIAL USE

Group D

D/1 - Factories
D/2 - Hotels and guesthouses
D/3 - Theatres, cinemas, concert and performance halls and the like
D/4 - Nursing homes and hospitals
D/5 - Credit, exchange and insurance institutions
D/6 - Buildings and premises for sporting activities
D/7 - Constructed buildings adapted for the special needs of an industrial activity and not susceptible of being put to a different use without radical transformation
D/8 - Buildings constructed or adapted for the special needs of a commercial activity and not susceptible of being put to a different use without radical transformation
D/9 - Floating or suspended buildings secured to fixed points on the ground: private toll bridges
D/10 Buildings for productive functions related to agricultural activities (farm buildings).

III. PROPERTIES FOR PARTICULAR USE

Group E

E/1 - Stations for land, sea and air transport services
E/2 - Municipal and provincial toll bridges
E/3 - Constructions and buildings for special public needs
E/4 - Closed enclosures for special public needs
E/5 - Buildings constituting fortifications and their outbuildings
E/6 - Lighthouses, traffic lights, towers for public use of the municipal clock
E/7 - Buildings intended for public worship
E/8 - Buildings and constructions in cemeteries, excluding columbaria, tombs, and family tombs
E/9 - Special purpose buildings not included in the previous categories of group E.

IV. URBAN ENTITIES

Group F
F/1 - Urban area
F/2 - Ruined buildings
F/3 - Units under construction
F/4 - Units in the process of being defined
F/5 - Solar terrace
F/6 - Building awaiting declaration (Circular 1/2009)

10.5. Taxation assumptions

Similarly to the "*Imposta Comunale sugli Immobili*" (ICI), in the context of the Imposta Municipale Unica (IMU), the method of determining the taxable base differs according to the type of property in question, i.e., whether it is buildings, agricultural land or buildable areas.

As of 1st January 2020, the provision governing how the IMU tax base is to be determined is set out in Article 1(745) of Law no. 160/2019. This article establishes, in a general manner and without reference to the previous discipline of ICI, that the taxable base of IMU is configured according to the value of real estate. Compared to the past, the definition of the tax base appears substantially unchanged. Next, a detailed analysis will be conducted for each category subject to taxation. In the recent amendments [31] the state reserve of 0.76 percent was confirmed for real estate for productive use classified in cadastral group D.

10.5.1 Buildings

Article 745 of Law no. 160/2019 states that: "*The taxable base of the tax is the value of property. In the case of buildings registered in the Cadastre, the value is that obtained by applying the following multipliers to the amount of*

31 Article 1, paragraph 744 of Law no. 160/2019 provides that: "*The revenue from the IMU deriving from property for productive use classified in cadastral group D, calculated at a rate of 0.76 per cent, is reserved for the State; this reserve does not apply to property for productive use classified in cadastral group D owned by the municipalities and insistent on their territory. The assessment and collection activities relating to property for productive use classified in cadastral group D are carried out by the municipalities, which are entitled to the greater sums deriving from the performance of the aforesaid activities by way of tax, interest and penalties*".

the annuities recorded in the Cadastre, in force on 1st January of the year of taxation, revalued by 5 per cent pursuant toArticle 3, paragraph 48, of Law No 662 of 23 December 1996:

a. *160 for buildings classified in cadastral group A and cadastral categories C/2, C/6 and C/7, excluding cadastral category A/10;*
b. *140 for buildings classified in cadastral group B and cadastral categories C/3, C/4 and C/5; c) 80 for buildings classified in cadastral category D/5;*
c. *80 for buildings classified in cadastral category A/10;*
d. *65 for buildings classified in cadastral group D, with the exception of buildings classified in cadastral category D/5;*
e. *55 for buildings classified in cadastral category C/1.*

Changes in cadastral income occurring in the course of the year, as a result of construction work on the building, take effect from the date of completion of the work or from the date of use, whichever is earlier".

The IMU tax base is reduced by 50 per cent[32] for:

- buildings listed for reasons of historical or artistic interest[33];
- buildings declared uninhabitable or unfit for habitation and de facto unused, limited to the period of the year during which these conditions exist;
- for building units[34] granted under gratuitous loan to first-degree relatives (parents or children) under certain conditions.

For buildings registered in the Cadastre and with a cadastral income, the taxable base for determining IMU is determined:

- by revaluing by 5 per cent the annuity recorded in the Land Register on 1 January of the year of taxation;
- multiplying the result thus obtained by the relevant multiplying coefficient.

32 See Art. 1, paragraph 747 of Law no. 160/2019. There are specific reporting requirements to benefit from this reduction.

33 Art. 10 of Legislative Decree no. 42/2004.

34 Except for those classified in cadastral categories A/1, A/8 and A/9.

The formula for calculating the IMU tax base is as follows:

VC	=	RC	x	105/100	x	M
Cadastral value		Cadastral income				Multiplier

Below is also a summary of how the IMU tax base of buildings registered in the land register is determined.

Type	Determining the tax base
Residential properties (group A, excluding A/10) Cellars, attics, storage rooms (C/2) Garages and parking spaces (C/6) Canopies (C/7)	160 × RC × 105/100 = RC × 168
Collective residences (group B) Craftsmen's workshops (C/3) Buildings and premises for sporting activities (C/4) Bathing and curative water establishments (C/5)	140 × RC × 105/100 = RC × 147
Shops and workshops (C/1)	55 × RC × 105/100 = RC × 57.75
Offices and private offices (A/10) Banks and insurance companies (D/5)	80 × RC × 105/100 = RC × 84
Properties for special use (Group D, excluding D5)	65 × RC × 105/100 = RC × 68.25
RC = cadastral income entered in the Cadastre on 1 January of the reference year.	

For buildings not registered in the Cadastre and without a cadastral income that are classifiable in group 'D' (buildings for special use, such as factories), wholly owned by companies and separately accounted for, the tax base is determined:

- by applying the appropriate coefficients to the book value;
- until the year in which the buildings themselves are entered in the Land Register with attribution of annuity.

10.5.2. Non-agricultural land

This category includes all land that, by virtue of its characteristics, lacks the necessary requirements to be recognised as agricultural land or to be granted building status.

Such land, therefore, is not registered in the New Cadastre, but this does not mean that it cannot be subject to economic use, for example in the event that the owner obtains consideration for the right of way granted to third parties over it.

Examples of non-agricultural land can be mountain peaks, glacial moraines, uncultivated forests, etc.

10.5.3. Agricultural land

Agricultural land is defined as land registered in the Cadastre for any use, including non-cultivated land[35]. The IMU taxable base of agricultural land, including non-cultivated land, is equal to the product of the cadastral income recorded in the Cadastre on 1 January of the year of taxation, revalued by 25 per cent[36], by the multiplier coefficient 135. The value of agricultural land is thus determined as follows:

VC	=	RD	x	$\frac{125}{100}$	x	M
Cadastral value		Income from land				Multiplier

Exempt from the tax are agricultural lands:

- owned and managed by direct cultivators and professional agricultural entrepreneurs (imprenditori agricoli professionali, IAP)[37], registered in the agricultural insurance system, including agricultural companies[38], regardless of their location;
- located in the municipalities of the smaller islands[39];
- with unchangeable agro-silvo-pastoral purposes with indivisible and non-transferable collective property;
- falling in demarcated mountain or hill areas[40].

35 Art. 1, paragraph 741 of Law no. 160/2019: "*e) agricultural land is defined as land registered in the Cadastre, for whatever use, including non-cultivated land*".

36 Pursuant to Article 3 paragraph 51 of Law no. 662 of 23 December 1996.

37 Referred to Art. 1 of Legislative Decree no. 99/2004.W

38 Referred to in Art. 1, paragraph 3 of Legislative Decree no. 99/2004.

39 Referred to in Annex A annexed to Law no. 448 of 28 December 2001.

40 According to Article 15 of Law no. 984 of 27 December 1977, on the basis of the criteria set out in the Circular of the Ministry of Finance no. 9 of 14 June 1993, published in Ordinary Supplement no. 53 to Official Gazette no. 141 of 18 June 1993.

10.5.4 Buildable areas

A buildable area is defined as[41] an area that can be used for building purposes on the basis of the general town planning or implementation tools, or on the basis of the actual possibilities for building determined according to the criteria laid down for the purposes of compensation for expropriation in the public interest. With regard to IMU, the legislator[42] taxed the buildable area and defined it as the area "*usable for building purposes according to the general town planning tools adopted by the municipality, regardless of the approval of the region and the adoption of implementing tools of the same*". The taxation of buildable areas arises from the mere building potential of the land, right from the first stage of the planning process.

In the context of buildable areas, the methodology for calculating the tax base moves away from the use of an 'objective' value, such as the annuity, and towards a 'subjective' value, represented by the common market value. This circumstance is an exception, as it is the only case in which an evaluative parameter of a 'subjective' nature is used[43]. For building areas, the taxable base for the IMU is the 'market value in common trade' as of 1 January of the year of taxation, or the date of adoption of the urban planning tools, determined with reference to the following valuation elements:

- the territorial area of location;
- the index of buildability;
- the permitted use;
- the charges associated with any land adjustment work necessary for its construction;
- the average prices observed on the market for the sale of areas with similar characteristics.

Only in the presence of constraints of absolute "no buildable area" resulting from the general zoning plan is the land excluded from IMU purposes[44].

41 Art. 1, paragraph 741 Law no. 160/2019.

42 Art. 36, para. 2, Law-Decree no. 223 of 04 July 2006.

43 For the sake of completeness, it should be noted that once the construction of a building plot has begun (with its registration in the "F3" category), its taxable value for the purposes of IMU calculation also takes into account the cost of construction.

44 For those municipalities that host, on their territory, areas designated or used for mining activities, the question often arises as to whether these areas are taxable as agricultural land, buildable areas or buildings, or even whether they are exempt from taxation. The recent orientation of the Supreme Court of Cassation according to which such land is considered to be buildable land seems

10.6. Assumptions for the future

10.6.1. IMU taxable base and incentives for energy and seismic efficiency

If the information in the building register is to be adjusted, it is to be hoped that this revision will take into account the changed environmental requirements of energy efficiency and seismic safety, so as to provide incentives for buildings in line with the latest standards.

On this point, it is worth noting the proposals of some trade associations (including the ANCE - Associazione Nazionale Costruttori Edili, National Association of Building Contractors) that have already in the past proposed to reward 'cadastrally', and thus also fiscally, the production, purchase and possession of property in line with the highest energy and seismic standards required by law.

This could be done by introducing a coefficient that, taking into account the energy (or earthquake-proofing) performance of the building, would act inversely on the taxable income and cadastral value, precisely in light of the building's lower environmental (and social) impact.

This mechanism would make it possible to compensate the 'negative external factors', produced by seismically unsafe and energy-intensive buildings, which the current system, paradoxically, seems to reward.

In this way, local taxation could also be a lever to pursue the public interest of environmental protection and urban regeneration, with positive effects on the community.

Although this proposal appears sustainable in the medium to long term, it does not appear to be the path the legislature intends to take to date, perhaps because of the transitory economic impact of other temporary relief measures. The Budget Law 2024[45], in fact, has provided, or rather confirmed, that at the end of the works facilitated by the tax deductions pursuant to Article 119 of Law Decree no. 34/2020 (the so-called superbonus) the resulting cadastral variation must be transmitted to the Revenue Agency with (upward) updating of the relative income.

objectionable and at odds with the definition of 'buildable land', which does not include agricultural land for the sole reason that it is used for agricultural activities. The municipalities that adhere to the jurisprudential interpretation apply as a taxable base the common market value of the buildable areas, formulating tax claims that are huge, considering the territorial extension of certain mining activities - usually considerably larger than a buildable lot - and irrational (think of the case of lake quarries) that risk undermining the economic balance of the entities operating in these sectors.

45 Article 1, paragraphs 86 and 87 of Law no. 213 of 30 December 2023.

10.6.2. IMU 2025: Municipalities Required to Submit the IMU Rates Schedule by October 14

A first step towards standardization and transparency in the process of determining IMU rates has been introduced: starting from 2025, municipalities will be required to prepare and submit the IMU Rates Schedule using the digital application available on the Fiscal Federalism Portal. This requirement is established by Article 1, paragraph 757, of Law No. 160/2019 and its subsequent amendments.

Failure to submit the schedule by the October 14, 2025 deadline will result in the automatic application of the standard rates set forth in paragraphs 748-755 of the same law, even in cases where the municipality has approved an increase.[46]

46 https://www.finanze.gov.it/it/inevidenza/Aliquote-IMU-Comunicato-del-28-novembre-2024/

11.
VAT and transfer taxes on real estate transactions (asset deal)

by G. Paladini

11.1. Introduction: VAT and transfer taxes on real estate transactions

In case of real estate transactions carried out in Italy as asset deal the main transfer taxes are: VAT, registration tax, for the registration of the agreements of the transaction at the Revenue Agency (*Agenzia delle Entrate*)[1], mortgage tax for the registration of the agreements in the Public real estate registries[2] and cadastral tax for the amendments of the ownership of the real estate assets in the Cadastre[3].

These taxes are linked and constitute the system for the indirect taxation of the transfer of real estate assets (buildings and lands).

Under the general principle of alternation between VAT and registration tax, as a rule, if the transaction is subject to VAT, the registration tax applies at the fixed amount of euro 200, rather than with rates (usually 9%), with some exceptions.

The VAT is applicable on the basis of the features of the seller: if the seller is a VAT taxable person, the sale will be in the scope of the VAT. Such circumstance occurs when the seller is a person that carries out an economic activity in the meaning of the VAT Law[4]. In brief, for the purposes of this analysis, the main players of the real estate industry are VAT taxable per-

1 The registration is mandatory by law for the preliminary sale and purchase agreement (Article 10 Registration Tax Law) and for the final sale and purchase agreement (Article 1, Tariff Part I, Registration Tax Law).

2 Under Articles 2643 ff. of the Civil Code.

3 This chapter does not address stamp duties applicable to the real estate transactions since usually the amount of such taxes is negligible.

4 Under Article 9(1) of the Directive 2006/112/EC a person qualifies as VAT taxable person if it carries out un economic activity in an independent way.

sons: commercial and real estate companies[5], real estate alternative investment funds (i.e. real estate investment fund and real estate Sicaf)[6], Italian listed Reits (Siiq) and SPV for the real estate securitization established under Article 7.2 of the Law no. 130/1999 (the law on securitization)[7].

11.2. The sale and purchase agreement

If the seller is not a VAT taxable person, the transaction is outside the scope of VAT and the registration tax will apply as follows[8]:

Buildable lands	9%
Agricultural lands	15%[9]
Other lands	9%
Residential properties as "first home"[10]:	2%
Other properties:	9%[11]

In this case, mortgage and cadastral taxes apply in the fixed amount of 50 euro each.

The tax regime described above is the ordinary regime: there are also some tax incentives (see Part I and chapter 17).

If the seller is a VAT taxable person, the transaction will be in the scope of the VAT.

Italian VAT Law, set out by Presidential Decree no. 633/1972, provides different tax regimes for land and buildings. Within the land category, a distinction must be made between buildable land and non-buildable land; with respect to buildings, a distinction must be made between residential and non-residential buildings.

The tax regime of the main cases is summarized below, while we refer to the following paragraphs for the analysis of the qualification of different real estate assets for the purpose of the taxes under consideration.

5 Also if they do not carry out a real estate business.

6 See Chapters 6 and 7 for the analysis of the real estate alternative investment funds.

7 Also a public entity can qualify as VAT taxable person if it carries out an economic activity.

8 Article 1, Tariff Part I, Registration Tax Law.

9 Assuming that the purchaser does not carry out an agricultural business.

10 I.e. transactions that may benefit from the "first home" tax incentive.

11 This category includes the buildings other than the residential buildings and other than the residential buildings having the requirements for the "first home" tax incentive: for example, retail, offices, logistic buildings.

Buildable land

VAT	Registration tax	Mortgage tax	Cadastral tax
22%	200 euro	200 euro	200 euro

Non-buildable land

VAT	Registration tax	Mortgage tax	Cadastral tax
Non applicabile	15% / 9%	50 euro	50 euro

Residential buildings (Article 10(1)(8-*bis*) VAT Law)

VAT	Registration tax	Mortgage tax	Cadastral tax
Taxable if the seller has built or renovated the building in the 5 years before the sale 10% (4% for “first home” tax incentive)	200 euro	200 euro	200 euro
VAT by option of the seller that has built or renovated the building more than 5 years before the sale 10% (4% for “first home” tax incentive)	200 euro	200 euro	200 euro
Exempt in the other cases	9% (2% for “first home” tax incentive)	50 euro	50 euro

Non-residential buildings (Article 10(1)(8-*ter*) VAT Law)

VAT	Registration tax	Mortgage tax	Cadastral tax
Taxable if the seller has built or renovated the building in the 5 years before the sale 10% / 22%	200 euro	3% (1,5% if at least a party to the transaction is a real estate alternative investment fund)	1% (0,5% if at least a party to the transaction is a real estate alternative investment fund)
VAT by option of the seller in the other cases	200 euro	3% (1,5% if at least a party to the transaction is a real estate alternative investment fund)	1% (0,5% if at least a party to the transaction is a real estate alternative investment fund)

Exempt in the other cases	200 euro	3% (1,5% if at least a party to the transaction is a real estate alternative investment fund)	1% (0,5% if at least a party to the transaction is a real estate alternative investment fund)

The ordinary VAT rate for the sale of assets is 22%. However, there are relevant cases in which Italian VAT law provides the 10% rate[12]. For example, in case of sale of the following assets:

- Buildings or portions of buildings, residential or commercial, renovated under Article 3(1), letters c), d) and f), of the Consolidated Law on Construction (Presidential Decree No. 380/2001), if the works have been carried out by the seller, also through contractorsi[13];
- Non-luxury residential properties[14] if the purchaser does not meet the requirements for the "first home" tax incentive (otherwise the rate would be 4%);
- Residential buldings or portions of residential buildings if the seller is the construction company[15].

With reference to the sale of residential properties, the 10% rate is applicable also if the asset is still under construction or renovation at the time of the sale, provided that the original destination is maintained.

The sale of non-luxury residential properties is subject to 4% VAT rate[16] if the purchaser is an individual that meets the requirements for the "first home" tax incentive[17]. The 4% rate is applicable, under the law, even if the property has not yet been completed at the time of the sale.

With reference to the rates of the mortgage and cadastral taxes we note that:

- The rates are reduced to the half of the ordinary rates (therefore, 2% rather thann 4%) if the sale concerns commercial properties pursuant to Ar-

12 Part III of the Table A of the VAT Law.

13 Number 127-*quinquiesdecies* of the Part III of the Table A of the VAT Law.

14 Residential buildings different from those classified in the cadastral categories for luxury properties (i.e. A/1, A/8, A/9).

15 Number 127-*undecies* of the Part III of the Table A of the VAT Law.

16 Part II of the Table A of the VAT Law.

17 Number 21 of the Part II of the Table A of the VAT Law. Such buildings are residential buildings different from those classified in the cadastral categories for luxury properties (i.e. A/1, A/8, A/9).

ticle 10(1)(8-*ter*) VAT Law and at least one of the parties to the transaction is a real estate investment fund[18] or a real estate Sicaf[19];

- If the purchaser is a SPV for securitization transactions set out under the Securitization Law (i.e. Law no. 130/1999) - so called ReOco or LeaseCo - the mortgage and cadastral taxes, as well as the registration tax, will be 200 euro each, rather than proportional[20];
- If the seller is a SPV for securitization transactions (ReOco or LeaseCo), the mortgage and cadastral taxes, as well as the registration tax, will be 200 euro each, provided that the purchaser is a commercial company and commits to transfer the assets within 5 years[21].

For the purposes of VAT and transfer taxes, the distinction between buildable land and non-buildable land is set out by the law In Article 36(2) of the Law Decree no. 223/2006[22], pursuant to which, for the purposes of VAT and transfer taxes, a land is to be considered buildable if it can be used for building purposes under the general planning instrument adopted by the Municipality regardless of the approval of the Region and the adoption of implementing instruments by the competent local authority[23].

The distinction between buildings under Article 10(1)(8-*ter*) of the VAT Law and buildings under Article 10(1)(8-*bis*) of the VAT Law is, in brief, the distinction between commercial buildings (*fabbricati strumentali per natura)* and residential buildings, as constantly stated by the Revenue Agency[24]. In the tax system at issue it is used the concept of "buildings instrumental by nature to a business " (*fabbricati strumentali per natura*) to describe the buildings defined by Article 10(1)(8-*ter*) of the VAT Law as buildings that "*by their characteristics are not susceptible to different use without radical transformation*"[25].

18 Article 35(10-*ter*) Law Decree no. 223/2006 converted into Law no. 248/2006.

19 Article 9 Legislative Decree 4 March 2014, no. 44.

20 Article 7.1(4-*bis*) Law no. 130/1999.

21 Article 7.1(4-*quater*) Law no. 130/1999.

22 Converted, with amendments, into the Law 4 August 2006, no. 248.

23 The Revenue Agency has noted that "*for tax purposes, a land is considered usable for building purposes before the completion of the administrative law process and the approval by the Region. To this end it is sufficient the adoption by the Municipality of the determination required by the administrative law*", Resolution 2 December 2008, no. 460/E.

24 Revenue Agency, Circular 4 August 2006, no. 27, introduction; Circular 1 March 2007, no. 12/E, paragraph 2; Circular 28 giugno 2013, no. 22/E introduction.

25 Article 10, paragraph 1(8-*ter*) VAT Law.

And the distinction between instrumental (i.e. commercial) and residential buildings is, in turn, based on the classification of the property in the Cadastre (*Catasto*) at the time of the sale and purchase agreement[26]: residential properties are those classified in cadastral group A, excluding those classified in category A/10 (offices), while instrumental properties are those classified in the other cadastral categories (A/10, B, C ,D, E).

The table at the end of this chapter provides the description of each cadastral category.

Therefore the concept of building is based, first and foremost, on the real estate unit as identified in the Cadastre, i.e., the real estate unit endowed with its own cadastral category (e.g. D/2 for hotels) and cadastral income[27]. Consequently, if the transaction involves an entire building, composed of a plurality of real estate units from the cadastral point of view, the analysis of the tax regime applicable for VAT and other transfer taxes will have to concern each real estate unit of the building being sold.

Consideration must then be given to whether the portfolio of the transaction includes appurtenances (pertinenze), i.e., real estate units permanently intended to serve or adorn another real estate unit, which constitutes the main property[28]. Typical examples of appurtenances are parkings (garages) and cellars.

The appurtenance relationship is based on an economic and legal link between an accessory property and a main property; the appurtenance has its own individuality and autonomy from the economic point of view and may be separate from the main property, but it is, by the owner's will, in a connecting relationship with the main property. This link is also reflected on the legal level: unless otherwise agreed between the parties, sale and purchase agreements having as their object the main property also include appurtenances[29].

According to the view of the Revenue Agency, the appurtenance is subject to the same tax regime of the main property[30]: thus, the appurtenance

26 Revenue Agency, Circular 4 August 2006, no. 27, introduction; Circular 1 March 2007, no. 12/E, paragraph 2; Circular 28 June 2013, no. 22/E introduction.

27 According to the constant interpretation by the Revenue Agency.

28 Article 817 Civil Code.

29 Article 818 Civil Code.

30 Revenue Agency Circular 1 March 2007, no. 12/E, paragraph 2; Circular 28 June 2013, no. 22/E, introduction.

of a residential real estate unit will be subject to the tax regime provided by Article 10(1)(8-*bis*) of VAT Law, even though it is itself classified in a cadastral category other than Group A-Residential. Likewise, the appurtenance of an instrumental real estate unit will be subject to the tax regime provided by Article 10(1)(8-*ter*) of VAT Law.

However, the identification of the applicable tax regime in concrete terms will still require an analysis of the appurtenance: for example, if the nature of appurtenance of a commercial building brings the real estate unit under the tax regime of the commercial buildings set out by the aforementioned No. 8-*ter*), it will still be necessary to verify whether the seller has carried out construction or renovation works on the appurtenance that is relevant for VAT purposes, in order to identify the tax regime of the sale of the appurtenance.

VAT-relevant renovation works are those carried out by the seller, including through contractors, and falling under the categories indicated in Article 3(1) letters c), d) and f), of the Consolidated Law on Construction. These are, in particular, works falling into the following categories:

- works of restoration and conservative rehabilitation
- orks of building renovation
- works of urban restructuring.

It should be noted that, for VAT purposes, construction works performed by the seller, either directly or through contractors, is relevant, and not any construction works not attributable to the seller (e.g., that performed by the tenant in the absence of a procurement contract between the seller and the tenant).

Thus, it is not in itself relevant whether construction works were carried out on the property being sold, but rather whether the seller carried out that works, either directly or through contractors[31].

For this purpose, the object of the seller's business is also irrelevant: the performance of the works indicated by the above-mentioned VAT rule, affects the determination of the VAT regime of the sale of the property, even in the event that the seller does not carry out an activity of construction or renovation of real estate assets as main or ordinary business.

31 Although the VAT rules do not explicitly link the VAT regime of the sale to the VAT paid on the construction or renovation works of the property, the application of VAT to the sale of newly built or recently renovated properties allows the VAT paid by the seller on the works to be transferred to the transferee, in a manner consistent with what normally happens in the VAT system (according to the mechanisms of deduction and recourse).

On the contrary, ordinary and extraordinary maintenance works, as defined by paragraphs (a) and (b) of Article 3(1) of the Consolidated Law on Construction do not affect the VAT regime of the sale of buildings[32].

The above shows the importance of analyzing the works related to the property: depending on the type of works and the date of completion of the works, the transfer of property will be subject to a different tax regime for VAT purposes and transfer taxes.

This analysis must necessarily be carried out on the basis of the technical documentation related to the construction or renovation works; thus, for example, it will be necessary to examine the SCIA (Certified declaration of start of activity - *Segnalazione certificata di inizio attività*) related to the works performed on the property.

With reference to the identification of the date of completion of the construction or renovation works relevant for VAT purposes, the following is noted.

The rules under analysis mention the "date of completion" of construction or renovation works, without establishing criteria for identifying this date. It must be considered that this date coincides, first of all, with the date indicated in the documentation on the completion of work prepared in accordance with the building regulations (so-called notice of completion).

However, it should be borne in mind that, for VAT purposes, it is necessary to adopt a substantive approach, such that the completion of the work coincides with the moment when the property is fit for use as a building, i.e., to be used[33].

Therefore, in summary, the completion of the works will generally coincide with the date of the end of the works communicated in accordance with the law, it being understood that if prior to this date the property was already being used in practice, e.g. leased to third parties, the same should be considered as completed for VAT purposes.

If the sale is taxable for VAT purposes, the tax will be calculated at the rate of 10% or 22% on the purchase price and must be paid by the buyer to the seller in addition to the price, with the following exceptions:

32 Presidential Decree. no. 380/2001.

33 Revenue Agency Circular 1 March 2007, no. 12/E, paragraph 10.

a. *reverse charge*[34]: if the seller opts, in the sale and purchase agreement, for the VAT, such tax will apply with the reverse charge procedure. The invoice will be issued by the seller without charging the VAT on the price, mentioning "reverse charge"; the purchaser must saupplement the invoice, inclcuding the VAT rate (22% or 10%) and the VAT amount, and must record the invoice both as a sale and as a purchase. In this way, the purchaser will record both the VAT for the sale and, as a deduction, the VAT for the purchase, offsetting the two amountsl[35]. Consequently, the VAT system avoids the circulation of cash VAT between the seller and the purchaser, with the aim of preventing tax fraud In real estate transactions. It Is worth pointing out that a reverse charge sale is still a taxable transaction for the seller and, as a result, does not limit his right to deduct VAT on purchases of goods or services (a right to deduct that is, on the other hand, limited by the making of VAT-exempt sales and leases);
b. *split payment*[36]: if the purchaser falls into the category of entities for which split payment applies (e.g., State-controlled companies and listed companies), the VAT will not be paid by the purchaser to the seller, but will be paid directly by the purchaser to the Revenue Agency. In cases where both reverse charge and split payment are applicable, the former will prevail.

Therefore, while the seller's status as a VAT subject is relevant in determining whether or not the sale falls within the scope of the VAT, the purchaser's features affect how the tax is paid (reverse charge or split payment).

In this perspective, it is Interesting to point out that registration, mortgage and cadastral taxes, if due proportionally, are calculated on the higher of (a) the price set out by the sale and purchase agreement and (b) the "value in common trade" (i.e., fair market value)[37].

The Revenue Agency can check whether the price set by the parties in the sale and purchase agreement is consistent with the market value of the property: the time limit for carrying out the tax audit is 2 years from the registration of the sale and purchase agreement.

34 Article 17, paragraphs 5 e 6, VAT Law.

35 It being understood that the percentage of deductible VAT will be equal to that which derives from the transactions carried out by the purchaser, according to the ordinary pro-rata mechanism set out by VAT Law.

36 Article 17-*ter* VAT Law.

37 Articles 43(1)(a) and 51 Registration Tax Law; articles 2 and 10 Mortgage and Cadastral Taxes Law.

For the purposes of the tax audit, the Agency analyses the price of the transaction considering (a) transfers, made in the last 3 years, of the same property or other properties with similar characteristics, (b) the net income of which the property is susceptible, capitalized at the average rate applied for similar real estate investments, as well as (c) any other valuation factor[38].

If the value determined by the Revenue Agency, through its own analysis, is higher than the price of the sale and purchase agreement, the Agency shall demand from the parties to the transaction the higher proportional taxes (registration, mortgage and cadastral taxes as the case may be) and interest. Pecuniary penalty is applicable if the value assessed by the Revenue Agency, reduced by 1/4, exceeds the price indicated by the parties in the sale and purchase agreement: in this case the penalty is 70% of the higher taxes[39]. In essence, then, if the difference between the price and the value estimated by the Revenue Agency is within a certain threshold, no penalties apply, but the Agency will only charge the higher taxes and interest.

The power of the Revenue Agency to carry out such tax audit is not precluded by the independence of the parties to the transaction: the tax audit can be initiated even if the real estate transaction was carried out between independent, unrelated parties, in a market transaction under normal conditions. Similarly, the circumstance that one, or both, of the parties of the transaction are entities subject to supervision by a competent authority (e.g., an Alternative investment fund manager) does not in itself preclude the tax audit by the Revenue Agency[40].

Based on the case law, such circumstances may be relevant in case of litigation to prove, along with other evidence, that the price represented the market value of that property at the time of purchase and thus challenge the Revenue Agency's valuation.

38 Article 51(3) Registration Tax Law.

39 Article 71 Registration Tax Law.

40 The system has some exceptions. Sales of properties carried out at public auction are not susceptible to value adjustment: in this case the taxable base is the price resulting from the auction (Article 44(1) Registration Tax Law). Another exception, but not relevant for institutional real estate transactions, concerns sales involving residential buildings in which the purchaser is an individual who is not acting in the exercise of a business activity.

11.3. The preliminary sale and purchase agreement: deposit and advance price

The preliminary sale and purchase agreement regarding real estate assets must be registered at the Revenue Agency and is subject to the registration tax of 200 euro (fixed amount)[41].

The obligation to register exists whether the contract is formed by notarized deed or by private deed (i.e. deed not drafted or certified by a notary public) or by private deed in the form of exchange of correspondence, that is, by exchange of a proposal and an acceptance[42].

If the preliminary sale and purchase agreement also provides for the giving of sums by way of deposit or down payment (i.e. advance price), in order to determine the amount of registration tax due for the deposit and down payment, it will be necessary to examine the tax regime of the final sale and purchase agreement, according to the provisions described in the previous paragraph.

Starting from 1st January 2025[43], if the sale of the property is subject to VAT and the registration tax of 200 euro, i.e., if the final sale and purchase agreement will be subject to this tax regime, the deposit is subject to the registration tax of 200 euro and not to the tax equal to 0.5% of the deposit[44]. In fact, the relevant regulations stipulate that either the 0.5% rate or the lower tax applicable for the final sale and purchase agreement (in the example: 200 euros) applies.

The tax paid on the preliminary sale and purchase agreement is then charged against the tax due for the registration of the final sale and purchase agreement.

41 Article 10, Tariff Part I, Registration Tax Law.

42 Article 1, Tariff Part II, Registration Tax Law, which identifies the documents to be registered only in case of use if formed by exchange of correspondence, mentions preliminary agreements, but excludes those for which the written form is required by the Civil Code under penalty of nullity. The latter are, therefore, subject to the registration obligation. For the preliminary real estate sale and purchase agreement, the written form under penalty of nullity is required by the Articles 1351 and 1350 of the Civil Code.

43 Note of the Article 10, Tariff Part I, Registration Tax Law. This rule applies since 1st January 2025 under Article 9(3) Legislative Decree no. 139/2024.

44 Assuming that the amount of the deposit is higher than 40,000 euro and, consequently, the 0.5% registration tax on the deposit is higher than 200 euro.

In addition, if the sale of the property is subject to VAT and registration tax of 200 euro, the advance price will be subject to registration tax of 200 euro.

If, on the other hand, the sale is subject to proportional registration tax at the rate of 9%, the advance price would be subject to registration tax at the rate of 0.5% of the advance price. It is understood that the registration tax paid for the advance price is then charged against the tax (9%) due for the registration of the final sale and purchase agreement.

The above provisions, effective as of January 1, 2025, were introduced by Legislative Decree no. 139 of September 18, 2024, in implementation of the registration tax reform[45].

11.4. Buildable lands

As anticipated, for the purposes of VAT and real estate transfer taxes, a plot of land is to be considered buildable if it can be used for building purposes under the general planning instrument adopted by the Municipality regardless of the approval of the Region and the adoption of implementing instruments of the same[46].

The rule identifies the moment from which a land is considered buildable for tax purposes by referring to the general urban planning instrument adopted by the Municipality in which the land is located. Therefore, if there is such an urban planning instrument adopted by the Municipality, the land will be buildable for tax purposes, even if the administrative-urban planning process had not yet been completed.

Of course, "tax buildability" operates only in terms of VAT and indirect taxes, it being understood that buildability in practice will remain subject to the completion of the administrative-urban planning process.

In addition, it will still need to be ascertained whether, at the execution of the sale and purchase agreement, other local administrative regulations, e.g., regional, are in effect that preclude construction[47].

45 The tax reform has been started by the Law 9 August 2023, no. 111 and is currently still in progress.

46 Article 36(2) Law Decree no. 223/2006 converted, with amendments, into Law 4 August 2006, no. 248.

47 A similar case was examined by the Revenue Agency in Resolution 2 December 2008, no. 460/E.

In the European VAT Directive (Directive 2006/112/EC), the notion of "building land" is left to be defined by member States, so that it is up to each EU State to define whether land qualifies as building land for VAT purposes[48].

Member states, in defining what land is to be considered "building land," are required to comply with the objective pursued by Article 135(1)(k) of the Directive, which aims to exclude from VAT only supplies of undeveloped land not intended to support a building[49].

The notion of buildable land for VAT purposes is also of interest in delineating the boundary with respect to the notion of building, in cases where there is a building under construction or renovation - given that, as noted above, the supply of buildings and the supply of buildable land are subject to different tax regimes.

In a recent decision, the Court of Justice of the EU addressed the VAT qualification of the sale of land on which foundations had been laid at the time of the transaction.

In its judgment of November 7, 2024, in Case C-594/23 (Lomoco Development), the Court of Justice clarified that, for VAT purposes, the supply of a building land on which only the foundations of a building for residential use were made cannot be qualified as a supply of a building for the purposes of Article 12(1)(a) of the Directive. According to the Court, such transaction must be qualified as a supply of building land.

The ruling is very interesting because it deals with the distinction between building, building land and building under construction, assets subject to different regimes for VAT and transfer taxes purposes (on this point see the following paragraphs).

11.5. Commercial properties and residential properties

Under the VAT Directive building shall mean any structure fixed to or in the ground[50].

48 Article 12(3) of Directive 2006/112/EC provides that, for VAT purposes, land, whether developed or not, defined as such by the Member States, is considered "building land".

49 EU Court fo Justice, decision 4 September 2019, in the case C-71/18 (KPC Herning), paragraph 53.

50 Article 12(2) Directive 2006/112/EC. Article 13-*ter* of the Regulation no. 1042/2013, that modified the EU Regulation no. 282/2011 on the place of supply of services for VAT purposes, provides a definition of real estate assets (buildings and lands) that however is relevant for other VAT rules different from those analyzed in this chapter.

The EU VAT law does not distinguish buildings according to their use, i.e., between residential and non-residential buildings, as is the case in Italian VAT law[51]. In the European VAT system, buildings are distinguished on the basis of value added, to determine when the sale of a building should be subject to tax, manifesting value added for VAT purposes, and when it should be excluded from tax.

In summary, the EU VAT law provides for a distinction between old buildings, i.e., with no value added for VAT purposes, and new buildings, i.e., with value added for VAT purposes: the sale of an old building, in principle, is not subject to VAT due to lack of value added[52].

The VAT Directive provides some alternative criteria that member States can adopt to distinguish between value-added and non-value-added buildings. As regards the criterion adopted by Italy, it is noted that the Directive[53]:

a. refers to the transfer made before the "first occupation" of the building;
b. provides that a member State may determine how buildings with value added are to be considered as buildings undergoing conversion;
c. provides that a member State may apply criteria other than "first occupation," such as the criterion of the period between the date of completion of the building and the date of first disposal[54].

Italian VAT law, as noted above, distinguish both between old and new buildings, depending on the date of completion of construction or renovation, defined by reference to Italian building regulations, and on the use of the buildings.

On this second aspect, Italian VAT law makes a distinction between buildings that are "*instrumental which, due to their characteristics, are not susceptible to different use without radical transformation*" and buildings other than instrumental. According to the constant interpretation of the Revenue Agency, this distinction is equivalent to the distinction between

51 In the Directive 2006/112/EC residential buildings are mentioned in the no. 10 of the Annex III on VAT rates.

52 EU Court of Justice, decision 4 September 2019, in the case C-71/18 (KPC Herning), paragraphs 56, 57; decision 16 November 2017, in the case C-308/16 (Kozuba Premium Selection), paragraphs 30, 31.

53 Article 12 of the Directive 2006/112/EC.

54 The EU Court of Justice has stated that "*Like the criterion of the first occupation, the purpose of the alternative criteria ais to, (…), distinguish new buildings, subject to VAT, from the old buildings, exempt from VAT under Article 135(1)(j) of the VAT Directive*", see decision 7 November 2024, in the case C-594/23 (Lomoco Development), paragraph 57.

residential buildings from the cadastral point of view (which would be different from the instrumental ones) and non-residential buildings from the cadastral point of view (which would be the instrumental ones).

In particular, the Revenue Agency stated that, for the purposes of VAT and other real estate transfer taxes, cadastral classification, constitutes, "*regardless of the actual use of the property, the objective criterion to be used to distinguish between instrumental buildings and buildings for residential use*"[55].

In addition, the Revenue Agency clarified that instrumental buildings by nature include real estate units classified, or classifiable, in the Cadastre in the categories of groups B, C, D and E, as well as in category A/10, while buildings other than instrumental buildings by nature include residential real estate units, classified, or classifiable, in the Cadastre in the categories of group A (except category A/10)[56].

The distinction on the basis of cadastral classification operates as an objective criterion, consequently disregarding the actual use of the properties[57]; this affects, above all, with respect to residential real estate, which will be classified as non-instrumental for VAT purposes, and subject to the tax regime provided for such real estate, even if it is used in the context of an economic activity and, therefore, as assets for an economic activity.

Also on this point, the Revenue Agency further stated that "*the VAT regime is closely related to the objective nature of the asset being supplied, that is, its factual and legal status at the time of the supply, thus disregarding the destination of the asset by the purchaser*"[58].

In the Italian system, therefore, as seen in paragraph 11.2 above, the distinction between residential and non-residential buildings is quite important: for further analysis of this matter, see Chapter 13.

11.6. Buildings under construction or under renovation

Some specific considerations need to be carried out on the case where the subject of the purchase and sale is a building classified in one of the following cadastral categories of Group F: F/2 "Degraded real estate unit", F/3 "Real

55 Among the many, Revenue Agency Resolution 14 January 2014, no. 8/E.

56 Revenue Agency Resolution 14 January 2014, no. 8/E.

57 Revenue Agency, Circular 28 June 2013, no. 22/E; Resolution 14 January 2014, no. 8/E.

58 Revenue Agency, Circular 21 June 2011, no. 28/E, paragraph 1.2.

estate unit under construction" and F/4 "Real estate unit under definition"[59].

These are categories defined from the cadastral point of view as "fictitious". Pursuant to Article 3, paragraph 2, of the Decree of the Minister of Finance no. 28/1998, these cadastral categories are intended to register in the Cadastre, for identification purposes only, without attribution of cadastral rent, buildings under construction or definition and buildings unsuitable for income-producing uses, due to the accentuated level of degradation.

Therefore, properties classified in one of these cadastral categories are identified for the purposes of the Cadastre, but lack an independent cadastral income based on their status[60].

From this point of view, properties classified in the cadastral categories of Group F do not qualify as real estate units in the strict sense, considering that the real estate unit is defined as the building, or the portion of the building, which, in its state and according to local use, has potential for functional and income autonomy, represented by the cadastral income[61].

In other respects, properties classified in cadastral categories of Group F have the necessary characteristics to be recorded in the Cadastre for recognition of the real estate assets, although without cadastral income[62].

Turning to the analysis of individual cases, for VAT and transfer tax purposes, the following is noted.

Buildings classified in category F/2 "Degraded real estate unit" are those buildings that are no longer habitable or, in any case, usable for their intended use, due to the high state of deterioration in which they are[63]. The degrade status of the property results in an inability to routinely produce its own income[64]. An example is an industrial building abandoned for many years.

The recording in the cadastral category F/2 is not possible when the building is still recordable in another cadastral category[65].

59 See Notaries National Association papers no. 88-2009/T and no. 181-2017/T.

60 The Circular of the Land Agency dated 29 October 2009, no. 4 clarified that the Group F is aimed at allowing the owners to record properties in the Cadastre, for legal purposes, even if the property is not a true real estate unit pursuant to the cadastral law.

61 Article 2 Decree of the Ministry of Finance no. 28/1998; Lan Agency Circular 10 August 2010, no. 3.

62 Article 3(3) Decree of the Ministry of Finance no. 28/1998 provides a list of buildings that are not recorded in the Cadastre, not even in the categories of the Group F.

63 Land Agency Circular 9 luglio 2010, no. 2.

64 Revenue Agency Circular 13 June 2016, no. 27/E, paragraph 1.1.

65 Revenue Agency Circular 13 June 2016, no. 27/E, paragraph 1.1.

In this regard, the Revenue Agency noted, first of all, that this is a durable cadastral classification of the property, unlike the classifications in F/3 "Real estate unit under construction" and F/4 "Real estate unit under definition" which are necessarily provisional under the law[66].

Given the distinction between instrumental buildings by nature and residential buildings, which, as seen, is based on cadastral classification in the categories of groups A, B, C, D, E, it should be considered that the collaborating property does not qualify as either an instrumental building or a residential building for the purposes of VAT and transfer taxes.

In particular, following the consolidated orientation of the Internal Revenue Service, according to which these tax regimes apply to properties classified in cadastral groups A, B, C, D, E, the sale of a collaborating property should not be subject to the VAT regime provided by Article 10, paragraph 1, numbers 8-*bis*) and 8-*ter*) of VAT Law.

Therefore, the sale of the degraded property should be qualified for VAT purposes as a sale of an asset other than buildings and, therefore, be subject to ordinary VAT at the rate of 22%.

It also follows that the registration tax and the mortgage and cadastral taxes should apply at the fixed rate of 200 euro each[67], since the VAT rules for true buildings do not apply.

This tax regime was confirmed in the Ruling of the Revenue Agency dated 7 November 2022, no. 554.

Similar considerations should apply to the transfer of property classified in cadastral category F/3 "Real estate unit under construction" at the time of the execution of the sale and purchase agreement.

On this point, see Revenue Agency's Ruling no. 241 of August 4, 2020 and other Agency rulings and circulars mentioned therein.

The Revenue Agency has clarified that in the case of buildings undergoing renovation, the sale is taxable for VAT purposes provided that the construction work has actually been carried out, even if only partially, while it is not sufficient the mere application for administrative authorizations to carry out building works. According to the Revenue Agency, if a building permit has been applied for or issued or a declaration of commencement of activi-

66 Revenue Agency Ruling 30 August 2019, no. 357.

67 Pursuant to: alternance prnciple between VAT and registration tax set out by Article 40(1) Registration Tax Law, Note to Article 1 of the Tariff of the Mortgage and Cadastral Taxes Law and Article 10(1) Mortgage and Cadastral Taxes Law.

ties has been submitted but construction works has not started, the building cannot be considered, for tax purposes, as a building under renovation[68].

In the case of properties classified in the cadastral category F/4 "Real estate unit under definition" at the time of the execution of the sale and purchase agreement, some specific considerations need to be made.

The F/4 category represents, from the cadastral point of view, a temporary classification, pending the final cadastral classification in one of the categories of groups A to E, with assignment of the cadastral Income[69].

Furthermore, these are buildings for which construction or renovation works may not yet have been completed; in such a case, from a factual point of view, the property would be in a situation similar to that of a property classified in category F/3 "Real estate unit under construction". Otherwise, if the works had been completed, the property in category F/4 would be in a different factual situation from that of a property in category F/3, although it would still lack an ordinary cadastral category and cadastral income.

In this regard, the Revenue Agency noted that the F/4 category would only respond to the transitional need to indicate that the property is in a phase of building transformation and would not be suitable to consider that a change of use (e.g., from residential to commercial) had already occurred[70].

According to the Ruling of the Revenue Agency dated 6 April 2022, no. 167, in the case of the sale of a property classified in category F/4, the VAT regime provided for buildings by Article 10, paragraph 1, no. 8-*bis*) and 8-*ter*) of VAT Law would not apply and VAT would apply at the ordinary rate of 22%.

The sale will be subject also to registration tax of 200 euro under the principle of alternance between VAT and registration tax[71].

However, with reference to the mortgage and cadastral taxes, the Ruling has stated the application of proportional taxes (a total of 4%) instead of the fixed amount of 200 euro each.

68 Circular 1 March 2007, no. 12/E, paragraph 10. This clarification seems to point out that the mere cadastral classification in the category F/3 is not sufficient if the works have not been started. Likely, this matter does not occur assuming that the correct classification in the F/3 category requires the actual inception of the renovation works.

69 Land Agency, Circular 29 October 2009, no. 4, paragraph 3.3.

70 Resolution 8 April 2009, no. 99/E which, however, deals with taxes different from VAT and transfer taxes.

71 Article 40 Registration Tax Law.

From the point of view of mortgage and cadastral taxes, therefore, the Revenue Agency's conclusion Is different from that formulated for the transfer of properties recorded in category F/2 or category F/3.

Moreover, in the Ruling under review, the Revenue Agency ruled out the applicability of the 10% VAT rate provided for in no. 127-undecies) of Table A, Part III, of VAT Law, for the sale of non-luxury residential houses, even if not completed, as long as the original use remains. The Revenue Agency held that, in the case at Issue, since the building was originally classified in a cadastral category for commercial buildings and then classified, at the time of the sale, in the fictitious category F/4, the reduced VAT rate provided for the sale of residential buildings, even if not completed, Is not applicable, since the original destination changed.

It is also interesting to mention another case examined by the Revenue Agency.

In the Ruling no. 365 of July 6, 2022, the Revenue Agency dealt with the case of a building under construction, with respect to which the interruption of work had occurred at a time when the building was not yet registered at the Cadastre in category F/3 “Real estate unit under construction” or in another cadastral category of group F.

According to the Revenue Agency, the sale at issue is subject to the VAT regime applicable to the sale of building land, thus VAT at the rate of 22% without reverse charge and registration, mortgage and cadastral taxes of 200 euro each, considering that, at the time of the sale, the property was recorded In the Cadastre as land and not as a building under construction, despite the fact that the construction works had already been partly carried out.

Although this point is not ckearly stated in the Ruling no. 365/2022, likely the Revenue Agency assumed the correctness of the cadastral classification of the asset as land rather than as building under construction; the Revenue Agency, In other words, assumed the correctness of the cadastral recording, being a matter excluded from the scope af the tax ruling.

Under Italian law, the Municipalities may carry out cadastral audits, together with the Revenue Agency, to verify the correct recording in the Cadastre of real estate assets, considering the actual status of the asset and similar assets[72].

72 Article 3(5) Law 23 December 1996, no. 662; Article 1(336) Law 30 December 2004, no. 311.

11.7. The draft law on urban regeneration

With reference to the transfer taxes on real estate transactions, it is worth pointing out the draft Law on the urban regeneration currently under analysis by the Parliament.

The law is aimed at incentivizing real estate transactions for the recovery of existing properties, in order to improve energy efficiency of buildings and meet certain social purposes.

The law should introduce also tax incentives.

In particular, it is possible the adoption of a tax incentive on registration tax, mortgage tax and cadastral tax according to which such taxes would apply at the fixed amount of 200 euro, rather than with the rates, in case of purchase of existing buildings in the context of urban regeneration projects as they will be defined by the law.

The tax incentive at issue, if adopted, would be a tax benefit in the following cases, for example:

- purchase of buildings recorded in the Cadastre as commercial buildings at the time of execution of the sale and purchase agreement, if the seller is a VAT taxable person, since, under the ordinary regime, the mortgage and cadastral taxes would be 4% (or 2% is at least one of the parties of the transaction is a real estate alternative investment fund);
- purchase of buildings if the seller does not qualify as VAT taxable person: in this case, under the ordinary regime the registration tax would be 9% on the market value.

The transfer taxes at the fixed amount of 200 euro each, rather than at the rates mentioned above, entail a tax incentive also because this excludes the risk of a tax audit by the Revenue Agency on the fair market value of the asset.

CADASTRAL CATEGORIES

Group A
A/1 - House of stately type
A/2 - House of civil type
A/3 - House of economic type
A/4 - House of popular type
A/5 - House of the ultra-popular type
A/6 - House of rural type
A/7 - House in small villas

A/8 - House in villas
A/9 - Castles, palaces of eminent artistic and historical merit
A/10 - Offices and private studios
A/11 - House and lodgings typical of the places where It Is located

Group B
B/1 - Boarding schools and boarding schools; boarding schools, shelters, orphanages, hospices, convents, seminaries and barracks
B/2 - Nursing homes and hospitals (when by their characteristics they are comparable with the standard reference units)
B/3 - Prisons and reformatories
B/4 - Public offices
B/5 - Schools, science laboratories
B/6 - Libraries, picture galleries, museums, galleries, academies, which are not located in buildings in category A/9
B/7 - Chapels and oratories not intended for the public exercise of worship
B/8 - Underground warehouses for food storage

Group C
C/1 - Shops and stores
C/2 - Warehouses and storage rooms
C/3 - Workshops for arts and crafts
C/4 - Buildings and premises for sports exercises
C/5 - Bathing and healing water establishments
C/6 - Stables, stables, sheds and garages
C/7 - Enclosed or open canopies

Group D
D/1 - Factories
D/2 - Hotels
D/3 - Theaters, cinematographs, concert and performance halls and the like
D/4 - Nursing homes and hospitals (when by their characteristics they are not comparable with the standard reference units)
D/5 - Credit, exchange and insurance institutions (when by their characteristics they are not comparable with the reference type units)
D/6 - Buildings and premises for sports exercises (when by their characteristics they are not comparable with the reference type units)
D/7 - Buildings constructed or adapted for special needs of an industrial

activity and not susceptible to different use without radical transformation
D/8 - Buildings constructed or adapted for special needs of a commercial activity and not susceptible to different destination without radical transformation
D/9 - Floating or suspended buildings secured to fixed points on the ground: private bridges subject to tolls
D/10 - Buildings for productive functions related to agricultural activities

Group E
E/1 - Stations for land, sea and air transportation services
E/2 - Municipal and provincial bridges subject to tolls
E/3 - Constructions and buildings for special public needs
E/4 - Enclosed enclosures for special public needs
E/5 - Buildings constituting fortifications and their dependencies
E/6 - Lighthouses, traffic lights, towers to make public use of the municipal clock
E/7 - Buildings intended for public use of cults
E/8 - Buildings and constructions in cemeteries, excluding columbaria, sepulchers, and family tombs
E/9 - Buildings for special use not included in the previous categories of group E

12.
Legal instruments for the enjoyment of real estate: indirect taxation aspects

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12.1. Introduction

In this chapter, the main legal instruments that allow third parties to use real estate are reviewed from an indirect taxation standpoint.

In addition to the most common type of contract (lease agreement), there are more complex forms of contract depending on effects and purposes (*i.e.*, contracts that allow the user to use the premises before purchasing it – "rent-to-buy" and finance leases) and the ancillary services provided to the user in addition to the mere use of premises (*i.e.*, rental of "co-working" spaces, "student housing" and "senior housing").

An examination and comparison between the different contracts will make it possible to draw certain conclusions about the current status of tax regulations, and its interpretation provided by the tax authorities and the case-law.

12.2. The lease

Building leases entered into in the exercise of a business or profession constitute a supply of services that are subject to VAT.

Under Article 10, paragraph 1, no. 8 of Italian Presidential Decree No. 633/72, real estate leases are generally VAT exempt, except in certain specific cases where an election of taxation can be made.

The situations for electing taxation differ depending on whether the real estate is residential or commercial, which distinction is made generally on the basis of the property's cadastral category, subject to certain exceptions recognised in practice and case law[1]. In any case, the VAT scheme also

1 The distinction between residential and commercial property is usually based on their ca-

depends on whether or not a property is classified as an appurtenance to another property[2].

12.2.1. Residential property

For residential property, the general VAT exemption scheme may be derogated from at the landlord's election, set forth in the lease, in the following cases:

1. residential property leases entered into by the companies that built or remodelled them; and
2. residential property leases used for "social housing" as defined in Italian Ministerial Decree of 22 April 2008[3].

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dastral classification, thus, regardless of how they are actually being used. Specifically, buildings classified or classifiable in cadastral group "A" (except for category "A/10") are residential buildings. Real estate units classified or classifiable in cadastral groups "B", "C", "D", "E" and in category "A10" are commercial buildings by their nature (namely, buildings that "*due to their characteristics, cannot be put to another use without significant renovation*") if their use as office or private studio is the result of an authorising administrative measure.
Although this is a topic that is not directly connected to the taxation scheme for leases, an "opening" intended to reflect the actual use of the property can be found in regard to residential property (based on the above distinction based on cadastral category) which, however, is used by the taxable person in an accommodation-type business (management of vacation homes, room rental, etc.) which entails the supplying of services subject to VAT (specifically, providing accommodation services subject to VAT at a rate of 10% under no. 120) of Table A, Part III of Italian Presidential Decree No. 633/72). In that regard, see Resolution No. 18/E of 22 February 2012.

2 The fact that a real estate unit is an appurtenance (for example, garages, basements) means that the appurtenant real estate is considered to be of the same nature as and, consequently, is subject to the same tax scheme imposed on the main real estate. However, a transaction involving the appurtenant real estate is subject to an independent tax regime, for which it must be determined whether the objective and subjective requirements for the tax scheme applicable to the transaction are satisfied. The Italian Revenue Agency's position on this topic is set forth in Circular No. 12/E of 1 March 2007.

3 According to Circular No. 22/E of 2013, the notion of "social housing" under Italian Ministerial Decree of 22 April 2008 comprises the following real estate: "a real estate unit used for residential use under a long-term lease that performs a function of general interest, to safeguard social cohesion and reduce housing hardship for disadvantaged individuals and families who are unable to access housing rentals in the open market". Also according to the Italian Revenue Agency, the above definition includes housing built or recovered by public and private entities with the use of public contributions or subsidies – such as tax exemptions, allocation of areas or real estate, guarantee funds and subsidies concerning urban zoning – intended for long-term or temporary rental for at least eight years at a below-market rent, or for sale.

The election to subject leases of residential property under a "free market" scheme to taxation can thus be exercised only by the "construction companies" and/or "remodelling companies" of the buildings, as identified under Article 10, paragraph 1, nos. 8, 8-*bis* and 8-*ter* of Italian Presidential Decree No. 633/72[4].

However, the election to tax "social housing" leases may be exercised regardless of who the landlord is (the option can be exercised by a taxable entity other than "construction" or "remodelling" companies).

Under No. 127-*duodevicies*) of table A, part III appended to Italian Presidential Decree No. 633 of 1972, taxable leases are subject to VAT at a rate of 10%.

Thus, the cases in which leases of residential buildings may be taxed by election are limited. This has significant consequences for landlords, since the (usually) exempt lease of the buildings in question generally has a negative impact on the pro rata deductibility of VAT. In this regard, reference is made to the comments in the previous chapter [8] ("Taxation of residential properties"), including for additional comments on the rules on objective non-deductibility under Article 19-*bis*1, paragraph 1, letter i) of Italian Presidential Decree no. 633 of 1972.

For registration tax purposes, residential property leases:

- if subject to VAT, are subject to a fixed registration tax (EUR 67); and
- if VAT-exempt, are subject to proportional registration tax (2%)[5].

12.2.2. Commercial property

Commercial property leases are also subject to a VAT exemption scheme, although the lessor may elect to have the tax applied in the lease.

4 According to the Italian Revenue Agency (see, *inter alia*, Circular 22/E of 2013), the above rules must be interpreted to mean that "construction companies" are the parties that hold the administrative permit for the construction or remodelling.
More specifically, "construction companies" can be considered not only companies that directly construct buildings with their own organisation and resources, but also those that use third-party companies to perform the construction. Consistent with the interpretive criteria developed in administrative practice, "construction company" also includes companies that occasionally construct buildings. "Remodelling companies" purchase a building and perform, or have others perform, the building works listed in Article 3, first paragraph, letters c), d) and f) of the Italian Consolidated Construction Law.

5 Article 5, paragraph 1, letter b) of the Tariff, Part I, appended to Italian Presidential Decree No. 131/86.

Unlike in the case of residential property, for commercial property the lessor may always exercise the election to be subject to VAT.

In this case, the ordinary rate of 22% applies.

For registration tax purposes, commercial property leases subject to VAT, whether taxable or exempt, are subject to proportional registration tax at a rate of 1%[6].

12.2.3. Additional remarks in relation to the tax regime for lease agreements

The election for VAT taxability indicated above must be expressly exercised in the lease agreement. The Italian Revenue Agency considers the option to be irrevocable for the entire lease term (except as discussed in the following paragraph). According to current practice, it appears that the ability to determine the VAT scheme chosen by the taxpayers based on their "clear conduct" – *i.e.*, by simply invoicing the rents based on the chosen scheme[7] – is not allowed, although this position seems excessively rigid and disproportionate to the need for certainty as to the applicable VAT scheme.

As to the irrevocability of election the VAT scheme, administrative practice allows for an exception in the case of "succession to the contract", specifically where a new party takes over as lessor. Practice does not clarify the cases where this exception can apply, focusing only on the most common case, *i.e.*, the sale of the property, which results in the purchaser automatically assuming the role of lessor. The latter may therefore decide to change the election made by the original owner/lessor to be taxed or exempt[8].

A further example seems to be the case of a change in the intended use of the leased property, *i.e.*, where the cadastral category changes and the property changes from residential to commercial (but the same conclusions should, in theory, also apply to the reverse). In this case, according to the Italian Revenue Agency, the lessor has the right to change the lease's tax scheme by executing an amendment to the original lease, which notes the cadastral change and indicates the election to be subject to VAT[9].

6 Article 5, paragraph 1, letter a-*bis*) of the Tariff, Part I, appended to Italian Presidential Decree No. 131/86.

7 See also Italian Supreme Court, decision No. 30600 of 27 November 2018.

8 See Circular 22/E of 2013, sec. 2. The new lessor may change the lease's VAT scheme by using the form "Election for VAT taxation of leases" under the Italian Revenue Agency's Measure No. 92492 of 29 July 2013.

9 See Italian Revenue Agency Resolution No. 364 of 12 December 2007. The response was is-

Lastly, it should be noted that the schemes described in this paragraph also apply, as a rule, to subleases.

12.3. Rent to buy

Article 23 of Italian Decree-Law No. 133 of 12 September 2014 (the "Decree"), converted into Italian Law No. 164 of 11 November 2014, governed the "rent-to-buy" contract.

This type of contract aims to give the lessee immediate use of the property and postpones transfer of title to the property to the future, with a portion of the rent payments allocated to the sale price. This type of contract should facilitate the purchase of real estate by persons who, when they enter into the contract, are unable to pay the minimum portion of the price normally required by banks to provide a loan.

This type of contract, as clarified by the explanatory report, "*is 'loosely knit' to allow private autonomy to better adapt the substance of the contract based on the specific needs and with a view to best satisfying the interests of both parties*".

It is therefore a complex contract, which has the following features:

- first and foremost, the contract gives the lessee the immediate use of the property against payment. Moreover, the user benefits from the "reservation effect" resulting from recording the contract, although they do not benefit from the favourable laws applicable to leases;
- a portion of the periodic rent payable by the lessee is treated as consideration for the future (potential) sale of the property;
- the contract covers the procedures to exercise the right to purchase and the subsequent conveyance of title to the property; and
- the rules also provide that, if the right to purchase is not exercised, part of the amounts paid by the lessee as rent (in relation to the portion thereof treated as consideration for the sale) must be returned to the lessee.

A rent-to-buy contract can be entered into for residential and commercial buildings.

Leaving aside an analysis of the relevant statutory provisions, the main tax rules for the various aspects of this contract are explained below, specifically in regard to the instructions provided by the Italian Revenue Agency in Circular no. 4/E of 2015.

sued in regard to a finance lease (initially involving a building for residential use leased on a VAT-exempt basis), but the same conclusions should also apply to "ordinary" leases.

12.3.1. Residential property

As to the VAT and registration tax scheme applicable to the rent payments for the enjoyment of the property, it must first be noted that they are usually subject to the same tax scheme applicable to rent payments under ordinary leases. That is because rent-to-buy contracts do not contain a clause transferring title that is binding on both parties, but instead contain a purchase option exercisable only by the tenant.[10] This first remark applies to contracts involving residential property and contracts involving commercial property.

That said, the tax scheme applicable to the rent-to-buy contract for residential property can be summarised as follows:

1. the rents paid to enjoy the property are taxed like normal rent and, therefore, will normally be exempt from VAT (and subject to proportional registration tax at the rate of 2%), subject to an election of taxation that can be made where the lessor qualifies as a "construction company" or "remodelling company" in relation to the property.[11] For VAT purposes, payments for use are subject to VAT under Article 6, paragraph 3 of Italian Presidential Decree No. 633/72 when they are paid;
2. the portion of the rent paid towards the price represents an advance payment of the consideration agreed to for the sale and, therefore, is subject to VAT under the rules for the sale of residential property. This consideration is usually exempt, except where taxation is mandatory if the landlord qualifies as a "construction company" or "remodelling company" and the transaction takes place within five years of completion of the work. After five years, only the aforementioned companies will be allowed to elect VAT taxation, while for all other companies (thus, other than "construction companies" or "remodelling companies") the transaction will necessarily be VAT exempt. In any event, the applicable VAT rates are the ordinary rates in effect at the time the advance is paid; in this regard, the Italian

10 Therefore, the contractual construct in question does not constitute, for VAT purposes, a sale of goods under Article 2, paragraph 2, no. 2 of Italian Presidential Decree No. 633/72 (which classifies leases with a clause transferring title that is binding on both parties as a sale of goods).

11 The Italian Revenue Agency (Circular No. 4/E of 2015, sec. 3.1.3) clarified that registration tax is levied in accordance with the rules governing leases and, therefore, may be paid on the rent due for the entire term of the contract or, alternatively, on the amount of the rent for each year. With reference to the applicability of the "flat tax" at a reduced rate (*cedolare secca*), see response no. 597 of 16 September 2021.

Revenue Agency has confirmed that the reduced rate of 4% can be applied where the transaction meets the requirements to benefit from the "first home" scheme (*agevolazione prima casa*). For registration tax purposes, the portion of the rent paid as an advance on the sale price will be subject to registration tax in a fixed amount where the advance is subject to VAT; otherwise (*i.e.*, where the advance is exempt from VAT) registration tax will be levied either at a rate of 0.5% or it will be equal to the registration tax provided for the final transfer deed, should it be lower[12];

3. if the lessee exercises the option to purchase the property, the ordinary rules for real estate sales apply for purposes of VAT and other indirect taxes. The tenant/purchaser may, *inter alia*, request application of the favourable scheme allowed for the "first home" purchase;
4. if the option to purchase the property is not exercised, and the portion paid as an advance on the price is thus repaid to the lessee, the owner is required, under Article 26, second paragraph of Italian Presidential Decree No. 633 of 1972, to issue a credit notice (*nota di variazione*) to the tenant for the amounts returned. According to the Revenue Agency (Circular no. 4/E of 2015, sec. 5.1.2.1), the credit notice must be issued for the total amount paid by the lessee as an advance on the sale price: thus, for the portion returned and for the portion retained. Since no conveyance took place, the prerequisite for the application of VAT on the amounts paid by the tenant as advances on the sale price is no longer satisfied. If the landlord retains a portion of the rents paid as an advance on the price, that portion, when the right to purchase is not exercised, becomes consideration payable for the exercise (for consideration) of the right granted to the lessee and, consequently, must be subject to VAT at the ordinary rate (22%) based on the ordinary rules for services.

12 The 0.5% tax rate applies as from 1 January 2025, according to the amendments introduced by Article 2 of Legislative Decree No. 139 of 18 September 2024 (setting forth "Provisions for the rationalization of registration tax, inheritance and gift tax and other indirect taxes different from VAT"), which amended the note to Article 10 of the Tariff, Part 1, attached to Presidential Decree 131/86, providing that advance payments not subject to VAT are subject to registration tax at the 0.5% rate (in lieu of the higher 3% rate previously applicable) or to the lower registration tax applied to the final contract, if any. The authors believe that the 0.5% registration tax must be paid on the total amount of the portion of the rents due as advance on the sale price, as set forth for the entire term of the contract.
For the sake of completeness, the authors believe that the aforementioned amendment to the taxation regime of advance and down payments, having a general scope, should apply also to rent-to-buy contracts.

5. According to the Italian Revenue Agency's interpretation, under the previous regime in case of exercise of the option to purchase the property, the lessee/purchaser was entitled to deduct registration tax paid on the advance payments from the registration tax that is due on the final transfer deed; conversely, in the event the purchase option was not exercised, the lessee was not entitled to a refund of any registration tax paid on the advances. Under the new regime introduced by Legislative Decree No. 139 of 18 September 2024, for rent-to-buy purposes, since the portion of the rent paid as advance payment is subject to registration tax either at the 0.5% rate or to the lower registration tax applicable to the final transfer deed, it seems that the refund of the registration tax paid on the advance is no longer an issue[13], with the exception of specific situations.

12.3.2. Commercial property

The tax scheme on the rent-to-buy contract for commercial buildings can be summarised as follows:

1. the rents paid to use the property are taxed like normal rent and, therefore, will generally be exempt from VAT (and subject to proportional registration tax at the rate of 1%), unless the lessor makes a taxation election. For VAT purposes, payments for use will be subject to VAT under Article 6, paragraph 3 of Italian Presidential Decree No. 633/72 when they are paid;
2. the portion of the rent paid towards the price represents, in this case as well, an advance payment of the consideration agreed to for the sale and, therefore, is subject to VAT under the rules for the sale of commercial property. This consideration will therefore normally be exempt, except where taxation is mandatory for sales made by "construction companies" or "remodelling companies" and the transaction takes place within five years of completion of the work. Apart from that case, the lessor is allowed to elect to subject to VAT the portion of the price paid as an advance on the price. In any event, the VAT

13 In this respect Assonime, Circular Letter No. 22/2024 of 27 November 2024, which highlights that the new regime narrows "the scope of the proportional registration tax, since the relevant provision now states that the tax due – calculated on the basis of the 0.5% rate – cannot exceed registration tax due for the final contract … therefore the new provision solves the issue of the recovery of a registration tax that will not be deducted from the registration tax due for the final contract". The aforementioned remarks are based on the assumption that the registration tax regime of the advance and down payments provided for preliminary agreements will continue to be applicable also to the scheme under examination.

rates applicable are the ordinary rates in effect when the advance is paid. For registration tax purposes, the portion of the payment made as an advance on the sale price is always subject to a tax in a fixed amount, regardless of the scheme (subject to VAT or exempt) applicable at the time of sale. Mortgage and cadastral taxes apply only when title is conveyed;

3. if the lessee exercises the option to purchase the property, the ordinary rules for real estate sales apply for purposes of VAT and other indirect taxes; and
4. if the option to purchase the property is not exercised, in substance the same principles described above for residential property apply. Therefore, the lessor must issue a credit note (*nota di variazione*) to the lessee. According to the Italian Revenue Agency (Circular no. 4/E of 2015, sec. 5.1.2.1), the credit note must be issued for the total amount paid by the lessee as an advance on the sale price: thus, for the portion returned and for the portion retained. Since no conveyance took place, the prerequisite for the application of VAT on the amounts paid by the lessee as advances on the sale price is no longer satisfied. As stated above for the rent-to-buy of residential buildings, in this case as well, if the lessor retains a portion of the rents paid as an advance on the price, that portion becomes consideration payable for the exercise (for consideration) of the right granted to the lessee and, consequently, must be subject to VAT at the ordinary rate (22%) based on the ordinary rules for services.

12.4. The financial lease

Without analysing here the specific civil law aspects[14], to the extent relevant

14 From a civil law standpoint, the legislature recently introduced general rules for finance leases with Article 1, paragraphs 136-140 of Italian Law No. 124/2017. Specifically, paragraph 136 defines that contract as follows: *"Finance lease means the contract whereby the bank or financial intermediary registered in the register under Article 106 of the Consolidated Law under Italian Legislative Decree No. 385 of 1 September 1993 undertakes to purchase or cause to be constructed real property chosen by, and according to the instructions of, the user, which assumes all the risks thereof, including of loss, and causes it to be made available for a given period of time for a set consideration which reflects the purchase or construction price and the term of the contract. Upon expiry of the contract, the user has the right to acquire title to the property at a predetermined price or, if the user does not exercise this right, it must surrender it"*. Previously, only the financial leasing of residential property to be used as the main residence was specifically regulated (Article 1, paragraph 76 et seq. of Italian Law No. 208/2015), defined as follows: *"In the finance lease for property to be used as the main residence, the bank or financial intermediary registered in the register under Article 106 of the Italian Consolidated Banking and Lending Law, under Italian Legislative Decree No. 385 of*

here we will merely note that the financial lease of real estate, with regard to the applicable tax regime, has traditionally been qualified by the Italian Revenue Agency as a "complex transaction", consisting essentially of the following three relationships: (i) the purchase contract whereby the leasing company acquires title to the property to be subject to the financial lease[15]; (ii) the financial lease between the leasing company and the user, whereby the former allows the user to use the property, and which normally requires an initial rent payment and periodic payments over the term of the lease; and (iii) redemption of the leased property, which occurs when the user, at the end of the lease term, exercises its option to purchase under the financial lease.

That said, the main tax aspects of the contractual construct in question can be examined.

12.4.1. The purchase of the real estate by the leasing company

The leasing company's purchase of the real estate is, in general, subject to the normal rules laid down, for purposes of VAT and other indirect taxes, for sales of real estate[16].

The only exception was for agreements executed from 1 January 2016 to 31 December 2020[17] in relation to residential properties[18], where the

1 September 1993, undertakes to purchase or cause to be constructed real property chosen by, and according to the instructions of, the user, which assumes all the risks thereof, including of loss, and makes it available for a given period of time for a set consideration which reflects the purchase or construction price and the term of the contract. Upon expiry of the contract, the user has the right to acquire title to the property at a predetermined price". This law should be considered still in effect in view of Article 1, paragraph 140 of Italian Law No. 124/2017.

15 For the sake of completeness, the author notes that a financial lease may also involve buildings to be constructed or under construction.

16 In this regard, the controversial position taken by the Italian Ministry of the Economy and Finance in response to parliamentary question no. C.5/05349 of 23 April 2015 is worth noting, where the Ministry denied the non-application of the "objective non-deductibility" under Article 19-*bis*1, paragraph 1, letter i) of Italian Presidential Decree No. 633/72 in relation to the purchase of residential buildings by leasing companies. In the Ministry's opinion, the leasing company cannot be considered a "construction company" under the cited law because this requirement – which is associated with the main purpose of the business engaged in – "*cannot be said to be true of a leasing company whose main business is purchasing buildings for subsequent resale*".

17 See Article 1, paragraphs 83 and 84 of Italian Law No. 208 of 28 December 2015.

18 Although the law is silent in that regard, it has been argued that if the requirements are met to apply the reduced rate above, the purchase of a residential property that is subject to VAT would also be subject to the reduced VAT rate of 4% under the "first home" rules (*beneficio prima casa*). The Italian Revenue Agency had also expressed this view in the "Finance Leases of Residential

purchase agreement was not subject to VAT or was exempt, and the lessee stated that he/she met the requirements to benefit from the "first home" rules. In that case, the last paragraph of Article 1 of the Tariff, Part I, appended to Italian Presidential Decree No. 131/86, provided that registration tax at the rate of 1.5% would apply "*if the conveyance is made to banks and financial intermediaries authorised to engage in finance leasing and involves residential homes in a cadastral category other than A/1, A/8 and A/9, acquired under a finance lease by users who satisfy the conditions set forth in Notes II-bis and II-sexies*". In addition, Note II-*sexies* was added to Article 1 of the Tariff, Part I, appended to Italian Presidential Decree No. 131/86, which specified that "*when applying Note II-bis to conveyances to banks and financial intermediaries authorised to engage in finance leasing, 'purchaser' will be considered to refer to the user and 'purchase agreement' will be considered to refer to the financial lease*". In any event, the "price/value" rules (*disciplina prezzo-valore*) were considered to be inapplicable[19]. This measure does not appear to have been extended and, therefore, agreements entered into on or after 1 January 2021 are subject to the ordinary tax rules. As a result, agreements for the purchase of residential property by leasing companies are subject to registration tax at the rate of 9% when the seller is not subject to VAT, regardless of whether the user is a natural person who uses the property as a "first home". For the sake of completeness, starting in 2021, the additional favourable rules on deducting the cost of residential financial leases for IRPEF [*imposta sul reddito delle persone fisiche* (Italian individual income tax)] purposes in Article 1, paragraph 82 of Italian Law No. 208/2015 for users of residential property used as the main residence must be considered inapplicable[20].

Real Estate" guide (sec. 3.3) published, with the assistance of Assilea [*Associazione Italiana Leasing* (Italian Finance Lease Association)] and the National Council of Notaries, in February 2016.

19 See, *inter alia*, the aforementioned Italian Revenue Agency "Finance Leases of Residential Real Estate" guide (sec. 3.3) of February 2016.

20 See Article 1, paragraphs 82 and 84 of Italian Law No. 208 of 28 December 2015. The favourable rules provided, for individuals under 35 years of age when they execute the contract and with a total income not exceeding EUR 55,000, the following incentives: (i) deductibility of 19% of the lease payments (up to EUR 8,000 per year) against the individual income tax due; and (ii) deductibility of 19% of the redemption price (up to EUR 20,000) against the individual income tax due. For persons aged 35 or over and with a total income not exceeding EUR 55,000, the tax incentives were as follows: (i) deductibility of 19% of the lease payments (up to EUR 4,000 per year) against the individual income tax due; and (ii) deductibility of 19% of the redemption price (up to EUR 10,000) against the individual income tax due.

Lastly, again for purchases of property by the leasing company, Article 57, paragraph 1-*ter* of Italian Presidential Decree No. 131/1986 provides that the user of the property under a financial lease is jointly and severally liable with the leasing company for payment of the tax relating to the purchase of the property subject to the financial lease (including where the property is to be built or is under construction). The user also became jointly and severally liable for mortgage and cadastral taxes under an amendment to Article 11, paragraph 2 of Italian Presidential Decree No. 347/1990. These special liability rules were introduced and made effective starting in 2011 by the Italian 2011 "*Legge di Stabilità*"[21]. The legislator intended to make the tax consequences of a financial lease transaction consistent with those of a traditional purchase agreement. Therefore, the user is also currently liable for indirect taxes payable on the purchase of the property, jointly and severally with the parties to the purchase transaction (seller and leasing company) and the public official in charge with the transfer of title.

12.4.2. The tax scheme for financial leases

Moving to an examination of the tax rules for financial leases, to start with, for registration tax purposes, it is no longer considered a lease, but is subject to the rules on finance contracts.

This classification is the result of the amendments made by the aforementioned Italian 2011 Budget Law. That Law amended the Note to Article 1 of the Tariff, Part II, appended to the Italian Consolidated Registration Tax Law[22], which now provides that "*Contracts relating to banking and financial transactions and services and consumer credit, <u>including finance leases of real estate</u>, which Title VI of Italian Legislative Decree No. 385 of 1 September 1993 requires to be in writing in order to be valid, are subject to registration only in the event of use (*caso d'uso*)*" (emphasis added). Previously, with the amendments under Italian Decree-Law No. 223 of 2006, financial leases were subject, for registration tax purposes, to the same rules applicable to ordinary leases.

As a result of the amendments made by the Italian 2011 Budget Law, financial leases once again benefit from the full alternative VAT/registration

21 This new rule was added, effective as of 1 January 2011, by Article 1, paragraph 15, letter a), no. 1 and letter b) of Italian Law No. 220 of 13 December 2010.

22 See Article 1, paragraph 15, letter a), no. 2 of Italian Law No. 220 of 13 December 2010.

tax scheme governed by Article 5, paragraph 2[23] and Article 40, first sentence[24] of the Italian Consolidated Registration Tax Law. Therefore, if the financial lease consists of a non-notarised private agreement, it will be subject to registration in the event of use (*caso d'uso*) where all the provisions of the contract relate to transactions subject to VAT. If registered, the financial lease will be taxed in a fixed amount.

As confirmed by the Italian Revenue Agency,[25] as a result of the amendments made to the aforementioned Note to Article 1 of the Tariff, Part II, the exceptions to the VAT/registration tax alternative principle, *i.e.*, the taxation rules in Article 5 of the Tariff, Part I, appended to the Italian Consolidated Registration Tax Law, apply only to ordinary real estate leases.

As to the scheme applicable for VAT purposes, given Italian laws that distinguish between sales of goods and supply of services[26], in theory it can be said that the financial lease or, rather, granting the use of an asset for periodic compensation, qualifies as a supply of a service (and not a supply of goods) since the lessor retains title to the asset until potential redemption by the lessee. Moreover, Articles 7-*quater* and 7-*sexies* of Italian Presidential Decree No. 633/1972 expressly include financial leases in "supply of services". The same can be said for Article 16, paragraph 3 of Italian Presidential Decree No. 633/1972, which governs the rate applicable to financial leases. The Italian Revenue Agency's practice confirms this approach[27].

As to the scheme applicable in practice, for VAT purposes financial leases are subject to the rules governing leases. This is the opinion of the Italian Revenue Agency, which has stated "*The provisions of Article 10, paragraph 1, nos. 8), 8-bis) and 8-ter) of Italian Presidential Decree No. 633/1972 do not provide specific rules for financial leases of real estate. Accordingly, for VAT purposes, rent payments under real estate finance leases are subject to the same treatment as for ordinary leases, while the portions relating to*

23 The provision states that "*Non-notarised private agreements are subject to registration in the event of use if all the provisions therein relate to transactions subject to value added tax*".

24 "*For agreements relating to the supply of goods and services subject to the value added tax, the tax is levied in a fixed amount*".

25 See Circular No. 12/E of 11 March 2011, sec. 1.2.

26 Articles 2 and 3 of Italian Presidential Decree No. 633/1972.

27 See, *inter alia*, Circular No. 18/E of 29 May 2013, sec. 3.5. An indirect confirmation can also be found in more recent public documents, such as - among others - the Legal Advice No. 904-2/2018 issued by the Italian Tax Authorities and the Ruling No. 478 of 27 September 2022.

the redemption of the property follow the rules for sales”[28]. Therefore, as a rule, financial lease rents will be subject to the taxation or exempt schemes based on the conditions set forth in Article 10, paragraph 1, no. 8) of Italian Presidential Decree No. 633/1972. As to the rate, Article 16, paragraph 3 of Italian Presidential Decree No. 633/1972 must be considered, which provides “*For the supply of services… under financial leases or rental or similar contracts, the tax is applied at the same rate that would be applicable to a supply of goods… provided under financial leases or rental or similar contracts*”.

12.4.3. The tax scheme for the exercise of the option to purchase the real estate

The purchase of real estate by exercising the redemption option, which is normally included in financial leases, is subject to special rules for indirect tax purposes.

The rules are set forth in Article 35, paragraph 10-*ter*.1 of Italian Law Decree No. 223 of 4 July 2006, which provides that registration, mortgage and cadastral taxes are levied in a fixed amount[29]. These rules’ purpose is to ensure that a direct purchase of the real estate and a purchase through financial leases are essentially equivalent. Therefore, for indirect tax purposes, the material tax burden (*i.e.*, the proportional taxation) is paid only once when the leasing company purchases the property.

It is reasonable to believe that the rule in question was not intended to provide tax relief. For that reason, the author does not believe that it was repealed by Article 10, paragraph 4 of Italian Decree-Law No. 23/2011[30]

28 See Circular No. 18/E of 29 May 2013, sec. 3.5.

29 The paragraph in question – added by Article 1, paragraph 15, letter c), no. 2 of Italian Law No. 220/2010, with effect from 1 January 2011 as part of the reform of the indirect taxation of financial leases brought about by the aforementioned Italian 2011 ”*Legge di Stabilità*” – provides that “*Registration, mortgage and cadastral taxes are payable in a fixed amount on sales by banks and authorised financial intermediaries under Article 106 of the Italian Consolidated Banking and Lending Law under Italian Legislative Decree No. 385 of 1 September 1993, as amended, if the user exercises the option to purchase the real property subject to the financial lease, or for real property subject to financial leases terminated because of the user’s default*”. Therefore, taxation in a fixed amount also applies to resales of real estate by financial intermediaries in relation to finance leases terminated because of the user’s default.

30 This rule, as is well-known, repealed all favourable tax rules applicable to agreements subject to proportional registration tax of 9% or 2%.

and, therefore, still applies to the redemption of residential buildings as well[31].

For the VAT regime, the Italian Revenue Agency takes the position[32] that the exercise of the purchase option is subject to the ordinary rules for sales of real estate under Article 10, paragraph 1, nos. 8-*bis*) and 8-*ter*) of Italian Presidential Decree No. 633/1972.

12.4.4. Additional remarks

In regard to the VAT treatment, it should be noted that the Court of Justice of the European Union has ruled that, under certain conditions, a financial lease would constitute a supply of goods rather than a supply of services. This approach would entail significant consequences, in particular with regard to the treatment of the periodic rent payments and the time when the transaction is considered to be carried out for VAT purposes.

In any case, this approach must be viewed taking into due consideration the misalignment between the notion of sales of goods for purposes of the VAT Directive (and the transposition thereof by certain EU countries) and the notion transposed into Italian law, which – as a general rule and subject to specific exceptions – requires transfer of legal title to the goods to constitute a sale[33].

That said, note, among the most significant decisions, judgement C-164/16 of 4 October 2017 (Commissioners for Her Majesty's Revenue & Customs v Mercedes-Benz Financial Services UK Ltd), where the Court ruled that "*the words 'contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment', used in Article 14(2)(b) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, must be interpreted as applying to a leasing contract with an option to purchase if it can be inferred from the financial terms of the contract that exercising the option appears to be the only economically rational*

31 In this regard, A. Busani, *Imposta di registro*, Milan, 2022, p. 2270 *et seq*. This interpretation is confirmed by the Italian Revenue Agency's "Finance Leases of Residential Real Estate" guide (sec. 3.4) of February 2016.

32 See Circular No. 18/E of 29 May 2013, sec. 3.5.

33 In this regard see, including for a comment on judgement C-164/16 cited below, F.T. Coaloa – A. Bonaria, *Leasing e sale & lease back: gli impatti delle sentenze della Corte di Giustizia*, in *il Fisco*, No. 41/2019, p. 3933 *et seq*. and G. Albano, *Sentenza 4 ottobre 2017 C-164/16: prime considerazioni*, in *La lettera di Assilea*, No. 6/2017, p. 36 *et seq*.

choice that the lessee will be able to make at the appropriate time if the contract is performed for its full term, which it is for the national court to ascertain". More specifically, the decision concerned a particular form of contract used in the United Kingdom by a car manufacturer to allow its customers to use vehicles by paying periodic rental payments and which includes an option to purchase at the end of the contract by paying a "balloon payment" of approximately 40% of the value of the vehicle[34].

According to the Court, "*the classification of a contract as a 'finance lease' is not, in itself, sufficient for the actual handing over of goods under that contract to be categorised as a transaction subject to VAT. In order for such a contract to be considered a 'supply of goods' within the meaning of the VAT Directive, it is also necessary to determine whether the contract is a 'contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment', within the meaning of Article 14(2)(b) of that directive.*" In case of purchase option, according to the Court, "*it must be stated that the phrase 'in the normal course of events' must be regarded as referring simply to the foreseeable performance of an agreement over its full term by the parties thereto, acting in good faith, in accordance with the principle that agreements must be kept*".

That said, a case-by-case evaluation must be made, based on the terms of the contract, in order to understand whether the exercise of the purchase option is the "normal" outcome of the contractual relationship. Specifically, the Court stated that "*The position would be different only if exercising the option to purchase, optional though it is in formal terms, appeared in fact, given the financial terms of the agreement, to be the only economically rational choice the lessee could make. That may in particular be the case where it is evident from the agreement that, when the possibility of exercising the option arises, the aggregate of the contractual instalments will correspond to the market value of the goods, including the cost of financing, and that the lessee will not be required, as a result of exercising the option, to pay a substantial additional sum*"[35].

34 The language of the decision indicates that the contract in question requires monthly rent payments, the sum of which amounts to approximately 60% of the sale price of the vehicle, including the cost of financing. If users wish to purchase the vehicle, they must thus pay around 40% of the sale price. This amount is an estimate of the average residual value of the vehicle at the end of the contract. Three months before the end of the contract, customers are asked whether they wish to exercise the purchase option. According to the findings of the referring court, almost half of the lessees decide to exercise the option.

35 In that decision, it is interesting to note that the description of the facts expressly stated that

The abovementioned decision C-164/16 is not the only judgement where the Court of Justice has taken positions that potentially differ from Italian practice. These include, among others, recent judgment C-201/18 of 27 March 2019 (Mydibel SA v État belge) on sales and leasebacks[36].

The Italian Supreme Court has also taken positions based on a similar rationale (*i.e.*, the essential equivalence, for VAT purposes, of the purchase of an asset through a financial lease and an ordinary purchase agreement) regarding certain VAT aspects of financial leases[37], although to date no rulings have been handed down specifically concerning the tax rules for the contracts per se. By way of example, the Italian Supreme Court – departing from several of its own precedents concerning similar situations – precluded the ability to use the "VAT ceiling" for the VAT charged on the rent payments under a real estate financial lease, stating the following principle: "*a financial lease relating to a building or a buildable area entails the transfer to the user of the economic possession of the property and is, therefore, comparable to a purchase of goods and not a purchase of services. It follows that the tax suspension rules in Article 8, paragraph 2 of Italian Presidential Decree No. 633 of 1972 are not applicable, due to the exclusion in paragraph 1, letter c) of that provision*"[38]. In the order last cited above, the Italian Supreme Court

a different type of contract – used by the same taxpayer – which provided that the sum of the rentals paid each month represents, as a rule, the total sale price of the vehicle, including the cost of financing, must be classified as a supply of a good (and not a supply of a service). To obtain title to the vehicle, only a small sum ("option fees") must be paid at the end of the contract. This final payment is set forth in the contract and is not dependent on exercise of the option. The "option fees" are withdrawn from the customer's account along with the final instalment, the payment of which coincides with the transfer of title.

36 In this judgment, the Court of Justice held that a sale and leaseback transaction represents a single financial transaction (the purpose of which is to provide liquidity to the company that sells the real estate to the leasing company), given the fact that the seller retains uninterrupted and long-term possession of the property in order to carry out active transactions subject to VAT. In essence, in the Court's view regarding the case before it and subject to review by the national court, the sale and leaseback cannot be split for VAT purposes into a sale followed by the leaseback of the same real estate to the original seller.

37 See, among others, Italian Supreme Court, Judgement No. 20951 of 16 October 2015, confirmed by subsequent Order No. 12457 of 10 May 2019. With these decisions, the Court established the user's right to a refund of the VAT paid on the financial lease rent payments under Article 30, paragraph 3, letter c) of Italian Presidential Decree No. 633/72, even before the redemption right is exercised. This is because a financial lease must be comparable, for the user, to the purchase of an "investment asset", which purchase is a prerequisite to request an "accelerated" refund.

38 Italian Supreme Court, Order No. 535 of 14 January 2021. See also Italian Supreme Court, Order No. 28728 of 18 October 2021.

expressly referred to decisions of the Court of Justice which have included finance leases in supplies of goods. This principle, although new for Italian Supreme Court decisions, conforms to the well-settled position of the Italian Revenue Agency which, albeit for the limited purpose of disallowing the use of the "VAT ceiling" (*plafond IVA*) for real estate finance leases, has always considered such leases as contracts for the purchase of real estate[39].

However, the Italian Revenue Agency limits the "putting in the same category" to this aspect, without extending it entirely to the tax scheme of financial leases., To date, it does not appear that the Italian Revenue Agency has officially changed its approach to categorising the contract, or that it has considered the Court of Justice's interpretation, as briefly discussed above[40,41].

39 The Italian Revenue Agency previously stated this principle in Circular No. 145/E of 1998, where it stated "*In any event, the prohibition on using the ceiling to purchase buildings under construction agreements or finance leases remains. This is because, even though Article 8, letter c) of Italian Presidential Decree No. 633/1972 expressly excludes only the sale of buildings from the benefit, the exclusion obviously must be extended to such methods purchasing the buildings, which achieve an equivalent effect*". The principle was most recently confirmed in Response No. 304 of 3 September 2020. Regarding adjustment of the deduction under Article 19-*bis*2 of Italian Presidential Decree No. 633/72, see also Response No. 3 of 17 September 2018.

40 The Italian implementing legislation should, in theory, prevent the extension whole cloth of the principles expressed by the Court of Justice, especially where the application of those principles would be to the detriment of the taxpayer. As an example, for further remarks on the subject, see R. Corso – P. Maspes, *La cessione c'*è o non c'è? *L'amletico caso dell'IVA sulla cessione del bene oggetto di sale and lease back,* in *Corr. Trib.,* no. 40, 2021, p. 3813 *et seq*. and C. De Ieso, *Stop alla scomposizione tripartita del sale and lease back: all'orizzonte nuove criticità sul trattamento IVA?*, in *Corr. Trib.,* No. 11, 2021, p. 971 *et seq.*

41 It is worth noting that the Italian Revenue Agency allowed the principles developed by the Court of Justice to become part of Italian law - overcoming, in particular, the principle that the transfer of the property right is the necessary and sufficient condition to constitute a transfer of assets - with regard to sale and leaseback contracts. The reference is the response to a request for an advance tax ruling (unpublished) issued by the Regional Directorate of Emilia Romagna No. 956/2754/2021 of 4 August 2021 and to Resolution No. 3/E of 3 February 2023, whereby the Italian Revenue Agency expressly ruled that – under certain conditions – a sale & lease back contract must be treated for VAT purposes as a financial agreement, without being split into a sale followed by the leaseback of the same asset. According to the Agency, this "re-qualification" must be based on a case-by-case analysis of the characteristics of the transaction. In particular, the sale & lease back must be qualified for VAT purposes as a financial transaction where the transferor/user continues to dispose of the leased asset "by *exercising the essential prerogatives of the owner*". The same conclusion was confirmed with the Resolution No. 206/E of 7 February 2023.

12.5. The lease of a "real estate business"

The lease of a business is a contract whereby one party (the lessor) grants to another party (the lessee) the right to use a business or a business unit, namely, a group of assets organised for the purpose of carrying on a business under Article 2555 of the Italian Civil Code[42].

The leasing of a business for consideration is a supply of services for VAT purposes under Article 3, paragraph 2, no. 1) of Italian Presidential Decree No. 633/1972. Therefore, ordinarily business lease rent payments are subject to VAT at the ordinary rate of 22% and the registration tax is applied at the fixed amount of EUR 200, in accordance with the VAT/registration tax alternative principle under Article 40 of Italian Presidential Decree No. 131/1986.

These rules are subject to an important exception in the case of the "lease of real estate business".

This exception is set forth in Article 35, paragraph 10-*quater* of Italian Decree-Law No. 223 of 4 July 2006, converted into Italian Law No. 248 of 4 August 2006, according to which "*The indirect tax rules for leases of buildings apply, if less favourable, also to leases of businesses if more than 50 per cent of their total value consists of the normal value of buildings, determined in accordance with Article 14 of Italian Presidential Decree No. 633 of 26 October 1972*".

This provision has a stated anti-tax evasion purpose, namely, to prevent improper use of the contractual form of a lease of a business to circumvent the indirect taxation rules on real estate leases.

For these rules to be applicable, the following conditions must both be satisfied:

a. the value of the buildings[43] must exceed 50% of the total value of the

42 This section examines only the leasing of commercial businesses (therefore, the leasing of land and agricultural businesses are not analysed) and in the cases where the lessor is a taxable person for VAT purposes. In this regard, it should be noted that lessors in corporate form and sole proprietors who own several businesses (or a single business if the subject of the lease is only a unit of that business) are taxable persons for VAT purposes. Conversely, a natural person who leases his/her only business (see Circular No. 18/E of 29 May 2013 and Resolution No. 35/E of 6 February 2008) and an individual who is not considered an "entrepreneur" (such as the heir of an entrepreneur who did not continue the business of the deceased) are not considered taxable persons for VAT purposes.

43 Resolution No. 126/E of 3 April 2008, clarified that the provision in question applies "*only where the total value of the business consists primarily of the normal value of commercial buildings*

business. Both parts of the fraction (*i.e.*, the buildings and the business) must be valued according to the criteria laid down in Article 14 of Italian Presidential Decree No. 633/1972[44]; and

b. the indirect taxation applicable to a lease of a business must be more favourable than that applicable to a lease of the buildings[45]. In theory, for the purposes of this comparison, only the registration tax rules should be considered[46], because the transaction VAT scheme (taxable or exempt) is irrelevant.

For transactions that are subject to VAT, the taxation rules for leases of commercial real estate will always be more unfavourable than those for the lease of a business[47].

Focusing on the services subject to VAT, satisfying both conditions above causes business lease rents to be subject to the proportional registration tax applicable to real estate leases (at the rate of 1% for commercial buildings).

which, under Article 10, paragraph 1, no. 8) of Italian Presidential Decree No. 633 of 26 October 1972, because of their features, cannot be put to a different use without significant renovation".

44 In this regard, Circulars No. 12/E of 1 March 2007 and No. 18/E of 29 May 2013.

45 In Resolution No. 35/E of 6 February 2008, the Italian Revenue Agency clarified that "*where the lease of a business is for a period of several years, in order to compare it with the rules governing the lease of commercial real estate, account must also be taken of Note I) to Article 5 of the Tariff, Part 1, appended to the Italian Consolidated Registration Tax Law, insofar as it reduces the registration tax if payment thereof is made in a single instalment for the entire contract term*". Response No. 124/E of 21 December 2018 is in agreement. There are no explicit positions regarding the situation where the business also includes residential property units.

46 In Circular No. 12/E of 1 March 2007, the Italian Revenue Agency stated that "*the anti-tax evasion rationale of the rule requires that the most unfavourable rules be identified when applying the proportional registration tax, which is imposed on all leases of commercial buildings, both taxable and exempt, entered into under Article 10, no. 8)*". That practice document also states that the comparison in question is not affected by "*the fact that exempt leases limit the lessor's right to a deduction, nor the fact that if the lessee has a limited right to a deduction, it would be less well served by a lease that is subject to VAT*". The irrelevance of the VAT rules for the purposes of the comparison in question was also confirmed by Circular No. 18/E of 29 May 2013 and Order No. 8243 of 4 December 2020 of the Italian Supreme Court, Division V. However, indications to the contrary can be found in Circular No. 27/E of 4 August 2006 and in Resolution No. 35/E of 6 February 2008, which stated the principle that the comparison should be carried out with respect to both taxes, VAT and registration tax.

47 This was also indicated by the Italian Revenue Agency in its Circular No. 12/E of 1 March 2007. However, the author notes that if the lease of a business is not subject to VAT, the registration tax due (levied at a rate of 3%, in accordance with the residual rule under Article 9, Tariff Part I appended to Italian Presidential Decree No. 131/1986) is more onerous than that applicable to a lease of real estate (taxed at a rate of 2%).

In theory, proportional registration tax is calculated on the total amount of the lease payments. However, neither the rule nor the Italian Revenue Agency's practice seem to allow the application of registration tax only to the portion of the rent attributable to the real estate component of the leased business[48].

However, the special rule has no impact on the VAT rules for the service, which continues to be mandatorily subject to VAT at the ordinary rate of 22% (therefore, the VAT exemption under Article 10, paragraph 1, no. 8 of Italian Presidential Decree No. 633/72 is not applicable)[49].

Lastly, the application of the rules in question should also have effects for the purposes of the taxation of subsequent documents relating to the same contract. As an example, agreements providing solely for reduction of the rent will benefit from the exemption from registration tax and stamp duty that apply to leases under Article 19 of Italian Decree-Law No. 133 of 12 September 2014, converted into Italian Law No. 164 of 11 November 2014[50]. For the same reason, taxpayers should have the option to pay registration tax annually on multi-year rental contracts under Article 17, paragraph 3 of Italian Presidential Decree No. 131/1986.

12.6. "Atypical" cases: tourism rentals, co-working spaces, student housing and senior housing

12.6.1. Tourism rentals

The concept of "tourism rental" generally refers to an accommodation-type business in which real estate is provided for residential use to persons seeking short-term stays.

From a statutory and administrative standpoint, this topic is governed by national, regional and municipal laws. From a tax perspective,

48 In this regard, the opinion of A. Busani, *Imposta di registro*, Milan, 2022 p. 2358., is worth noting: "*However, it continues to be clear that, in a lease of a business including real estate, the contract need not state a single all-inclusive rent, but may separate the rent for the property (or properties, if properties are involved for which the lease thereof results in different rates) from the rent relating to the lease of the remaining business assets, with the consequence that each of those rent payments must be subjected to its own taxation (Article 23, paragraph 1, Italian Consolidated Registration Tax Law) and the anti-tax evasion rule becomes inapplicable*".

49 See, *inter alia,* Circular No. 18/E of 29 May 2013.

50 Resolution No. 124/E of 21 December 2018.

however, with the sole exception of "short leases"[51], there are no specific rules, and therefore reference must be made to the general principles and clarifications provided by the tax authorities.

In the case of tourism rentals by individuals or entities who are taxable persons for VAT purposes[52], the tax rules for indirect taxation purposes varies depending on whether the transaction is considered to be a hotel-type service or property management.

Specifically, if the service is considered to be provision of accommodation in "accommodation facilities" in accordance with no. 120) of Table A, Part III, appended to Italian Presidential Decree No. 633/1972, it is subject to VAT at the reduced rate of 10%[53], and the registration tax applies in a fixed amount in accordance with the VAT/registration tax alternative principle under Article 40 of Italian Presidential Decree No. 131/1986[54].

Determining the scope of the situations falling under no. 120) above requires an interpretive effort that is not simple. Consider that this

51 The rules for "short leases" are set forth in Article 4 of Italian Decree-Law No. 50 of 24 April 2017, converted into Italian Law No. 96 of 21 June 2017, and is applicable to "*leases of real estate for residential use for a term not exceeding 30 days, including leases that include linen and cleaning services, entered into by natural persons not in conjunction with the exercise of a business, directly or through entities that perform real estate brokerage or manage computer portals that connect people looking for a property with people who have real estate units to rent*". These rules – which, as can be seen from the language cited above, is only applicable to services rendered by natural persons not in conjunction with the exercise of a business – are not analysed here.

52 The transaction is subject to VAT if the lessor is in corporate form or is operating in the context of a non-occasional activity organised as a business. On this point, see the Ministry of Finance's ruling on "bed and breakfasts" in Resolution No. 155 of 13 October 2000, which stated that "*exclusion from VAT can apply only if the activity is not engaged in systematically or in an on-going manner and without that organisation of resources which is an indication of engaging in the activity as a professional*".

53 In this case, the VAT exemption scheme under Article 10, no. 8 of Italian Presidential Decree No. 633/1972 cannot be applied. In this regard, it should be noted that Article 135(1) of Directive 2006/112/EC provides that the VAT exemption scheme for the letting and leasing of immovable property excludes "*the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites*".

54 The registration tax is applicable only in "case of use" if the contract is entered into in the form of an unauthenticated private agreement (under Article 5 of Italian Presidential Decree No. 131/1986). However, that contract will be subject to mandatory registration (by a set deadline, "*in termine fisso*") if formalised via a public agreement or an authenticated private agreement (still in the fixed amount of EUR 200).

provision refers to “*services provided to customers accommodated in the accommodation facilities referred to in Article 6 of Italian Law No. 217 of 17 May 1983*”, and this law was repealed by Italian Law No. 135 of 29 March 2001[55]. Following this repeal, Article 1 of the Prime Ministerial Decree of 13 September 2002 was enacted, providing that all references to the repealed law were to be understood as referring to this Prime Ministerial Decree and to regional industry regulations.

Therefore, given this regulatory framework, the tax authorities have stated on several occasions that being considered an “accommodation facility” for the purposes in question requires that the operation constitute a business of a tourism/hotel nature based on national and regional industry regulations[56].

According to the Revenue Agency, the reference to regional industry laws is “*essential in order to determine the proper VAT scheme for the provision of the ‘hotel or similar’ accommodation*,” “*provided that there are regional industry laws; otherwise the provision of accommodation will be subject to the VAT treatment of services in the hotel sector, where the same falls within the scope of application of the [...] Prime Ministerial Decree of 13 September 2002 (or other ordinary law in force in that industry)*”[57].

Situations not covered by the aforementioned no. 120) are, instead, subject to the tax scheme applicable to real estate leases (described in the second section above), whereas the registration is obligatory only in “case of use” for leases with a term of no more than 30 days in total

55 This law was in turn repealed by Italian Legislative Decree No. 79 of 23 May 2011.

56 See the following Italian Revenue Agency documents: Response No. 84/E of 3 March 2020, Resolution No. 8/E of 14 January 2014, Resolution No. 196/E of 31 July 2007, Circular No. 12/E of 1 March 2007, and Resolution No. 117/E of 10 August 2004. In legal commentary, this approach was considered by some to be unacceptable, since it refers to regional law and may lead to different tax treatment depending on the region where the property is located.
Although it relates to a regulatory framework that is no longer in effect, it may be helpful to refer to the clarifications made by the Ministry of Finance in Circular No. 9, Part I, of 14 February 1980. In particular, Circular No. 9/1980 stated that “*the concept of ‘hotel services’ must be considered to include not only the provision of accommodation, but also a whole series of related or ancillary operations (e.g., laundry, parking, bookings, etc.)*”, and that persons providing services of a hotel-type nature include “*guesthouses, i.e., those who, for payment, habitually provide accommodation, with or without meals, in furnished rooms provided that [...] it is not a mere rental of premises but involves, on the part of the service provider, the provision of other ancillary services typical of that relationship, such as cleaning and tidying up of rooms, changing linen, washing and ironing clothing, etc.*”

57 Resolution No. 117/E of 10 August 2004 is in agreement.

during the year[58], provided that they are entered into in a form other than a public agreement or an authenticated private agreement[59].

It should be noted that the case law of the Italian Supreme Court seems to prefer a less formal approach than that described above. According to the Italian Supreme Court, the application of VAT at the reduced rate of 10% would require that, in conjunction with the provision of a furnished property, in addition to services that are merely ancillary to the lease (such as air conditioning, water, electricity and gas), other services be provided, such as room cleaning, change of linen, meals, etc.[60] However, it does not seem to matter whether the activity falls within the scope of the regulations governing the hotel sector.

Classifying tourism rentals as hotel business also has important implications for the deductibility of VAT on costs incurred in connection with the property.

As is well-known, VAT paid in relation to the purchase and maintenance of residential property is generally non-deductible, under Article 19-*bis*1, letter i) of Italian Presidential Decree No. 633/1972. However, by way of interpretation, the Italian Revenue Agency[61] added an exception to this limitation, stating that "*residential property used by the taxable person in an accommodation-type business (management of holiday homes, room rental, etc.) involving the provision of services subject to VAT must be treated, regardless of its cadastral classification, in the same way as buildings which are commercial by nature*". In relation to this real estate, therefore, "*the tax on the purchase of goods or services relating*

58 The Italian Revenue Agency has clarified that for the purposes of calculating the 30 days, the terms of all contracts entered into in the same year between the same parties regarding the same property must be counted (see Circular No. 26/E of 1 June 2011 and Circular No. 12/E of 16 January 1998).

59 In accordance with Article 2-*bis* of the Tariff Part II, appended to Italian Presidential Decree No. 131/1986.

60 See, *inter alia*, Order No. 6502 of 20 March 2014.

61 See Resolution No. 18/E of 22 February 2012.

to those types of services is deductible even though it relates to units which, from a cadastral perspective, are residential"[62] [63].

For the purposes of deducting VAT on the costs of maintaining or renovating residential real estate, it must be determined whether, when the work is being performed, the property is already being used for accommodation or is unequivocally intended for such use.

The reduced rate referred to in the aforementioned no. 120) cannot be applied in relation to services which, although provided by hotel operators, serve purposes other than accommodation[64].

62 The Italian Supreme Court came to the same conclusion. See decision No. 4606 of 9 March 2016 which, in relation to the deductibility of VAT incurred on the costs of renovating residential property intended for agritourism use, states that the limitation on the deduction in question is "*justified where the final consumer benefits directly from such work, as a 'user in their own right' of the property for personal residential use, or where the renovated residential property is intended for 'mixed use' by the taxable person, with the result that in these cases [...] the prerequisite under EU law on which the tax deductibility is based is no longer satisfied.*" The Italian Supreme Court went on to say that with this being the rationale for the law in question, it is necessary to "*distinguish real estate 'for residential use' – according to the corresponding zoning and cadastral use – which entails direct use by the final consumer, from real estate used in the 'agritourism' business, for which the property's residential function, which is the means of providing the service involving hospitality to and accommodation of customers, is directly instrumental to the performance of the economic activity subject to VAT*". Similarly, decision No. 8268 of 29 April 2015, in relation to VAT incurred on the costs to renovate residential property used as a guesthouse and holiday home and, more recently, Decision No. 35256 of 30 November 2022.

63 The position of the Italian Revenue Agency was most recently confirmed in the Response No. 392 of 24 July 2023, concerning a case in which a real estate company has purchased a residential property, then outsourcing to a third company the management of a tourist rental activity, on the basis of a mandate with representation. In particular, the Italian Revenue Agency stated that "if the tourist accommodation activity is carried out by the company - even if through an outsourcer - in compliance with the sector regulations: - the related services are subject to VAT according to No. 120 of Table A, Part III, annexed to the VAT Decree, i.e. 10 per cent", and it also confirmed that "as a result of the taxability of the accommodation services in question, in accordance with the general principles of VAT, the tax on the purchase of goods or services pertaining to these types of services is deductible even though pertaining to units that, from a cadastral point of view, are residential". With Ruling No. 60 of March 6, 2024, the Italian Revenue Agency confirmed that the mentioned beneficial regime provided for hospitality business does not apply to the input VAT paid by a Municipality in connection to the purchase of buildings devoted to "social housing" purposes, classified for cadastral purposes as residential, where they are merely intended to be leased. In particular, "since the Municipality carries out a mere rental activity of 'social housing', the buildings are not used in the context of an hospitality business and, therefore, the derogation exception does not apply and the right to deduct VAT is precluded pursuant to the mentioned article 19-bis1)".

64 See Ministry of Finance Circular No. 460639 of 15 July 1987, which stated that services consisting of the provision by hotel companies of rooms for conferences, exhibitions, fashion shows,

12.6.2. Co-working spaces

The term "co-working spaces" normally refers to furnished office space made available along with a number of additional services, such as postal, secretarial, administrative/accounting and cleaning services, internet connection, meeting rooms, etc. In practice, the case in question takes on different forms, as they may consist of spaces assigned within shared environments, or actual "private spaces" intended for an individual user's exclusive use for a period of time, which may be prolonged.

The provision of "co-working" spaces by professional operators is not subject to specific tax rules, and thus it must be determined whether, based on the nature and significance of the additional services provided, the relationship should be classified as a mere property rental, or rather as a "complex service".

In accordance with the criteria set out by the Italian Revenue Agency in its Circular No. 12/E of 1 March 2007, a "complex service" is defined as a service which consists not only of the provision of a specific space, but also "*additional services which are material to the purpose of the contract*" and which do not consist of services that are merely independent or ancillary to the lease. In the Agency's view, a relationship "*including multiple services aimed at supporting the performance of a work activity, such as secretarial and postal services, etc., in which the authorisation to occupy certain spaces of a building is only a means of providing a complex service*", cannot be classified as a "mere" real estate lease[65].

In these cases, the transaction is considered as a general supply of services subject to VAT at the ordinary rate of 22% and the registration tax will be applied at most in a fixed amount, in accordance with the principle of alternative VAT/registration under Article 40 of Italian Presidential Decree No. 131/1986[66].

Otherwise, the tax scheme for real estate leases described earlier is applied. It should be clarified that providing additional services that are not

etc., do not qualify for the reduced rate under no. 120). See also Ministry of Finance Circular No. 9 of 14 February 1980.

65 The situation examined by the Agency concerned the provision of furnished rooms for office use along with a number of additional services such as postal, secretarial and administrative/accounting services (Circular No. 12/E of 1 March 2007, sec. 8.1).

66 The registration tax is applicable only in "case of use" if the contract is entered into in the form of an unauthenticated private agreement (under Article 5 of Italian Presidential Decree No. 131/1986). However, that contract will be subject to mandatory registration (by a set deadline, "*in termine fisso*") if formalised via a public agreement or an authenticated private agreement (still in the fixed amount of EUR 200).

considered to be either components of a "complex service" together with the provision of space or as operations that are merely ancillary to the lease of real estate, will result in application of the VAT rules for the relevant service (considered individually).

On this topic, for interpretation purposes, it is worthwhile keeping in mind that the Italian Revenue Agency has classified as a "complex service" a service consisting of providing classrooms equipped to provide professional courses, together with certain additional services, including room arrangement and installation of PCs connected to a video projector with screen and flip chart, telephone connections, normal cleaning of the spaces provided, IT assistance and reception[67].

12.6.3. Student housing

The term "student housing" refers to services consisting of the provision of accommodation for "off-campus" university students along with additional services, such as reception and security, study rooms, laundry, gym, etc.

In this case as well – given the absence of specific tax rules – the proper indirect tax scheme can only be determined by analysing the specific situation, considering the nature and significance of the additional services provided along with the accommodation.

Based on the principles for co-working spaces discussed above, it is thus deemed necessary to determine whether the services rendered in addition to the mere provision of the space can be considered "*material to the purpose of the contract*" and not services that are merely independent or ancillary to the lease. See the previous section on co-working spaces for a further guidance on identifying the applicable tax scheme[68].

It is understood that, where the property is held by a third person or entity engaged solely in the real estate business (and which leases the property to the company providing the services in question to the end users), the lease should be subject to the normal tax scheme for real estate leases.

Having said this in general terms, it should be noted that special regimes apply:

67 See Response No. 318/E of 25 July 2019.

68 The tax scheme might also depend, in this case, on whether the accommodation is classified as part of residential or commercial buildings.

pursuant to Article 10(20) of Presidential Decree No. 633 of 26 October 1972, which provides for a VAT exemption regime in respect of "*educational services for children and youth and teaching services of any kind, including for training, continuing education and vocational retraining, provided by institutes or schools recognised by government agencies and non-profit organisations, including services relating to accommodation, board and the supply of books and teaching materials, including those provided by institutions, boarding schools or guesthouses that are attached, dependent or functionally connected...*". This regime is applicable not only when the services relating to accommodation and board are rendered by the same entity that provides the teaching activity, but also when there is no coincidence between these entities, if certain conditions are met[69];

to board and lodging provided to university students by institutions or entities for the right to university study established by the Regions. Article 2-*bis* of Italian Decree-Law of 24 April 2017, which was added during conversion into Italian Law No. 96 of 21 June 2017, provided an interpretation of these provision and established that these services fall within the VAT exemption rules in Article 10, paragraph 1, no. 20) of Italian Presidential Decree No. 633/1972[70].

12.6.4. Senior housing

The term "senior housing" generally refers to services consisting in the provision of housing to self-sufficient elderly individuals, along with additional services such as gyms, libraries, common areas, reception and security, availability of support staff, etc.

Determining the tax scheme applicable to these services requires, first of all, a determination, based on the nature and significance of the services provided, of whether the VAT exemption under Article 10, paragraph 1,

69 In this regard, see, for example, the analysis developed by the Italian Revenue Service under Resolution No. 251 of 16 July 2019.

70 It should also be noted that the VAT exemption is also applicable to services provided by university colleges managed by the entities specified in Article 1, paragraph 603 of Italian Law No. 296 of 27 December 2006, which operate exclusively in the areas referred to in Article 1, paragraph 4, of Italian Law No. 338 of 14 November 2000 (*i.e.*, managing accommodation and residences for university students and offering support services for teaching and research and cultural and recreational activities to others enrolled in universities) (see Article 1, paragraph 603 of Italian Law No. 296 of 27 December 2006 and Article 2, paragraph 4-*bis* of Italian Decree-Law No. 16 of 2 March 2012, converted into Italian Law No. 44 of 26 April 2021).

no. 21 of Italian Presidential Decree No. 633/1972 for "*services provided by children's homes, orphanages, kindergartens, retirement homes for the elderly and the like, [...] including meals, clothing and medicines, treatments and other ancillary services*" applies[71].

It may be helpful to consider the main interpretative criteria used in the practice and the case law.

The Italian Revenue Agency is of the view that the language of the above provision indicates that the list contained therein is not exhaustive and, therefore, services provided by organisations "similar" to those expressly listed (including retirement homes[72]) are also "*exempt when they ensure housing, which may be combined with other services considered de facto ancillary to the main service, to persons who, because of their status, are in need of protection, assistance and care*"[73].

Based on the Italian Supreme Court's interpretation[74], what qualifies the services provided by a retirement home for the purposes of the exemption in question is "*housing provided to elderly individuals*"; any additional services of "*providing clothing, medicines and food, as well as treatments and other services to the home's guests*" must be considered *"merely 'ancillary' to the housing, which is obviously the only service that is essential*"; moreover,

71 As of 1 January 2016, if these services are provided by social cooperatives and their consortia to the individuals indicated in Article 10, paragraph 1, number 27-*ter* of Italian Presidential Decree No. 633/1972 (which include the elderly and disabled adults), VAT is applied at a reduced rate of 5% under no. 1) of Table A, Part II-*bis* appended to Italian Presidential Decree No. 633/1972 (on this topic, see Italian Revenue Agency Response No. 400/E of 10 June 2021).

72 In any event, without prejudice to the special rule indicated in the previous footnote.

73 See Resolution No. 164/E of 25 November 2005. In the same view, more recently, Ruling No. 221/E of 27 April 2022, which confirmed the applicability of the VAT exemption iat stake to the so-called "sheltered housing" services in favour of mentally handicapped persons, which provide for the provision of a home and communal facilities, together with the provision of support services in the performance of daily activities. Resolution No. 551267 of the Ministry of Finance of 6 December 1989 should also be recalled, whereby the VAT exemption under Article 10, no. 21) of Italian Presidential Decree No. 633/1972 was considered not applicable to a situation where an association for the care of handicapped persons provided a holiday home for its members, because "*the services provided by 'holiday homes' do not differ in substance from those provided by hotels*", with the result that "*they cannot be considered as services worthy of the specific social attention that inspired the legislator to afford preferential tax treatment*".

74 See decision No. 11353 of 3 September 2001. It should be noted that the principles laid down in this decision have also been recently referred to by the Revenue Agency (see Response No. 400/E of 10 June 2021).

whether the rest home has the necessary authorisations is irrelevant[75]. According to the Court, therefore, for the purposes of applying this VAT exemption, consideration must be given "*firstly, to the nature of the service, which must consist of housing and only to a lesser extent other assistance, and secondly the recipients of the services, who must be individuals deserving of particular protection and care, such as the elderly*".

Useful guidance can also be found in the case law of the Court of Justice of the European Union. The law in question transposes Article 132(1)(g) of Directive 2006/112/EC, which provides for a VAT exemption for "*the supply of services and of goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other bodies recognised by the Member State concerned as being devoted to social wellbeing*". The Luxembourg Judges (Judgment C-335/14 of 21 January 2016) ruled on the application of this exemption, as transposed by Belgian law, to services provided by a residential centre for the elderly, consisting of housing designed for one or two persons with an equipped kitchen, living room, bedroom and equipped bathroom, as well as additional services for payment, which are also available to persons outside the facility (a bar-restaurant, hairdresser and beautician, physical therapy room, occupational therapy, laundry, outpatient clinic with testing room and a doctor's office). The Court, in referring the decision on whether the VAT exemption applied to the national court, stated that "*the same treatment with regard to VAT should be given to the service consisting of the provision of dwellings, whether those dwellings are provided by an old people's home or whether they are provided by a serviced residence*", with the result that not only services "*consisting of the provision of dwellings adapted for elderly persons*" may benefit from the exemption, but also additional services that "*are intended for the support and care of elderly persons and correspond to the services which old people's*

75 The Italian Revenue Agency has stated on several occasions that this exemption is objective in nature, and therefore the provider's legal nature is irrelevant (see, among many, Italian Revenue Agency Response No. 221/E of 1 July 2019). Resolution No. 74/E of 27 September 2018 is also along these lines; it states that "*the exemption applies regardless of the person or entity providing the service; moreover, it must also be verified whether the persons benefiting from the services fall within the category of disadvantaged individuals worthy of social protection*".
Moreover, for the exemption in question to apply, the "overall" management of the retirement home must be assessed (see, of many, Italian Revenue Agency Response No. 240/E of 3 August 2020).

homes are obliged to offer also in accordance with national legislation"[76].

If the senior housing services are covered by that VAT exemption, the registration tax will be applied in the fixed amount of EUR 200[77].

Otherwise, it must be determined whether they can be considered a lease of real estate or a complex service, as discussed above in relation to co-working spaces and student housing.

Lastly, the remarks made above with regard to student housing apply to senior housing, *i.e.*, where the property is owned by an entity that is not the company providing the services to the end users, the rental of the property to the latter company should be subject to the ordinary rules for leases.

12.7. Conclusions

The foregoing brief analysis highlights some concerns with the current regulatory framework.

The goal of standardising the indirect taxation of the various types of contracts has not yet been fully achieved (see, for example, the rules on "residential financial leases" for properties used as the "first home"). This increases the complexity of the taxation system, which, moreover, applies registration tax in addition to VAT.

At the same time, there are the well-known distortions caused by the inability to apply VAT on a general basis (at least at the lessor's election) to leases of residential properties (which topic is discussed in detail in another chapter of this volume, including in regard to the onerous aspects of direct taxation). While the application of VAT may in some cases represent a significant burden for the lessee, at the same time professional operators (real estate companies and funds, for the most part) should be allowed to choose the most efficient VAT scheme from the standpoint of the financial sustainability of the transaction.

76 Although the Court did not take a specific position, authoritative commentators believe that the tenor of the decision seems to imply that the exemption applied to the case examined (see B. Terra, J. Kajus and O. Henkov, *Commentary on European VAT – Chapter 9 – Exemptions – Global Topics*, IBFD, updated December 2020).

77 The registration tax is applicable only in "case of use" if the contract is entered into in the form of an unauthenticated private agreement (under Article 5 of Italian Presidential Decree No. 131/1986). However, that contract will be subject to mandatory registration (by a set deadline, "*in termine fisso*") if formalised via a public agreement or an authenticated private agreement (still in the fixed amount of EUR 200).

The scenario is even more complex with regard to "atypical" contracts.

With regard to finance leases, the peculiar interpretative guidance coming from the Court of Justice and the Italian Supreme Court require the Italian Revenue Agency to take a clear position.

Similarly, services that are "innovative" but are becoming increasingly widespread still involve significant aspects of uncertainty in many cases. The notion of the "complex transaction", as the Italian Revenue Agency has developed in specific cases, currently requires operators to use a case-by-case approach and, by its very nature, may lead to inconsistent results. Not to mention that classification as a "complex transaction" entails the application of VAT at the ordinary rate of 22%, which makes it potentially unfeasible for individuals and other entities who/that cannot deduct VAT on purchases. Therefore, in this area too we hope that action (including legislative action) will be taken to resolve the uncertainties surrounding the tax treatment, although such action will have to take into account the financial feasibility of the overall tax burden and will also have to be developed as a function of the merits of the services in question.

13.
Taxation of residential properties

by F. Mantegazza, C. Galli

13.1. Introduction

The Italian tax system traditionally treated residential properties (*rectius*, buildings or portions of residential buildings) as assets solely destined for private use without considering the possibility to have such assets used as part of a business activity or as object of professional investment activity. Said approach has led to deny, usually without admitting to prove otherwise, the applicability of the tax regimes normally applicable to business activity such the deductibility of costs or the recoverability of input VAT.

Said approach arises from the need traditionally perceived by the law-maker to prevent abuses that could be realised by introducing in a business activity assets that were in reality intended solely for private use. To meet such a need (which seems to be more of historical rather than legal nature) the tax system has been characterized by a stringent approach based on which an almost absolute presumption that residential properties are deemed to relate to business only in the hands of taxpayers that carry out construction or qualifying refurbishment works.

Said approach should be dismissed as the proper acknowledgment by the tax system of the economic and investment value of residential properties may provide a significant boost to the real estate sector.

A boost to the residential sector would incentivize new developments and would be of benefit in terms of wider offer of living solutions for citizens and also for the whole real estate sector, which represents one of the most important pillars of the real economy, and for the lease of residential properties as a reply to the increasing demand for this service in the light of the new living needs.

The following intends to provide an overview of the current tax regime of residential properties having regard to lease activities in the view of firstly highlighting the limitations and the inconsistencies and then provide some proposals of amendment that would be useful to give a boost to the sector.

13.2. The definition of residential properties

The Italian tax system does not provide for a specific definition of residential properties. The definition of "building" is usually found in a dated circular letter issued by the Ministry of Public Works[1] according to which "*The term building or construction refers to any covered construction, limited by streets or empty spaces or divided from other constructions by vertical structures that move, without any interruption, from the basement to the roof, that has one or more free entries on the street, and that may have one or more independent stairs*". With respect to the definition of "residential" property – as opposed to the concept of "instrumental" property – the cadastral qualification is of relevance. As clarified by the Tax Authority, "*the distinction between residential properties and instrumental properties must be made having regard to the cadastral qualification of properties, irrespective of their actual use*" so that "*the category of residential properties includes properties that are included or that could be included in the cadastral category "A", with exclusion of properties falling the A10 category*"[2].

For the purpose of the following the properties considered are those that are included or that could be included in the above cadastral categories.

13.3. The direct tax regime

13.3.1. Enterprises or companies

13.3.1.1 The tax regime set out by art. 90 of TUIR

Residential properties held as part of a business activity for the purpose of the subsequent lease are in principle subject to the tax regime foreseen by art. 90 of Presidential Decree of 22 December 1986, no. 917 ("Decree 917/86"). Said tax regime is significantly different from that applicable to residential properties the construction or the trading of which represent the business activity (so called "trading" properties) or, in general, for properties other than residential properties that are instrumental to a business activity (so called "instrumental" properties).

1 Circular of Public Works Ministry of 23 July 1960, n. 1820, referred to in the Resolution of the Ministry of Finance of 26 May 1998, n. 46/E and Circular of the Revenue Office of 27 March 2015, n. 14/E.

2 Circular 27/E of 4 August 2006, confirmed by Circular 12/E of 1 March 2007 and Circular n. 22/E of 28 June 2013.

Indeed, the tax regime of "investment" properties is determined by derogating from the rules that are generaly applicable for the purpose of calculating the business income and with the result of a completely peculiar tax regime.

Pursuant to art. 90, paragraph 1, last sentence of Decree 917/86, the income of "investment" properties is determined as the higher between:

1. the cadastral value (increased by 5%); and
2. the lease fee reduced, up to 15% of the amount of the same lease fee, by the costs for ordinary maintenance as defined by art 3, paragraph 1, letter a) of Presidential Decree no. 380/2001 (including in said definition works for the reparation, renovation and substitution of the finishes of the buildings and those that are necessary for the purpose of completing or maintaining existing technological plants), documented, actually incurred and borne by the lessor[3].

With respect to the above properties, deductibility of costs is limited not only having regard to the relevant amount considering that only costs actually incurred and borne by the lessor are of relevance as it is limited to their nature considering that only costs arising from ordinary maintenance as defined by art 3, paragraph 1, letter a) of Presidential Decree no. 380/2001 are of relevance.

In substance, the tax regime set out by art. 90 of Decree 917/86 does not recognize the nature of instrumental properties to residential properties held by an enterprise as part of a lease activity. The tax regime of "investment" properties prevents the deduction of costs related to their acquisition, construction and management (save for ordinary maintenance and, in any case, within the limit of 15% of the lease fee) with a method of taxation which is in the substance that of a wealth tax.

As a consequence, expenses and other negative items of income (other than the above-mentioned expenses for ordinary maintenance) relating to "investment" properties are fully not deductible and the only deductible expenses are general expenses relating to the administration of the company.

Considering the principle of non-deductibility of negative items of income, the property tax IMU paid in relation to "investment" properties is

3 Circular n. 10/E/2016 of the Revenue Office states that *"if the parties decide that in the lease agreement the costs of ordinary maintenance are charged to the tenant instead of the lessor, the latter is not entitled to deduct the amounts of said costs and the lease fee will be considered for the whole amount as provided for in the agreement".*

fully not deductible for corporate income tax purposes (IRES). In this respect, it is worth mention that the property tax paid in relation with instrumental properties is partially deductible for corporate tax (IRES) purposes (in the measure of 50% for tax period 2019, 60% for tax periods 2020 and 2021 and 100% starting from 2022).

In addition to the above, it should be considered that the tax regime set out by art. 90 of DPR 917/86 implies that residential properties owned by companies to be leased give rise to income which is taxable for corporate tax purposes (IRES) even in the case the property is not actually leased. In such a case, art. 41 of DPR 917/86 provides that the cadastral income of the property (step-up by 5% and increased by 1/3) forms in any case part of the taxable income.

Lease fees of residential properties form part of the taxable income for corporate tax (IRES) on an accrual basis, irrespective of the actual collection and based on the mere ownership in accordance with art. 26 of DPR 917/86.

Art.26 of DPR 917/86 has been modified by art. 3-quinques of Law Decree no. 34/2019 with respect to lease agreements executed starting from 1 January 2020. Lease fees arising from lease agreements executed after said date, if not collected, do not form part of the taxable income provided that the absence of the relevant collection is accompanied by the request to free the property due to delinquency o by the injunction of payment. Lease fee not collected by the owner during the relevant tax periods and collected in following fiscal years should be subject to the provisions set out by art. 21 of DPR 917/86 with respect to income referred to in art. 17, paragraph 1, letter n-bis of DPR 917/86. The tax regime generally applicable would imply that lease fees that are not collected in the relevant tax years are subject to separate taxation in the tax year during which collection occurs in accordance with the provisions applicable to income realized in the form of refund of taxes or other expenses deducted from the taxable income in previous years. However said regime of separate taxation seems to be applicable only for persons that are subject to personal income tax (IRPEF) whilst it seems that in the case of persons that are subject to corporate income tax (IRES) the lease fees lately collected should form part of the taxable income of the tax period of collection in accordance with the ordinary rules.

Agreements executed before 31 December 2019 remain subject to the tax regime foreseen by art. 26 of Decree 917/86 previously in force based on which income from lease agreements form part of the taxable income, irrespective of actual collection, until the issuance by the competent Court of the order for the tenant to free the property. In particular, lease fees can be excluded from the taxable income subject to the completion of the relevant judicial procedure intended as the procedure confirming the order to free the property referred to in arts. 657 and ff of the Code of Civil Procedure. As a consequence of said procedure, the Court confirms the order to free the property and issue the order of its enforcement.

When the judicial procedure assesses the existence of delinquency with respect to lease fee due in previous tax periods, a tax credit is attributed to the lessor the amount equal to the taxes paid on the lease fees not collected as assessed by the Court. Starting from the completion of the judicial procedure and issuance of the order to free the property, the cadastral income (step-up by 5% and increased by 1/3) forms part of the taxable income.

13.3.1.2. Tax credit for energy upgradings of buildings

Significant uncertainties exist with the possibility to take advantage of the tax benefits foreseen for energy upgrading of residential properties that are leased out. Said benefits are represented by tax credits granted in connection with expenses incurred for energy upgrading.

The tax credit is recognised in the measure of 65% (that may be increased to 70% or to 75% with respect to specific categories of works). The tax credit may be used in equal amounts over a 10 year-period.

The provisions concerning energy upgrading have been issued by means of temporary extensions of the original law that have been granted over time[4].

Based on the law provisions, the tax credit is recognized, among the others, to persons that realise business income and suffer expenses for energy upgrading of existing buildings, portions of existing buildings or on single existing units of any cadastral category, even rural, owned or held[5].

A divergence of interpretation as to the subjective scope of application of the tax credit currently exists and represent another hurdle to the investment in residential properties for the purpose of the subsequent lease.

On one hand, the wording of the law expressly includes in the subjective scope of application of the tax benefit the persons that realise business income and that incur expenses for energy upgrading of existing buildings without making any distinction based on the typology of the building or their use.

4 See. art. 1, paragraphs 344 and following, Law. 296/2006 (Financial Law 2007).

5 See art. 2 of Ministerial Decree of 19.2.2007.

On the other hand, the Tax Authority has expressed the opinion that the tax credit can be granted only to persons that realise business income and that that directly use the buildings. With respect to enterprises, the Tax Authority has initially observed that "*the tax provisions relating to energy upgrading is intended to incentive the improvement of the energy performance of existing building by granting a tax benefit that, based on a systematic interpretation should be intended as referred solely to taxpayers that directly use the buildings object to the works*" and have further argued that "*the possibility to benefit from the tax credit by companies or, more in general, by entrepreneurs, should be intended as applicable solely to instrumental buildings that are directly used by the same in carrying out their entrepreneurial activity*". On the basis of the assumption that "*the tax benefit cannot be applied to works carried out on properties that are the object of the business activity*", the Tax Authority has expressly excluded from the scope of application of the tax benefit works carried out:

1. by a company a real estate company in relation to buildings that are destined to be leased out;[6]
2. by a construction company in relation to properties that are destined to be traded[7].

In other words, the Tax Authority is of the view that persons that carry out a business activity can take advantage of the tax credit only with respect to instrumental properties that are directly used as part of the business activity and are not capable of autonomously generate income.

Said restrictive interpretation has been rejected by a number of court decisions. The line of reasoning that affirms the applicability of the tax benefit irrespective of the typology of the properties and the use of the same by the company has been sustained by several First Degree and Second Degree Tax Courts[8] and by the Supreme Court[9].

In particular, the Supreme Court has observed that the rationale of the law of the tax credit as resulting from the law is to incentivize the realization of works for the energy upgrading of the whole national real estate stock

6 Resolutions of the Revenue Office n. 340/2008.

7 Resolutions of the Revenue Office n. 303/2008.

8 Among the others, see CTP Milan, decision n. 1641/12/2017, CTP Vicenza, decision. 468/2017, CTP Varese n. 94/1/13, CTP Milan n. 111/46/2016, CTP Treviso n. 45/01/13, CTP Pavia n. 68/2/2014, CTR Milano n. 2549/12/15, decision CTR Bologna n. 3697/3/16, CTR Milano, decision. 1063/19/2014, CTR Perugia, decision n. 99/3/2016.

9 See Court of Cassation, decision n. 19815 of 23 July 2019, decision n. 29162 of 12 November 2019.

in the view of a public interest for energy saving and is consistent with the wording of the relevant law provisions which do not provide for any limitation neither of objective nature (with respect to the cadastral category of properties) nor of subjective nature (by granting the benefit to individuals, to non-commercial entities and to persons that carry out a business activity, including companies) to the applicability of the benefit.

The Supreme Court has observed that the distinction carried out by the Tax Authority between instrumental properties (destined to the own activity or to that of third parties in accordance with art. 43, paragraph 2 of Decree 917/86), trading properties (held for trading) and investment properties (destined to the lease activity in accordance with arts 37 and 90 of Decree 917/86) is not always of relevance but is to be taken into account only from an accounting and tax perspective. Art. 1, paragraph 344 of the Budget Law for 2007 which initially introduced the benefit does not set out any objective differentiation and simply recognizes the tax credit for energy upgrading (consistently with the EU Directive which, in turn, does not differentiate). Art. 1, paragraph 20 of Law no. 244/2007 implements the modalities foreseen by art. 2, paragraph 1, letter b) of Ministerial Decree of 19 February 2007 which refers to entities that carry out a business activity without making any distinction.

Said decisions have taken the view that the benefit for energy upgrading has a general objective both from an objective perspective (as it concerns properties of any cadastral category) and from a subjective perspective (as it concerns individuals, entrepreneurs and companies or entities that carry out business activity) also stating that properties of a company, the activity of which is that of leasing of properties, must be considered as instrumental properties and, as such, may benefit of the tax credit.

It appears clear that this matter should be taken into consideration taking into account that the lien of interpretation brought forward by the Tax Authority represents a significant hurdle to the investment in energy upgrading by companies the main activity of which is the lease of either instrumental or residential properties that instead appear – both on a legal and systemic perspective – all eligible for the tax benefit.

13.4. The VAT regime

13.4.1. The leasing of residential property

The leasing of residential property (performed in the furtherance of a trade) constitutes a supply of services subject to VAT. It is however generally an exempt transaction (without credit)[10], together with financial leases of residential properties (Article 10(1)(8-*bis*) of Presidential Decree 633 of 26 October 1972)[11]. The only exceptions are constituted by the possibility to opt into the application of the tax in the following cases[12]:

- leasing by the businesses that have developed (or redeveloped[13]) the relevant property; or
- leasing, also by other businesses, of residential properties used as social houses[14].

In the case of exercise of the option, VAT is applicable at 10% (n. 127- *duodevicies*), Table A, Part III, of Presidential Decree 633/72).

As it will be illustrated further in dealing with the deduction of input VAT, this general exemption constitutes the principal tax hurdle to the widespread professional economic exploitation of residential property.

13.4.2. The sale of residential property

Under applicable legislation, also the sale of residential property is subject to a general exemption (without credit) regime (Article 10(1)(8) of Presidential Decree 633/72), subject to the exception of the application of VAT[15] that is

10 The exemption regime is ordinary provided under Directive 2006/112/EC, whose Article 135(1)(l) indeed provides an exemption regime in relation to "*the leasing or letting of immovable property*". The subsequent paragraph 2 waives the exemption regime in relation to "*(a) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites; (b) the letting of premises and sites for the parking of vehicles […]*". The subsequent Article 137(1)(d), however, allows Member States to carve out from the exemption regime also "*the leasing or letting of immovable property*".

11 Previously, the application of VAT at 10% was also provided leasing by the businesses that had developed the building for subsequent resale (n. 127-*ter*), Table A, Part III, of Presidential Decree 633/72).

12 As amended by Decree Law 83 of 22 June 2012.

13 In this chapter, reference to "redeveloped" properties shall be meant to be made to properties that have undergone qualifying renovation, urban restructuring, restoration or preservation works, as set out under Article 3(1)(c), (d) and (f) of Presidential Decree 380 of 6 June 2001 (the Construction Code).

14 As defined by the decree of the Ministry for infrastructures, together with the Ministry of social welfare, the Ministry for family policies and the Ministry for young population and sports of 22 April 2008, i.e. "*residential properties permanently let for the purposes of general interest, to foster social cohesion, address housing problems of individuals and families at a disadvantage, that are not in a position to access the letting of properties on the free market*".

15 At the following rates: 4% if the purchaser is eligible for the application of the regime on

(i) mandatory, in the case of sale of property by the businesses that have developed (or redeveloped) them, provided that the sale is effected within five years from the completion of the relevant work, or (ii), subject to the option by the seller, in the case of sale by the same qualifying businesses after five years. No other exceptions are provided, so that any sale of residential property whenever effected by a person other than the developer or redeveloper will be exempt from VAT (without credit), thus causing a corresponding non-deductibility of input VAT possibly suffered on the purchase of goods (including the property) and services.

No VAT applies instead on the contribution by a business to a collective investment undertaking of a plurality of properties mainly rented out. Indeed, such transactions are treated[16] as a transfer of going concern (out of scope)[17]. Since the relevant piece of legislation does not provide otherwise, it should be inferred that this special regime, under the relevant conditions, also applies to the contribution of residential property.

13.4.3. The deduction of input VAT on purchases

The general exemption (without credit) applicable to output transactions (sales and leases) hits the relevant suppliers by undermining, if not eliminated altogether, the possibility to credit input VAT paid on purchases, as well as on expenses pertaining to the relevant property, such as management, maintenance and refurbishment expenses. Indeed, under Article 19(5) of Presidential Decree 633/72, the exempt supplies implies a proportional reduction of the right to credit input VAT, to be calculated, as set out under Article 19-*bis*(1) in proportion to the ratio between supplies that entitle to credit input VAT (i.e. transactions other than the ones that are exempt without credit) effected in the relevant year and the same amount includes a of

owner-occupied dwellings (n. 21, Table A, Part II, of Presidential Decree 633/72); 10% in the case of sale by businesses that have performed qualifying redevelopment works on the property (n. 127-*quinquiesdecies*, Table A, Part II, of Presidential Decree 633/72) and, more in general, in the case of disposal of "non-luxury" properties(n. 127- *undecies*, Table A, Part II, of Presidential Decree 633/72), whereas the disposal of "luxury" properties is subject to VAT are the ordinary rate (with the exception of the sale of luxury properties by the business that preformed qualifying redevelopment works on the property, in which case the lower 10% rate prevails).

16 Under Article 8(1-*bis*) of Decree Law 351 of 25 September 2001, as converted and amended into Law 410 of 23 November 2001.

17 As per Article 2(3)(b) of Presidential Decree 633/72.

the exempt transactions effected in the same year. This implies that, in the case of businesses whose sole or principal activity is the lease or sale of residential property – other than those that developed or redeveloped the properties or those that are engaged in the leasing of social houses – input VAT on purchases, of the properties and other, becomes substantially non-deductible, thus constituting a higher cost of the same activity.

Further penalising the deduction regime in question is the interpretation of the tax authority concerning the applicability of the separation of activities, as provided for in Article 36 of Presidential Decree 633/72. In particular, according to the tax authority (see, most recently, Reply no. 23 of 2023), the separation of activities would be feasible only with reference to properties belonging to different cadastral categories, while it would not be allowed with regard exclusively to the VAT regime (exemption or taxation) of transactions concerning properties belonging to the same cadastral category; a case in which the pro-rata deductibility mechanism would be applicable. This discrimination, which appears unjustified and not in line with either the text of the law or the principle of neutrality established by the Sixth Directive, should be eliminated following the implementation of the tax reform, which also provides for an intervention aimed at "enabling taxable persons to make the deduction more in line with the actual use of the goods and services used for the purposes of taxable transactions, providing, in particular, for the option of applying the pro rata criterion of deductibility only to the goods and services used by a taxable person both for transactions giving rise to a right of deduction and for transactions not giving rise to such a right" (Article 7 paragraph 1 letter d) no. 1) of Law no. 111/2023).

As a further demonstration that lawmakers do not consider, with few limited exceptions, the sale and lease of residential property as belonging to a genuine business activity, the law also contemplates a case of absolute non-deductibility of input VAT suffered on the purchase of residential property, or the lease, maintenance, refurbishment or management of the same (Article 19-*bis*.1(i) of Presidential Decree 633/72). The right to credit input VAT would be preserved only in the hands of businesses whose sole or principal activity is the development of residential properties and of businesses that, having effected exempt supplies, suffering the partial or total inability to deduct input VAT under the general pro rata rules described above. The piece of legislation as written stipulates the absolute prohibition to deduct input VAT suffered on residential property depending on how the properties are registered with the land registrar, the actual business use of the same being irrelevant (as confirmed by the Circular of the Tax Authority n. 12/E of 1 March 2007).

However, this last prohibition to deduct input VAT, which is not sanctioned by the Sixth Directive, is potentially in breach of the fundamental principle of neutrality of VAT and it has indeed triggered substantial controversy. Courts have interpreted the provision not so much in sense of the total prohibition but, rather, as an obligation by the business claiming the deduction to provide "reinforced" evidence that the relevant piece of residential property is actually used in the furtherance of a genuine business activity. According to the Supreme Court[18], indeed, "*the right to deduct input VAT cannot be denied on the grounds of the formal registration of the property in the land registrar as residential property, due regard having to be given to its actual utilisation*" and that, in any event, "*the purchaser will have to demonstrate not only that the purchase is objectively and concretely made in the furtherance of a business, according to the general provision under Article 19 of Presidential Decree 633 of 1972, but also that the property is no longer being used as a private residence, in relation to which an objective prohibition to deduct input VAT is provided*". In other words, the formal registration of the property as residential at the land registrar does not prevent, of itself, the right to deduct input VAT suffered on the purchase, provided that, on the basis of objective elements, having regard to the actual use of the property, the taxpayer duly demonstrates that the property belongs, at least potentially, to a genuine business.

In the same direction, the Supreme Court[19] has also stated that the limitation imposed by the tax rule "on the deductibility of the VAT paid in recourse for the renovation costs of buildings intended for residential use is, in fact, justified where the final consumer benefits directly from such work, as a "user in his own right" of the immovable property for personal residential use, or where the renovated immovable property for residential use, is put to "mixed use" by the taxable person, with the result that in such cases - except in the case of undertakings whose exclusive or principal activity is the construction of immovable property - the same presupposition, laid down by Community legislation, on which the right to deduct tax is based (through

18 See Decision n. 12911 of 15 May 2019, confirming the prior decisions of the same Court, such as Decision n. 5559 of 26 February 2019; Decision n. 6883 of 8 April 206; Decision n. 10264 of 26 April 2017; Decision n. 16546 of 22 June 2018.

19 Decision n. 35256 of 30 Novembre 2022.

which the principle of fiscal neutrality is implemented), namely the use of the immovable property in the exercise of economic activity subject to VAT, is no longer met". In consideration of this rationale of the law, "it is therefore necessary to distinguish real estate "for residential use", according to the corresponding town-planning and cadastral destination, which implies direct enjoyment by the final consumer, from properties used, on the other hand, for the exercise of the business", observing that "the above considerations are in line with the indications of the Court of Justice of the European Union"[20].

Finally, also the tax authorities have endorsed the EU-law compliant interpretation by the Supreme Court and have confirmed, in Ruling n. 18/E of 22 February 2012 that residential properties used by taxpayers in the furtherance of an hospitality business (holiday rentals and similar) that implies the making of taxable supplies, have to be treated, regardless of the registration in the land registrar, as business assets, so that the costs for the acquisition and maintenance of such properties are not subject to the prohibition to deduct input VAT provided under Article 19-*bis*.1 (i) of Presidential Decree 633/72. In sum, when such residential properties can be used, according to the Regional tourist legislation, as tourist hospitality facilities, they imply the making of taxable supplies subject to a 10% VAT under n. 120) of Table A, Part III, of Presidential Decree 633/72.

13.5. The other indirect taxes

The general exemption regime provided for VAT purposes in the case of residential properties implies, consequently, the application of other transfer taxes, such as registration tax, mortgage tax and cadastral tax.

To this end, it is worth emphasising that the acquisition of residential properties with the aim of redevelopment and economic exploitation suffers a significant disadvantage because of the burden constituted by indirect taxes.

Transfers of residential property exempt from VAT suffer, by way of derogation from the general principle of "substitution" between VAT and registration tax provided under Article 40 of Presidential Decree 131/1986, ad valorem registration tax under Article 1 of the Tariff, Part I of Presidential Decree 131/1986, at the rate of 2% if the transfer concerns residential properties (other than the ones classified as A1, A8 or A9) and subject to the

20 Making reference, among the others, to Decisions C-118/11, C-515/07 e C-334/10.

conditions provided under note 2-bis of Article 1 of the Tariff, Part I of Presidential Decree 131/1986 (tax benefits for owner-occupied dwellings) or at a rate of 9% in all other cases, subject to the minimum amount of EUR 1,000 under Article 10(2) of Legislative Decree 23/2011. Cadastral and mortgage taxes are applied in the lump-sum of EUR 50 each according to Article 10(3) of Legislative Decree 23/2011.

If, instead, the sale is subject to VAT, registration, mortgage and cadastral taxes are each applied in the lump-sum of EUR 200.

The general regime of application of ad valorem registration tax in the case of transfer of residential property is waived only in the case of contribution of a plurality of properties, predominantly let, under the regime provided under Article 8(1-bis) of Decree Law 351/2001. Under this regime, contributions to closed-end real estate funds of a plurality of properties predominantly let at the time of the contribution, are treated as contributions of a going concern or of a branch of business. Consequently, all the relevant provisions in the domain of VAT, registration tax, cadastral and mortgage taxes as applicable to the transfers of a going concerns become applicable[21]. In other words, for the purposes of VAT, the contribution of a plurality of properties predominantly let to closer than real estete funds are not treated as "supplies of goods" but transfers of going concern. Therefore, such contributions are outside the scope of VAT and are not subject to the relevant formalities. The same contributions are assimilated to the contribution of going concern's also for the purposes of registration, mortgage and cadastral taxes, so that all such taxes apply in the lump-sum of EUR200 each.

For these purposes, as confirmed by guidance issued by the Tax Authority, the notion of "property" must be deemed to be derived from the notion as applicable for the purposes of registration in the land registrar[22], as provided for the purposes of VAT. What matters is that a given good is classified as a "property" in the land registrar. The provision does not contemplate a particular condition in relation to the type of property, nor in relation to its features, so that it should be deemed applicable also the contribution of residential properties[23].

21 More in particular, Article 2(3)(b) of Presidential Decree 633/72 (VAT); Article 4(1)(a)(3) of the Tariff, Part I, of Presidential Decree 131/86; Article 10(2) and Article 4 of the Tariff of Legislative Decree 347 of 31 October 1990.

22 See Circular n. 22/E of 19 June 2006.

23 See Assonime Circular n. 10 of 1 March 2005 and Circular of the Notaries Association n. 2-2009/Tof 15 May 2009.

Starting from 2014, the special regime provided for purchases by property trading businesses has been repealed. This regime, although subject to very strict conditions and not frequently utilised, allowed at least in certain cases the mitigation of double transfer taxation in the case of purchase and resale of residential properties[24].

Hence, the existing taxation system is such to make often not economically viable the purchase of residential property by professional investors, the purchase by whom it is not aimed at direct use of the property but to the resale of the same (when transfer taxes are applied once again).

The indirect tax burden, on top of constituting a substantial hurdle to the growth in the Italian market of professional players specialised in the redevelopment of existing properties, is also drawing financial resources out of the same property redevelopment. Which appears somewhat inconsistent with the approach that lawmakers have always adopted in respect of the redevelopment of properties as a stimulus to the wider consumption; reference should be made to the several tax incentives for income tax purposes available to all those owners that perform qualifying works on the properties.

The significance of the redevelopment of existing properties has been confirmed by the legislation contained in the so-called "growth decree", which introduced a temporary measure (Article 7 of Decree Law 34 of 30 April 2019) aimed at mitigating the described issue. The measure provides for the application of lump-sum indirect taxes in the case of purchase of whole buildings by businesses active in the development and redevelopment. Despite the effort made by the lawmakers, such measure does not seem to constitute a sufficient stimulus to actually foster widespread renovation and redevelopment of the existing properties, probably because of the stringent conditions that the enjoyment of the benefit is subject to and because of the temporary nature of the measure.

For the above reasons, it is necessary to introduce permanent incentivising measures, able to remove the multiple application of registration tax at 9% and mortgage tax at 4% (2% where one the parties is a real estate invest-

24 Reference is made to the prior registration tax provision as per Article 1(6) of the Tariff, Part I, of Legislative Decree 131/86, providing for a significant reduction of registration tax to 1% in the case of sales of property exempt from VAT under Article 10(1)(8-*bis*) of Presidential Decree 633/72, made to business active in the resale of properties, provided that in the purchase deed the purchaser declared its intention to resell the relevant properties within three years from purchase. Such provision was applicable to the exempt sale of residential properties by VAT taxable persons. Mortgage and Cadastral taxes were instead applicable in the lump-sum of EUR 200 each.

ment fund) combined, possibly subject to the condition that the relevant properties are substantially redeveloped before being subsequently resold.

To this end, the tax benefit could be subject to the execution of significant renovation works (setting a minimum qualifying investment, possibly proportionate to the acquisition price of the property), without prejudice for the condition to resell the redeveloped property within a certain period from purchase. Moreover, the scope could be extended to all professional operators (businesses and investment funds), consistently with the equivalent treatment that businesses investment funds already enjoy for the purposes of indirect taxation on property investments. Moreover, considering the significant number of properties currently held by private individuals, such incentivising regime should be applicable regardless of whether the sellers are VAT taxable persons, thus being applicable also to sales by private individuals.

13.6. Closing remarks and reform proposals

Concrete experience confirms the growth, and the greater of growth of interest, of the professional exploitation of residential properties. Be it the investment by institutional investors – such as investment funds managed by Italian or foreign asset managers – typically investing in several properties to let them out and draw a stable flow of income; or the use of residential properties in the framework of the touristic/hospitality activity, the existing tax regime constitutes a heavy burden that significantly constrains the growth of such activities, undermining the relevant economic potential. The most significant burden is undoubtedly constituted by the substantial inability to deduct input VAT by persons, funds or businesses, other than the ones that have developed or redeveloped the properties, that, not being in a position to opt for the application of VAT on their output transactions – leases and sales – end up suffering significantly from the inability to deduct input VAT under the pro rata rule. As a matter of substance, such penalisation ends up being an unsurmountable hurdle, since the overall cost of the investment taking into account non-deductible VAT becomes substantially uneconomical.

This substantially prevents the actual development of the professional investment in residential property, which in other countries represents a successful asset class and a significant boost to the local economy. This, and the penalisation for direct tax purposes that, by preventing as a matter of substance the deduction of costs, results in the taxation of an "income" artificially inflated.

The concern of the lawmakers, aimed at preventing abuse, appears somewhat justifiable and deserves appropriate measures. That cannot however result in the outright penalisation of the economic exploitation of residential properties, treating it as a business only in the hands of developers and redevelopers.

It is now clear that it is necessary to overcome this dichotomy, overhauling the existing tax framework and allowing also businesses engaged in the management and lease of residential property the ability to calculate taxable income as any other business and to apply VAT on output transactions, as it happens for developers and redevelopers.

This reform can no longer be postponed, to allow also in Italy the development of new forms of exploitation of residential properties (such as co-living, well established in the Anglo-Saxon countries and Germany) and, more in general, to cope with increasing demand of quality residential properties available on the rental market. The intervention of institutional investors also in the residential property market is indeed essential to foster urban regeneration and renovation of the housing stock.

It therefore evident the need to amend the rules governing direct taxation (IRES) of the residential property letting activities and of the income arising from the same, by expressly providing that all such properties shall be treated as business assets also for tax purposes, allowing the calculation of the relevant income as a difference between actual revenues and actual costs and, more in general, by providing the applicability of all the provisions concerning business assets.

By recognising that such residential properties used by businesses to professionally perform a letting activity are to be treated as business assets would therefore require (a) the full deductibility of costs and expenses; (b) the ability to deduct also IMU, as currently provided for business assets or as an additional deduction, given the significant burden constituted by such tax for this type of business; (c) the deduction of depreciation allowances also for residential buildings used in a business framework (possibly at a higher rate than provided for commercial properties given the shorter useful life of residential properties).

Should the concern remain to prevent the abuse of corporate vehicles to invest in private assets, subjective or objective conditions could be provided to allow the recognition of residential properties as business assets (e.g. based on the professional nature of the members or their number, the actual size and complexity of the activity in terms of stock revenues, the arm's-length nature of the tenants, etc.).

Finally, in relation to VAT, it is worth emphasising as the development of an institutional market of residential lettings cannot exist without allowing the option to apply VAT on leases and runs of residential properties by entities and collective investment undertakings even if the same did not develop or redevelop the relevant property. Indeed, the current exemption regime for VAT purposes results in a significant penalisation, as it implies the inability to deduct input VAT on purchases, thus undermining their financial returns. The ability to opt into the application of VAT might be limited to those entities that have Italy perform as their sole or principal business the letting of real estate[25]. Similarly, the absolute prohibition to deduct input VAT currently provided under Article 19-*bis*.1 (1)(i) of Presidential Decree 633/72 should be abolished, thus restating the full neutrality of VAT.

An important opportunity for the implementation of law changes along the lines set out above is offered by the delegation law for the tax reform, which provides for an intervention aimed at "revising the provisions governing [VAT] exempt transactions, also identifying the transactions for which taxpayers may opt for taxability, in compliance with the criteria set forth by the European Union legislation" (Article 7, paragraph 1, letter b) of Law No. 111/2023)[26] and also provides for an intervention aimed at "harmonising the criteria for the deductibility of the tax on buildings with

25 Also providing the applicability of the reduced 10% rate as per n. 127-duodevicies) of Table A, Part III, of Presidential Decree 633/72.

26 The report reads as follows: "The delegation criterion referred to in paragraph 1(b) provides for a review of the provisions governing exempt transactions, also identifying possible cases in which to allow taxpayers to opt for taxability. The revision, which will necessarily have to be in line with European Union legislation as interpreted by the Court of Justice, will make it possible to better define exempt hypotheses, such as, for example, those in the real estate sector. This sector, in particular, is currently characterised by complex legislation that distinguishes the applicable tax regime according to the instrumental or residential nature of the real estate and the type of operators. The tax regime provides, as a general rule for the supply and leasing of buildings, for VAT exemption with numerous exceptions. For example, taxability is compulsory for the supply of residential and business premises carried out within five years of the completion of construction or renovation work by the companies that have carried out the work, and optionally for the supply of residential premises carried out by the same companies after five years, as well as for the supply of business premises by anyone. The option for taxability is also granted, in the field of leases, to undertakings that have constructed or renovated residential buildings or to undertakings that use the buildings for social housing, as well as in any case to undertakings that lease instrumental buildings. In implementing the delegation criterion, it would therefore be possible to carry out a thorough review of the matter, making it more coherent and organic".

those provided for by European Union legislation" (Article 7, paragraph 1(d)(2) of Law No. 111/2023)[27].

It is important to point out that the report accompanying the delegation law explicitly refers to the possibility of intervening in order to revise the regulations governing the real estate sector.

With reference to the identification of cases in which the taxable person may opt for taxability in accordance with the criteria set forth in the European Union legislation, it should be noted that Article 137, paragraph 1 of Directive no. 2006/112/EC, entitled "Right of option", provides that Member States may grant their taxable persons the right to opt for taxation of "the supply of buildings or parts thereof and of the land on which they stand" carried out "before first occupation" (pursuant to Article 12(1)(a)) and "the leasing or letting of immovable property". The option granted by the Directive to the Member States makes no distinction between residential and business properties.

The principles expressed by the Directive make room for the possible extension of the right of option to apply VAT in relation to both the sale and leasing of residential properties which have not been constructed and have not been the object of urban restructuring, as well as of restoration and renovation works as referred to in Article 3, paragraph 1, letters c), d) and f), of Presidential Decree No. 380/2001 carried by the seller or the lessor.

Having regard to the regulation of VAT deductions, the possible revision of the regime of taxability by option also for the sales and leases of residential properties could make it possible to overcome the current limitations to the deduction of input VAT set forth in Article 19-bis1, paragraph 1, letter i) of Presidential Decree No. 633/72 and linked to the mere cadastral classification of the property, thus referring to the general provisions on the exercise of the right to deduct VAT, thus removing the main obstacle to the professionalisation of the investment in residential property.

27 The report reads as follows: "The second amendment to the rules on deduction (number 2), pursuing the same purpose highlighted above, specifically concerns the real estate sector in which the exercise of the deduction is currently excluded (Article 19(1)(i) of Presidential Decree No 633 of 1972) in relation to the VAT due on the purchase, rental, management and renovation of residential buildings for businesses other than those engaged exclusively or predominantly in construction in the residential sector. This objective non-deductibility must therefore be reviewed in order to make the exercise of the deduction in this sector too consistent with the nature of the transaction for which the goods or services purchased are used".

14.
Main tax incentives for the building sector

by L. Dal Cerro, L. Di Nunzio, M. Milanese, F. Squarcia

14.1. Introduction and history of incentives

Tax incentives for buildings and energy efficiency, originally conceived as emergency and temporary measures, have over the last decade become structural elements to support the construction sector.

The following is a non-exhaustive list of the main categories of works:

a. works aimed at recovering the building heritage and improving the energy efficiency of the buildings under Article 16-*bis* of the Consolidated Income Tax Act or TUIR (this macro-category also includes deductions related to the purchase of renovated buildings or the purchase of newly built garages and appurtenant parking spaces);
b. works aimed at the energy requalification of buildings ("*ecobonus*") pursuant to Article 14 of Law Decree 63/2013;
c. anti-seismic works and works aimed at improving the static safety of buildings (the "*sismabonus*") under Article 16, paragraph 1-*bis* of Law Decree No. 63/2013 (a macro-category which also includes deductions related to the purchase of anti-seismic buildings);
d. works included within the scope of the "*superbonus*" introduced by Article 119 of Law Decree No. 34/2020 (the "*Decreto Rilancio*").

The above-mentioned bonus first appeared in 1998, following the introduction of tax deductions for building renovation. In particular, Article 1 of Law 449 of 27 December 1997 introduced a 41% deduction for expenses incurred in 1998. Subsequently, the rate was reduced to 36% for expenses incurred in 2000 and 2001.

The deduction was extended from time to time until 2011 when Law Decree No. 201 of 6 December 2011, converted into Law No. 214 of 22 December 2011, added Article 16-*bis* of TUIR (Deduction of expenses for works to restore the building heritage and energy requalification of buildings), making such deduction structural.

Over the last few years, the legislator has extended and modified its structural elements, such as rates, beneficiaries and eligible works.

Period	Normative reference	Rate
January 1998 - December 1999	Law No. 449/1997	41%
January 2000 - December 2001	Law No. 488/1999, Law No. 388/2000	36%
January 2002 - December 2002	Law No. 448/2001	36%
January 2003 - December 2003	Law No. 289/2002	36%
January 2004 - December 2005	Law No. 47/2004	36%
January 2006 - September 2006	Law No. 266/2005	41%
October 2006 - June 2012	Law Decree No. 223/2006 (converted into Law No. 248/2006) Law No. 296/2006 Law No. 244/2007 Law No. 203/2008 Law No. 191/2009 Law No. 220/2010 Law Decree No. 201/2011 (converted into Law No. 214/2011)	36%
June 2012 - December 2016	Law Decree No. 83/2012 (converted into Law No. 134/2012) Law No. 147/2013, Law No. 190/2014, Law No. 208/2015 Law Decree No. 63 of 2013 converted by Law No. 90/2013	50%
From January 2017	Law No. 232/2016, Art. 1, paragraphs 2, letter (c), and 3	variable rates

The tax relief for the energy requalification of buildings is a measure introduced by 2007 Finance Act (Law No. 296/2006, Article 1, paragraphs 344 to 349), providing for a tax deduction, both for IRPEF and IRES purposes, equal to the expenses incurred and calculated on individual works within a maximum limit. The deduction, which originally amounted to 55% of the expenditure incurred, has been repeatedly modified over the years.

Period	Normative reference	Rate
January 2007 - December 2012	Law No. 296/2006	55%
January 2013 - December 2016	Law Decree No. 63/2012, Law No 90 of 2013	65%
From January 2017	Law No. 232/2016, Art. 1, paragraph 2, letter (a)	variable rates

It is worth mentioning the relief introduced by Article 16 of Law Decree No. 63 of 2013 (the *sismabonus*) with respect to works in relation to anti-seismic measures on buildings located in high seismic hazard zones (zones 1 and 2) identified by the Order of the President of the Council No. 3274 of 20 March 2003. The legislation, subsequently amended, provided for a 65% deduction for expenses incurred from 4 August 2013 to 31 December 2013.

Decreto Rilancio increased to 110% the deduction rate for expenses incurred for specific energy efficiency and seismic risk-reduction measures (*superbonus*). *Decreto Rilancio* introduced the possibility of transferring the relief to third parties, an option already existing in the legal system but applicable only to very limited types of works[1]. In fact, under Article 121 of Law Decree 34/2020, the beneficiary may opt not only for the invoice discount that is granted by the suppliers of goods or services which accept a "bonus" or "credit" as a "payment in kind" from the beneficiary of the works, but also for the pure transfer against cash of the credit corresponding to the incentive.

The further mechanism of circulation of the credits thus formed, extended also to the other "minor" *bonuses*, has represented a turning point in the success of these *bonuses*, creating a real "market of credits" in which the main financial operators of the country are involved in supporting the real estate sector. Since the introduction of the *superbonus*, several amendments to the law have tried to balance competing interests such as the need for legality, the fight against fraud, the certainty of transactions and preservation of the secondary market for the incentive mechanism, as described in more detail in paragraph 14.5 below.

The *bonuses* listed above, which were created as incentives to individuals to spend on quality works towards a general improvement in the real estate stock, have recently taken on even more strategic importance under two interrelated profiles: on one hand, the implementation of the National Recovery and Resilience Plan (PNRR) and, on the other, the ambitious plan for "decarbonisation" by 2050 approved by the United Nations Conference (COP26 Climate Change Conference) in Glasgow, which will require the

1 Article 16, paragraph 1-*septies*, of Law Decree No. 63/2013, which governs demolition and reconstruction works in seismic areas, states that: "*The beneficiaries referred to in the previous paragraph may opt, instead of the deduction, for the transfer of the corresponding credit to the companies that carried out the works or to other private entities, with the option of subsequent transfers of the credit. Transfer to credit institutions and financial intermediaries is not allowed.*"

construction sector to decarbonise over the next thirty years at a rate three times faster than the previous thirty years[2].

The PNRR is part of the Next Generation EU (NGEU) programme: the €672.5 billion package, roughly half of which is made up of grants (€312.5 billion) and the rest low-interest loans (€360 billion), was agreed by the European Union in response to the pandemic crisis[3].

For Italy, the programme envisages investments of €191.5 billion, financed through the Recovery and Resilience Facility (RRF), the main instrument of the NGEU, and to a lesser extent through the Supplementary Fund, established by Law Decree No. 59 of 6 May 2021, to be drawn from the multi-year budget variance approved by the Council of Ministers on 15 April 2021.

The total investment figure expected from the implementation of the programme is €222.1 billion, 40% of which is earmarked for climate change investments[4].

One of the objectives of the plan is the renovation of public and private buildings to improve their energy efficiency through thermal insulation, the replacement of heating and cooling systems and self-generation of electricity, as well as through energy efficiency monitoring by users.

The goal set by the EU is to double the efficiency rate of buildings by 2025. This path began with the introduction of the *superbonus*, a measure that will be discusses in a dedicated paragraph.

It should be pointed out that the objectives of the PNRR are not limited to residential construction, but also to commercial construction, as well as the promotion of infrastructure improvements and ecological transition.

Among the "missions" identified in the PNRR, the "green revolution and ecological transition" (the so-called "second mission" or M2), which includes measures to improve the efficiency of public and private real estate, is of particular interest to the construction sector. This mission includes:

- the implementation of a programme to improve the efficiency and safety of public building stock;
- the revitalisation of the building industry in terms of environmental sustainability and earthquake-proof performance.

2 Maurizio Carmignani, *PNRR, National Recovery and Resilience Plan, what it is and what's new*.

3 See the explanatory document of the National Recovery and Resilience Plan published by the Ministry of Economy and Finance on 25 May 2021.

4 See the illustrative document published by the Ministry of Economy and Finance referred to above.

With regard to "energy efficiency", in the framework outlined by the Ministerial Decree of 6 August 2021, reference should be made to:

- M2C3 (Mission 2 Component 3) "*Ecobonus* and *sismabonus* up to 110% for energy efficiency and safety of buildings" (M2C3-1), which provides for the aforementioned extension of the *superbonus*, due to Investment 2.1 (Enhancement of *ecobonus* and *sismabonus for* energy efficiency and safety of buildings);
- M2C3-4 on "Simplification and acceleration of procedures for energy efficiency measures"; and
- M2C3-2, which sets the objective "Restructuring *superbonus* and *sismabonus*" due to Investment 2.1 (Enhancement of *ecobonus* and *sismabonus* for energy efficiency and safety of buildings).

Over the past two years, the various building *bonuses* have played an important role in relaunching the economy and the entire construction industry.

It is clear that the construction sector plays a central role in national economic growth. Qualified building works – capable of involving an articulated chain of specialised operators, from the ESCOs[5] to traditional building companies, from institutional investors to real estate companies - have provided a response to the difficulties of an economic situation which began before the pandemic and which saw Italy relegated to last position in Europe for economic growth.

The strategic role of *bonuses* in the building sector has emerged not just in quantitative terms but also through its ambitious qualitative objectives. The *bonuses* have, in fact, led to an improvement in the country's housing stock, both in terms of the structural strength of buildings and their energy efficiency.

Following some striking episodes of fraud that have recently emerged, further safeguards have been introduced to protect the certainty of credits and legality, such as (see paragraph 13.5 below) the new limits on the circulation of bonuses and a review of the rules governing the liability of assignees. In relation to the liability of assignees, a joint liability has been claimed by the tax authorities, which adopted a rather aggressive approach towards taxpayers triggering very negative effects on the certainty of trades and the expectations of market operators.

5 In general terms, the acronym refers to *energy* service companies, dedicated to the supply of energy services, such as energy efficiency improvements, which assume the risk of the initiative thereby freeing the end-customer from any organisational and investment burden.

If the changes to the liability of the assignees have had the effect of temporarily removing from the system the large operators, today the credit circulation system is considered to be more mature and allows operators to purchase under conditions of greater security and legal certainties than before.

Pursuant to Law Decree No. 11 of 2023, as from 17 February 2023 the exercise of the options of invoice discount and assignment of receivables is no longer permitted in an attempt to tackle the numerous frauds and to control the public expenditures. Law Decree No. 11 also introduced a grandfathering regime for outstanding works, which can still originate transferable *bonuses*, as described in paragraph 14.5 below.

The success of the *bonuses* has so far been largely linked to the possibility of the credits having a secondary market, which has allowed even small banks that are for this very reason closer to the territory, to effectively finance works. Therefore, risk is to reduce significantly the effectiveness of *bonuses* and "displacing" operators, causing them an unexpected liquidity crisis.

While the stock of receivables still outstanding is being allocated within the limits permitted by law, it is time to embrace a new course that should pave the way for more contemporary measures for the energy transformation of the real estate sector. The new measures should be designed to support more ambitious environmental requirements and reconcile them with the control of public expenditures.

In this respect, on 17 March 2023, the European Parliament approved the so-called "green houses" directive (Energy Performance of Buildings Directive - EPBD), which aims to reduce: (i) the average primary energy consumption of the entire residential building stock by, respectively, 16% by 2030 and 20 - 22% by 2035; and (ii) the average primary energy consumption of non-residential buildings by, respectively, 16% by 2030 and 26% by 2033.

Specifically, the Green Homes Directive provides for the following measures:

- phasing out of fossil-fuelled boilers by 2040. In order to facilitate the achievement of this objective, Member States will be able to make subsidies available to taxpayers from 1 January 2025;
- obligation to install appropriate solar systems: (i) by 31 December 2026, on all new public and non-residential buildings with a useful floor area over 250 m2; (ii) by 31 December 2027, on all existing public buildings with a useful floor area; (ii) by 31 December 2027, on all existing public build-

ings with a usable floor area greater than 2,000 m2; (iii) by 31 December 2028, on all existing public buildings with a useable floor area greater than 750 m2; (iv) by 31 December 2030, on all existing public buildings with a useable floor area greater than 250 m2; (v) by 2027, on all existing non-residential buildings with a usable floor area greater than 500 m2 where the building undergoes an intervention requiring a major administrative permit; and (vi) by 30 December 2029, on all new residential buildings and all new covered car parks physically adjacent to buildings;
- obligation for new residential buildings to have zero emissions from fossil fuels, as of 1 January 2028 for publicly owned buildings, and as of 1 January 2030 for all other new buildings;
- obligation for new buildings with more than 5 parking spaces to install at least one charging point for every 5.

In order to ensure that these targets are met, Member States are allowed to provide for possible incentives, hopefully including tax incentives.

The following analysis will help sheding light on the virtuous aspects of the experience gained so far in the field of building bonuses and on those externalities which will be important to keep in mind when designing the next set of incentives.

14.2. Tax incentives applicable to corporate and other taxpayers

Taxpayers, residents or non-residents in the territory of the State who incur expenses for the subsidised works[6] are eligible to benefit from the tax incentives in question. In addition to the owners of the buildings subject to the work, the holders of real or personal rights of enjoyment over such buildings are also included. In particular, the following categories are eligible for the *bonuses*:

a. owners or bare owners;
b. holders of *in rem* rights (usufruct, use and/or surface);
c. tenants or lessees (also in the context of a free lease (*comodato*) arrangement), provided that they have obtained the consent of the landlord and that the rental or lessees' contracts are duly registered.

The following categories of individuals are entitled to the deduction, provided that they incur the expenses and that such expenses are adequately documented with specific wire transfers and relevant invoices:

6 See Revenue Circular of 24 February 1998, No. 57, paragraph 2.

a. a cohabiting family member of the owner or holder of the property in question (spouse, relatives up to the third degree and relatives-in-law up to the second degree);
b. a separated spouse who is the assignee of the property in the name of the other spouse;
c. a Partner in a civil union[7];
d. a cohabiting partner who is not the owner of the property in question nor the holder of a loan agreement, for expenses incurred after 1 January 2016[8].

In view of the special features of the regulations applicable to each of the building *bonuses*, we refer you to the below paragraphs for more detailed information.

Individuals who "exclusively" realise incomes subject to substitute tax or separate taxation are not eligible to benefit from the deduction[9]. According to Circular No. 2/E of 14 February 2020, paragraph 1, such persons would not be able to benefit from the deduction from gross taxation as they are subject to a flat tax in specific cases under which they have no other ordinary taxable income (except as clarified in paragraph 13.3).

In terms of beneficiaries, in the past, building works incentives were aimed at individuals and reserved for residential properties. Indeed, Article 1 of Law No. 449 of 27 December 1997, concerning measures for the recovery of building stock, introduced in 1998 a deduction for expenses relating to measures for the recovery of building stock, the use of which was, and still is, expressly limited to taxpayers subject to income tax as individuals, whether or not resident in Italy[10].

As from 2002, Law No. 448 of 28 December 2001 (the 2002 Finance Act) extended the tax incentive provided for in Article 1 of Law No. 449 of 27 December 1997, as amended, to restoration and renovation works and building renovation involving entire buildings, carried out by construction or renovation firms and by building cooperatives, provided that they subsequently

7 Law No. 76/2016, equates the legal bond arising from marriage with that arising from civil unions in order to guarantee the protection of rights arising from civil unions between persons of the same sex.

8 See Revenue Agency Resolution No. 64/E of 28 July 2016.

9 The deduction in question is not available to persons who are "exclusively" holders of income deriving from business activities or from the exercise of arts or professions who have joined the flat-rate scheme under Article 1, paragraphs 54-89, of Law No. 190 of 23 December 2014.

10

sold or assigned the property. Even in that case, however, the deduction was not intended for the building firm, but was attributed to the subsequent purchaser or assignee of the property unit in the form of an IRPEF deduction.

Law No. 296 of 27 December 2006 (the 2007 Finance Act) introduced a deduction (*ecobonus*) for energy requalification works on existing buildings, parts of existing buildings and existing property units of any cadastral category, including rural buildings, and for other energy qualification works provided for therein (see Article 1 of the Ministerial Decree of 19 February 2007), the application of which was extended to entities and persons under Article 5 of the TUIR who do not have a business income, as well as to individuals who do have a business income (see Circular No. 36/E of 2007).

Article 2 of the Ministerial Decree of 19 February 2007 also specified how, in the event that the works referred to in the same Article 2, paragraph 1 were carried out on leased property, the deduction due to the lessee was calculated on the cost incurred by the relevant lessor.

A similar path was followed for the so-called *sismabonus,* which, like the *ecobonus*, was extended to companies in relation to buildings they "owned or held".

Notwithstanding some law provisions introduced at the time in favour of the industrial sector and commercial buildings, at first the Italian Revenue Agency decided to adopt a restrictive interpretation of the *ecobonus* rules vis-à-vis IRES subjects, by excluding the application of relief to properties accounted as goods. Resolution No. 303/E of 15 July 2008 clarified thatthe relief could not apply to companies in the building sector, in the light of the clarifications contained in the technical report accompanying the 2007 Finance Act and a systematic interpretation of the law, according to which the deduction was intended for the users of the goods and not for those who traded in them. The Agency made reference to the provisions of the amended renovation *bonus*, which, as stated above, was extended to construction or renovation companies and building cooperatives for buildings sold by them to private individuals only, confirming that, in the absence of an explicit provision for the *ecobonus*, the possibility for construction companies to access such incentive should be considered excluded.

On the basis of similar arguments, the benefit was also excluded for a company engaged in purely rental activities, in relation to works carried out on buildings used for residential rental purposes, since they constituted "*the object of the activity carried out and not instrumental assets*" (Resolution No. 340/E of 1 August 2008).

The position expressed in Resolutions Nos. 303 and 340 gave rise to a huge volume of litigations before the tax courts as a consequence of the challenge of tax authorities of the tax deductions benefitted from the real estate companies for energy requalification works carried out on buildings rented to third parties, or intended for sale, qualifiableas goods, which were resolved in favour of the taxpayers.

The Supreme Court (see Judgments Nos. 19815 and 19816 of 23 July 2019; Nos. 29162 and 29164 of 12 November 2019; No. 29163 of 12 November 2019) acknowledged that the *ecobonus* legal framework did not make any distinction between the various categories of properties relevant for income tax purposes[11]. Such classifications were only part of the accounting provisions and reference to them was made only when expressly provided by the law.

Also noted that the Supreme Court in the *ecobonus* provisions on financial leases (see Article 2, paragraph 2, of the Ministerial Decree of 19 February 2007), "*the deduction is attributed to the user*"/lessee rather than the lessor. In the absence of an equivalent provision on operating leases, the tax deduction, in the Court's opinion, would be due to the landlord/lessor and not to the tenant "*provided, of course, that the amounts in question are incurred by the landlord and not contractually transferred to the tenant*" (Supreme Court Judgment No. 19815/2019).

Consistently with the aforementioned decisions, Resolution No. 34/E of 2020 clarified that, contrary to what was indicated in Resolutions Nos. 303 and 340 above, the relief is available to entrepreneurs/companies (i.e. holders of business income) who carry out the works on their properties in the context of a business activity and who incur the related costs, regardless of the qualification of such properties for income tax purposes.

The extensive interpretation led the authorities to conclude in favour of the availability of the *bonuses* to construction companies on their properties being accounted as inventories. The same positive conclusion was expressed in favour of real estate management companies leasing their properties to third parties on an ordinary basis.

The same recognition is also made with respect to anti-seismic works carried out on buildings by business income taxpayers, for the purposes of deductions under Article 16, paragraph 1-*bis* et seq. of Law Decree No. 63 of 4 June 2013 (*sismabonus*).

11 *Immobili strumentali*, *immobili merce* and *immobili patrimonio*.

In another context, i.e. the recently expired "*facade bonus*", pursuant to Article 1, paragraph 219, of Law No. 160 of 27 December 2019, Circular No. 2/E of 14 February 2020, clarified that, again from a subjective point of view, all taxpayers resident or non-resident in the territory of the State, regardless of the type of income they accrue, who incur expenses for the execution of the subsidised works and who own or hold the property based on a suitable title, are entitled to benefit from such incentive[12].

The recent Answer 550/2022 of 7 November 2022 moved from this conclusion to recognise the availability of the *sismabonus* and the facade *bonus* in favour of a foreign real estate holding company which is subject to corporate income tax in its country of residence, although it did not own any income sourced in Italy save for the income from the property being refurbished (*reddito fondiario*).

Answer 550/2022 concluded in favour of the non-Italian company's right to use the bonus as, although generating taxable income is a pre-condition to use the bonus in the form of a tax deduction, it is not the only form of use of such *bonus*. Precedents of the Revenue Agency admitted to benefit from the bonus also taxpayers who, benefiting from special tax regimes, were not able to use the bonus as a deduction against their gross tax liability in their annual tax return. Those who cannot benefit from the deduction due to the absence of off-settable gross tax liability can peacefully access the alternative methods of using such benefit, i.e. by way of assignment or invoice discount.

Persons incurring expenses for qualifying works for the purposes of, *inter alia*, the *ecobonus*, the *sismabonus* and the facade bonus, as defined above, may, instead of the direct use of the relevant deduction in the annual tax return, opt for a contribution in the form of a discount on the consideration due up to a maximum amount equal to the consideration itself, transferred as a payment in kind to the supplier who carried out the works, and recovered by that supplier in the form of a tax credit or, alternatively, through a subsequent transfer of such tax credit to third parties. A further mechanism to monetise the incentive would be the direct transfer by the beneficiary of such tax credit to third parties.

12 Hence, individuals, including those using the properties in the course of a professional activity, public and private entities that do not carry out commercial activities, simple partnerships, associations between professionals and individuals who earn business income (including partnerships, corporations and entities subject to IRES) may qualify for the purposes of these *bonuses*.

Answer 550/2022 therefore concluded by confirming that (save for the Superbonus[13], which has specific limitations and is reserved to individuals who do not carry out business activities) the benefit was available to an owner of real estate units in Italy, even if not the holder of income (other than income from land or properties (*reddito fondiario*)). The absence of a source of income, although preventing the relevant taxpayer from offsetting the bonus directly in the tax return, still allowed the taxpayer the possibility to access alternative forms of use of such bonus, i.e. assignment or invoice discount.

Having clarified that the *bonuses* (except for the *bonus* on building renovation) may also be enjoyed by entrepreneurs and enterprises, it is interesting to note that Answer No. 550/2022 was provided on the basis of the fact that the foreign real estate holding company could not be assimilated into a real estate investment fund. The Revenue Agency took in fact a rather restrictive position in relation to investment undertakings and similar entities that are exempt from corporate income taxes.

The position seems now consolidated and also the very recent Answer no. 138/2023 was consistent with this principle. The relevant ruling request was filed by a partnership which was seeking for clarifications about the availability of *seismic bonus*, *ecobonus* and facade *bonus* arising from renovation works. Answer 138/2023 confirmed the partnership's entitlement to the *bonuses*, clarifying that the partners (as opposed to the partnership itself) were entitled to benefit from the relevant tax deduction. A partner was however a real estate fund and, according to the Revenue Agency, was prevented from using the bonus directly. For the fund, the possibility of indirect use via invoice discount or credit assignment is also excluded, unless it is the partnership itself to transfer the credit to third parties.

The following paragraph will be devoted to the analysis of this restrictive approach towards institutional operators such as investment funds.

13 With regard to the *Superbonus*, paragraph 9 of Article 119 of Law Decree 34/2020 identifies the categories of taxpayers eligible for this deduction. The deduction is mainly aimed at individuals and, as far as business income taxpayers are concerned, they are eligible only in relation to works on common parts of condominium buildings. For the analysis, see paragraph 13.12 on the Superbonus.

14.3. Applicability of these tax incentives to special categories of subjects (real estate funds, real estate securitisation companies ex art. 7.2 L. 130/1999, support vehicles ex art. 7.1 L. 130/1999, pension funds, SIIQ)

In the preceding paragraph, we identified the tax reliefs applicable to persons with business income, having already noted that the legislator has left a certain lack of specificity in the definition, by not indicating in the *ad hoc* legislation specific subjective requirements to be met in order to benefit from the *bonus*.

Notably, having regard to the literal content of the legislation on *ecobonus*[14] and *bonus facades*[15], as well as with reference to that on the *seismic bonus*[16], there are no specific subjective requirements that must be met by those who intend to take advantage of the benefits at stake. But even with regard to the relief for *overcoming architectural barriers*[17] it is easy to see how the legislator has entrusted the relief to broad terms - "[...] *taxpayers are entitled to a deduction from gross tax* [...]" -, thereby including all taxpayers, whether resident or not.

In the same direction – and correctly so – are some of the guidelines released by the Revenue Agency[18], which confirm the possibility of benefitting

14 See Article 14 of Law Decree No. 63 of 4 June 2013, converted into Law No. 90 of 3 August 2013, the first paragraph of which refers to Article 1, paragraph 48 of Law No. 220 of 13 December 2010, which in turn refers to Article 1, paragraphs 344 to 347 of Law No. 296 of 27 December 2006. It should also be noted that Article 2, entitled "*Subjects eligible for the deduction*", Ministerial Decree of 19 February 2007, identifies the following beneficiaries of the *ecobonus*: "*1. 1. [...] the deduction from income tax is due: a) to individuals, entities and persons under Article 5 of the TUIR, approved by Presidential Decree No 917 of 22 December 1986, who do not have business income, [...]; b) to persons who have business income [...].*" On this point, the Court of Cassation, in its Judgment No. 29164 of 12 November 2019, also had occasion to clarify how the rules on the subject of *ecobonus* "*do not place any limitation, either objective (with reference to the cadastral categories of buildings) or subjective (recognising the* bonus *to "individuals", "not holders of business income" and holders of "business income", obviously including companies), to the generalised operability of the tax deduction*".

15 Article. 1, paragraph 219, Law 27 December 2019, No. 160.

16 Article. 16, (1-*bis* to 1-*septies*) Law Decree No. 63 of 4 June 2013, converted into Law No. 90 of 3 August 2013.

17 Article. 119-*ter*, D.L. 19 May 2020, No. 34, converted into Law No. 77 of 17 July 2020.

18 Reference is made to Circular No. 36/E, par. 1 of 31 May 2007 (which is still valid as it is referred to in the more recent Circular No. 19/E of 8 July 2020, as regards the *ecobonus*, and Circular No. 2/E, par. 1 of 14 February 2020, as regards the facades *bonus*.

from the above-mentioned *bonuses* for persons resident or not in the territory of the State, holders of business income or other income.

If this is the normative and interpretative context of reference, the same fate has not been suffered by certain types of entities that typically (or rather by their very conformation) invest in the *real estate* sector and that, at a systemic level, constitute the main players to whom reference should be made. This is the case in certain positions taken by the Revenue Agency[19] on the basis of which eligibility for the *ecobonus* and the *facade bonus* has been denied to certain types of entities which, due to their tax regime, are IRES subjects but do not pay the tax.

These are real estate investment funds[20], real estate SICAFs[21], real estate securitisation special purpose vehicles "7.2"[22], securitisation special purpose vehicles "7.1"[23] and SIIQs[24].

In particular, Rulings No. 372 of 25 May 2021 and No. 415 of 16 June 2021 denied the applicability of the *ecobonus* and the *facade bonus* respectively (i) to a SICAF and (ii) to a support vehicle company *pursuant to* Article 7.1. Law 130/1999 ("REOCo")[25]. Moreover, in unpublished responses, the Revenue Agency reached the same conclusion with express reference to real estate investment funds and SIIQs.

In the cases analysed in Rulings Nos. 372 and 415, the companies asked the Agency to confirm that they could benefit from such *bonuses* by transferring the tax credit to third parties pursuant to Article 121 of Law Decree No. 34/2020, since they could not benefit from the deduction due to the absence of gross income tax from which such deduction could be made. It should be recalled that while for SICAFs, like real estate investment funds, the absence of gross income tax is due to the fact that this type of entity is itself exempt from IRES[26] pursuant to Article 9, Legislative Decree No. 44 of 4 March 2014, which extends the exemption regime from that provided for funds pursuant to Article 6, Legislative Decree No. 351/2001, for REOCos

19 Answers to questionnaire No 372 of 25 May 2021 and No 415 of 16 June 2021.

20 Article. 6, D.L. 25 settembre 2001 No. 351, converted into Law No. 410 of 23 November 2001.

21 Article. 9, Legislative Decree No. 44 of 4 March 2014.

22 Article. 7.2., L. 30 April 1999, No. 130.

23 Article. 7.1., L. 30 April 1999, No. 130.

24 Article. 1, paragraphs 119 to 141, L. 27 December 2006, No. 296.

25 See chapter [-], paragraph. [-], on REOCo.

26 For the sake of completeness, SICAFs are not exempt from IRAP, unlike real estate funds.

the deduction of gross income tax is due to the fact that this type of entity is itself exempt from IRES. In the case of a REOCo, on the other hand, this absence comes from a factual circumstance, i.e. from the activity it carries out as a vehicle company for securitisation transactions pursuant to Law 130/1999, as reiterated in Answer No. 415 of 16 June 2021.

In both Rulings (Nos. 372 and 415), the Revenue Agency concludes that the aforementioned *bonuses* are not available because real estate SICAFs and REOCos do not have taxable income, the former due to legislation, the latter *de facto*, due to lack of the possibility of deducting tax through tax credits accrued as a result of the subsidised expenses. In the case of a REOCo, that conclusion applies irrespective of the fact that a paradigm of the company may, at the end of its business life, at least in theory, have a taxable income, once all the creditors of the REOCo's wealth have been satisfied.

In support of its claim, the Revenue Agency recalls Circular 24/E, paragraph 1.2 of 8 August 2020, on the subject of the *110% superbonus* (and regulations therefore similar to those discussed herein) where it stated that the benefit is not available to OICRs (real estate or securities) because "*although they are subject to corporate income tax (IRES) pursuant to Article 73, paragraph 1, letter c), of the TUIR, they are not subject to income tax and regional tax on productive activities*".

A similar approach has been adopted by the Revenue Agency with respect to the case of SIIQs, which, similarly, are the beneficiaries of a special tax regime consisting in the exemption of rental income. It should be noted that, in the Revenue Agency's opinion, the fact that the SIIQ per se is the beneficiary of a regime which only partially provides for exemption from IRES and IRAP, i.e. on income from the rental and transfer of real estate, does not change the conclusion. However, according to the Revenue Agency, the portion of taxable income would in any event be marginal in relation to overall income.

The denial to the SIIQs of building *bonus* by the Revenue Agency appears to be wrong for the following four reasons:

i. First, the literal interpretation of the rules law which, as seen above, lacks any subjective requirements does not exclude the entities under discussion from the benefits. In particular, one shall observe that the wording used in the rules on the incentives deriving from *ecobonus*, *bonus facades* and *sismabonus* – where there is no such limitation based – and that used by the legislator for the *superbonus*, where there is a list of eligible entities (*i.e.* condominium, individuals outside the business, IACP, housing cooperatives with undivided ownership, etc.[27]). The list of the type of beneficiary for the *superbonus* does not include UCITS and REOCos and, in general, companies. From literal interpretation it follows that the conclusion reached in the two Answers Nos. 372 and 415 to Circular No. 24/E of 2020 is inaccurate.

ii. Secondly, adopting a teleological interpretation of the *bonus* rules in question, one would have to conclude that the legislator's aim is not so much to facilitate certain categories of persons (and not others), but, on the contrary, to protect a public interest, by stimulating the requalification of the building stock by means of renovation, conservative restoration or by improving energy efficiency. Therefore, granting the benefit only to certain persons and denying it to others does not appear to be compatible with the purpose of the rules in question.

iii. Thirdly, the Revenue Agency argues that the *bonuses* are not available by relying on the fact that such entities (funds, SICAFs, REOCos and SIIQs) are not subject to income taxes. Therefore, ontologically, they would not have tax liability from which to deduct the tax credit granted to them. However, this approach appears simplistic, since the deduction of the credit from the "gross tax" is only one of the various ways of using the incentive, in addition to the transfer of the same credit to third parties and which will be discussed in greater detail below. There is nothing, therefore, to suggest that the deductibility of the credit from gross tax should take precedence in establishing whether or not a person may benefit from the *bonus* in other ways, also provided for by law. As a corollary to that third argument, it should be noted that the legislation in question does not make the transfer of the credit conditional on the actual existence of gross tax from which the *bonus* may be deducted. On the contrary, the transfer of the credit was introduced precisely in order to allow the *bonus* to be used also by persons who, in the relevant tax period, have no gross tax for deduction (whatever the reason for the absence of gross tax). And the argument that the entities in question (funds, SICAFs, REOCos and SIIQs) do not accrue "gross taxes", against which the deduction of the *bonus* can be offset, seems to have been overlooked by the Agency in relation to other entities, thus leading to contradictory results. In particular: (*i)* Answer No. 561 of 26 August 2021 acknowledged the possibility for a pension fund to benefit from the

27 Article. 119, Law Decree No. 34 of 19 May 2020, converted into Law No. 77 of 17 July 2020. See also Circular No. 24/E of 8 August 2020, paragraph 1.

bonus through the alternative mechanisms of the transfer of the tax credit or the discount on the consideration pursuant to Article 121 of Law Decree 34/2020; (*ii*) the same *favour* was granted by the Agency in the case of persons who exclusively own income subject to separate taxation or to substitute tax (e.g., the "taxpayers" who are subject to separate taxation or to substitute tax), (iii) the same favour has been granted by the Agency in the case of persons who have only income subject to separate taxation or to substitute tax (e.g., the so-called minimum taxpayers *under* Article 1, paragraphs 54-89 of Law 190/2014) or who could not benefit from the corresponding deduction because the gross tax is absorbed by other deductions or is not due (see Reply 2 October 2020, No. 432, and Reply 12 November 2020, No. 543). In conclusion, it is considered that the fact that the rules also refer to the "*deduction from gross tax*" cannot preclude the application of the tax *bonuses* to real estate UCITS and REOCos, nor the fact that such entities/subjects are ordinarily without gross tax for deduction purposes. Moreover, such an interpretation would be even more jarring in the context of the tax regime for SIIQs, which, as is well known, may structurally present, albeit not predominantly, gross tax to be declared.

iv. Moreover, the position of the Revenue Agency on OICR, REOCos, and SIIQs does not seem to take due account of the fact that the regime that exempts such entities from income taxes is the result of a precise legislative choice, aimed at coordinating the taxation of shareholders/investors with that of the body/company that operates simply by inverting the criterion of taxation of corporate profits (taxation in the hands of the vehicle and exemption in the hands of the recipient) in order to provide that the taxation takes place at the level of the investors rather than the entity that holds the investment. Moreover, it seems appropriate to point out that the Agency's argument that such entities are excluded from the *bonus* due to their exemption regime would not be applicable to all possible situations concerning such entities. Reference is made to these hypotheses (*i) as to* real estate funds and SICAFs, in the case of application of the "transparency" regime provided for by Article. 32, paragraph 3-*bis*, Law Decree. 78/2010, where the deduction should be attributed (precisely, for "transparency") to the investors, who could also be subjects with "gross tax"; (*ii*) as to SIIQs, in the case of permanent establishments of REITS resident in the EU/EEA that, pursuant to paragraph. 141-*bis* of Article. 1, Law 296/2006, apply a substitute tax of 20% on the income from rental activity (the same income that is exempt for resident SIIQs).

For the reasons set out above, it is desirable that past restrictions in the interpretation are eliminated.

Indeed, an even slight opening by the Revenue Agency could be found in the Ruling 26 August 2021, n. 516, with which the Agency granted the possibility of using the eco-bonus, earthquake-bonus and facade bonus to a "pre-existing" pension fund (i.e. funds already established on 15 November 1992, i.e. before it was regulated the supplementary pension system by Legislative Decree No. 124 of 21 April 1993).

In the case dealt with there, similarly to Rulings Nos. 372 and 415, the taxpayer requested confirmation of the possibility of taking advantage of these bonuses, through the transfer of the tax credit or the discount on the invoice, not being able to benefit from them through the deduction, given the absence of gross tax from which to make this deduction, since the pension fund itself is subject to a substitute tax of the income tax pursuant to Article 17, paragraph 6, Legislative Decree 5 December 2005, No. 252.

The Revenue Agency recognizes the entitlement – and with this could open the way towards a rereading of the previous practice which denied this eventuality for funds, SIIQ, and real estate vehicles Law 130/1999 – of the aforementioned real estate bonuses through one of the alternative methods of use provided for by Article 121, Law Decree 34/2020, since the "pre-existing" pension funds are subject to a substitute taxation of income taxes and, therefore, these are subjects who could not have used the said bonuses directly as a deduction since it could not – correctly – find any obstacle from the subjective point of view.

14.4. Objective requirements

The right to benefit from the deduction in principle is granted to taxpayers that have incurred, and borne, certain documented expenses, provided that they have a suitable title to the relevant property, such as:

a. owners or bare owners;
b. holders of *in rem* rights (usufruct, use, dwelling and/or surface);
c. tenants or lessees, provided that they have obtained the consent of the landlord and that the rental or lessees' contracts are duly registered. [28]

28 Cf. Circular No. 36 of 31 May 2007, which states that "*In addition, they must own or hold the property on the basis of a suitable title which may consist of ownership or bare ownership, a right in rem or a lease, including a finance lease, or a free loan agreement*".

The holder of the property is eligible to benefit from the tax incentive if it has a duly registered deed at the earlier of: (i) the time the works are actually commenced or at (ii) the time the expenses for the works are incurred. In addition, the holder must have obtained the owner's consent in writing to perform the works at the latest by the submission of the first tax return in which the holder of the property starts enjoying the incentives.

If the works are carried out by the lessor in relation to a real estate property under a financial lease agreement, the lessee (and not the lessor) will be able to benefit from the deduction, which will be calculated taking into account only the expenses for eligible works incurred by the lessor and not the leasing fees charged to the lessee[29].

The tax period in which the expenses are considered to have been incurred changes according to the type of taxpayer: for business income taxpayers the accrual principle applies, while for non-entrepreneurial individuals the cash principle applies. The beneficiaries of the deduction must have appropriate documentation proving the actual incurrence of the expenses. For the purposes of calculating the expenditure limits, reference is to be made to the number of real estate units registered in the land register at the beginning of the works and not those resulting at the end of the works[30]. Examples of expenditure documentation are the invoices and the wire transfers by which the payments have been effected.

Leaving aside at this stage the specific requirements under each tax incentive, as a general rule the incentives are available only for works performed on "already existing" real estate units and not in the context of "new construction". Proof of the building's existence can be verified by regular registration in the land register. Indeed, works carried out on units registered in category F/3[31] are excluded from the possibility of benefitting from the deductions, while work carried out on F/2[32] and F/4[33] units are in principle not excluded. For buildings registered in the F/2 and F/4 categories, it is possible to enjoy the incentives only if the works do not fall within the scope of new construction, according to letter (e) of Article 3, paragraph 1, of Presiden-

29 See Article. 2(2) of the Interministerial Decree of 19 February 2007.

30 See Circular No. 30 of 22 December 2020.

31 F/3 - Unit under construction.

32 F/2 - Co-operating units.

33 F/4 - Unit under definition.

tial Decree 380/2001. Also, demolition and reconstruction works can enjoy the incentives only to the extent they qualify as "building renovation work" within the meaning of letter (d) of Article 3 of Presidential Decree 380/2001.

14.5. Arrangements for transferring tax incentives by way of assignment or invoice discount

Generally speaking, except for the above-mentioned interpretative rigidities expressed in the practice of the tax authorities and in respect of funds, SICAFs, REOCos and SIIQs, the tax incentives discussed in this chapter[34], which will be reviewed in paragraph 13.7 below, can be used by means of deduction from the gross tax due.

The annual deduction quotas vary according to the bonuses to be used. In particular, in the case of *ecobonus* and facade bonuses, the credit can be deducted in ten equal annual instalments[35], while in the case of *sismabonus* and bonuses for overcoming-elimination of architectural barriers, in five equal annual instalments[36]. In the case of the *superbonus*, the deduction generally takes place in five equal annual instalments and in four equal annual instalments for the portion of expenses incurred after 1 January 2022[37].

If this represents the most "immediate" form of use – except that, in the opinion of the Revenue Agency, it would not be usable by funds, SICAFs, REOCo and SIIQs - there are then two other forms of use governed by Ar-

34 These are: (i) *ecobonus*; (ii) *sismabonus*; (iii) *facade bonus*; (iv) *architectural barriers bonus*; (v) *110% superbonus*.

35 This is provided for: (i) for the *ecobonus* by Article 14, paragraph 3, Law Decree No. 63 of 4 June 2013, converted into Law No. 90 of 3 August 2013; (ii) for the *facades bonus* by Article 1, paragraph 222, Law No. 160 of 27 December 2019; (iii) architectural barriers *bonus*.

36 For the *sismabonus*, see Article. 16, paragraph 1-*bis*, second sentence, Law Decree No. 63 of 4 June 2013, converted into Law No. 90 of 3 August 2013, while for the *bonus* for overcoming/eliminating architectural barriers, see Article. 119-*ter*, paragraph 2, Law Decree No. 34 of 16 May 2020, converted into Law No. 77 of 17 July 2020.

37 See Article 119, paragraph 1 of Law Decree No. 34 of 16 May, 2020, converted into Law No. 77 of 17 July, 2020, as amended by Article 1, paragraph 28, Letter (a) of Law No. 234 of 30 December, 2021, as of January 1, 2022. In addition, paragraph 3-*bis* of Article 119 of the cited Law Decree 34/2020 provides for expenses incurred as of 1 July 2022 by *istituti autonomi case popolari* (IACP), entities having the same social purposes as the aforementioned institutions, established in the form of companies that meet the requirements of European legislation on "*in house providing*" for works carried out on properties. Finally, the 110% *superbonus* can be deducted in four annual instalments of equal amounts for expenses incurred by cooperatives of indivisible ownership for work on buildings owned by them and assigned to their members.

ticle 121, Law Decree 34/2020, applicable to persons who in the years from 2020 to 2024 have incurred and/or sustain facilitated expenses, namely:

a. by receiving a contribution, in the form of a discount on the consideration due (in jargon, the "invoice discount" or sconto in fattura), up to the amount of the consideration itself. In such a case, the transferee's suppliers may in turn use it for themselves, by way of offsetting (including horizontally);
b. by assigning a tax credit of the same amount to a third party[38,] as further detailed below.

The above-mentioned rule governing the option of transferring the tax credit to third parties (in addition to "invoice discount") has been subject to a number of amendments which have resulted in stratifications of cases arising *ratione temporis*.

In the first version, the one introduced by Law Decree No. 34/2020, the rule allowed the tax credit to be transferred to third parties without a limit on the number of sequential transfers, thus leaving it up to the market to determine who should be the final person to use the credit for deduction/compensation. When Law Decree 34/2020 was converted into law, paragraph 1-*bis* was added to Article 121, according to which the option in question may also be exercised in relation to each stage of progress of the works and, in the case of the *superbonus*, such stages of progress must not be (for the purposes of the tax incentive) more than two for each overall work, each of which must refer to at least 30% of the same work[39].

Subsequently, because distorted uses by persons who had not carried any part of the building works giving rise to the tax credit were recorded in investigations conducted by various public prosecutors' offices , in order to counter fraudulent use the following rules were introduced:

- first of all, the obligation to issue the certificate of conformity and the attestation of the fairness of the expenses in case of exercise of the option of the "invoice discount" or the transfer of the credit. Such obligation is provided for by Article 121, paragraph 1-*ter*, of Law Decree No. 34/2020 originally introduced by the so-called anti-fraud decree (Article 1, paragraph 1, letter (b), Law Decree No. 157 of 11 November 2021).

38 On the VAT-registered regime of transfers of such credits, see Answer to Interpretation No 369. of 24 May 2021.

39 See Circular No. 24/E, paragraph. 7 of 8 August 2020, and Replies No. 53 of 27 January 2022 and No. 56 of 31 January 2022.

This decree was then repealed by Article 1, paragraph 41, Law No. 234 of 30 December 2021 (the s "Budget Law 2022"). The provision contained in the current paragraph 1-*ter* of Article 121 of Law Decree No. 34/2020 was reintroduced as of 1 January 2022, by Article 1, paragraph 29, Law No. 234/2021, without prejudice to the legal effects produced during the term of the previous anti-fraud decree. It should also be added that the obligation in question does not apply to *bonuses* other than the *superbonus* in respect of works already classified as free building (*edilizia libera*) activities pursuant to Article 6 of Presidential Decree No. 380/2001 (Consolidated Text on Construction), Ministerial Decree. of 2 March 2018, or the regional regulations, and to works of a total amount not exceeding €10,000 carried out on individual building units or on the common parts of the building, except for works falling under the *facade bonus* (under Article 1, paragraph 219, of Law No. 160 of 27 December 2019);

- second, the limitation on the number of transfers of the tax credit under Article 121, Law Decree No. 23/2020. In particular, Article 28, paragraph 1, letter (a) of Law Decree No. 4 of 27 January 2022 initially provided for the limitation of the circulation of the tax credit to a single transfer, thus making the market that had been formed in the medium term around such tax credits less attractive[40]. Subsequently, this rule was repealed by Article 1, paragraph 1, of Law Decree No. 13 of 25 February 2022, which was awaiting conversion into law at the time of writing, and at the same time the regulation of the assignment of the credits was revised, allowing the possibility of limiting circulation to only two assignments, provided that they are made in favour of banks and financial intermediaries registered in the register provided for by Article 106 of T.U.B., companies belonging to a banking group registered in the register provided for in Article 64 of T.U.B. or insurance companies authorised to operate in Italy pursuant to Legislative Decree No. 209 of 7 September 2005. In short, the possibility of making unlimited "chain transfers" is eliminated, allowing only two further transfers with respect to the first one made by the person

40 This rule was strongly criticised by the operators in the sector because it severely compressed the market for tax credits. Moreover, in the reply given by the Chamber of Deputies on 9 February 2022, nos. 5-07464 and 5-07466, it was noted that "In light of the legislative developments mentioned and the provisions introduced by Law Decree No. 4 of 27 January 2022, the Cassa Depositi e Prestiti has deemed it necessary to suspend its operations on a transitional basis pending the appropriate technical investigations and the necessary operational "adjustments", thus leaving room for possible amendments to the rules currently under discussion.

who generated the right of withdrawal (in total, therefore, three transfers are allowed) provided that the further two transfers are made in favour of banking entities as identified above. Finally, Article 28.2 of Law Decree No. 4/2022 provides transitional rules for cases in which, as at 16 February 2022, the receivables had already been subject to a previous option (invoice discount/sale). In such cases, on a transitional basis, further assignment to third parties, but not beyond, has been permitted, including credit institutions and other financial intermediaries. Finally, the third paragraph of Article 28 of Law Decree No. 4/2022 provides that contracts concluded in breach of the new rules are void.

The regime of the discount on the invoice and the transfer of tax credits from building bonuses has met with a further reform, introduced by the Law Decree 16 February 2023, No. 11, converted into Law 11 April 2023, No. 31, containing "Urgent measures regarding the transfer of tax credits relating to tax incentives" (hereinafter, "L.D. 11/2023").

With this reform, among other provisions (on the liability of the transferees of tax credits, pursuant to Article 1, paragraph 1, L.D. 11/2023, please refer to the following paragraph), the following changes were introduced starting from 17 February 2023:

i. the prohibition for public administrations to be assignees of tax credits deriving from building bonuses (art. 1, paragraph 1, letter a), L.D. 11/2023);
ii. the generalized ban on applying the so-called invoice discount pursuant to art. 121, paragraph 1, letter a), Legislative Decree 34/2020, and to carry out the transfers of the aforementioned tax credits pursuant to art. 121, paragraph 1, letter b), L.D. 11/2023.

With reference to the second point, the restrictive measure of credit assignments does not apply – on the one hand – to expenses relating to interventions to overcome and eliminate architectural barriers pursuant to Article 119-*ter* L.D. 34/2020[41] and – on the other hand – to eligible expenses that meet certain requirements before 17 February 2023, distinguishing in this regard between bonuses deriving from superbonus 110% and bonuses other than superbonus 110%.

41 See Article 2, paragraph 1-*bis*, L.D. 11/2023, as introduced upon conversion into law.

In the case of 110% superbonus interventions[42], the prohibition of transfer and discount on the invoice does not apply if before 17 February 2023[43]:

a. the sworn "CILA" is presented, for interventions other than made by condominiums[44];
b. in the case of condominium interventions, the resolution of the condominium meeting approving the execution of the works is adopted and the sworn "CILA" is presented;
c. an application has been presented for the acquisition of the authorization title for the demolition and reconstruction interventions.
d. In the case of interventions other than those that give the right to the 110% superbonus, the prohibition of transfer and discount on the invoice does not apply if before 17 February 2023[45]:
e. the request for the qualifying residential title has been submitted where due[46];
f. for interventions for which the presentation of a permit is not required, the works have already started;
g. the preliminary contract is duly registered, or the final contract for the sale of the property has been stipulated, in the case of execution of restoration or conservative rehabilitation[47] and building renovation interventions[48] concerning entire buildings, carried out by companies that do so within eighteen months from the date of completion of the works to the subsequent sale/assignment of the property. Similarly, in the case of interventions carried out on buildings located in the municipalities falling within the zones classified as seismic risk 1, 2 and 3, through the demolition and reconstruction of entire buildings carried out by companies which provide, within thirty months from the date of completion of the works, the subsequent alienation of the property.

The L.D. 11/2023, as converted into Law, then provides for further specifications of the case which even after 17 February 2023 can be continued the option for the discount on the invoice and the transfer of tax credits from

42 Article 119, L.D. 34/2020.

43 Article 2, paragraph 2, L.D. 11/2023.

44 Article 2, paragraph 2, L.D. 11/2023.

45 Article 2, paragraph 3, L.D. 11/2023.

46 Sworn notice of commencement of works – Article 119, paragraph 13-*ter*, L.D. 34/2020.

47 As defined by Article 3, paragraph 1, letter c), Presidential Decree 6 June 2001, No. 380.

48 As defined by Article 3, paragraph 1, letter d), Presidential Decree 6 June 2001, No. 380.

building bonuses. In particular, the discount options on the invoice/transfer of credits that can be done even after 17 February 2023 are those:

i. operated by[49] autonomous public housing institutions (IACP), similar institutions compliant with European legislation on "house providing", undivided ownership housing cooperatives for interventions on properties owned by the same cooperatives and assigned to their members, ONLUS, voluntary organizations and social promotion associations registered in the appropriate registers;
ii. carried out in relation to[50] interventions relating to buildings damaged by seismic events as from 1 April 2009 pursuant to Article 119, paragraph 8-*ter*, first sentence, L.D. 34/2020 and to buildings damaged by meteorological events that occurred in the Marche region from 15 September 2022 for which a state of emergency was declared.

Finally, the Law Decree repeals various provisions set out in Law Decree no. 63/2013[51], including: (i) the assignment of the credit in place of the deduction for incurring the costs for energy requalification interventions; (ii) the assignment of the credit instead of the deduction for the expenses incurred for first-level renovations established by the guidelines for the certification of the energy performance of buildings; (iii) the assignment of the credit instead of the deduction for the expenses incurred for building renovation, demolition and reconstruction.

14.6. Liabilities of suppliers and assignees

In the context of their transferability, the success of the tax incentives for works (measured in relation to their objectives, such as (i) injection of cash into the system and (ii) structural support of the sector) was first of all guaranteed by the fairly simple mechanism by which taxpayers could monetise the relevant tax credit. Prior to the recent changes that, with some exceptions, prevented the circulation of the tax incentives, this ease has depended on the possibility that the deduction or credit generated by the incurrence of the relevant investment can be transferred without complications. It is true, however, that although facilitated, the free circulation of credit should have not limit the possibility of effecting appropriate checks and preventing possible abuses, hence the need for trans-

49 Article 2, paragraph 3-*bis*, L.D. 11/2023.

50 Article 2, paragraph 3-*quater*, D.L. 11/2023.

51 Article 2, paragraph 4, L.D. 11/2023.

fer formalities and procedures. In regulating the transfer of tax credits deriving from tax incentives, it has been therefore clear that there is a need to balance these two interests: on the one hand, stimulating monetisation by ensuring (legal) certainty of the transfer of the benefit and, on the other hand, allowing the appropriate checks to be made.

The key principle for facilitating – and thereby encouraging – the circulation of the credit has been therefore to make the purchaser's right to the relevant tax benefit undisputable to the extent that the purchase was made in good faith. This implies that the right of the Revenue Agency to challenge the quality or quantity of the tax credit should not have been addressed to the purchaser if such purchaser had complied with the necessary formalities for the transfer.

This principle was first elaborated with reference to the "*sismabonus acquisti*" (Article 16, paragraph 1-*septies*, of Law Decree No. 63 of 2013), the first example among the tax credits related to works which provides for the immediate monetisation by the purchaser of the property subject to the qualifying works for the *sismabonus*. Later, with clarifications on the so-called *"superbonus"*, provided in Circular no. 24/E of 2020 and more broadly in the subsequent Answer to parliamentary question no. 5-04585 submitted to the Chamber of Deputies, the administration started to formalise the concept of *bona fide* purchase.

Essentially, it has been clarified that the beneficiary of the tax deductions (i.e. the person who incurred the subsidised expenses) is the only person liable against the Revenue Agency and that the suppliers are jointly and severally liable only when they have participated in the violation. The *bona fide* transferee does not lose the right to use the tax credit, which will be recovered from the beneficiary and, if necessary, in the event of untruthfulness in the declarations or asseverations, from the relevant expert who released the relevant declarations or asseverations, including the rights deriving from the compulsory insurance policies.

This position, has however been balanced by a series of measures that the Government has adopted with the aim of countering fraudulent behaviour and, in particular, reducing monetisation of non-existent credits, through the so-called anti-fraud decree, already mentioned in the previous paragraph[52]. In addition, it has strengthened the reporting and control mecha-

52 As mentioned, with Decree Law No. 157 of November 11, 2021 , the government introduced several measures to counter fraudulent behavior in the field of tax incentives and strengthened the preventive control powers carried out by the Internal Revenue Agency. Among the main nov-

nisms with the introduction of the obligation to refrain from carrying out the transfer transaction in the presence of suspicious transactions[53].

The 2022 Budget Law[54] repealed the anti-fraud decree, the provisions of which were included in the legislation allowing the "invoice discount"[55].

As reported in the previous paragraph, as a result of fictitious transactions which allegedly generated non-existent tax credits amounting to billions of Euros and which, by exploiting multiple transfers to various nominees, led to extreme difficulties in tracing and verifying the source of the fraud and those responsible for it, the Government introduced prohibition of further assignments after the first one[56]. This limitation on circulation was necessary precisely because of the primacy of the principle of purchase in good faith: in other words, the Revenue Agency, not being able to recover the credit from the purchaser who did not participate in the fraud, was forced to seek resort in to the most extreme limitation, i.e. by making it impossible for the beneficiary to transfer and monetise the credit after the initial transfer.

In a sense, the limit on multiple assignments represents a confirmation of the principle of protection of the *bona fide* purchaser, although, with the

elties introduced were (i) the extension of the compliance endorsement and asseveration certifying the adequacy of expenses in the head of the taxpayer who wants to take advantage of building bonuses other than superbonus such as ecobonus, seismbonus, front building bonus; (ii) the strengthening of preventive controls carried out by the Revenue Agency and the related power granted to it to suspend the effectiveness of the communication required to exercise the option of invoice discount or credit assignment.

53 The introduction of Article 122-*bis* into Law Decree No. 34/2020 concerning measures to prevent fraud in the area of the transfer of receivables. Law Decree No. 4 strengthening preventive controls allows the Revenue Agency, within five working days from sending of the transfer communication, to suspend, for a period not exceeding thirty days, the effects of such communication. The risk profiles justifying such suspension are (i) the consistency and regularity of the data in the communication, (ii) the data relating to the credits and (iii) similar transfers made previously. The verification of the first two items is carried out with respect to the data in the Register of Tax Relations or in any case in the hands of the tax authorities.
Paragraph 4 of the aforementioned provision provides that the persons involved in the transfers reported to the Revenue Agency shall not proceed with the purchase of the credit if the requirements for reporting suspicious transactions to the Financial Intelligence Unit ("*UIF*") are met. In this regard, it is necessary to take into account the risks associated with the fictitious nature of the credits, the presence of credit assignees who pay the price of the transfer with funds of illicit origin, and the performance of abusive financial activities by unauthorised persons who carry out multiple credit purchase transactions with a large number of assignors.

54 Article. 1, paragraph 41, of Law No. 234 of 30 December 2021.

55 Articles 121 and 122-*bis* of Law Decree No. 34 of 2020.

56 With Law Decree no. 4 of 27 January 2022.

aim of reducing fraudulent mechanisms, it has led to a stop in the market of bonuses. The impossibility of prompt monetisation through subsequent assignment has led to a crisis in the entire credit system with potentially important repercussions for the entire building sector.

As mentioned, this limitation was later mitigated (at least until the final stop of the assignments), by a later measure[57] by which the government introduced the compromise of channelling transfers subsequent to the first one to regulated intermediaries, as they guarantee greater diligence and a lower propensity for fraud with the possibility of making only two successive transfers, but only to supervised entities such as banks, other intermediaries and insurance companies.

As the latest legislative intervention, made concurrently with the amendments introduced by Law Decree No. 11 of 16 February 2023 (which, as already mentioned, provided, with some exceptions, for the end of the bonus circulation), the government declined the concept of "good faith", which excludes by absolute presumption the joint and several liability of the supplier who applied the invoice discount and the transferee. Pursuant to the new paragraph 6-*bis* of Article 121 of Law Decree no. 34/2020, joint and several liability is, however, excluded, except in the case of fraud, if the transferees prove that they have acquired the tax credit and are in possession of the technical documentation relating to the works that originated the tax credit[58]. The long list of documentation can be replaced, in cases of transferees acquiring the tax credits from entities considered reliable (in particular, banks, listed companies or companies that are part of the group of listed companies), with an certification of possession of the documentation issued by the transferor. It should be noted that, under paragraph 6-quater below, the absence of documentation does not in itself entail the joint and several liability of the transferee, who will still be able to prove the occurrence of diligence (or slight negligence) during the assessment.

14.7. Tax incentives for energy efficiency measures under Article 14 of Law Decree No. 63 of 4 June 2013

As mentioned in the introductory paragraph, energy efficiency and the renovation of buildings are among the objectives of the "PNRR". One of the

57 Law Decree no. 13 of 25 Febrary 2022.

58 See letter from a) to i-*ter*) of the mentioned paragraph 6-*bis*.

focus of the PNRR plan is increasing the energy efficiency of public and private buildings. Therefore, the possibility of taking advantage of this tax benefit presupposes that the buildings subject to the interventions are already equipped with a functioning winter air-conditioning system, and for co-operating buildings (category F/2), the Italian Revenue Agency has clarified that there must be a pre-existence of the same.

Works that are eligible for tax incentives are:

a. global energy requalification – this category includes works aimed at reducing the need for primary energy that allow a certain performance index to be reached[59];
b. works on the shell of existing buildings – this category includes works that are carried out on the building shell such as:
   i. thermal insulation of vertical opaque structures and/or horizontal opaque structures[60];
   ii. replacement of windows, including frames[61];
   iii. installation of solar shading;
   iv. thermal insulation of common parts of condominiums where such building shell covers more than 25% of the gross surface area of the building[62];
   v. hermal insulation of common parts of condominium buildings where the building shell is of more than 25% of the gross surface area of the building, which is carried out on buildings located in seismic zone 1, 2 or 3, with simultaneous implementation of seismic reduction works.[63]

59 Energy performance index for winter air conditioning not exceeding the values defined in Annex A of Ministerial Decree of 11 March 2008.

60 In point 2.1, letter (a), of Annex A of Ministerial Decree of 6 August 2020, the technical requirements shall be certified by technical asseveration. In particular, the effectiveness of the works shall be certified by determining a variation in the transmittance of the structures on which the work is performed, between the results before the work and the results after the work, consistent with the thresholds indicated in Table 1 of Annex E of the Ministerial Decree of 6 August 2020. For this type of work, Article. 7, paragraph 1, of the Ministerial Decree of 6 August 2020 requires the production of an Energy Performance Certificate ("APE") for the post-work situation.

61 For this type of work, Article. 7, paragraph 1, of the Ministerial Decree of 6 August 2020 requires the production of the APE only for the post-work situation. This documentation is not required if the works relate to single building units.

62 The Circular of the Revenue Agency No. 24 of 8 August 2020 clarified that the requirement to exceed 25% of the gross dispersing surface is determined by the vertical opaque surfaces (external walls), horizontal opaque surfaces (roofs, floors) and inclined surfaces.

63 The Italian Revenue Agency, in Answers No. 293 of 22 July 2019, No. 138 and 139 of 22 May

c. installation of solar collectors – this category includes the installation of solar panels[64];
d. works relating to heating systems – this category of works includes:
    i. full or part replacement of air-conditioning systems with condensing boilers;
    ii. full or part replacement of winter air-conditioning with systems equipped with high-efficiency heat pumps;
    iii. full or part replacement of winter air-conditioning systems with systems equipped with hybrid appliances;
    iv. functional replacement, in whole or in part, of winter air-conditioning systems equipped with micro-generators;
    v. replacement of traditional water heaters with heat pump water heaters dedicated to the production of domestic hot water[65];
    vi. installation of winter air-conditioning systems equipped with heat generators powered by combustible biomass.
e. installation of multimedia devices or "building automation"[66] – this category of works includes the purchase, installation and commissioning of building automation devices and systems in housing units.

The table below provides a summary of the percentage of the deduction due, according to the various types of works and the maximum deduction limit.

2020 and No. 18 of 8 January 2021, clarified that:
- in order to benefit from the subsidy, the requirements of the *sismabonus* and *ecobonus* must be met;
- after 1 January 2017 works must be carried out according to authorisation procedures;
- the effectiveness of the works to reduce seismic risk must be certified by qualified professionals in accordance with Ministerial Decree No. 58 of 28 February 2017;
- in the case of the conversion of a non-residential building into a residential one, tax deductions are granted if the administrative decision authorising the works clearly states that they involve a change of use of the building to a residential use;
- the building concerned must have an existing heating system.

64 The building in which the solar panels are installed does not need to have a heating system.

65 For these works it must be certified that heat pumps are installed that have a coefficient of performance at least equal to the relevant minimum values set out in the tables in Annex F of Ministerial Decree of 6 August 2020.

66 These are the measures under Article 1, paragraph 88, of Law No. 208/2015, also under letter f) of Article 2, paragraph 1, of the Ministerial Decree of 6 August 2020.

Type of work	Deduction rate	Deduction limit (Euro)
Global energy upgrading (work *a*)	65%	100,000
Works on the building shell – insulation of opaque structures (work *b.i*)	65%	60,000
Works on the building shell – replacement of windows including frames (work *b.ii*)	50%	60,000
Works on the building shell – installation of solar shading (work *b.iii*)	50%	60,000
Works on the building shell covering more than 25% of the dispersing surface area (work *b.iv*)	70%	28,000
Works on the building shell covering more than 25% of the dispersing surface area and achieving certain specific efficiency requirements (work *b.iv*)	75%	30,000
Works on the building shell covering more than 25% of the surface area which are carried out in seismic zone 1, 2 or 3 and which at the same time involve a change to a lower risk class (work *b.v*)	80%	108,800
Works on the building shell covering more than 25% of the surface area which are carried out in seismic zone 1, 2 or 3 and which at the same time involve a transition to two or more lower risk classes (work *b.v*)	85%	115,600
Installation of solar collectors (work *c*)	65%	60,000
Works relating to heating systems – condensing boilers (work *d.i*)	50%	30,000
Works relating to heating systems – condensing boilers with simultaneous installation of advanced thermoregulation systems (work *d.i*)	65%	30,000
Works relating to heating systems – systems equipped with condensing hot-air generators (work *d.i*)	65%	30,000
Works relating to heating systems – systems equipped with high-efficiency heat pumps (work *d.ii)*	65%	30,000
Works relating to heating systems – installations equipped with hybrid appliances (work *d.iii*)	65%	30,000
Works relating to heating installations – installations equipped with micro-power generators (work *d.iv*)	65%	100,000
Works relating to heating systems – replacement of traditional water heaters (work *d.v*)	65%	30,000
Works relating to heating systems – installation of winter air conditioning systems (work *d.vi*)	50%	30,000
Installation of *building automation*	65%	15,000

In order to benefit from the above-mentioned deduction, the legislation requires the following:

- filing of the technical report (if required);
- acquisition of an asseveration from a qualified technician attesting to the level of the costs (if required);
- acquisition of the energy performance certificate ("APE");
- payment of the costs incurred in carrying out the works by bank or postal transfer;
- transmission of the communication to ENEA within 90 days of the end of the works.

14.8. Tax incentives for works adopting anti-seismic measures under Article 16, paragraphs 1-bis to 1-septies[67] of Law Decree No. 63 of 4 June 2013

Article 16, paragraphs 1-*bis* to 1-*septies*, of Law Decree No. 63 of 4 June 2013, converted into Law No. 90 of 3 August 2013, regulates the *sismabonus*, an incentive aimed at stimulating the adoption of safety measures for building heritage from a seismic point of view.

The incentive consists of the deduction from gross income tax of an amount equal to 50% (subject to the following specifications based on the type of property) of eligible expenses incurred between 1 January 2017 and 31 December 2024[68] up to a maximum (of the same expenses) of €96,000 for each year and for each real estate unit (including appurtenances) located in high-risk seismic zones (zones 1 and 2), as identified pursuant to Order of the Prime Minister No. 3274 of 20 March 2003, in respect of buildings used for residential and productive activities. Therefore, the maximum deduction would amount to €48,000 for each building unit[69]. The deduction can be made in five equal annual instalments starting from the year in which the eligible expenditure is incurred and in the following four years.

With regard to the identification of the eligible expenses, Article 16, paragraph 1-*bis* of Law Decree 63/2013 refers to those provided for by Article 16-*bis*, paragraph 1, letter (i), of TUIR, i.e. expenses relating to (i) the static safety of the

67 Paragraph 1-*septies* deals with the purchase of earthquake-resistant houses.

68 Provision last extended by Article 1, paragraph 37, letter (b), No. (1), Law No. 234 of 30 December 2021, as from 1 January 2022.

69 Article. 16, *comma* 1-*bis*, D.L. 4 *giugno* 2013, No. 63, conv. in L. 3 agosto 2013, No. 90.

structural parts of the building, and (ii) the preparation of the mandatory documentation to certify the safety of the building, in particular the structural parts, as well as the implementation of the measures necessary for the issuance of such documentation. The works related to the adoption of anti-seismic measures and the execution of works for static safety must be carried out on the structural parts of buildings or complexes of buildings structurally connected and include entire buildings and, where they are in historic city centres, must be carried out on the basis of unitary projects and not on individual building units.

In this regard, Ministerial Decree No. 58 of 28 February 2017 sets out the guidelines for the seismic risk classification of buildings and the procedures for certifying the grade. In particular, the designer of the structural work certifies the risk class of the building before the works and the class achievable after the execution of the designed work. The director of works and the static tester (the latter if required by law), after completion of the works and testing, certify the conformity of the works carried out with the original project submitted.

The amount of the deduction, compared to the basic 50%, increases in the following two cases.

a. In general, for seismic risk improvement, it increases to:
   - 70% of the eligible costs if the implementation of the works results in a reduction of the seismic risk by one risk class;
   - 80% of eligible expenditure if the risk is reduced by two risk classes.
b. In particular, in the case of work concerning common parts of the building:
   - 75% of eligible expenditure in the case of a move to a lower risk class;
   - 85% of eligible expenditure if the risk is reduced by two risk classes.

A special case is governed by paragraph 1-*septies* of Article 16, Law Decree 63/2013, i.e. if the anti-seismic works are carried out in municipalities falling within the zones classified as seismic risk 1, 2 and 3, as identified by Order of the Prime Minister No. 3519 of 28 April 2006, through demolition and reconstruction of the entire building.

In this case, the work can also take place with a volumetric variation of the pre-existing building, if allowed by the urban planning rules. In this regard, Resolution No. 34/E of 27 April 2018 clarified that the administrative title authorising the works must show that the work consists of conservation of existing building stock, rather than anew construction.

An objective requirement for the application of these rules (paragraph 1-*septies*) is that the works must be carried out by construction or renovation companies, which must sell the property within thirty months of the date of completion of the works (otherwise the benefit does not apply).

In these cases, the deductions are granted to the purchaser of the real estate units up to 75% and 85%, respectively, of the price of an individual real estate unit, as stated in the public deed of sale and, in any case, up to a maximum amount of expenditure of €96,000 for each real estate unit.

Having said that, with regard to the subjective requirement for the application of the aforementioned provision (paragraph 1-*septies*), the Decree provides that the works are carried out by "construction or real estate restructuring companies". This aspect was the subject of the Revenue Agency's Answer No. 890 of 30 December 2021 (of similar tenor to that contained in its Answer No. 141 of 22 May 2020[70]), which examined the case of an asset management company (SGR) managing a real estate alternative investment fund owning a real estate complex which may be eligible for tax relief under paragraph 1-*septies*. The fund, through its SGR, was about to start demolition and reconstruction works aimed at converting the property into a social residence with the purpose, *inter alia*, of reducing the seismic risk by more than two classes. The building works were to be carried out indirectly by the fund, i.e. through contracts awarded to third party companies.

The Italian Revenue Agency, in adopting the opinion received from the Bank of Italy, concludes that real estate alternative investment funds cannot be qualified as "construction-renovation companies" for the purposes of the legislation in question, as they cannot generally carry out construction activities (as their objective). This conclusion is in contrast with the precedent set out in Resolution No. 46/E of 18 April 2011, where it was acknowledged that purchasers of newly built appurtenant garages could benefit from the tax credit even if the

70 With its Answer No. 141 of 22 May 2020, the Revenue Agency denied the possibility for the purchase of a property, to enjoy the incentives on building works pursuant to Article 3, letters (c) and (d), Presidential Decree No. 380 of 6 June 2001, carried out by the property owner (a real estate fund) through a third party contractor. The reason for denying the applicability of the relief is that real estate funds cannot be regarded as "construction undertakings". This conclusion, in fact, contrasts with another precedent, contained in Resolution No. 46/E of 18 April 2011, which recognised the possibility of benefitting from the tax credit for purchasers of newly built garage and parking spaces sold by real estate funds. On the other hand, in the VAT regulations (Article 10, paragraph 1, nos. 8, 8-*bis* and 8-*ter*, Presidential Decree No. 633 of 26 October 1972), there is a clear equalization of companies that do not habitually carry out construction activities, through the phrase "also through contractors". The fact that this phrase is not expressly repeated in the legislation on tax *bonuses* does not seem sufficient to exclude its application in the case of investment funds.

seller is a real estate investment fund. But, apart from this, the Agency's arguments do not seem to be convincing because the Bank of Italy (in its opinion transcribed in Answer 890/2021) admits that the activities carried out by real estate funds, since they are entities intended for *real estate* investments[71], may "*reasonably include the activities of development of real estate assets (including, by way of example, redevelopment, restructuring and development, also understood as construction activities) whose implementation is entrusted to specialised third parties, for example by means of a contract*". In this context, it should also be noted that in the VAT context (Article 10, paragraph 1, nos. 8, 8-*bis* and 8-*ter*, Presidential Decree No. 633 of 26 October 1972), the legislation suggests that any entity may be defined as a "construction-restructuring company", due to the phrase "*also through contractors*". It therefore seems illogical to exclude investment funds from the relief simply because they are not themselves "construction companies". In this way, the argument put forward by the Revenue Agency does not seem to be sufficiently supported.

14.9. Tax incentives for works for the recovery or restoration of the facade of existing buildings, including those involving only external cleaning or painting, as under Article 1, paragraphs 219 and 220, of Law No. 160 of 27 December 2019

Article 1, paragraph 219, of Law No. 160 of 27 December 2019 ("Budget Law 2020"), introduced the *facade bonus*, a tax relief initially equal to 90% of the expenses incurred for works aimed at the recovery and restoration of the external facade, including works consisting only of cleaning or painting, of existing buildings located in zone A or B, as identified by Ministerial Decree No. 1444 of 2 April 1968. The relief, initially provided by Budget Law 2020 only for expenses incurred in 2020 and 2021, was extended for expenses incurred in 2022 by Budget Law 2022, which reduced the rate to 60%.

71 The combined provisions of Article 12, paragraph 2, and Article 4, paragraph 1, letter (d), Ministerial Decree No. 30 of 5 March 2015, provide that real estate investment funds must be invested to the extent of at least two-thirds of their total gross value in real estate assets, real estate rights, including those arising from real estate financial leasing contracts and from concessionary relationships, and participations in real estate companies and/or parts of other real estate investment funds, including foreign ones. The percentage is reduced to 51% if the assets of the investment fund are also invested to the extent of not less than 20% of their value in financial instruments representing securitisation transactions involving real estate, rights in rem in real estate, or mortgage-backed loans. The aforementioned investment limits must be reached within 24 months of the start of operations of the investment fund.

Law No. 197 of 29 December 2022 ("Budget Law 2023") did not extend the possibility to benefit from the facade bonus also for expenses incurred in 2023. However, the analysis of this bonus is nevertheless proposed as the taxpayers are still allowed to offset the residual instalments for expenses incurred up to 2022. Moreover, the analysis is necessary as the Italian Revenue Agency has provided a series of generalised clarifications which - although they have been rendered specifically on the the facade bonus - may have a generalised applicability to the other bonuses. The facade bonus isIt is, in fact, one of the most successful bonuses, which has greatly engaged the Italian Revenue Agency in a series of punctual clarifications for the benefit of the formation and fruition of other bonuses as well, and in general for the discipline of bonuses relating to building works.

The purpose of the regulation is to improve urban decorum and to preserve the building structure while respecting its typological, formal and structural elements, in compliance with the general town planning instrument and its implementation plans, and also to encourage energy improvement works.

According to paragraph 219[72], the following taxpayers are eligible for the *facade bonus:*

a. individuals, including those carrying out professional activities;
b. public and private entities that do not carry out commercial activities;
c. partnerships;
d. professional associations;
e. entities subject to corporate income taxes.

As already stated in the introductory paragraph, persons whose income is subject to substitute tax or separate taxation are not eligible for the deduction[73].

In order to benefit from this deduction, the beneficiaries must own or hold the building under works on the basis of a suitable title at the time the works are started or at the time the expenses are incurred, if the latter is prior to the start of the works. Therefore, the beneficiaries of the facade bonus are those taxpayers who own the building undergoing work as owners or have other *in rem* rights to enjoy the property (usufruct, use, dwelling or

72 See Circular No. 2/E of 14 February 2020, paragraph. 1.

73 Such as persons with income from business activities or from the exercise of professional activities who have joined the flat-rate regime set forth in Article 1, paragraphs 54 to 89, of Law No. 190 of 23 December 2014.

surface). A lease or loan agreement entitles the tenant to benefit from the facade bonus to the extent that the tenant receives the consent of the owner of the building to carry out the work and the lease and/or loan agreement is duly registered[74].

The promissory purchaser can benefit from the bonus in relation to expenses incurred for restoration and renovation works on the facade of the property being purchased. However, the facade bonus is only available provided that a preliminary sale and purchase agreement has been signed and registered.

It should be noted that the taxpayer who autonomously carries out renovation and restoration works on facades can benefit from the bonus in respect of the costs incurred in the purchase of the materials used to carry out such works.

As regards the objective elements of the case, the works must involve the restoration or renovation of the external facade of existing buildings, parts of existing buildings[75] or building units, regardless of the cadastral category to which they belong.

The reference to "existing buildings" excludes from the scope of the bonus works which are carried out on buildings under construction or on buildings demolished and subsequently rebuilt[76].

One of the objective requirements is the location of the buildings concerned. In fact, the law requires that they be located in zone A or B pursuant to Ministerial Decree 1444/1968, or in zones assigned to them under regional or municipal building regulations. The assignment to zone A or B must result from town planning certificates issued by the competent local authorities.

Article 2 of Ministerial Decree No. 1444/1968 cited above identifies zones A and B as follows:

a. Zone A: "*the parts of the territory affected by urban agglomerations of a*

74 If the title to the property is not properly registered at the time the work started or the expenses were incurred, the deduction is not available even if the person who incurred the expenses subsequently regularised it.

75 Resolution No. 831/E of 21 December 2021 also applies the incentive to part works, aimed at solving a problem located only on a portion of the facade.

76 Circular No. 2/E of the Revenue Agency of 14 February 2020 excludes the possibility of claiming the facade bonus even if following works classified as "building renovation" the reconstruction of the building takes place without an increase in volume compared to the existing building.

historical, artistic or environmental value or by portions of such agglomerations including the surrounding areas that can be considered an integral part of the agglomerations themselves, due to the abovementioned characteristics";

b. Zone B: "*the parts of the territory which are totally or partially built up, other than zones A: zones in which the covered area of existing buildings is not less than 12.5% (one eighth) of the land area of the zone and in which the territorial density is greater than 1.5 m3 /m2* ".

Therefore, buildings located in zone C or similar, i.e. "*parts of the territory intended for new settlements, which are undeveloped or in which the pre-existing building does not reach the limits of surface area and density referred to in letter b) above*", or in zone D or similar, i.e. "*parts of the territory intended for new settlements for industrial plants or similar*", are excluded from the facade bonus.

The reference to Ministerial Decree No. 1444/1968 was made by the legislator as a uniform reference parameter throughout the national territory in consideration of the fact that this Ministerial Decree identifies, within the scope of State competence, homogeneous zones with the purpose of establishing urban allocations, limits on building density, heights of and distances between buildings to be observed for the purposes of the formation of new town planning instruments or the revision of existing ones[77].

However, as clarified in Resolution No. 3 of 8 January 2021 of the Italian Revenue Agency, the above-mentioned Ministerial Decree is not binding on Municipalities, which are not required to apply the same zoning and consequent designation provided for therein. Therefore, for the purposes of the facade bonus, the buildings under work may be located in areas that are included in territorial zone A or B or equivalent areas, regardless of their denomination. In any case, the assignment to zone A or B must result from town planning certificates issued by the Municipalities[78].

The work must concern only the vertical opaque structure[79] of the facade, the balconies or the ornaments and friezes. This limits the scope of the works to those carried out on the visible external shell of the building

77 See Resolution of the Italian Revenue Agency of 8 January 2021, No. 23.

78 See Circular of the Italian Revenue Agency No. 2/E of 14 February 2020.

79 This includes, for example, the consolidation, restoration, improvement and renovation of the elements constituting the vertical opaque structure of the facade as well as the mere cleaning and painting of the surface.

(i.e. the entire external perimeter) and, in particular, on the elements of the facade that constitute exclusively the vertical opaque structure. On the other hand, horizontal or inclined opaque structures of the external shell such as, for example, roofs and floors of unheated rooms do not qualify.

The eligible works are:

a. exterior cleaning or painting of the opaque structures of the facade;
b. works on the opaque structures of the facade that have a thermal influence or that affect more than 10% of the plaster of the total gross dispersion surface area of the building; and
c. works, including cleaning or painting, on balconies, ornaments or friezes.

The replacement of windows, frames, grates, doors and gates, as well as the repainting of shutters and blinds, are excluded from qualified works, as they are ancillary to the frames, which are themselves excluded from the facade bonus[80].

In addition, work on internal facades is excluded, except for works on facades that are visible from the street or from public land. Similarly, the expenses incurred for works on neighbouring surfaces, such as cloisters, cavities, courtyards and internal spaces are excluded, except for those visible from the street or from public land. The Italian Revenue Agency has assimilated to public land a private road for public use[81] on the basis of decisions of the Supreme Court discussing matters different from those at stake[82].

With regard to the costs which qualify for the incentive, the calculation includes the costs of purchasing materials, design and other professional services, provided that they are related to the works, as well as all costs strictly related to the implementation of the works (e.g. the cost of installing scaffolding, value added tax if not deductible, stamp duty, etc.).

It is important to note that Article 1, paragraph 220, of Budget Law 2020 has extended the deduction rate to energy efficiency works carried out on the facades which involve an improvement from a thermal point of view of the building or which involve more than 10% of the plaster of the total gross dispersing surface area of the building. The purpose of the law is, on the one hand, to encourage the improvement of urban decorum and, on the

80 See Resolution of the Italian Revenue Agency No. 346 of 11 September 2020.

81 See Resolution of the Italian Revenue Agency No. 337 of 12 May 2021.

82 The Criminal Court of Cassation, in Judgment No. 2582 of 26 January 2011, held that a neighbouring road was assimilated as a municipal road if it was for public use as it was intended for collective passage.

other hand, to favour energy improvement works on buildings which would otherwise benefit from a lower deduction percentage as provided for in Article 14 of Law Decree 63/2013. These works, however, can benefit from the facade bonus provided that they meet the following conditions:

a. the requirements set out in the decree of the Ministry for Economic Development of 26 June 2015, which defines the methods required for the computation of the energy performance of buildings, the prescriptions and the so-called minimum requirements for the energy performance of buildings and building units[83];
b. the established thermal transmittance values are:
c. set forth by Ministerial Decree of 11 March 2008, as updated by the Ministerial Decree of 26 January 2010, for works started before 6 October 2020;
d. set forth by Ministerial Decree of 6 August 2020, for works started on or after 6 October 2020.

With regard to the time allocation of expenses, reference should be made:

a. for individuals, including persons carrying out professional activities, and non-commercial entities, on a cash basis. In this respect, reference should be made to the date of payment, irrespective of the date of commencement of the work[84];
b. for sole proprietorships, companies and commercial entities, on an accrual basis, according to which the deduction is due at the time of completion of the services pursuant to Article 109, paragraph 2, of the TUIR. The tax period for which the deduction is granted therefore coincides with the period in which the works are accounted for by the beneficiary –generally, this period coincides with the period for completion of the works – regardless of the date on which the work is carried out or the payment of the consideration.

Paragraph 219 of the Budget Law 2020 does not set any limitation with respect to the date of commencement of works, allowing for the calculation, for the purposes of the benefit, of expenses “documented and incurred” prior to the date of commencement of works.

83 See Annex B to Table 2 of the Decree of the Minister of Economic Development of 11 March 2008, as amended by the Ministerial Decree of 26 January 2010.

84 The actual payment must be evidenced by a bank or postal transfer (“*parlante*”) containing the data required by the sector regulations and the application of the appropriate withholding by the credit or postal institution in charge (see Article 25 of Law Decree No. 78 of 31 May 2010).

The reference to the expenses incurred, as referred to in paragraph 219, is to the expenses borne by the taxpayer. Therefore, where the taxpayer has received contributions, the amount of those contributions must be deducted from the amount on which the incentive is to be calculated. Moreover, the incentive is not granted if the expenses incurred have been reimbursed and such reimbursement has not been taken into account in the determination of the taxpayer's income. On the contrary, as for the taxpayers which are subject to corporate income taxes, if the reimbursement has contributed to the determination of the income, the right to deduct remains intact[85].

The law does not set a maximum limit in respect of the amount of the deduction to which the taxpayer is entitled, nor a maximum limit for the eligible expenses. Therefore, it is considered that the facade bonus is due on the entire amount of the expenditure incurred by the taxpayer.

Circular No. 2/E cited above identifies a series of additional obligations for taxpayers, including that they:

a. notify in advance the date of commencement of work to the competent local health authority, if such notification is required under the current provisions on construction site safety;
b. keep invoices as proof of expenses actually incurred in carrying out the works and the relevant receipt for the payment;
c. keep and exhibit the building permit required by current legislation in relation to the type of work to be carried out or, if the legislation does not provide for any building permit, a declaration in lieu of affidavit, made pursuant to Article 47 of Presidential Decree No. 445 of 28 December 2000, indicating the date of commencement of work and confirming that the work carried out is eligible for the facade bonus;
d. in case of a property yet to be surveyed, keep a copy of the request for registration in the cadastral registry;
e. in case of work on the common parts of residential buildings, keep a copy of the assembly resolution approving the execution of the works and the costs allocation table;
f. in case of works carried out by the holder of the property undergoing work, keep the declaration of consent of the owner of the property to carry out the works.

In addition to the above requirements, the beneficiaries subject to IRPEF who do not earn income subject to corporate income taxes must make the

85 See Circular of the Italian Revenue Agency No. 2/E of 14 February 2020.

relevant payments by bank or postal transfer ("*parlante*") containing the data required by the sector regulations and the application of the appropriate withholding by the credit or postal institution in charge (see Article 25 of Law Decree No. 78 of 31 May 2010).

If the works lead to an improvement in the energy performance of the building, in addition to the above requirements, the requirements set out in the decree of 19 February 2007 also apply (see paragraph 13.10 on the *ecobonus*). In particular, those who intend to benefit from the incentive must acquire and keep:

a. the description of the work, with the CPID code assigned by the ENEA website, signed by the beneficiary and by a qualified technician[86];
b. an asseveration issued by a qualified technician certifying that the works carried out meet the technical requirements;
c. a copy of the energy performance certificate (APE), drawn up by a technician involved in the works, for each individual building unit for which tax incentives are requested;
d. a copy of the technical report required under Article 8(1) of Legislative Decree 192/2005, or the equivalent regional provision;
e. technical data sheets of the materials and building components used and, where applicable, CE markings with associated declarations of performance;
f. the printout of the email sent to ENEA containing the CPID code, which is a guarantee that the documentation has been transmitted.

Furthermore, it should be noted that some of the measures eligible for the facade bonus may also be included in the energy requalification measures relating to the building shell under Article 14 of Law Decree 63/2013, or in the measures for the recovery of the building heritage under Article 16 of the same decree. In view of this potential overlapping of several benefits, the taxpayer will be entitled to benefit, for the same expenses incurred, from only one of these benefits, as he/she is often required to declare in self-certifications submitted by contractors that he/she is not the beneficiary of other incentives for the same works.

86 The description sheet must contain the following elements:
the identification data of the building and of the person who bore the costs;
the type of work carried out;
the resulting annual energy savings;
the cost of the work, including professional fees;
the amount used to calculate the deduction.

14.10. Tax incentives for works to eliminate architectural barriers under Article 119-*ter* of Law Decree No. 34 of 19 May 2020

Article 1, paragraph 42, letter (a) of Law No. 234 of 30 December 2021 introduced a new incentive to encourage the implementation of measures aimed at overcoming or eliminating architectural barriers in existing buildings, provided that such measures comply with the requirements set out in Ministerial Decree No. 236 of 14 June 1989.

Like the other incentives described above, the rule grants the right to deduct from gross income tax a portion of eligible expenses incurred in the calendar year 2022. The deduction must be divided into five equal annual instalments and amounts to 75% of the expenses incurred calculated on a total amount not exceeding:

a. 50,000 for single-family buildings or building units located within multi-family buildings that are functionally independent and have one or more independent entrances from the outside;
b. 40,000 multiplied by the number of building units in the building for buildings consisting of two to eight building units;
c. 30,000 multiplied by the number of building units in the building for buildings with more than eight building units.

The deduction is also recognised in relation to works to automate the systems of buildings and individual building units which are aimed at reducing architectural barriers and, in the event of replacement of the system, the costs relating to the disposal and reclamation of the materials and the replaced system.

This is without prejudice to the fact that, pursuant to Article 121, Law Decree No. 34 of 19 May 2020, converted into Law No. 77 of 17 July 2020, it is possible to opt for the deduction as an alternative to:

- the transfer to other parties of the tax credit corresponding to the deduction due;
- a contribution, in the form of a discount on the consideration due, up to a maximum amount equal to the consideration itself, advanced by the suppliers who carried out the subsidised works ("invoice discount").

14.11. *Superbonus* under Article 119 of Legislative Decree No. 34 of 19 May 2020[87]

Article 1, paragraph 119, of Law Decree No. 34 of 19 May 2020 has added to the deductions already provided for energy efficiency and seismic risk reduction measures a particularly favourable incentive at a rate of 110%, the so-called *superbonus*, for expenses relating to specific energy efficiency and seismic risk reduction measures, as identified in paragraphs 1 and 4 of Article 119.

This incentive was available to taxpayers who incur expenses for the measures under Article 119 initially in the period from 1 July 2020 to 30 June 2022. The incentive for expenses in respect of the period from 1 July to 31 December 2021 is divided into five annual instalments of equal amounts, while the portion of expenses attributable to the following period, starting on 1 January 2022, is divided into four annual instalments. According to paragraph 8-*quinquies*, as introduced by Article 2, paragraph 3-*sexies* of Law Decree- No. 11 of 2023, the incentive for the expenses incurred from 1 January 2022 to 31 December 2022 may be divided into ten annual instalments of equal amount, starting from 1 January 2023. This option may be exercised by the taxpayer in the tax return for the 2023 tax period, provided that the incentive in relation to fiscal year 2022 has not been already used in the tax return for the relevant tax period[88].

The Budget Law 2022 extended the *superbonus* until 2025, providing for a progressive reduction of the deduction rate and in the number of taxpayers who can continue to benefit from the *superbonus* with a deduction rate of 110%. In particular, Law Decree No. 176 of 18 November 2022 intervened on paragraph 8-*bis* of Article 119, further modifying the deduction rates for 2023, 2024 and 2025 and introducing requirements to be able to benefit from these deductions.

87 The analysis will be limited exclusively to driving works carried out on the common parts of buildings where more than 50% of the total area is devoted to residential use.

88 For completeness, Law Decree No. 176 of 18 November 2022, paragraph 4, provides that the suppliers or the assignees may split into ten annual instalments of equal amount the outstanding tax credits obtained by assignment or invoice discount through options filed with the Revenue Agency by 31 March 2023, to the extent that the split option is filed with the Italian Revenue Agency. The measure of the Italian Revenue Agency No. 132123 of 18 April 2023 clarifies that the filing could be made via the available electronic platform (*Piattaforma cessione crediti*) no later than 2 May 2023, or through an authorised intermediary no later than 3 July.

Notably, in case of works carried out by individuals on condominiums and individuals on buildings consisting of two to four real estate units, the incentive is also available for expenses incurred by 31 December 2025. Nevertheless, expenses incurred by 31 December 2022 benefitted from the deduction rate of 110%, while for expenses incurred in 2023 the deduction dropped to 90%, and those incurred in 2024 and 2025, respectively, deal 70% and 65%.

Pursuant to Article 1, paragraph 894 of the Budget Law 2023, the rate reduction from 110% to 90% for expenses incurred in the year 2023 did not apply in the following cases:

- interventions other than those carried out by condominium owners for which, as of 25 November 2022, the communication of the commencement of works certified pursuant to Article 119, paragraph 13-ter, of the *Decreto Rilancio*, i.e. the CILAS was issued;
- works carried out by condominium owners for which the shareholders' resolution approving the execution of the works was adopted prior to the date of entry into force of Law Decree 176/2022 and provided that, as of 31 December 2022, the CILAS was issued for such works;
- interventions carried out by condominium owners for which the assembly resolution approving the execution of the works was adopted on a date between 19 November 2022 and 24 November 2022 and provided that for such interventions, as at 25 November 2022, the CILAS was executed; and
- interventions involving the demolition and reconstruction of buildings for which, as at 31 December 2022, the application for the acquisition of the planning permission was submitted.

The expenses incurred by the taxpayer for interventions that met the above requirements could therefore continue to benefit from the 110% deduction until 31 December 2023.

This regime applied not only to works on common parts, but also to those carried out on individual building units, i.e. the so-called towed works (*interventi trainati*).

For works carried out on real estate units by individuals who held the property outside the exercise of business, arts or professional activities, the incentive was equal to 110% for expenses incurred by 30 September 2023, provided that by 30 September 2022 at least 30% of the total works was carried out[89]. Article 24 of Decree-Law No. 104 of 10 August 2023 further extended for this type of intervention the possibility of taking advantage of the 110% deduction for expenses incurred until 31 December 2023, provided that at least 30% of the work had been performed by 30 September 2022.

Pursuant to paragraph 8-ter of Decreto Rilancio Decree, the deduction of 110% was available for expenses incurred until 31 December 2025 on works carried out in the municipalities of the territories affected by seismic events occurred after 1 April 2009 where a state of emergency is declared.

For works carried out starting from 1 January 2023, the deduction was 90% for the expenses incurred until 31 December 2023, provided that the taxpayer was the owner of the right of ownership or other real right of enjoyment over the real estate unit, that the same real estate unit was used as a principal residence and that the taxpayer had a "reference income" not exceeding €15,000.

Pursuant to paragraph 8-bis1 of Article 119 of the *Decreto Rilancio*, the 'reference income' is calculated by dividing the sum of the total incomes proxied, in the year preceding the year in which the expenditure is incurred, by the taxpayer, the taxpayer's spouse, the person bound by civil union present in the taxpayer's household and the taxpayer's family pursuant to Article. 12 of Presidential Decree 917/1986 and who, in the year preceding the year in which the expenditure for the measures was incurred, complied with the conditions laid down in paragraph 2 of said Article 12.

It can therefore be seen how the *superbonus*, from a widespread facilitation in support of the building industry, has become more markedly an aid in favour of less well-off taxpayers, who would otherwise have difficulty in financing interventions that are in any event important for the renovation of the housing sector.

Pursuant to Article 119(9) of the *Decreto Rilancio*, the *superbonus* applies to works carried out by:

a. condominiums and individuals not engaged in business activity, arts or professions, on buildings consisting of two to four separately registered building units, even if owned by a single owner or co-owned by several owners;
b. individuals not engaged in business activity, arts or profession, on indi-

89 A further extension concerned the deadlines for works carried out by the autonomous institutes for social housing (IACP) and by cooperatives of indivisible ownership housing, which can benefit from the 110% deduction for expenses incurred up to 31 December 2023, provided that at least 60% of the work has been carried out by 30 June 2023.

vidual building units up to a maximum of two building units per person;

c. the autonomous institutes for public housing, the so-called IACP, as well as entities having the same social aims as the aforementioned institutes, set up in the form of companies in compliance with European legislation on *in-house provision* for works carried out on buildings used for public housing and owned or managed by them on behalf of the Municipalities;
d. indivisible housing cooperatives, for works carried out on buildings owned by them and assigned for use to their partners;
e. non-profit organisations of social utility under Article 10 of Legislative Decree No. 460 of 4 December 1997, voluntary organisations registered in the registers under Article 6 of Law No. 266 of 11 August 1991, and associations for social promotion registered in the national register and in the regional registers and registers of the autonomous provinces of Trento and Bolzano provided for in Article 7 of Law No. 383 of 7 December 2000;
f. amateur sports associations and clubs registered in the register established pursuant to Article 5(2)(c) of Legislative Decree No 242 of 23 July 1999, only in case of works on buildings or parts of buildings used as changing rooms.

The following table summarises who is eligible for the *superbonus* and the relevant deductions for the tax periods 2023, 2024 and 2025:

Post amendments of Law Decree No. 176/2022 (“*Decreto Aiuti-quater*”) and Law Decree No. 11/2023 (“Blocca opzioni”)	
General subjects envisaged by para. 9 of Art. 119 of DL 34/2020	From 1.7.2020 to 30.6.2022, at a rate of 110%.
- Condominiums - Individuals, outside the exercise of xbusiness, art or profession, for works on buildings made up of 2 to 4 distinctly stacked real estate units, even if owned by a single owner (or co-owned by several individuals pro indiviso)	From 1.7.2020 to 31.12.2025, with rate - 110% for expenses incurred until 31.12.2022; - 110% or 90% for expenses incurred in the year 2023; - 70% for expenses incurred in the year 2024; - 65% for expenses incurred in the year 2025. The extension until 31.12.2025 (with rates 110-90-70-65%) also concerns natural persons carrying out the interventions on individual real estate units within the same condominium or building.

ONLUS, ODV and APS	From 1.7.2020 to 31.12.2025, at a rate of: - 110% for expenses incurred until 31.12.2022; - 110% or 90% for expenses incurred in the year 2023; - 70% for expenses incurred in the year 2024; - 65% for expenses incurred in the year 2025. The extension until 31.12.2025 (with rates 110-90-70-65%) also concerns natural persons carrying out the interventions on individual real estate units within the same condominium or building. The ONLUS, ODV and APS, referred to in Article 118 co. 10-bis of DL 34/2020, which - engage in the provision of social, health and welfare services; - whose members of the Board of Directors do not receive any remuneration or indemnity; - carry out operations on buildings in cadastral categories B/1, B/2 or D/4; - owned by such persons in full or bare ownership, or in usufruct, or held on gratuitous loan, - benefit from the 110% *superbonus* for expenses incurred up to 31.12.2025.
Natural persons for interventions in single-family buildings or functionally independent building units with independent access	From 1.7.2020 to 30.6.2022, at a rate of 110%. The *superbonus* was payable at 110% for expenses incurred by 31.12.2023 if by 30.9.2022 the interventions are not completed and at least 30% of the total intervention is carried out (see Circular Resolution from Revenue Agency 6.10.2022 no. 33). The superbonus was granted at the rate of 110% for expenses incurred by 31.12.2023 for works carried out in the so-called "villette" owned by natural persons in such territories affected by the flooding events occurred after 1.05.2023 who, as at 30.09.2022, had carried out works for 30% of the total intervention (Article 1, paragraph 10, of Law Decree no. 61 of 1 June 2023). For interventions started from 1.1.2023, the *superbonus* was payable at a rate of 90% in relation to expenses incurred by 31.12.2023, provided that: - the taxpayer was the owner of the right of ownership or right in rem of enjoyment over the property unit subject to the interventions; - the property unit was used as the principal dwelling - the taxpayer had a "reference income" not exceeding € 15,000, determined in accordance with the procedures set forth in paragraph 8-bis 1 of Article 119 of Decree-Law 34/2020.
- IACP and equivalent bodies (the extension also applies to individuals carrying out work on individual property units within the same building) - Housing cooperatives with indivisible ownership, for work carried out on buildings owned by them and assigned for use by their members	From 1.7.2020 to 30.6.2023 at 100% rate. *Superbonus* of 110% for expenses incurred up to 31.12.2023 if at 30.6.2023 at least 60% of the work was carried out.

Like the other benefits in the building sector, the *superbonus* operates as a deduction from the amount of gross tax. Confirming the guidelines of the Italian Revenue Agency, Circular No. 24/E of 8 August 2020 establishes that the persons identified in paragraph 9 of Article 119 cannot benefit from the *superbonus* if they own only income subject to separate taxation or substitute tax, or if the gross tax is absorbed by other deductions or is not due (as in the case of persons falling into the "no tax area"), since they do not have sufficient capacity to benefit from the corresponding deduction deriving from the *superbonus*.

Circular 24/E of 8 August 2020 specifies that the legislator intended to limit the application of the *superbonus* to real estate units held by individuals in a private capacity only. Therefore, properties that are considered capital assets or instrumental buildings are excluded from the scope of the *superbonus*.

The above-mentioned Circular 24/E also clarifies that this limitation applies only to property units, thus allowing taxpayers carrying out business activity and self-employed individuals to benefit from the *superbonus* in relation to expenses incurred for works on the common parts of condominiums, provided that they participate in the sharing of these expenses as co-owners. The deduction is available irrespective of whether the property unit held qualifies as a capital asset or instrumental building, or constitutes the main object of the company's activity.

Circular No. 24/E of 8 August 2020 clarified that expenses relating to common parts of a building can be considered only if they relate to a residential building as a whole. This requirement must be verified according to the principle of the prevalence of residential use for the entire building. Therefore, taxpayers carrying out business activities are eligible for the *superbonus* only if the requirement of the prevalent residential use of the building is met. If this is not the case, only the owners or holders of residential units in the same building are eligible for the *superbonus*.

The beneficiaries must hold the real estate units on the basis of an appropriate title at the time the work starts. The required title includes, in addition to ownership and other real rights of enjoyment, any personal rights of enjoyment. Persons holding the real estate units under a lease or free loan (*comodato*) for use agreement are also entitled to the *superbonus*, provided that they have obtained the express consent of the owner of the property to carry out the works and the lease or free loan for use agreement is duly registered.

The promissory purchaser of the property subject to the work is also entitled to benefit from the *superbonus* provided that the preliminary contract of sale has been duly registered.

Law Decree 34/2020 identifies the scope of the *superbonus* as the expenses incurred for works carried out on common parts of residential buildings in condominiums, on single-family residential buildings and their appurtenances, on residential property units located within multi-family buildings and their appurtenances, provided that they are functionally independent and have one or more independent accesses from the outside, and on individual residential property units and their appurtenances.

Works carried out on real estate units that are registered in the land register under the cadastral categories A/1, A/8 and A/9 do not fall within the scope of the *superbonus*.

Lastly, expenses relating to works on buildings under construction are not eligible for the *superbonus*, as the works must be carried out on existing buildings. However, the *superbonus* is available for works carried out through the demolition and reconstruction of buildings, provided that they can be classified as "building renovation" pursuant to Article 3, paragraph 1, letter (d) of Presidential Decree 380/2001.

Paragraphs 1 and 4 of Article 119 of Law Decree 34/2020 provide for types of energy efficiency and seismic risk reduction works, the "leading" or "main" works (*interventi trainanti*), which qualify for the deduction. These types of works are defined in the following subsections.

(a) Thermal insulation of building shells

This refers to insulation of the opaque vertical, horizontal and inclined surfaces which affect the building shell with coverage of more than 25% of the gross dispersing surface area of the building or a building unit located inside a multi-family building that is functionally independent and has one or more independent accesses from the outside.

These works must comply with the "U" (heat loss) transmittance requirements, expressed in W/m^2K, as defined in the Decree of the Minister for Economic Development of 11 March 2008. The relevant parameters are those applicable on the date of commencement of works.

Expenditure on roof insulation is also eligible for the *superbonus* if the roof is a separating element between the heated volume and the outside, on condition that:

i. when taken together with other insulation measures carried out on the opaque shell, more than 25% of the total gross dispersion surface area is affected;
ii. it leads to an improved rating of two energy classes for the building, even if carried out in combination with other energy efficiency measures and the installation of photovoltaic and storage systems.

For these works, the deduction is calculated on the total amount of expenses up to:

i. €50,000 for single-family buildings or functionally independent building units in multi-family buildings;
ii. €40,000 multiplied by the number of building units in the building for buildings consisting of two to eight units;
iii. €30,000 multiplied by the number of building units in the building for buildings with more than eight units.

(b) Works for the replacement of winter air-conditioning systems in common parts of buildings

This concerns works carried out on common parts of condominium buildings for the replacement of existing winter air-conditioning systems with:

i. centralised condensing heating, cooling or domestic hot-water systems, with an energy efficiency rating at least equal to product class A as set out in the Commission Delegated Regulation (EU) No. 811/2013 of 18 February 2013, using heat pumps, including hybrid or geothermal systems, also combined with the installation of photovoltaic systems and related storage systems;
ii. micro-cogeneration plants;
iii. solar collector systems.

The deduction is calculated on the total amount of expenses not exceeding:

a. €20,000 multiplied by the number of building units in the building for buildings with up to eight units;
b. €15,000 multiplied by the number of building units in the building for buildings with more than eight building units.

If the installation of photovoltaic systems or storage systems is carried out at the same time, the expenditure limit for this type of work is added to that for the replacement of air-conditioning systems.

(c) Works for the replacement of winter air-conditioning systems in single-family buildings or building units located within multi-family buildings

This refers to works carried out on single-family buildings or functionally independent building units with one or more independent entrances from the outside, located in multi-family buildings, to replace existing winter air-conditioning systems with:

i. condensing heating, cooling or domestic hot-water systems, with an energy efficiency rating at least equal to product class A as set out in the Commission Delegated Regulation (EU) No. 811/2013 of 18 February 2013, using heat pumps, including hybrid or geothermal systems, also combined with the installation of photovoltaic systems and their storage systems;
ii. micro-cogeneration plants;
iii. solar collector systems.

The deduction is calculated on a total amount of expenses not exceeding €30,000 per building unit. Within the above limit, the deduction is also available for expenses relating to the disposal and reclamation of the replaced system.

Also for this type of work, if the installation of photovoltaic systems and related storage systems is carried out in combination, the expenditure limit provided for such works is added to the above expenditure limit.

(d) Anti-seismic works

Specifically, this concerns anti-seismic works for the static safety of the structural parts of buildings or complexes of buildings structurally connected, pursuant to Article 16-*bis*, paragraph 1, letter (i), of Presidential Decree 917/1986, whose authorisation procedures began on 1 January 2017, relating to buildings located in seismic zones 1, 2 and 3 pursuant to Prime Ministerial Order No. 3274 of 20 March 2003, including those under which seismic risk is reduced by one or two classes, including those on common parts of condominiums (paragraphs 1-*bis* to 1-*sexiens* of Law Decree 63/2013).

The 110% deduction also applies to expenses incurred by purchasers of so-called earthquake-resistant homes, i.e. real estate units forming part of buildings located in areas classified as seismic risk 1, 2 or 3, which have undergone earthquake-resistant works by means of demolition and reconstruction of the building by construction or renovation companies and which, within thirty months of the completion of the works, are subsequently resold by those companies (paragraph 1-*septies* of Article 16 of Law Decree 63/2013).

The amount of expenditure eligible for the *superbonus* is:

i. €96,000 for works on individual building units;
ii. €96,000 for works on the purchase of "earthquake-resistant houses";
iii. €96,000 multiplied by the number of building units in each building, for works on the common parts of condominium buildings.

The law also provides that certain types of works, the "towed" works (*interventi trainati*), may also benefit from the higher deduction rate of 110%, provided that they are carried out together with the leading works (*interventi trainanti*) eligible for the *superbonus*. In particular, Circular No. 24/E of 8 August 2020 clarifies that this requirement is met if the measures are carried out in a period of time identified as falling between the date of commencement and the date of completion of the works for the implementation of the leading measures.

Towed works are defined in Article. 119, paragraph 2, of L.D. 34/2020 and in all the energy efficiency works pursuant to Article. 14 of L.D. 63/2013.

Finally, the *superbonus* is also available for the following types of works:

a. the installation of grid-connected photovoltaic solar systems on certain buildings, up to a total amount of expenditure not exceeding €48,000 per real estate unit and in any case within the expenditure limit of €2,400 per kW of power of the photovoltaic solar system;
b. the simultaneous or subsequent installation of storage systems integrated into the subsidised solar photovoltaic systems, up to an expenditure limit of €1,000 per kWh.

In order to have access to the *superbonus*, thermal insulation of the shell and the replacement of existing winter air-conditioning systems must:

a. comply with the requirements set out in the decree of the Minister for Economic Development in agreement with the Minister for the Economy and Finance and the Minister for the Environment and Protection of Land and Sea and the Minister for Infrastructure and Transport of 6 August 2020; and
b. ensure, taken as a whole and "in conjunction" with the energy efficiency measures under Article 14 of Law Decree 63/2013, that the installation of solar photovoltaic systems and, possibly, storage systems, results in an improved rating by at least two energy classes.

14.12. Tax incentives for the installation of plugs for the recharging of electric vehicles under Article 16-ter of Law Decree No. 63 of 4 June 2013

Article 1, paragraph 1039, of Law 145/2018 ("2019 Budget Law") introduced Article 16-*ter* to Law Decree No. 63/2013. Under this provision, taxpayers were granted a deduction from gross tax for the installation of electric vehicle-charging stations. The provision did not establish any subjective constraints, so both individuals and corporate taxpayers could benefit from the deduction[90]. The incentive was granted for expenses incurred by taxpayers who owned or held the property on the basis of an appropriate title[91]. Due to it not being extended to the 2022 Budget Law, the installation of electric plugs will be eligible for the relevant building bonus only if the requirements for considering it a trailed work under the *superbonus* provisions are met.

90 Cf. Resolution No. 32/E of 28 February 2019 which states "*Considering that the provision in question does not set any subjective constraint (given the generic reference to "taxpayers"), its scope must be understood in a broad sense since the rule clearly intends to favour the diffusion of standard power charging points not accessible to the public as defined in Article 2, paragraph 1, letters d) and h), of Legislative Decree No. 257 of 16 December 2016. Therefore, persons liable for personal income tax ("IRPEF") and corporate income tax ("IRES") who incur the expenses for the eligible works, if the expenses have remained their responsibility, and own or hold the property or area under a suitable title, may benefit from the deduction* ".

91 Cf. Resolution No. 32/E of 28 February 2019.

PART III
Real Estate financing instruments

15.
Choices of financial structure and value in the Real Estate sector

by A. Cafarelli, M. Dallocchio, M. De Vincenzi

15.1. The CFO and the role of the finance function

The role of the finance function is to ensure that sufficient financial resources are available to carry out corporate affairs[1].

On the basis of this definition a double meaning can be given of the role of the Chief Financial Officer (CFO):

- in a traditional view, he/she is a buyer of financial securities, whose goal is to minimize the total cost of the company's sources of capital;
- in an innovative view, he/she is a seller of financial instruments, whose goal is to maximize the selling price of the securities sold.

If we adopt the innovative view, the CFO's goal is no longer to minimize the cost of capital, but rather to maximize the selling price of the securities sold by the business.

An excessive inclination to minimize the cost of capital can, in fact, lead to a short-sighted behaviour and induce a chief financial officer to take actions that have an immediate benefit but are damaging in the medium-long term.

Taking the minimization of the cost of capital as sole objective can lead to bad decisions. For example, comparing the raising of new capital through capital increase or a bank loan, founding the judgment on the sole basis of a comparison between the costs of the two alternatives is a limited line of reasoning. The reason is that different corporate lenders are not exposed to the same financing risk.

The cost of a source of financing must always be linked to the risk for the investors. Therefore, it is reasonable to compare two forms of financing that are identified by an equivalent level of risk for each of the lenders.

It is therefore worth classifying certain examples of the limits of the "traditional" view of finance:

1 Paragraphs 1,2,3 of this Chapter are an adaptation by the authors of the topics dealt with in the book "Financial Choices" by Maurizio Dallocchio, Bocconi Editore University, 2018.

- excessive short-term debt in order to seize the temporary advantage of a lower cost of debt compared to long-term finance can jeopardize financial stability;
- negotiating a marginal reduction of the interest rate on the debt in return for a mortgage charge can damage the business in the medium term;
- a systematic preference in favour of resorting to debt rather than share capital on the pretext of the lower cost of debt can jeopardize the very survival of the company in the medium term.

According to the innovative view of the finance function, the CFO, in creating debt and equity instruments for the market, sells investors the integrity of the reputation of the management, the quality of the business' assets, the financial and legal strength and finally the capacity for generating income. From a systemic and comprehensive viewpoint, all these aspects determine the capacity of a company to create stable and lasting cash flows over time.

It is thus clear that the CFO through the financial instruments offers investors the future cash flows arising from the performance of business activities. In this phase, the CFO's role is to transform commercial and industrial sources and investments into financial sources and investments, and to distribute the flows of cash among the various groups of investors in line with their performance expectations.

Subsequently, investors transform cash flows into negotiable financial instruments, the value of which is determined from time to time by current opportunities available on the market.

The value of securities essentially reflects the market's evaluation of a company. If a company has weak or inadequate business management, obtaining sufficient support from financial investors will be difficult. As a result, the expected market returns will increase, causing a decline in the company's stock prices. It is the objective of the CFO to convince the market of the quality of the company's fundamentals, preserving the virtuous mechanism that defines the price of the securities on the market. The better the perception of the business, the higher the price that investors will be willing to pay to buy its securities.

15.2. The choice between debt and equity financing

The financial structure of a company is the composition of its sources of capital. In planning business financing policies, or defining strategies to model a company's financial structure, the fundamental question a *CFO* has to answer is simple and direct: "What is the right debt to equity ratio?". The answer to this question is the basis for a definition of the financial structure. If an optimal financial structure existed, depending on the characteristics of a company, the result would be tremendous. Given the financial flows that it would be able to generate, an optimal financial structure would guarantee the maximum possible value.

The reasoning is simple: a company can be seen as a macro – investment and the current value of the future cash flows that it will be able to generate is the basis of its valuation. Now, given that there is a "right" (or optimal) ratio between debt and equity, this must ensure the lowest total cost of funding for the company. And consequently the lowest possible remuneration (of course depending on the business' objective conditions of risk) for the providers of capital. In a scenario of this nature, the value of the company is at its highest, given that the flows will be discounted at the lowest possible rate (representative of the weighted average cost of capital, or WACC).

However, a CFO cannot freely make his or her own choices regarding the mix of financing to be put together in order to achieve the best WACC. Let us consider, for example, the typical average Italian company, where closed ownership and limitation of equity are normally a constraint to growth. The CFO will often be forced to resort to debt, even if equity would be the best choice. This situation can also occur in large listed companies. It is not uncommon that, for reasons connected to control, the CFO may not propose a capital increase, even if necessary for long-term sustainability (if not for the very survival of the business).

The relationship between a company's financial structure and the value of its capital, in the most common approach to valuation, the discounting of operating cash flows, is the company's weighted average cost of capital, according to the following methodological approach:

$$V = F/r$$

where:
V = value of the company;
F = operating cash flows;
r = weighted average cost of capital for the company.

A company's cost of capital is commonly defined as its weighted average cost of capital and consists of the average of return on debt and equity capital, weighted to reflect the contribution of each to total financial resources in terms of the debt and equity capital invested in the company.

The rate of return on capital is calculated according to the following formula:

$$r = K_d \cdot \frac{W_D}{W_D + W_E} + K_e \cdot \frac{W_E}{W_D + W_E}$$

where:
r = weighted average cost of capital;
WE = market value of equity capital;
WD = market value of net debt;
Ke = cost of equity capital;
Kd = net cost of debt.

Now, as is common knowledge, the weighted average cost of capital decreases as the debt ratio increases due to the lower cost of debt capital compared to equity capital. Obviously, the validity of this assumption is not without limit, since beyond a certain level of debt the weighted average cost of capital increases. This is due to the uncertainty inherent in the rates of return on debt and equity capital as a result of the increase in what is known as "financial risk".

Accordingly, the value estimation method indicates that, operating cash flows generated by the business being equal, the optimal capital structure is that in which the weighted average cost of capital has the lowest value, and that, up to reasonably sustainable debt levels, the company's value increases as the weight of debt in the company's capital structure rises.

Contrary to the principles of business accounting, which mainly look to the *past* of a business, corporate finance focuses on its *future*, incorporating expected risk and return issues.

The participation of the shareholders in the business risk is connected with the rights of governance, which allow them to influence management decisions and define governance through voting rights. We have already mentioned that debt is not part of business risk (except in situations of financial distress) and therefore it will not be impacted by an increase in the overall value of a company, even if it can possibly achieve greater solidity in terms of lower risk, assuming the same return on debt securities. Recourse to leverage can instead have an impact on the value of a business, which reflects more than proportionally on the value of equity.

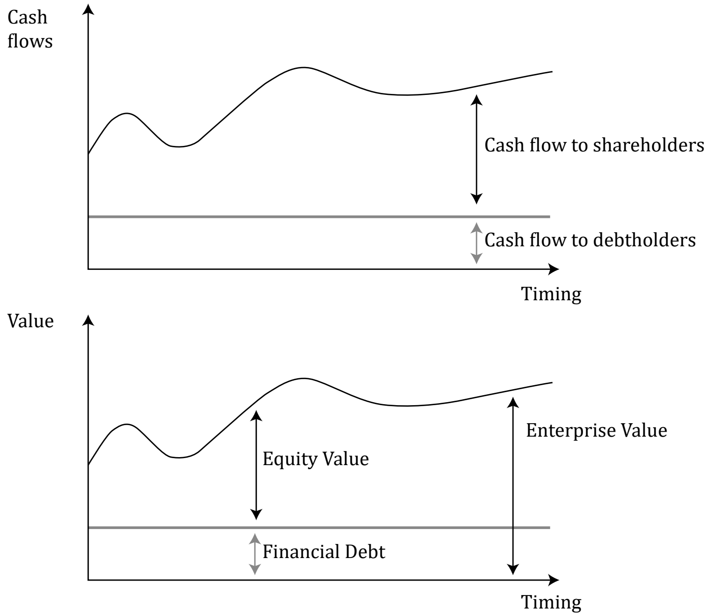


Illustration 1 - Graphic representation of business value

The general assumption is that, as is well known, the cost of debt is lower than the cost of share capital () as the former does not share in business risk (with certain exceptions). Therefore, compared to a financial structure based exclusively on equity, the inclusion of a portion of debt (within limits that we will define) will reduce the; a portion of the most expensive resource (equity capital) will be replaced by a less expensive one (debt).

However, the higher the value of the debt, the higher the risk of the shareholder and therefore the required by the market. The increase of the will have the effect of partly cancelling the positive impact of debt. Moreover, traditional theory claims that over a certain level of debt the risk of default becomes real, with negative repercussions on the required by investors, which will inevitably grow.

The company will have an interest in increasing its indebtedness up to the level in which the positive impact of debt will be fully compensated by the higher return requested by the market. It is at this point that the optimal financial structure, i.e. the one that minimizes WACC and consequently increases business value, is identified. Beyond this level, as debt increases, its benefits will be more than compensated by the increase in returns required by the market.

In conclusion, empirical evidence shows that the optimal financial structure can be achieved by resorting to a sustainable amount of debt, avoiding excesses that cause disproportionate risk and long-term unsustainability.

The following illustration exemplifies a situation where 40% debt on total funding (and therefore, by difference, 60% of equity) ensures a minimum cost of capital.

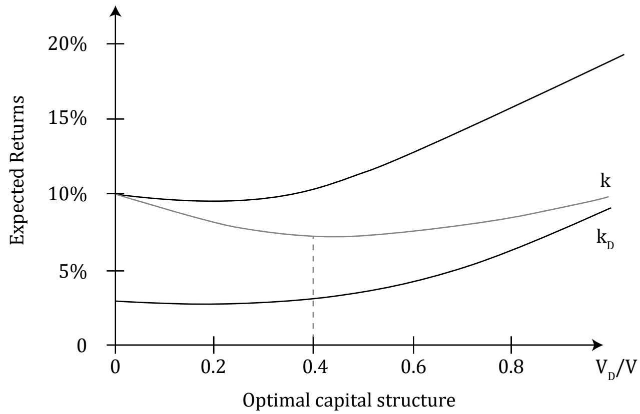


Illustration 2 - Conventional approach to the optimal financial structure

15.3. Analysis of financing policies

The analysis of corporate financing policies involves the need to understand how the company has financed its growth over time.

For this purpose there are three main sources of financing:

- "actual" internal funds (i.e. the cash flow from operating activities);
- financial indebtedness;
- net equity.

It follows that three points need to be studied in depth: the scale and rate of change in the current cash flow; the policy of access to share capital; debt policy.

With particular reference to the dynamics of indebtedness and share capital, aspects worthy of further study are highlighted below.

With reference to the dynamics of share capital, did the company resort to shareholders during the period under review? If so, for what purpose: reducing indebtedness or financing an important operational investment plan? Has the company repurchased own shares (as a way to return excess cash to shareholders)? Has this resulted in a substantial change in indebtedness?

With regard to the dynamics of share capital, two situations should be distinguished:

- if there is evidence of debt reduction, is the reduction in line with the decision to improve the company's financial structure? Has it been carried out to contain the amount of debt incurred in an economic phase in which interest rates were particularly high? Does the company still have valid growth opportunities, or is debt reduction a result of a lack of investment projects?
- if there is evidence of increased indebtedness, is the company using a residual debt capacity or is it at risk of unbalancing its financial structure? Which component prevails: short-term or long-term debt? Is this new debt intended to finance productive investments or non-operating or other investments (such as the repayment of pre-existing debt)?

On an operational level, the analysis of the financing policies of a company can be carried out through two approaches that must be integrated: a "dynamic" and a "static" approach.

The dynamic approach aims at verifying the company's ability to meet its debt, leveraging the cash flows generated by operations, possibly "net" of the cash flows linked to the management of investments.

A careful analysis of financing also requires a static type of examination, conducted in order to understand the absolute and relative level of financial debt, placing it in relation to the company's net assets or to appropriate income configurations.

Both approaches aim at verifying the sustainability of loans and, consequently, of corporate investment policies.

Dynamic approach

To conduct a financial analysis based on a dynamic approach necessarily involves the use of information contained in the cash flow statement, thanks to which we are able to identify the main areas of origin and destination of financial resources.

The principle that should guide the analysis of debt sustainability is that the company must be able to generate sufficient cash flows to ensure the regular servicing of debt.

The first flow configuration to be carefully considered is cash flow from current operations. This flow is a function of three factors:

- the growth rate of the company and of the sector to which it belongs;
- the operating profitability;
- the ability to properly manage the net working capital of the business.

In a nutshell, the cash flow from operations is the sum of after tax EBITDA and of the change in the National Collective Labour Agreement (NCLA) during the period under observation.

The greater the ability to generate cash flows from its operating activities, the greater the company's ability to sustain high levels of indebtedness.

Companies with low current cash flows, instead, are forced to finance their investments with continuous capital injections, be they financial debt or new equity capital.

One indicator that typycally permits a dynamic analysis of the sustainability of a company's capital structure is the *Debt Service Cover Ratio* ("*DSCR*"), commonly used in professional practice, estimated as the ratio of operating cash flow during the period to the flow relating to debt servicing (principal and interest) during that same period.

The *Debt Service Cover Ratio* is calculated as follows:

$$DSCR = \frac{FCO}{(k_t + I_t)}$$

where:
FCO = operating cash flow for the period *t*;
Kt = principal payments to be made in the period *t*;
It = interest payments to be made in the period *t*.

The meaning of this ratio is clear: the resources generated by operating activity must be sufficient to cover the servicing of debt to lenders, in all periods considered. The greater the lender's risk aversion, the higher the level of DSCR required. With regard to the concrete use of the DSCR, in many cases an express request in terms of "average" DSCR is associated also with a minimum specific level of DSCR, along a defined period of time.

A second coefficient used to assess the efficiency of company financing decisions, often associated with the use of DSCR, is the *Loan Life Cover Ratio* ("LLCR"). The indicator represents the ratio of the sum of the present value of the future operating cash flows that the company will be capable of generating until the final period in which the debt is to be repaid, to residual debt on that same date.

The *Loan Life Cover Ratio* is calculated as follows:

$$LLCR = \frac{\sum_{t=s}^{s+n} \frac{FCO_t}{(1+i)^t} + RCD}{D_t}$$

where:
s = time period;
n = duration of the repayment period;
$FCOt$ = operating cash flow for the period t;
i = discount rate;
DCR = debt cash reserve;
Dt = residual debt for period t.

An *LLCR* higher than 1 can be interpreted as the cash surplus freely available to shareholders over the period of the project, should they wish to settle the transaction and repay the full residual debt using the net proceeds generated during the residual term of repayment of the loan.

Once again, it will be appropriate to remind that high debt levels involve greater control by lenders, which exerts positive pressure on the management, and which will actually work in favour of the company, minimizing any imbalance between the interests of the management and the interests of the shareholders in the long-term creation of value.

Static approach

Once the dynamics of the company's cash flows have been examined over a period of time, the analysis of business financing must address the overall level of corporate indebtedness and the relative weight of financial debt, that is to say the company's capacity to pay off the raised debt, including in the hypothesis of a sale of the invested capital. Once again, it is a matter of assessing whether the corporate financing structure is sustainable and consistent with the investments made. To elaborate on this subject, set out below are some of the indicators commonly adopted by international analysts in developing static analysis.

The first useful data for the purpose of assessing the relative weight of liabilities and the degree of risk of the business' financial structure can be derived from the debt to equity ratio. The most common formulation of this is as follows:

$$\textit{Debt to Equity Ratio} = (\textit{Total Liabilities}) \,/\, (\textit{Net Equity})$$

Interpretation is quite simple: businesses with a lasting competitive advantage tend to use their own income capacity to finance their assets and therefore should show a higher level of equity than total liabilities. On the contrary, businesses without stable competitive advantages tend to resort more to debt in order to finance their investments and therefore typically show a higher debt ratio. It must be said that the decision to collect substantial "slices" of indebtedness can also respond to a desire to compress the total cost of capital.

Various versions of the debt ratio exist, depending on the specific aspect of the loan mix which is intended to be investigated.

The most common include those targeted at:

- analysing the weight of financial liabilities only, thus excluding non-financial liabilities. A ratio constructed in this way allows for a more targeted measure of the corporate financial structure, eliminating from the analysis any liability items of a non-strictly financial nature. The most common denomination for this version of the debt ratio is the leverage ratio, or leverage.
- The net financial position is used in place of total financial debt. This solution is particularly rewarding when the company has excess liquid resources. In these cases, actual indebtedness is properly calculated as total debt net of the cash that is not necessary for operational needs.
- Enter as denominator the sum of the Net Equity and as numerator the chosen form of indebtedness (Total Liabilities, rather than just financial liabilities or NFP), so as to obtain the percentage weight of the debt on total financing.

Regardless of the methods used to calculate the ratio, the information provided by the leverage shows the degree of dependence of a company on external lenders. The greater the weight of third-party equity on own equity, the greater the company's need to depend on external lenders in order to secure the necessary capital to fund its operations. The connection between the debt ratio and financial risk is therefore quite evident.

An indicator that is immediately understandable in determining the ability of the business to meet payment of its debt, ensuring the continuity of the business, is obtained through the ratio:

(Net Financial Position)/(Gross Operating Income)

This indicator is extremely useful in professional practice, precisely because it can be easily interpreted. The Gross Operating Income (GOI) represents an excellent approximation of cash flow generated by operating activities (especially in the absence of high growth rates). A low ratio within reasonable threshold values is evidence of the company's ability to meet the service of existing debt. High values are instead indicative of possible tensions due to lack of liquidity. In practice, values above 2.5 - 3 are generally considered “aggressive”, while below these values it is generally believed that the company can easily cope with its debt.

However, it is worthwhile considering that the sector a business belongs to has a significant influence on the analysis and reading of the indicators. In this case, and with an emphasis on the real estate sector, it is not unusual to have high ratio indicators and not necessarily for reasons of “ill-health”. Consider, for example, the possible values of an indicator for a developer in the initial phase of the investment, perhaps when the property land is being reclaimed.

The ratio between operating income and financial charges (Interest Cover Ratio) also provides a useful support for the assessment of a company’s ability to service debt, and in particular the periodic payment of financial charges:

Interest Cover Ratio = (Operating Income)/(Financial Charges)

The Interest Cover Ratio (ICR) indicates the company’s ability to meet the payment of financial charges through the income generated by its core business.

In conclusion, the duties of a CFO include the identification of the most appropriate way to finance the various components of invested capital, and in particular how much of it to finance through short-term sources and how much through medium and long-term financial instruments.

A fundamental principle of sound financial management is based on financial matching, i.e. the tendential search for a correspondence between the maturities of assets and liabilities. Basically, long-term investments (operating fixed assets) should be financed with long-term resources, while short-term investments could be financed with resources with matching maturity.

As an example, we can consider an investment with a long-term usefulness. This investment can be financed through a loan the maturity date of which matches the investment (*matching*), or through a short-term loan with an annual maturity that can be renewed (*mismatching*), both at the same initial rate of interest. Which is the riskier of the two strategies? The second option is clearly the riskier, for two main reasons:

- due to the “interest rate risk”, the cost of the loan could change at the end of the first year, possibly showing undesired growth;
- due to the “refinancing risk”, if the short-term debt is not renewed, the company will have to reimburse it as early as the end of the first year, when the new plant, in all likelihood, has not yet displayed its full economic usefulness and generated the cash flows needed to settle the loan.

15.4. Segment dynamics and the real estate sector

The factors that inform the composition of a company's financial structure are influenced, sometimes even significantly, by the business segment to which they belong. It is typical, in particular, that companies in capital intensive sectors operate at higher levels of indebtedness, and sectors with limited investments in fixed assets are characterized by a more modest resort to leverage.

Academic literature has shown how the sector variable is capable of explaining an important share of the differences in debt levels between companies. For example, companies operating in regulated business segments (such as utilities) usually operate with a high level of debt, since regulations permit them to have a lower operational risk and more stable cash flows. Conversely, players in sectors with more volatile cash flows and lower tangible asset levels should make less use of leverage.

The impact of the sector variable on company debt choices takes on considerable significance, and the median debt of the sector of operation can be regarded as a benchmark to which companies in the sector tend to align themselves. It is appropriate to emphasize that, whilst acknowledging that the sector variable is of considerable significance in decisions regarding financial structure, other variables, such as the company's life cycle, also contribute to explaining the differences that may be seen in the debt ratios of companies in the same sector. Besides, within the same sector, specific operating considerations and the type of business activity play a primary role in the definition of a company's financial structure.

We set out below the results of an analysis of the financial structure of a large sample of listed companies, in 21 business sectors[2], all with market capitalization in excess of 100 million euros[3].

The analysis has been conducted by examining the level of debt,

- calculated as the ratio between gross debt[4] and the sum between the latter and market capitalisation (D/(D + E)).

2 The reference markets are Italy, Spain, France, Germany and the United Kingdom. Banks and insurance companies were excluded from the sample, which included a total of 1502 observations.

3 The analysis included listed companies, in the reference geographical markets, which for 2017 presented a market capitalization of over 100 million euros.

4 Gross debt has been calculated as the sum between short-term financial debt and medium/long-term financial debt.

- calculated as the ratio between net debt[5] and the sum of the latter and market capitalisation (NFP/(NFP+E)).

As expected, the analysis emphasized similar financial structures between players in the same sector and significant differences in the average debt ratio among players in different sectors.

The results that emerge are consistent with the evidence widely obtained from previous analyses.

The following illustration shows the average value of the debt ratio (considering gross indebtedness) between the different reference sectors.

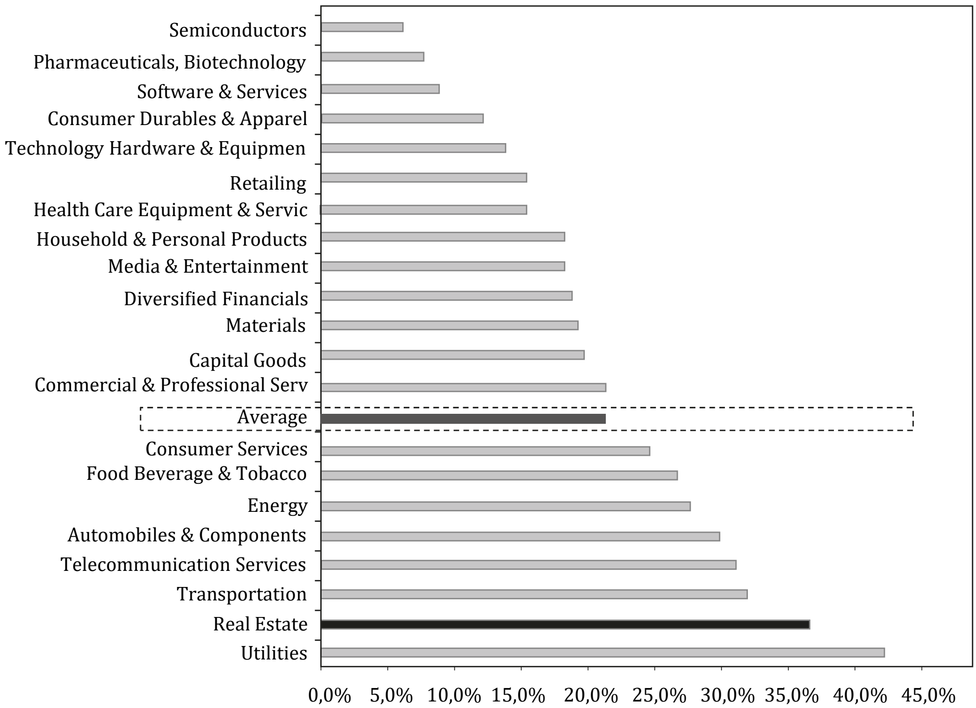


Illustration 1 - Cross-sector analysis of the gross debt ratio. 2017 Data (Source: prepared by the authors using Bloomberg data)

The survey shows a ratio of approximately 21%, considering cross-sector data, while the real estate sector (*real estate*), as expected, shows a significantly higher level of debt compared to the average value of all analysed sectors, equal to approximately 36%.

5 To obtain net debt, cash and cash equivalents have been subtracted from gross debt.

The following illustration shows the dynamics of gross and net debt for the period 2014-2017 for real estate companies, by comparison to the average cross-sector figure.

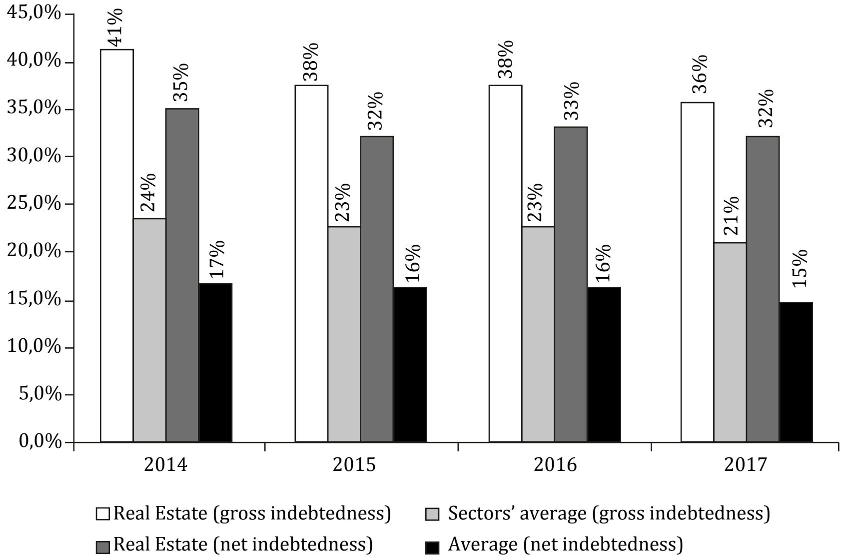


Illustration 2 - Debt ratio for the players in the *real estate* sector and comparison with the cross-sector value, 2014-2017. (Source: prepared by the authors using Bloomberg data)

Considering the Italian market, the sector of *real estate* is characterized by players who, on average, show higher ratios than those of their European *competitors*. The trend also concerns the average cross-sector figure and the following illustration shows that the debt ratio of Italian listed companies is set on average higher values than in the rest of Europe as shown before.

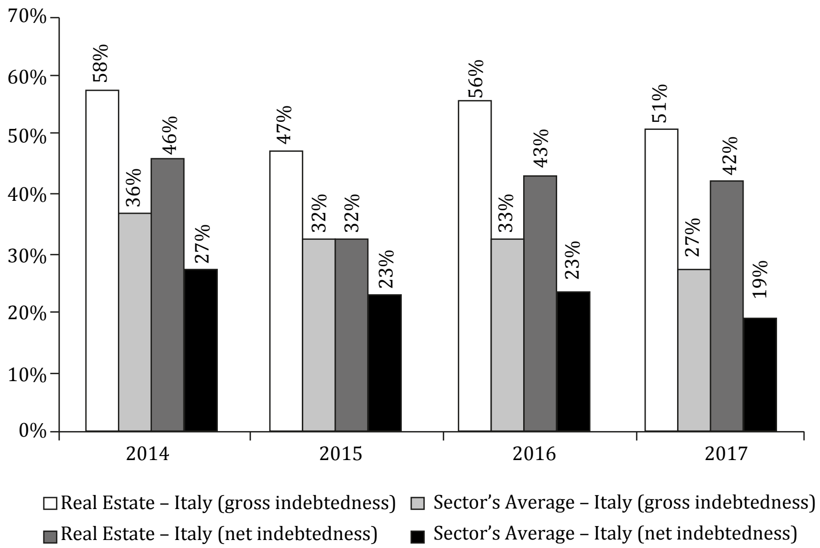


Illustration 3 - Debt ratio for the players in the real estate sector and comparison with the cross-sector value, Italian market 2010-31 August 2017. (Source: prepared by the authors using Bloomberg data)

Considering the parameter of the share capital, in the Italian context the weight of the real estate[6] sector among listed companies is rather limited. Between 2014 and 2017, the capitalization value of real estate companies on average approximates 2%[7] of the overall stock market capitalization.

6 The reference sample for the *real estate* sector consisted of the companies belonging to the "FTSE Italia Edilizia e Materiali" and "FTSE Italia Beni Immobili" segments of Borsa Italiana, which included a total of 20 companies (namely Astaldi, Buzzi Unicem, Caltagirone, Cementir Holding, Gruppo Ceramiche Ricchetti, Italmobiliare, Panariagroup Industrie Ceramiche, Salini Impregilo, Trevi Finanziaria Industriale, Vianini, Aedes, Beni Stabili, Brioschi, Coima Res, Compagnia Immobiliare Azionaria, Gabetti, IGD - Siiq, Industria e Innovazione, Prelios, Risanamento).

7 This share is concentrated on a few operators: in 2017, Buzzi Unicem alone represented about 45% of the total capitalization of the sector.

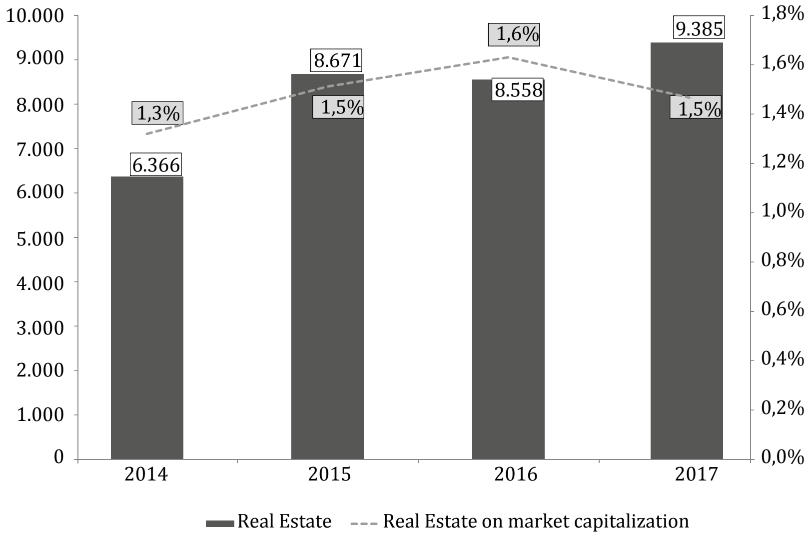


Illustration 4 - Capitalization of real estate companies and percentage impact compared to the total capitalization for the 2014-2017 period, Borsa Italiana. (Source: prepared by the authors using Borsa Italiana data)

Considering the dynamics of share prices, we then calculated[8] certain parameters representative of the degree of significance of the prices, for 2018.

- **float**[9]: currently outstanding shares that can be freely traded on the stock market. For real estate companies, the median value for 2018 varies between 32% and 36% compared to a median stock exchange value of around 40%.

FLOAT						
	Borsa Italiana		FTSE Italia Edilizia e Materiali		FTSE Italia Beni Immobili	
	average	median	average	median	average	median
Last month	46%	38%	34%	32%	37%	36%
Last 12 months	47%	40%	35%	32%	39%	36%
(Number of outstanding shares/Number of issued shares). Source: Bloomberg						

8 The latest survey dated 27 December 2018. Stock market data refer to companies listed on the MTA and AIM Italia segments of Borsa Italiana.

9 This is equal to the ratio between the number of freely outstanding shares and the number of issued shares. Source: Bloomberg.

- turnover velocity[10]: expression of the degree of liquidity of the shares, measurable by the ratio between the number of dealings in a given period and the total number of shares in the company. For real estate companies, the median value for 2018 was approximately 30%, in line with the median stock market value.

TURNOVER VELOCITY						
	Borsa Italiana		FTSE Italia Edilizia e Materiali		FTSE Italia Beni Immobili	
	average	median	average	median	average	median
Last month	4%	1%	7%	2%	1%	1%
Last 12 months	72%	31%	90%	41%	33%	29%
(Number of dealings/Average numerb of shares of the company). Prepared by the authors using Bloomberg data						

- **volatility**[11]: expression of the average deviation of prices from their average value, and therefore the degree of risk of any individual security. The companies in the real estate sector have a median value for 2018 that is higher than the stock market value.

VOLATILITY						
	Borsa Italiana		FTSE Italia Edilizia e Materiali		FTSE Italia Beni Immobili	
	average	median	average	median	average	median
Last month	40%	33%	46%	38%	127%	39%
Last 12 months	41%	33%	42%	36%	88%	43%
Standard dev. on annual basis of price var. Source: Bloomberg						

The analyses permit to emphasize how the trend in the prices recorded last year shows values of turnover velocity – a proxy for liquidity – and float in line with stock market trends but balanced by a significantly higher volatility.

In conclusion, it may be observed that the use of debt capital may yield financial and economic benefits for businesses, and establishing an adequate, effective level of debt is a significant factor to the creation of company value.

10 Calculated as the ratio between the number of dealings in any chosen period and the number of shares in the company. Source: Bloomberg.

11 Measured by the *standard* deviation, on a yearly basis, of the price variations of the share and/or of the reference index. Source: Bloomberg.

Although the authors do not believe it is possible to establish a single optimal financial structure for businesses a priori, considering the constant need to adapt to the changing conditions in the competitive system of reference, a sound financing policy that is consistent with the company's operating strategy is essential to doing business profitably.

15.5. The credit market and the real estate sector

The real estate sector is, by its very nature, largely exposed to the availability of funding and investments in the real estate sector are historically characterized by ample resort to leverage.

One aspect that considerably impacts on businesses' decisions with regard to their financial structure is related to the underlying conditions of the relevant credit market.

Even in countries where the main source of funding on the market is represented by bank loans (in Europe, the Southern Countries), alternative options are available for smaller and less developed businesses. Given the situation, the consequences of adverse economic contingencies that affected global financial markets after 2008 – which also resulted in a sharp decline in access to bank loans for households and businesses – determined a situation of severe vulnerability for the real economy.

Turning to Italy in particular, the financial structures of enterprises have historically shown a marked preference for bank borrowings, and a more modest resort to the equity and bond markets, when compared to the international scene. These peculiar features had a deep impact on financing capacity during the aforementioned economic crisis and thus resulted in extreme difficulty for companies in obtaining financing, as a consequence of the decline in bank lending. Additionally, the reduced access to credit by enterprises affected not only smaller companies with fragile financial situations, but also larger companies with stronger balance sheets.

It seems uncontroversial to observe that deal flow in the real-estate sector is strongly influenced by access to financing and liquidity. During periods when credit access conditions are looser and more financing is available for enterprises, surplus production capacity may occur, laying the foundations for a subsequent contraction of the market. In the Italian domestic market, banks played a fundamental role in supplying credit for the development of the real-estate sector, but there is a danger that the approach to managing the risk tied to this type of investment will become increasingly strict, affecting the ability of some types of companies to grow.

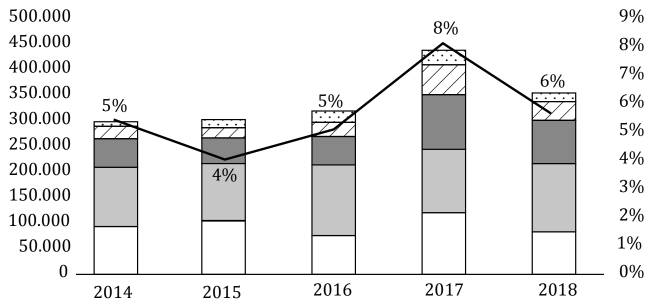
The most recent Bank of Italy figures[12] show a general improvement in credit access conditions for households and businesses, supported by low, though growing, interest rates.

Access to credit by enterprises has increased in the last twelve months, but the growth did not show in all sectors of activity. Specifically, bank loans to non-financial companies increased overall by 1.1%, mainly to manufacturing companies (+ 2.1%) and service companies (+ 2.3%). At the same time, the decline in loans to companies operating in the building sector continued, setting at -2.4% last year.

As is common knowledge, bond issuance is one of the main alternative sources of debt capital. To assess how widespread the use of bonds as a source of capital is, we analysed bonds with a value of more than €100 million, placed during the period 1 January 2014 – 31 August 2018 in Italy, Spain, France, Germany and the United Kingdom. The analysis shows a strong increase in the value of the bonds issued in the last two years and in particular:

- a constant increase in the total value of the bonds placed, with a peak in 2017 and a 2014-2018 CAGR of approximately 4%;
- on average, the bonds issued in the *Real-Estate* segment accounted for approximately 6% in the same reference period.

As may be clearly seen from the following charts, bond issues in Italy and Spain were much more modest than in the three other countries analysed.



	2014	2015	2016	2017	2018
Spain	9.442	16.097	22.075	29.143	17.273
Italy	23.248	19.694	25.579	57.863	36.455
Germany	55.472	51.994	57.742	104.217	82.938
France	116.596	110.118	141.635	128.465	134.028
United Kingdom	93.887	104.602	73.443	119.514	83.029
% Real Estate	5%	4%	5%	8%	6%

Illustration 1 - Value of bond issues, 1 January 2014 - 31 December 2018. (Source: prepared by the authors using Bloomberg data)

12 Source, Bank of Italy, Economic Bulletin, January 2019.

In this scenario, it is entirely reasonable to conjecture that enterprises operating in countries with highly liquid bond markets will obtain funding by issuing bonds and thus finance the debt of their subsidiaries, since credit is not available in Southern European markets.

Within international groups, one might suppose that the changing general conditions and the effects of a more difficult access to credit in some countries have driven companies that are based in countries where alternative forms of funding (such as bond issuance) are more developed to increase their recourse to financing, for one reason in order to meet the need to fund their subsidiaries in Southern Europe.

16.
Legal aspects of financing instruments in the Real Estate sector

by M. Lisanti, M. Monterosso[1]

16.1. Loans and other banks finance

16.1.1. Preliminary remarks

Under Italian law and therefore within Italy, the business of granting loans to third parties is a "regulated activity", which may only be carried out by the following persons[2]:

a. Italian banks;
b. banks of another Member State of the European Union;
c. non-EU banks duly authorised to carry out lending business in Italy, having opened a branch in Italy or having received a specific authorisation from the Bank of Italy to operate on a cross-border basis in Italy;
d. authorised financial intermediaries, registered in a special list held by the Bank of Italy;
e. financial companies having their registered office in a Member State of the European Union, provided that their controlling interest is held by one or more banks having their registered offices in the same country[3];

1 Authors as follows: from 15.1 to 15.3, and from 15.5 to 15.12: Mario Lisanti; from 15.4 to 15.7: Michele Monterosso. Mario Lisanti would like to thank Annalisa Santini, Michele Milanese, Beatrice Melito, Davide Cipolletta, Federico Squarcia, Daniele Dainese, Andrea Scarfone and Aurora Pignalosa for their valuable help to this work.

2 Article 106 of Legislative Decree no. 385 of 1 September 1993 (the Italian Consolidated Banking Act), also known as "*Testo Unico Bancario*" and subsequently referred to as "TUB", together with, among others, the relevant implementing and interpretative second-level rules, including Ministerial Decree no. 53/2015 of the Ministry of Economy and Finance.

3 Article 18 (2) of the TUB.

f. securitisation vehicles pursuant to Law no. 130/1999[4], within the limits and under the terms specified therein and subsequently supplemented by secondary regulations;
g. Italian or EU collective investment undertakings (in Italian called "*organismi di investimento collettivo del risparmio*" or "OICR") that invest in credits, pursuant to, respectively, Article 46-*bis* and 46-*ter* of Legislative Decree no. 58/1998[5], within the limits and under the terms specified therein and subsequently supplemented by secondary regulations; and
h. European long-term investment funds (ELTIF) pursuant to the Regulation (EU) 2015/760[6], which, once authorised by the competent national authority, due to the direct applicability of the above-mentioned Regulation within the Member States, may invest in credit and other debt instruments, subject to the conditions set out therein.

For the sake of completeness, it should be noted that the legislation expressly provides that Italian insurance companies and Sace S.p.A. (a subsidiary of Cassa Depositi e Prestiti dedicated to export credit) may carry out lending activity in Italy, within the limits and according to the conditions set out in the applicable laws[7].

Although several non-bank entities are allowed to lend into Italy, the true leaders in the Italian lending market are banks, whether Italian or foreign, which are involved in almost all the financing transactions both in the "*Commercial Real Estate*" (CRE) segment and in the residential and industrial sectors.

In the paragraphs that follow, we will analyse the main aspects of bank loans typically used in the Italian Real Estate market and the related contractual documentation.

4 Law no. 130 of 30 April 1999 (the Italian Securitisation Law). On securitisation, see para. 15.8 below.

5 Legislative Decree no. 58 of 24 February 1998 (the Italian Consolidated Financial Act), also known as "*Testo Unico della Finanza*" and hereinafter referred to as "TUF". On direct lending by funds, see para. 15.9 below.

6 Regulation (EU) 2015/760 of the European Parliament and the Council of 29 April 2015 on European long-term investment funds, currently in force. This Regulation was subsequently amended by Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023, which was published in the Official Journal of the European Union on 20 March 2023 and with effect from 10 January 2024.

7 Article 114 (2bis) of the TUB. On direct lending by Italian insurance companies, see para. 15.9 below.

16.1.2. Traditional loans and "credito fondiario"

The loan (*mutuo*) is certainly one of the most widely used credit instruments in the Italian Real Estate market. The loan contract is governed by Article 1813 et seq. of the Italian Civil Code. Article 1813 states: "*A loan is the contract by which a party delivers to the other a certain amount of money or other fungible items, and the other undertakes to return an equal amount of items of the same kind and quality*". The reference to the "delivery of money" firstly stresses what legal experts call the "real nature" of the loan contract, which is entered into and implemented through the delivery of the *res* from the lender to the borrower; secondly, it highlights the almost philosophical contradiction between a traditional loan, on the one hand, and the modern financing agreements used in everyday practice, on the other. In the latter, especially in the CRE sector, there is no actual transfer of money between the parties, and – above all – a contract is considered entered into not when the loan is disbursed, but well before that, when the parties agree that the bank shall make a certain sum of money available to the borrower (commitment), and the borrower will choose freely whether to request or not the actual utilisation of the available credit, in accordance with the terms and conditions agreed between the parties.

Though with difficulty, both legal scholars and court decisions[8] have progressively opened up to a classification of certain types of loans as contracts of a consensual nature, *i.e.* as contracts that in line with the above-mentioned market practice and like the credit facilities that will be dealt with in the next paragraph – are concluded not by means, and only at the time, of the transfer of the money, but through the mere agreement reached between the parties on the essential features of the loan and on the terms and conditions of its utilization.

Within the broader category of financing methods used in Real Estate transactions, it is worth mentioning the sub-group of "*credito fondiario*", a specific type of mortgage loan which is governed by Article 38 et seq. of the TUB.

The *credito fondiario* is a special medium or long-term financing[9] granted by banks and which is secured by a first ranking mortgage on real property,

8 See, among others, the decision of the Supreme Court, Section III, no. 7773 of 19 May 2003, which has been confirmed by, among others, the decision of the Court of Rome, Section IV, no. 13404 of 25 June 2019 and the Supreme Court, Section III, no. 9838 of 14 April 2021.

9 Under applicable tax laws, a medium or long-term financing is a financing with a duration of more than eighteen months.

up to a maximum amount identified as a percentage of the value of the mortgaged property or the cost of the works to be performed on it, including the cost of the land or property to be developed[10].

The laws on the *credito fondiario* provide for a number of exemptions from ordinary rules, exemptions that in some cases are in favour of the bank/lender, in others of the borrower. The former include:

a. a mortgage created to secure a *credito fondiario*, registered at least ten days before the declaration of judicial liquidation of the mortgagor, may not be subject to claw-back actions (this is known as the "accelerated consolidation of the mortgage for *credito fondiario*");
b. Article 166 of the Corporate Crisis and Insolvency Code[11] (*i.e.* the rule governing the actions to claw back certain contracts, transactions and payments made by the company before the declaration of judicial liquidation) does not apply to payments made by the debtor to discharge obligations relating to a *credito fondiario*; and
c. the enforcement action on mortgaged assets securing a *credito fondiario* can be initiated or continued by the bank even after the declaration of judicial liquidation of the debtor, by way of derogation from the provisions set forth under Article 150 of the Corporate Crisis and Insolvency Code.
Provisions in favour of the borrower include the following:

10 On these aspects, Article 38 (2) of the TUB refers to the implementing regulations of Bank of Italy, to be issued in accordance with the decisions of the Interministerial Committee for Credit and Savings ("*Comitato Interministeriale per il Credito e il Risparmio*" or "CICR"). At present, a *credito fondiario* cannot exceed 80 per cent of the value of the mortgaged assets or the cost of the works to be performed on them. This percentage may be raised up to 100 per cent if one or more additional guarantees are given, including, among others, bank or insurance guarantees, in each case according to the criteria set by the Bank Italy. By decision no. 33719 of November 16, 2022, which has been confirmed by the decision of the Supreme Court, Section III, no. 7949 of 20 March 2023, the United Sections (Sezioni Unite) of the Supreme Court ruled on the limit of fundability of the *credito fondiario* and ex officio requalification of the agreement, clarifying that it is neither null and void nor qualifies as an ordinary mortgage loan, but is a perfect *credito fondiario*, the one stipulated between the bank and the customer albeit exceeding the maximum financeable limit (i.e. 80 percent of the value of the mortgaged assets or the cost of the works to be performed on them, pursuant to Article 38 (2) of the TUB). With this decision, the United Sections (Sezioni Unite) reverse previous case law, according to which a loan granted for an amount exceeding 80 per cent of the value of the mortgaged assets was not irregular but void, without prejudice, however, to the possibility, if all the conditions are fulfilled, of converting the credito fondiario affected by nullity into an ordinary mortgage loan.

11 Legislative Decree n. 14 of 12 January 2019 .

a. whenever they have repaid one fifth of the original debt, debtors may request a proportional reduction of the secured amount, and have the right to obtain the partial release of one or more mortgaged properties by producing documents or expert reports showing that the remaining charged assets are a sufficient security for the sums still due pursuant to Article 38 of the TUB;
b. the borrower may settle in advance, in whole or in part, its debt by paying to the bank an overall amount agreed at the time of the execution of the loan contract; and
c. the bank may invoke delayed payment as a cause for termination of the contract, but only if payment has been delayed at least seven, even non-consecutive, times (and "delayed payment" shall mean a delay of between thirty and one hundred and eighty days after each relevant payment date).

It should be noted that, even when a Real Estate finance transaction meets all the legal requirements to be eligible as *credito fondiario*, the parties can decide not to follow this route. They can instead enter into what is commonly known as "*finanziamento ipotecario*", *i.e.* a mortgage-secured financing which is subject to ordinary provisions (if all eligibility conditions are met and the parties want to enjoy the benefits of *credito fondiario*, they will insert in the loan agreement an express reference to Article 38 et seq. of the TUB).

In practice, where the borrower is a corporate vehicle or a Real Estate alternative investment fund (AIF), and there is therefore a general presumption on ring fencing, *i.e.* mitigation of the debtor's judicial liquidation risk, banks tend to prefer a mortgage-secured financing in the form of *finanziamento ipotecario* rather than *credito fondiario*, as several of the provisions to the debtor's advantage set out in the *credito fondiario*'s laws cannot be derogated from.

16.1.3. Credit facilities

A further type of credit contract widely used in the Real Estate sector, and the main type in the CRE field, is the credit facility agreement (*apertura di credito*). Also this contract is expressly regulated by the Italian Civil Code, which includes it in the category of banking contracts. According to Article 1842 of the Italian Civil Code, "*a bank credit facility agreement is a contract whereby the bank undertakes to make available to the other party a sum of money for a given period of time or indefinitely*".

Unlike a loan (*mutuo*), at least in the traditional meaning of this term as outlined above, a credit facility is a contract that becomes binding through the mere agreement of the two parties: the bank undertakes to make available to the other party a sum of money for a given period of time or indefinitely, and the debtor, in return for this commitment, undertakes to pay the bank a price inclusive of a commission (commitment fee) and a fixed or floating interest depending on the sum actually utilized from time to time.

Article 1843 (1) of the Italian Civil Code expressly provides that the debtor can draw from the facility several times, and can, by subsequent repayments, restore the available funds. Credit facilities that entitle the borrower to redraw the sums previously drawn and reimbursed are known as 'revolving credit facilities', whereas credit facilities that do not provide for the possibility to redraw previously repaid amounts are called 'term facilities'.

In the Italian CRE market, most of the finance:

a. comes in the form of a credit facility (*apertura di credito*), whether revolving or term;
b. even when the legal conditions are met, is – except for special cases – not subjected by the parties to the *credito fondiario* regime set forth in Article 38 et seq. of the TUB, hence qualifying as a 'mortgage-secured financing' (*finanziamento ipotecario*); and
c. is fixed-term (the debtor can request the drawdown of the credit line only within a limited period of time, which is referred to as the 'availability period').

In practice, the bank and the borrower, before signing the credit agreement setting out the final terms and conditions of the financing, sign a mandate agreement, known as 'mandate letter' or 'commitment letter', relating to the potential arrangement and underwriting of the financing. This letter sets out the main terms of the credit transaction, normally contained in an annex of the letter called 'term sheet', and, except for very rare exceptions, expressly provides that the credit contract has not yet been concluded and that the bank has not yet undertaken any obligation to provide the loan facilities which are being negotiated by the parties.

Once the overall structure of the financing is agreed and the other documents or deliverables essential to ensure the successful completion of the transaction (for example, a resolution of the credit committee of the bank, the appraisal of the value of the property to be mortgaged, or the due diligence reports on environmental, tax, Real Estate, corporate or zoning matters) have been provided on satisfactory terms, the bank and the borrower will sign the credit agreement, often in the form of an authenticated private agreement (*scrittura privata autenticata*) or as an exchange of proposal and acceptance, as well as the other finance documents. These generally include the security documents, the fee letters and a hedging strategy letter on the further documents to be signed to mitigate the risk of an increase in the interest due by the debtor during the whole or part of the life of the loan or a portion of it[12].

The loan agreements concluded in the Italian CRE market usually contain one or more of the following credit facilities:

a. *acquisition facility*: credit line for the purchase of a specific Real Estate asset (including shares or quotas of Real Estate companies or units of Real Estate AIFs) that can generally be drawn in one single loan and only for a very limited period of time. In certain cases, this type of facility can also be used to finance all or part of the costs borne by the debtor in connection with the overall Real Estate transaction and known as 'transaction costs', such as advisors' fees and tax charges. The latter also includes the amount contractually due by the debtor to the bank to pay the "*imposta sostitutiva*" (substitute tax) on medium – long term financing pursuant to Presidential Decree no. 601/1973. As a matter of law, this tax is not due by the debtor but by the bank; as a consequence, the corresponding amount is usually not included in the funds actually advanced by the bank at closing, but it is retained by the bank itself on the disbursement date;
b. capex facility: credit line through which a borrower finances the development of a Real Estate asset (or the renovation or extension of an existing property) and which will, over time, be repaid through the proceeds from the sale or management of such property. Being often structured in the form of a term facility, a capex facility does not allow for a new withdrawal of the sums drawn and reimbursed, but – unlike an acquisition facility – a capex facility can normally be drawn in several loans and over a reasonably long period of time, which will depend on the duration of the works to be financed (the utilizations will be made in accordance with a mechanics usually known as "stato avanzamento lavori" or "SAL");
c. VAT facility: credit line used to finance the VAT costs to be incurred in connection with the development of a Real Estate project (its key features are similar to those of a capex facility);
d. working capital facility: credit line that allows for the sums drawn and repaid to be redrawn (it is, therefore, a revolving credit facility), usually employed to finance the borrower's working capital requirements and, in cer-

12 On the hedging aspects of Real Estate financing transactions, see chapters 19 and 20.

tain cases, all or part of the transaction costs. In the field of corporate lending, i.e. in respect of corporate borrowers, this type of credit line is used to finance any cash or liquidity requirement of the borrower or its subsidiaries (in this case the facility is used for "general corporate purpose"); and

e. refinancing facility: credit line used to repay existing indebtedness and available generally in a single drawdown and only for a very limited period of time (as a term facility, it is not possible to redraw sums already drawn and repaid).

16.2. The borrowers

Banks are the main lenders in the Italian Real Estate market, including in the CRE segment. The possibile borrowers include:

a. Italian companies that conduct their business exclusively in the Real Estate field (including, inter alia, SIIQ and SIINQ)or that decide to use their Real Estate assets as collateral to obtain finance at a cheaper price and/or on better terms;
b. corporate vehicles created *ad hoc* (SPVs) to develop a Real Estate project (newco) or to carry out the acquisition (bidco) of a Real Estate asset; in the latter case, bidco may subsequently merge with the target company and thus carry out an LBO transaction pursuant to Article 2501-*bis* of the Italian Civil Code (if no post-acquisition merger is planned, bidco may also be a foreign company, for example a limited liability company under Luxembourg law);
c. Real Estate alternative investment funds (AIFs)[13]. Since funds do not have legal status, the loan agreement and other finance documents must be signed by the asset management company ("SGR", which stands for "società *di gestione del risparmio*"), which will sign the documents "on behalf" of the fund managed by it (if the borrower is a compartment of a fund, it will be necessary to specify it expressly in all the finance documents and in the party clause). In certain transactions, the lenders require that the loan agreement be signed by the SGR also in its own name, to ensure that the SGR can take on certain undertakings or give certain representations and warranties on matters unrelated to the fund but pertaining only to the SGR itself (for example corporate or regulatory matters); and

13 On Real Estate AIFs, see chapter 6.

d. Real Estate investment companies with fixed capital (SICAFs)[14]. It has to be highlighted that all borrowers that could not be qualified as "enterprise" ("impresa"), were not suitable to benefit from the supporting measures provided by the emergency legislation in connection with the Covid – 19 pandemic (i.e. moratorium and State-guaranteed loans).

16.3. The templates of the Loan Market Association

Anyone operating in the Italian Real Estate Finance market will know (and frequently pronounce) the acronym "LMA", which – as practitioners know well – stands for "Loan Market Association". The LMA is an association founded in London in 1996 for the purpose of improving the efficiency, transparency and liquidity of primary and secondary markets for syndicated loans in Europe, the Middle East and Africa. At present, the association has over 600 members from more than sixty countries. Members include banks, investors, advisory firms, rating agencies and law firms.

One of the main goals of the LMA is the development of contractual templates to be used mainly in the context of private equity-sponsored financing transactions, or in the field of investment grade corporate lending or Real Estate finance. LMA templates are the result of careful drafting and updating, and have a typically "balanced" nature, as they are the result of a fair compromise between the interests of the lenders and those of the borrowers. Models of this type can make negotiations between the parties shorter, and therefore easier, and can help standardize contractual practices in the different countries, thus indirectly increasing the number of potential cross-border financing and investment transactions.

Initially, LMA templates were governed only by English law. In recent years, contractual models governed by the laws of countries other than England and Wales have been introduced. In the Real Estate field, for example, LMA has issued templates governed by German law (and in the German language).

So far, LMA has not published templates governed by Italian law (or in Italian). Nevertheless, LMA templates are widely used in the Italian market and are often referred to also when the loan agreement is governed by Italian law and is in the Italian language. In this case, the parties and their respective advisors apply, with the necessary additions and modifications, the English

14 On Real Estate SICAFs, see chapter 7.

law templates drawn up by the LMA for Real Estate Finance transactions, including the "*Single currency term facility for real estate finance multi-property investment transactions*" template and the "*Single currency term facility agreement for Real Estate finance*" template[15].

The most important changes to be made to the English model with a view to adapting it to the Italian legal framework and/or to Italian borrowers include:

a. an amendment of the clause governing the consequences of an Event of Default, to insert specific provisions on the three different legal concepts that may govern this situation in the Italian legal system, namely "immediate repayment" (*decadenza dal beneficio del termine*) (Article 1186 of the Italian Civil Code), "express termination clause" (*clausola risolutiva espressa*) (Article 1456 of the Italian Civil Code) and "contractual withdrawal" (*recesso convenzionale*) (Article 1373 and, for credit facilities, Article 1845 of the Italian Civil Code)[16];
b. changes in the clause on the transfer or assignment of the lenders' commitments and loans, with a view to structuring the "transfer by novation" under English law as "transfer of contract" (*cessione del contratto) under Italian law, so as to include any undrawn commitments of the assignor, and the "assignment of rights"* under English law as "assignment of loan receivables" (*cessione del credito*) under Italian law;
c. the inclusion, in the facility agent or security agent clause, of specific provisions to define the relationship between such facility or security agent and the lenders as a "*mandato con rappresentanza*" (agency with representation) under Italian law, and other express provisions and authorisations concerning conflicts of interests (Article 1394 of the Italian

15 Both are available on the LMA website: www.lma.eu.com.

16 In certain Italian law loan agreements, the "events of default" are divided into three categories: (i) events falling within the scope of Article 1186 of the Italian Civil Code, insofar as they are a result of an actual or potential worsening of the financial profile of the borrower or of the guarantee and security package supporting the loan;
events caused by a breach of contract made by the borrower, the serious nature of which has been pre-determined by agreement between the parties and which accordingly entitles the bank to request the termination of the contract and the immediate repayment of the loan together with interest and other ancillary items, pursuant to Article 1456 of the Italian Civil Code; and (iii) events that reduce or could reduce the prospects of recovery of the sums that have been lent, and that, by express agreement between the parties, are sufficient to grant the bank a right of withdrawal from the contract pursuant to Article 1373 or 1845 of the Italian Civil Code, a right which, according to case law, is to be exercised in good faith (i).

Civil Code) and contracts with oneself (Article 1395 of the Italian Civil Code);

d. the introduction of a specific clause pursuant to which the parties agree that, for the entire term of the loan[17], the total interest to be paid by the borrower shall never exceed the usury cap established under the Italian law on usury (Law no. 108 of 7 March 1996) and its implementing regulations;
e. the insertion of clauses to limit the compounding of interest in accordance with the applicable laws (Article 1283 of the Italian Civil Code and Article 120 of the TUB). Like the laws on usury, the provisions on compounding of interest are considered mandatory rules and therefore applicable also to contracts governed by foreign law entered into by Italian borrowers;
f. any amendments that are necessary to ensure compliance with any applicable regulatory provisions concerning the transparency of contractual conditions and relationships with customers ("*Trasparenza delle condizioni contrattuali e dei rapporti con i clienti*") pursuant to Title VI of the TUB, as well as the insertion of a cross-reference to the provisions on the transparency of banking and financial transactions and services issued by the Bank of Italy;
g. the inclusion of undertakings ("impegni di fare e di non fare") and of representations and warranties in line with the standard practice in the Italian market. The former will include clauses prohibiting the creation of "segregated asset portfolios" (*patrimoni destinati) or the borrowing of "dedicated financings*" (*finanziamenti destinati*), pursuant to – respectively – Article 2447-*bis* and 2447-*decies* of the Italian Civil Code. The latter will include representations and warranties concerning the present or prospective state of insolvency or financial stress of the borrower, which

17 Please note that there has been a recent order from the Supreme Court on the supervening usury (usura sopravvenuta) taking a position in stark contrast to the previous one: in fact, following the 2017 decision, the prevailing guideline excluded the supervening ineffectiveness of the interest rates clause which was originally sub-threshold but then - during the execution of the contract - exceeded the usury threshold rate established by the ministerial decrees. Instead, in the most recent order (no. 27545 of 28 September 2023) issued by the same Court it has been affirmed that usurious interest incurred during the course of the agreement are undue amounts, and consequently the creditor claiming the payment of interest become ultra-legal (in the course of the contract) would determine the performance of an objectively disproportionate service; this being contrary to the general principle of good faith which requires the parties to cooperate during the whole performance of the contract.

shall reflect the specific provisions that govern these matters in the Italian legal system, including, among others, the Corporate Crisis and Insolvency Code and Article 1977 of the Italian Civil Code on the assignment of the debtor's assets to its creditors;

h. the insertion, in the clauses of the loan agreement that deal with personal guarantees given by Italian obligors, of a cap on the maximum guaranteed amount, so as to comply with Article 1938 of the Italian Civil Code on guarantees for future debts (which is considered a mandatory rule and, therefore, applicable also to personal guarantees given by an Italian person under a foreign law). Further amendments can be necessary, in light of the overall structure of the transaction, in order to comply with other similarly mandatory or otherwise applicable Italian rules on corporate benefit (pursuant to Article 2384 of the Italian Civil Code) and financial assistance (Article 2358 and 2474 of the Italian Civil Code); and
i. the introduction of various definitions, such as, by way of example, "Accounting Principles", "Italian Bankruptcy Act", "Italian Civil Code", "Italian Banking Act" and "Italian Financial Act", as well as the amendment of certain tax clauses in order to reflect certain peculiarities of the Italian tax system (the main change is the inclusion of the definition "Italian Qualifying Lender"[18] to identify the potential assignees of the loan who

18 In contracts drafted in Italian, we often see the definition of "*Finanziatore Qualificato*", which means, for example: (a) a bank or a financial institution authorised or licensed to carry out banking or financial activities within the territory of Italy pursuant to Italian Legislative Decree No. 385 dated 1 September 1993, or an alternative investment fund established under Directive 2011/61/EU and duly authorised or licenced to carry out lending activity under Legislative Decree No. 58 dated 24 February 1998 that it is tax resident in Italy pursuant to article 73 of the Italian Presidential Decree number 917 of 22 December 1986 and the relevant international tax treaties not acting for the purposes of facility agreement through a permanent establishment located outside of Italy; (b) a bank or financial institution which is authorised or licensed in a country which is a member state of the European Union to carry out banking or financial activities and it is subject to taxation in Italy pursuant to article 152 of Italian Presidential Decree number 917 of 22 December 1986 with a permanent establishment in Italy with which that lender's participation in the loan is effectively connected; (c) an entity in respect of whom the interest payments made by from Italy are exempt from withholding tax under Italian laws (including Articles 26, paragraph 5-*bis*, of the Italian Presidential Decree No. 600 of 29 September 1973); (d) a securitisation vehicle established under the Italian law n. 130 of 30 April 1999; or (e) an entity that: (i) is treated as resident of a jurisdiction having a double tax treaty with the Republic of Italy which makes provision for full exemption from tax imposed by the Republic of Italy on interest; (ii) does not carry on a business in Italy (or the jurisdiction of source of interest (if different)) through a permanent establishment with which the lender's participation in the loan is effectively connected; and (iii) fulfils any other conditions which must be fulfilled under the relevant double tax treaty to obtain full exemption

will not be subject to withholding tax, pursuant to Italian law, on the payment of interest due by the debtor, and who are therefore pre-approved by the same debtor given the neutrality, from a tax point of view, of the loan assignment).

16.4. Typical covenants in the Real Estate sector

16.4.1. Preliminary remarks

Loan agreements structured by the main banks operating in the Real Estate Finance sector are characterised by the presence, consolidated as a market standard and gradually refined over the last decade, of a set of covenants to measure the performance of the counterparty and the collateral during the term of the loan. These covenants are aimed at ensuring the maintenance of the financial and operating balance of the borrower so that the benchmarks standing at the time of signing of the contract are not significantly altered during the life of the loan, and constitute an essential protection to the lending bank as well as an effective measure of the performance of the investment and of the management of the underlying Real Estate by the borrower. Covenants are essentially classified as financial covenants when they have a financial nature and information covenants when they concern any collateral.

The nature, set and frequency of assessment of all the covenants present in a loan agreement may vary according to the specific agreement and to the various factors, including: (i) type of borrower (Italian SPV, SGR in the name and on behalf of a Real Estate fund, SICAF, listed property company or SIIQ), (ii) nature of the loan whether with or without recourse, (iii) nature of the loan, whether or not secured by a security package, including, first of all, a mortgage, (iv) specific nature and asset class of the Real Estate constituting the main collateral of the facility and their use as office, retail (shopping centres, retail parks, designer outlets, highstreet units), industrial or logistics, and finally (v) negotiation between the parties.

Set out below is a summary of the main financial and information covenants usually found in loan agreements between major Italian and international financial institutions, and institutional and qualified investors operating in the purchase and management of commercial Real Estate in Italy.

from withholding taxes imposed on interest payments made by the borrower.

16.4.2. Financial covenants

Financial covenants undoubtedly represent the main and most effective tool for the measurement of the performance of the borrower during the term of the loan agreement. The determination of the levels for financial covenants is subject to a careful negotiation between the parties and the underlying parameters are set in a scrupulous and transparent way, in order to ensure the maintenance of a financial balance and creditworthiness of the borrower during the term of the loan. Specifically, common practice requires the setting of benchmarks at such levels as to ensure that the performance of financial and Real Estate management is substantially in line with the initial levels and with the provisions of a business plan shared and agreed between the borrower and the lending bank at the time of signing the contract. Compliance with the financial covenants, therefore, ensures the maintenance of a balance during the life of the loan and, accordingly, the maintenance of a capital allocation within certain parameters set by the lending bank at the time of the initial assessment of the operation.

The financial covenants contained in loan agreements secured by Real Estate collateral can be summarized as (i) balance sheet covenants (*Loan To Value*, *Debt/Equity ratios*), and (ii) revenue-based or cash-flow covenants (*Interest Cover Ratio*, *Debt Service Cover Ratio*, *Debt Yield* and *Occupancy Ratio*). Below is a summary table for each class of financial covenants.

16.4.3. Balance sheet covenants

These covenants represent a crucial measure of the financial performance of the borrower, with specific reference to the market trends which may significantly impact on the valuation of the property or the underlying Real Estate portfolio and, consequently, with the valuation of the borrower net of financial indebtedness.

Real estate values can be subject to volatility during the typical term of Real Estate loan agreements (5-10 years); the market value of the specific commercial properties is therefore periodically estimated by means of appraisals prepared by independent experts according to international standards at least once a year. The increase or decrease of the values observed is a function of various factors, including mainly: (i) trends in interest rates and market yields, (ii) trends in cash flows from existing lease contracts in place and occupancy level of a building, and (iii) extraordinary maintenance that may require significant *CapEx* during the term of the loan.

The trend in market value consequently impacts the parameters of *Loan To Value* and *Debt/Equity* permitted and recorded from time to time, as summarized below.

Covenant type	Calculation method	Note
Loan To Value (LTV)	Ratio expressed as a percentage of (i) the amount of the loan or loans drawn and not repaid undertaken by the borrower on a given assessment date, and (ii) the market value of the property or properties held by the borrower at the same assessment date.	The maximum level provided for in the agreement can be established for the entire term of the loan (e.g. Max LTV 60%) or progressive step-down schemes that re-align after each given assessment date (*e.g.* Max LTV 60% -55% -50%).
Debt/Equity (D/E)	Ratio expressed as a percentage of (i) total financial indebtedness incurred by the borrower at a given assessment date, and (ii) Net Asset Value of the borrower at the same assessment date.	The Debt/Equity covenant ratio can be accompanied or replaced by a minimum level of Net Asset Value parameter for the borrower. Once again, the maximum level provided for in the agreement can be established for the entire term of the loan (*e.g.* Max D/E 60%) or progressive step-down schemes that realign after each given assessment date (*e.g.* Max D/E 60% -55% -50%).

16.4.4. Revenue-based or cash-flow covenants

These covenants are aimed at monitoring the profitability of the borrower and more specifically at measuring whether they are able to service their financial indebtedness, especially in a scenario of increasingly tight monetary policy and rising interest rate levels reducing the cushion between free cashflows and debt service[19].

The basic parameter for measuring the suitability of cash flows generated by the building or the commercial properties held by the borrower to service its indebtedness is the Net Operating Income, calculated on a time

19 ECB Governing Council is determined to ensure that inflation returns to its 2.00% medium-term target in a timely manner. Inflation finally is showing declining trends but is still expected to remain higher than target. For this reason ECB entered into a restrictive monetary policy territory in the course of 2022 and 2023 and a further 25bps interest rate increase was decided on September 14th 2023. Accordingly, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility have reached 4.50%, 4.75% and 4.00% respectively. The more recent macro scenario characterized by geopolitical tensions and an overall inflation more in control triggered a series of cuts in the last 18 months, until the most recent ECB measure, effective from February 5th 2025, which sets avobementioned base rated respectively at 2.90%, 3.15% e 2.75%.

period determined on a historical basis (*e.g.* the 12 months preceding a given assessment date) or on a prospective basis (*e.g.* the 12 months following a given assessment date) and determined as the difference between flows from the Real Estate borrower's core business (typically income from underlying Real Estate lease contracts) and operating costs. This parameter is the essential driver in the calculation and assessment of compliance with the minimum values of the *Interest Cover Ratio*, *Debt Service Cover Ratio*, *Debt Yield* and *Occupancy Ratio* covenants, as summarized below.

Covenant type	Calculation method	Note
Interest Cover Ratio (ICR)	Ratio expressed as a percentage of NetOperating Income (difference betweenflows from the Real Estate borrower'score business, typically income from Real Estate lease contracts, and operating costs, typically linked to ordinary property management and including property taxes, insurance premiums, ordinary maintenance expenses, asset, property and facility management fees) and Interest (floating or fixed base rateplus margin) related to the borrower's financial indebtedness outstanding at agiven assessment date.	Typically used in bullet repayment loans. Usually such covenants are calculated either on a historical basis (*e.g.* 3, 6 or 12 months looking back) or on a prospective basis (*e.g.* 3, 6 or 12 months looking forward). The prospective Net Operating Income calculations exclude on a cautionary basis any and all flows generated from lease agreements with expiry during the observation period or an exercisable break option, in the absence of any evidence of a renewal or a failure to exercise a break option. The minimum level provided for in the agreement can be established for the entire term of the loan (*e.g.* Min. ICR 150%) or through progressive step-up schemes that re-align after each given assessment date (*e.g.* Min. ICR 150% -200% -250%).
Debt Service Cover Ratio (DSCR)	Ratio expressed as a percentage of Net Operating Income (difference between flows from the Real Estate borrower's core business, typically income from Real Estate lease contracts, and operating costs, typically linked to ordinary property management and including property taxes, insurance premiums, ordinary maintenance expenses, asset, property and facility management fees) and Debt Service (sum of interest calculated taking into account floating or fixed base rate plus margin and an agreed amortization rate) in connection with the borrower's financial indebtedness outstanding at a given assessment date.	Used in loans with a periodic partial or full amortization profile of the principal amount. Usually the covenants in question are calculated either on a historical basis (*e.g.* 3, 6 or 12 months looking back) or on a prospective basis (*e.g.* 3, 6 or 12 months looking forward). Once again, the prospective Net Operating Income calculations exclude on a cautionary basis any and all flows generated from lease agreements with expiry during the observation period or an exercisable break option, in the absence of any evidence of a renewal or a failure to exercise break options. The minimum level provided for in the agreement can be established for the entire term of the loan (*e.g.* Min. DSCR 150%) or through progressive step-up schemes that re-align after each given assessment date (*e.g.* Min. DSCR 150%-175%-200%) can be designed.

Covenant type	Calculation method	Note
Debt Yield (DY)	Ratio expressed as a percentage between Net Operating Income (difference between flows from the Real Estate borrower's core business, typically income from Real Estate lease contracts, and operating costs, typically linked to ordinary propertymanagement and including property taxes, insurance premiums, ordinary maintenance expenses, asset, property and facility management fees) and thetotal of the borrower's financial debt outstanding at a given assessment date.	Used especially by international banks in combination or as an alternative to the ICR and DSCR parameters. Usually such covenants are calculated either on a historical basis (*e.g.* 3, 6 or 12 months looking back) or on a prospective basis (*e.g.* 3, 6 or 12 months looking forward). Once again, the prospective Net Operating Income calculations exclude on a cautionary basis any and all flows generated from lease rentals with expiry during the observation period or an exercisable break option, in the absence of any evidence of a renewal or a failure to exercise break options. The minimum level provided by contract can be established for the entire term of the loan (*e.g.* Min. DY 6.0%) or progressive step-up schemes that re-align after each given assessment date (*e.g.* Min. DSCR 6.0%-6.5%-7.0%) can be designed. A minimum level of Net Operating Income (Min NOI) can be combined with the Min DY covenants as a further measure of the financial and income producing capacity of the borrower or the underlying collateral.
Occupancy Ratio (OR)	Ratio expressed as a percentage of (i) cash flows generated by rents related tothe asset or properties held by the borrower on the leased floor area only and (ii) the level of expected rents when stabilized or at market levels at a given assessment date, on the entire floorarea (level calculated considering the rent when fully stabilized on let spaces and the potential rent or estimated rental value on vacant areas).	A minimum occupancy covenant is increasingly included in loans to counterparties who hold properties or portfolios for office use, retail or logistics with a certain vacancy profile or operational component to be closely monitored, or in loans secured by income-producing RealEstate for which it is considered necessary to monitor the rate of occupancy as the main performance driver. A variant of this covenant is the percentage calculation on the floor area actually occupiedin proportion to the total, instead of the calculation of income.

16.4.5. Information covenants

The financial covenants described above undoubtedly represent the main and most effective tool for the measurement of the performance of the borrower during the term of the loan agreement. However, loan agreements to Real Estate borrowers have additional covenants to provide periodic information to the lending bank, so as to allow the lender to monitor the main events related both to the core and extraordinary Real Estate management events that may occur during the life of the loan.

Information covenants are also essential to provide the lending bank with all the calculation tools necessary to verify financial covenants by submitting a compliance certificate that must contain all the details of the calculation methods of each financial covenant at the various assessment dates, and all financial and Real Estate documentation necessary for the bank to carry out periodic portfolio management and monitoring activities. They include, in particular, company documents (*e.g.* amendments to the articles of association, minutes of shareholders' and board of directors' meetings), accounting and financial documents (*e.g.* financial statements, statements of accounts, business plans) and specific Real Estate documents (*e.g.* valuation reports prepared by independent appraisers, rent-rolls setting out the rental position, asset and property management reports, and evidence of insurance renewals). Set out below is a non-exhaustive summary of the main covenants to provide information required by market standards on recent financing transactions to operators active in the investment and management of commercial Real Estate, which can be modified and integrated on the basis of the specific transaction.

Covenant type	Note
Corporate documentation	Information on any changes to the articles of association. Minutes of the Meetings of the Shareholders and of the Board of Directors. Timely delivery of any other information requested by the lending bank, including any information requested in order to comply with the *Know Your Customer* procedures and information that may be required to verify compliance with FATCA regulations.
Financial and accounting documentation	Financial statements, half-year reports, interim reports, together with an independent auditor's report.
Tax documentation	Information relating to any circumstance that involves a significant change in the tax, administrative or regulatory treatment of the borrower compared to those in force at the date of signing theloan agreement.
Business plan	Updated version of any business plan after any changes have beenmade to the initial version.
Compliance certificate	Document to be delivered signed by the legal representatives of theborrower containing a certification of financial covenants at the relevant assessment date, with details and justifications of the calculations underlying each covenant. Quarterly, half-yearly or annually.

Covenant type	Note
Estimate report on the market value of the relevant property or Real Estate portfolio	Expert report provided by a primary independent expert based on international valuation standards (RICS, Tegova, etc.), addressed directly to the lending bank or to the borrower (with reliance letter in favor of the lending bank). Basis for the calculation of the LTV parameter. Quarterly, half-yearly or annually.
Rent-roll of the relevant property or Real Estate portfolio	Tenancy schedule with details of the updated rental situation specific for each lease agreement and an indication of start date, maturity date, possible withdrawal options, rental amount, any late payments, effort ratios. Copy of each new lease agreement signed.
Asset and property management report	Periodical reports prepared by the asset manager containing any strategic information related to the positioning of the property or the portfolio of properties held by the borrower, including letting strategies and extraordinary maintenance. Periodical reports prepared by the property manager containing relevant information regarding the performance of the Real Estate (especially the billeddetails generated by the tenants and the consequent effort ratios for retail properties) and ordinary maintenance interventions, as well as details of any condominium and/or consortium resolutions and distribution of the service charges billed to the tenants.
Insurance documentation	Evidence of periodic insurance renewals and information on anyindemnities relating to damage on properties under warranty.
ESG documentation	ESG external ratings concerning borrower or sponsor of the transaction, relevant KPIs set where applicable, energy performance certificates and other relevant information concerning the real estate collaterals of the transaction,

16.4.6. Testing methods

Both financial covenants and information covenants are subject to detailed contractual provisions in relation to the respective reporting periods (testing dates) and subsequent delivery of the relevant calculations; this aspect is usually the subject of negotiation between the parties. Common practice is having an assessment of financial covenants at least once a year, more often on a half-yearly basis and sometimes on a quarterly basis, or on each interest payment date. A half-yearly assessment currently appears to be most common among institutional operators, and the same frequency is expected for the delivery of the main information covenants.

The set of covenants provided for in the financial documentation agreed between the parties must be assessed by a team of specialized resources dedicated to portfolio management operations (on the bank's side) and treasury/finance/financial reporting operations (on the borrower's side).

16.4.7. Main cure mechanics

As already pointed out and detailed, the architecture of financial and information covenants in the structure of the loan is intended to regulate the maintenance of a financial and operating balance by the borrower, ensuring that the parameters that were in place at the time of entering into the agreement are not significantly altered over the life of the loan. The covenants are, therefore, an essential protection tool for the lending bank and at the same time offer a synthetic measure of an investment's performance and of the borrower's Real Estate management.

The importance of maintaining the financial and information benchmarks negotiated between the parties and provided for in financial documents is of great importance, in particular for the financing bank, for optimal risk management and for the allocation of risk weighted assets (RWAs) and capital in line with the provisions made at the time of the execution of the agreement. The initial structuring of the financing in terms of its duration and pricing is indeed strongly impacted by the analysis of RWA consumption and capital requirements, which is in turn based on the assumption that certain financial balances have to be maintained in the project, in terms of equity, maximum LTV, maximum D/E, adequate cashflow in terms of minimum ICR, minimum DSCR and target DY.

In case during the life of a loan and on one or more test dates, any of the financial or information covenants are not met, specific remedial mechanisms, to be carried out within a limited number of working days (*e.g.* 5-15 working days), will be provided in the documentation. A hard covenant breach can typically be remedied through a partial repayment of the loan in an amount such as to reset the financial benchmarks within their contractually established limits. This partial repayment can be performed by using part of the cash already available by the borrower, or through an injection of new equity, or by means of a combination of the two. In certain cases, if the parties have agreed and implemented soft covenant mechanisms at thresholds that precede those of the hard default covenant breaches, the repayment obligation is anticipated in time through mechanisms that set aside cash provisions from the cash flows generated by the borrower and channelled in order to create specific buffers, in a process known as "cash trap mechanics".

The failure to take remedial action within the time limits provided for in the contract gives rise to an Event of Default under the financial documentation.

16.5. Other usual clauses in loan agreements

In addition to the covenants described above, Real Estate loan agreements contain a number of standard clauses on various financial, regulatory, corporate, property or tax matters. These include:

a. Purpose and utilization of the facilities: this clause specifies the purpose of each credit line and the methods and any limits of utilization (*e.g.* one or more loans, possibility to redraw amounts that have been repaid, etc.).
b. Conditions precedent for the utilisation of the loan: the disbursement of the loan is subject to the prior satisfaction of specific conditions precedent, including the receipt by the bank (or, in the case of a syndicated loan, by the facility agent/security agent) of certain documents in form and substance satisfactory to the bank (or, as the case may be, the facility agent/security agent)[20].
c. Mandatory and voluntary prepayments: this clause lists the circumstances in which the borrower is required to prepay, in part or in full, the outstanding loan, and at the same time regulates the timing of the prepayments and identifies the bank accounts (generally pledged) into which the relevant payments shall be made[21]. With regard to voluntary prepayment, the clause sets certain limits on the size and numbers of prepayments and often restricts the ability to prepay the loan within the first eighteen months from the disbursement date, in order to ensure that the loan and related security package may benefit from the special regime

20 "Documentary" conditions precedent include, by way of example: the deed of incorporation and the articles of association of the borrower; resolutions by the borrower's corporate bodies; property appraisal/valuation; Real Estate/notarial reports; due diligence reports; legal opinions; copy of the sale and purchase agreement and lease agreements; copy of insurance policies; copy of any administrative law documents (*e.g.* authorizations/licences, permits, etc.); and evidence of equity payments by the borrower's shareholders.

21 Mandatory prepayment clauses cover the following cases: (i) illegality of the loan: also due to regulatory changes, the granting of the loan by the bank is no longer lawful, and all outstanding amounts must be repaid; (ii) expropriation/sale of properties: in the event of expropriation or sale of all the properties securing the loan, there will be an obligation to repay the loan in full; (iii) insurance and other proceeds: insurance and/or other indemnification proceeds received by the borrower must be used for mandatory prepayment of the loan (except insofar as they are used to restore the previous status within the time limit agreed between the parties); (iv) excess cash: the amount corresponding to a given percentage (*e.g.* 60/70%) of the borrower's excess cash, calculated on each reporting date, must be used for the mandatory prepayment of the loan; and (v) change of control of the borrower or substitution of the SGR: in the event of a change in the controlling shareholder of the borrower or substitution of the SGR that manages the fund (except in specifically identified cases), the entire loan must be repaid.

of the "imposta sostitutiva" (substitute tax) under Presidential Decree no. 601/1973[22].

d. Gross-up clauses: these provide for an increase in the amount owed by the borrower as interest on the loan, in order to neutralize – from a practical standpoint – the application of any Italian withholding tax in respect of interest paid to non-resident lenders. Gross-up clauses keep the lender unaffected by any changes in the regulations that may occur after the loan agreement has been signed, and that involve the application of withholdings by the Italian borrower at the time of paying interest. If the activation of these clauses depends, in practice, on a fact or act attributable to the lender, the contracts normally establish that the gross-up indemnity shall not be applicable and, therefore, the lender shall receive interest net of the withholding tax due by law.
e. Representations and warranties: these clauses contain the representations and warranties given by the borrower to the lenders (in certain cases these clauses may cover also other companies belonging to the same corporate group of the borrower, insofar as they are considered relevant for the overall financing transaction). The key representations are given with regard to the following:
   - legal status and valid incorporation and existence of the borrower;
   - the fulfilment by the borrower of all the obligations required by law and by the articles of association (or by the fund regulation) for the execution of the loan agreement and the related contractual documentation;
   - the absence of events of default, also as a consequence of the execution of the loan agreement and related documentation;
   - permits and authorisations: all the authorisations necessary for entering into and executing the loan agreement (and related documentation) have been obtained by the borrower, are in force and are valid and effective, and any building permits/approvals (or other instrument of an administrative nature) in relation to the properties has been validly obtained by the borrower, is in force and is valid and effective;
   - accounts: the borrower's accounts have been drawn up in compliance with any applicable laws and Accounting Principles[23] and contain a true,

22 For an analysis of these issues, see chapter 14.

23 "Accounting Principles" generally indicates the local GAAPs established by the National Council of Chartered Accountants and by the Italian Accounting Board, and, in their absence, the

complete and fair assessment of the financial position of the borrower;
- litigation: absence of litigation, of any nature, in relation to the property or to the borrower (the clause is sometimes mitigated by limiting it to disputes that, if they were settled to the detriment of the borrower, could have a "Material Adverse Effect")[24];
- property: the property is free from encumbrances, charges or burdens except, if applicable, as indicated in the notarial report on title and other property matters, and complies with the laws and regulations in force, including zoning and building regulations and environmental and health and safety regulations;
- validity and effectiveness of all the insurance policies of the property, in relation to which there are no pending proceedings or requests for damages and/or indemnity or claims;
- environmental issues: absence of requests for environmental damages in relation to the property or the area where it is located, and compliance with any environmental law;
- accuracy and completeness of the information provided by the borrower to the bank;
- *pari passu*: the payment obligations of the borrower under the loan agreement (and related documentation) are not subordinated to other payment obligations of the borrower to third parties, without prejudice to the mandatory rules provided for under Italian law;
- loans and security: the borrower has no "financial indebtedness", except as expressly declared and approved by the bank, and has not created any security on its assets except as provided in the loan agreement or in other security documents expressly declared and approved by the bank;
- insolvency: on the execution date of the loan agreement, no insolvency and/or crisis proceedings and/or recovery process are pending in respect of the borrower; and
- date and repetition of the representations and warranties: the state-

international principles established by IASB (International Accounting Standard Board).

24 "Material Adverse Effect" generally indicates an event that – in the reasonable opinion of the bank – can (a) impair the ability of the borrower to meet its payment obligations pursuant to the finance documents, (b) substantially affect the business activity and/or the asset and financial position of the borrower, and/or (c) affect the ownership of any of the properties and/or the validity or effectiveness of any security and guarantees given in favour of the bank

ments are made on the date of execution of the loan agreement and (except for specific representations) must be considered repeated on each drawdown date and on the first day of each interest period (when a representation is repeated, it is considered given in relation to the circumstances existing at the time of repetition).

f. Information covenants: see above, para. 16.4.5.
g. Financial covenants: see above, para. 16.4.2, 16.4.3 and 16.4.5.
h. General undertakings: this clause contains a number of undertakings to be complied with by the borrower, often in order to preserve the content of the representations or warranties or to remedy any problematic situations detected by the bank during the preliminary assessment of the transaction (it is not infrequent that such situations, if particularly significant, become the subject of a specific conditions subsequent in the agreement, so as to put considerable pressure on the borrower). The most relevant general undertakings for our purposes are those concerning:
   - bank accounts: this clause contains the rules governing the operation of the bank accounts opened by the borrower with a third-party bank or with the lending bank itself; the credit balance of all the bank accounts, with few exceptions, is pledged as security for the repayment of the loan. Each of the accounts is dedicated to receive/transfer amounts for a specific purpose or a category of pre-determined purposes (for example, payment of VAT, payment of interest and repayment of the principal amount of the loan, payment of project development costs, payment of sums for the mandatory prepayment of the loan, collection of the rents, etc.). Each account is dedicated to specific operations, and is managed in accordance with the provisions of the pledge agreements and the other clauses of the loan agreement;
   - negative pledge and other prohibitions: prohibition on the borrower's ability to grant security over its assets other than those granted as a security for the loan agreement and other finance documents; prohibition on selling the real property, with the exception of "authorised sales"; prohibition on contracting additional financial indebtedness; prohibition on signing contracts that entail expenses exceeding a pre-determined basket;
   - insurance policies: obligation to enter into and maintain primary insurance policies on the property, to cover all the risk categories regarded by the bank as relevant, taking into consideration the type of Real Estate transaction to which the loan is linked;
   - Real Estate development agreement/works: undertaking by the bor-

rower to perform and fulfil its obligations in accordance with the terms and conditions of each of the "development contracts"; an undertaking not to modify the key terms and conditions of any Real Estate development agreement, unless the bank provides its prior written consent; undertaking to obtain and maintain all the permits necessary to properly carry out any development works;
- hedging: undertaking by the borrower to execute, within a certain term (generally 60 or 90 days from the date of the disbursement of the loan), one or more hedging contracts, in order to limit the risk of fluctuations in the interest rate applicable to the loan, in accordance with what was agreed pursuant to the hedging strategy letter; and
- extraordinary transactions and dividends: prohibition against the borrower approving mergers, de-mergers, transformations and/or transfers of going concern, or in any case any transaction of an extraordinary nature, without the prior written consent of the bank; prohibition against the borrower (if existing in the form of an SPV or a fund) distributing dividends or other proceeds before the loan is fully repaid and all the amounts owed by the borrower pursuant to the other finance documents are duly paid or settled.

i. <u>Events of Default</u>: this clause lists the circumstances which, when they occur, entitle the bank, after any agreed grace period and if the default is not remedied, to request the immediate repayment of the loan, even before its expiry date, as well as the payment of the interest and any other amount owed by the borrower under the other finance documents. An Event of Default (or, in some cases, a "Potential Event of Default", if provided for in the contract) can also trigger the activation of a mechanism known as "drawstop", whereby the bank is no longer required to provide the sums made available to the borrower (*e.g.* in the case of a revolving facility or a term facility not yet fully drawn), unless the right to invoke this provision is expressly waived. The following are the main events of default:
   - non-payment;
   - breach of financial covenants;
   - breach of other obligations;
   - state of insolvency;
   - insolvency and/or crisis proceedings and/or recovery process;
   - legal proceedings brought by creditors or other third parties in relation to assets, receivables or rights of the borrower;

- termination of the business activity;
- litigation, of any nature, in relation to the property;
- invalidity or ineffectiveness of any of the finance documents;
- destruction or total loss of the property;
- false statements;
- cross-default; and
- breach of environmental laws.

j. Facility agent/security agent: this clause applies to loan agreements with more than one lender. Pursuant to it, the lending banks mandate another bank, usually also a lending bank under the same agreement (the "agent") for it to carry out, in the name and on behalf of the other lending banks, activities for the management of the loan and the ancillary guarantees and security (in some cases, especially in large loans with several international banks, the agent responsible for managing the security package, called the "security agent", can be different from the agent responsible for managing the financial flows regarding the loan, called the "facility agent").
k. Assignment of loan/syndication: this clause regulates two different situations: the transfer, by the lending bank, of its contractual position as a lender pursuant to the loan agreement, which will include all the legal positions and rights/obligations arising from the same agreement, including any commitments to lend under any revolving credit facility or term facility not entirely disbursed ("transfer of contract" pursuant to Articles 1406 and the following of the Italian Civil Code); or the assignment, again by the lending bank, of one or more of its receivables under the loan agreement, such as, for example, receivables in respect of the repayment of the outstanding loan and the payment of interest and other accessory items ("assignment of receivables" pursuant to Articles 1260 and the following of the Italian Civil Code). The former transfer must be previously authorised by the borrower (Article 1407 (1) of the Italian Civil Code), while the second, at least in theory, can be carried out without particular restrictions by the lending bank. In practice, however, the two types of assignment are subject to the same regime, namely:
   - the transferee (also called "new lender") must comply with the subjective requirements set by Italian law for the transfer of the contract or of the receivables, and shall not trigger the activation of gross-up clauses in relation to the interests pertaining to it (in essence, the transferee must fall within the definition of "Italian Qualifying Lend-

er" or "Soggetto Autorizzato", for which reference should be made to, respectively, the final part of paragraph 16.3 and note 18) above; and
- where an Event of Default is pending, assignments shall not be subject to contractual restrictions.

In certain cases, the borrower may expressly exclude any potential assignees who, for commercial or other reasons, may not be considered suitable counterparties in the loan agreements nor creditors of the amounts provided (in the jargon called "blacklisted lenders", often listed in a specific annex to the agreement). For their part, lending banks may request, for reasons of internal policy or for regulatory purposes, that certain parties are expressly included among the pre-authorised assignees (this clause is often the subject of close negotiation between the parties). Finally, pursuant to Article 1263 of the Italian Civil Code, the assignee will automatically acquire any accessories to the credit, first of all the guarantees backing it, although, for the purposes of the enforceability *erga omnes* of such transfer, some additional actions will be necessary (for example, for the mortgage, an annotation in the property registry will be required pursuant to Article 2843 of the Italian Civil Code).

16.6. Security interests and guarantees

16.6.1. Preliminary remarks

In order to protect their claims – and as a condition precedent to the disbursement of the loan – and, indirectly, also to discourage the other creditors of the borrower from initiating enforcement actions over the assets of the borrower, the lenders require guarantees and security interests, of various types, whether given by the borrower or by third parties (*e.g.* shareholders of the borrower).

The registration of some of the most commonly used types of security in the Real Estate sector, first of all mortgages, is very expensive from a tax point of view[25]. Accordingly, Real Estate Finance transactions concluded in the Italian market are structured in such a way as to be able to benefit from the substitute tax (*imposta sostitutiva*) provided for in Presidential Decree no. 601/1973. One of the eligibility requirements for these beneficial rules

25 With regard to the tax treatment of each guarantee and security usually taken by the banks to back Real Estate financing, as well as on the requirements and methods for benefiting from substitute tax pursuant to Presidential Decree no. 601/1973, please refer to chapter 16.

has to do with the term of the secured loan, which cannot be less than 18 months and one day. In practice, credit facilities with a term of less than 18 months and one day (known as 'bridge financing' or 'short-term facilities') are not eligible for the otherwise "expensive" mortgages, but only for security interests that in order to be perfected do not require the filing of the documentation with public offices or registers (such as personal guarantees, pledges of shares and, with certain rare exceptions, pledges of receivables or assignment of receivables by way of security).

Another preliminary consideration has to do with the inclusion among the obligations secured by the security package of the borrower's obligations under hedging contracts entered into to implement the hedging strategy letter signed in conjunction with the loan agreement. According to a conservative but prevailing view, such obligations are not deemed eligible for the substitute tax mentioned above. Consequently, in practice hedging contracts are typically secured solely by personal guarantees, pledges of shares, receivables and assignment of receivables by way of security.

Finally, mention should be made of the special rules concerning "financial collateral" established by Legislative Decree no. 170/2004[26], the main objective of which is to facilitate the enforcement of security by the secured creditor by establishing some exceptions to the normal rules and permitting enforcement by the secured creditor "*even if a turnaround or winding-up procedure is initiated*". Where the security offered by the borrower falls within the scope of application of the above Decree (this should be verified in case of pledge or assignment by way of security of financial instruments, receivables and cash), and where the other conditions established by the Decree have been met, banks and their advisers may expressly designate the security arrangement as "financial collateral" pursuant to Legislative Decree no. 170/2004 and negotiate various specific clauses regarding the enforcement of the security.

The main types of security interest and guarantees securing Real Estate financing transactions are discussed in the following sections.

16.6.2. In rem security interests

In the Real Estate field, the mortgage is regarded as the most important security interest *in rem*. Although mortgages (as opposed to pledges) must be

26 Legislative Decree no. 170 of 21 May 2004.

enforced through the courts, and enforcement is estimated to take from 3 to 4 years, lenders always demand that the borrower or a third party grant a mortgage on one or more real properties that are involved in the overall transaction – or that are simply owned by the borrower – to secure the loan. Furthermore, the function of a mortgage is not only to provide security, but also to grant the mortgagee priority, as discussed in further detail below, thus also deterring third parties from taking enforcement action against the mortgaged property.

Mortgages are governed by Article 2808 et seq. of the Italian Civil Code. Article 2821 et seq. of the Italian Civil Code govern the voluntary mortgage, which is the variety of mortgage used in Real Estate Finance transactions (the other types are legal and judicial mortgages).

All mortgages, regardless of type, grant the creditor (i) the right to appropriate the mortgaged property (including in respect of a third-party buyer) to satisfy the creditor's claim and (ii) the right of priority of satisfaction, over other competing creditors, in respect of the proceeds of the expropriation procedure.

In order to be valid, mortgages must be granted by public deed or private agreement authenticated by a notary, and may also take the form of a unilateral deed. Mortgages must be registered in the relevant Real Estate registers in order to be validly established. The mortgage deed and registration entry must identify the mortgaged property and the maximum secured amount in detail.

A mortgage may be created on real property or other rights *in rem* on real property, including usufruct and "*diritto di superficie*" (ground lease). It should be noted that mortgages do not entail the dispossession of the asset nor transfer of ownership of the asset to the mortgagee: rather, possession and ownership are retained by the mortgagor.

In practice, a mortgage securing a loan of (for example) €10 million is normally granted and registered for a maximum secured amount of €20 million, consisting of €10 million for the principal amount and €10 million for interest and other ancillary amounts on the loan.

The other security interest *in rem* that is commonly used in Real Estate financing transactions is the pledge, governed by Article 2784 et seq. of the Italian Civil Code. Like mortgages, pledges can be established by the debtor (*i.e.* the borrower of the loan) or by third parties (for example, the borrower's shareholders or unitholders). Pledges also grant the creditor the right of priority to be paid using the pledged asset.

In contrast to mortgages, pledges can be enforced outside the courts (Article 2797 of the Italian Civil Code). Additionally, if a pledge – due to the type of asset pledged or the nature of the parties involved, among other reasons – falls within the scope of application of Legislative Decree no. 170/2004, it will be even easier and faster to enforce the pledge, with evident benefits for the lenders.

Pledges are employed above all to establish a security interest over the borrower's share capital. In view of the ability to exercise the voting rights associated with the pledged shares, lenders obtain a means of potential control over their primary counterparty and above all in portfolio financing transactions – a faster way out in situations of default (as exit may be achieved by simply enforcing the pledge of the borrower's share capital, rather than enforcing all of the mortgages granted on properties owned by the borrower).

In the Real Estate sector, corporate borrowers are usually set up as limited liability companies or joint stock companies.

Pledges over the corporate capital of limited liability companies (S.r.l.) are typically established by authenticated private agreement, in view of the subsequent formalities required by law. For the purposes of the right of priority, the agreement must be filed by the authenticating notary within 30 days with the register of companies within whose district the registered office of the company whose quotas (*quote*) are subject to pledge is located. If the company has a shareholder register, it is common practice to require – as an additional formality that is no longer essential in view of certain recent amendments of the law – that the pledge be recorded in the quotaholder register, often using a formula set out in an annex to the pledge agreement.

When the shares of a joint stock company (S.p.A.) are pledged, the pledge agreement may also be concluded by exchange of proposal and acceptance (it is of course possible to use an authenticated private agreement, which is the preferred option for banks and their advisers, except where this could trigger material tax costs). In order to ensure the right of priority – as required by paragraph three of Article 2787 of the Italian Civil Code – the pledge must be created by "*an agreement with a date certain, which contains a sufficient indication of the claim and property*". This requirement may also be satisfied if the pledge is concluded by exchange of correspondence, provided that the date of conclusion of the contract is absolutely certain. In practice, there are many ways to satisfy the "date certain" requirement. One of the most common of these is to have a notary prepare a true copy of the acceptance (signed by the pledgor) of the pledge offer (signed by the pledgee).

In the case of shares represented by share certificates – the scenario most frequently encountered in the Real Estate sector – since it is doubtful whether such shares qualify as "financial instruments" pursuant to Legislative Decree no. 170/2004 (unlike the shares in listed companies, which certainly fall within the scope of the Decree), there are two ways to establish pledges: either the share certificate is endorsed with the signature of the pledgor (or a representative of the pledgor), authenticated by a notary, and it is at the same time delivered to the pledgee (or a representative of the pledgee), or the pledge is recorded both on the share certificate and in the company's shareholder register – in both cases by a director of the company that has issued the shares being pledged. It should be noted that, even in this latter case, for the purposes of the right of priority, paragraph two of Article 2787 of the Italian Civil Code requires that the certificates representing of the pledged shares be placed in the possession of the pledgee or a third party designated by the parties (in syndicated lending, the certificates are typically held by the security agent).

When shares or quotas are pledged, the pledgee, unless otherwise agreed, holds the rights to vote and to collect dividends, in accordance with Article 2352, paragraph one, and Article 2791 of the Italian Civil Code, respectively. In practice, the parties expressly waive these provisions, instead agreeing that the pledgor will retain the sole power to exercise both rights until the occurrence of an Event of Default, or, in some cases, until a demand for payment of the secured sums (*i.e.* a declared default).

Where the borrower is a Real Estate AIF, things become more complicated. The granting of the pledge over the units of the fund/ borrower is often subject to negotiations between the banks and the investors who hold the units. This is why this form of security, which Italian case law normally considers a pledge of receivables[27], is less common in the Italian market. In order to have a rapid exit instrument following a default, lenders usually obtain a pledge of the entire share capital of the Italian or foreign vehicle that holds the units of the fund/borrower.

Another type of pledge commonly used in Real Estate transactions is the pledge of the bank accounts held by the borrower with the lender or other banks (if the borrower is a Real Estate AIF, the bank in question will be the fund's custodian bank).

This type of security is normally deemed a "pledge of receivables" and thus requires that the bank with which the account is held be notified of the pledge or that the pledge be accepted by the bank in question, in both cases by a document with a date certain, for the purposes of the right of priority (Article 2800 of the Italian Civil Code). By contrast, the classification of a "pledge of receivables

27 See the decision of the Supreme Court, Section I, no. 28900 of 29 November 2011.

deriving from a bank account" as financial collateral pursuant to Legislative Decree no. 170/2004 is not entirely clear (the analysis must be conducted on a case-by-case basis, and in order to take a prudent approach, it will be possible to create the pledge also in compliance with the provisions of the Italian Civil Code).

In the case of a pledge of receivables, the pledgee is in theory entitled to control the bank account (Articles 2802 and 2803 of the Italian Civil Code). In practice, however, with some very rare exceptions (for example, "reserve accounts"), the borrower continues to control the accounts until an Event of Default occurs, so as to avoid jeopardising or impeding the borrower in its ordinary course of business[28].

Since the balance of the account may vary, and often changes from one day to the next, particularly in the case of "operating accounts", the deed of pledge typically requires that the pledgor periodically notify the custodian bank with which the account is held, by a document with a date certain, that the security continues to apply with express reference to the balance of the account as at the date of the notice.

16.6.3. The Pactum Marcianum

Law Decree no. 59/2016 (the "Banks Decree", converted by Law no. 119/2016) introduced a new instrument into Italian law: financing for companies secured by the transfer of real property subject to a condition precedent, governed by Article 48-*bis* of the TUB.

The essence of this instrument is the ability of the borrower and lender to agree, in order to secure a loan, to transfer to the lender ownership of real property (or another right *in rem*) subject to the condition precedent of default by the borrower, in the forms and according to the terms set out in paragraph five of Article 48-*bis* of the TUB. Such an agreement, which represents a form of "balanced foreclosure", *i.e.* a contractual arrangement that is not in conflict with the prohibition of foreclosure agreements established by Article 2744 of the Italian Civil Code, is usually referred to as "*Pactum Marcianum*" since: (i) before transfer, the real property (or other right *in rem*) is appraised by an expert appointed by the court; and (ii) the creditor

28 This is achieved through a power of attorney granted by the pledgee to the pledgor. For the entire term of this power of attorney – which will be terminated if an event of default occurs – the pledgor is empowered to undertake all transfers and other banking transactions in respect of the bank account, at its discretion, subject to the restrictions of the loan agreement.

is required to return to the borrower or third party the amount, if any, by which the appraised value of the asset (or right) exceeds the total amount of the defaulted debt and transfer costs.

The real property or right *in rem* may be owned by the borrower itself or by a third party. What matters is that the borrower is an enterprise; as a result, loans to Real Estate AIFs would appear on their face to fall outside the scope of application of Article 48-*bis* of the TUB, unless one believes that such funds can be regarded as "enterprises"[29].

The provision in question requires that the lender, under the loan agreement, be a bank or another entity authorised to provide credit to the public pursuant to Article 106 of the TUB. According to a literal and restrictive interpretation of the rule, this would seem to exclude credit funds, which can be allowed to carry out lending business if they comply with the provisions set out, as discussed below, in the TUF.

No definition of "financing" is provided. Accordingly, it appears reasonable to conclude that all types of financing arrangements, regardless of their term and characteristics, are eligible for the *Pactum Marcianum*, which may be entered into when the loan agreement is signed or – if the contract was already in force when the new statutes entered into effect – by notarised deed, by way of subsequent amendment of the contractual conditions (however, since the law refers to "loan agreements", hedging contracts connected to the loan secured by the *Pactum Marcianum* should not benefit from this new instrument). If the loan is already secured by a mortgage, the *Pactum Marcianum*, once registered, prevails over the registrations and entries made after the registration of the mortgage.

It is still too early to draw conclusions as to the success of this new instrument in terms of its spread and use in the practice of Real Estate financing transactions. But that it represents a further tool for lenders in addition to the usual security package – principally mortgages – that can be used to secure loans. It should also be emphasised that the enforcement of the *Pactum Marcianum* is not mandatory. Lenders can decide not to use this instrument (by not initiating the procedure for the appointment of the expert) and instead to opt for the traditional route of the enforcement procedure, in spite

29 Supporting a qualification of Real Estate AIFs as enterprises and therefore for the applicability to them of certain insolvency provisions, the Tribunal of Milan (Civil Section II) has taken a stance with an order of 1 August 2016, endorsing the restructuring agreement pursuant to Article 182-*bis* relating to the Aster fund managed by Vegagest SGR S.p.A.

of all of the limits of this option – particularly the notoriously unexpeditious nature of Real Estate enforcement in Italy. Finally, a piece of advice for lenders wishing to protect themselves when drafting a *Pactum Marcianum*: it will be necessary to clarify that such pacts do not have the force of final settlement, meaning that if the value of the asset or right is insufficient to cover the defaulted debt, the lender will retain full standing to act, in the forms and in the venues it deems appropriate, to recover its residual claim.

16.6.4. Personal guarantees

The guarantee (*fideiussione*)[30] is one of the most common personal guarantees in Real Estate Finance transactions. It is granted by a party other than the borrower – typically a shareholder or other member of the same group of companies – or by a bank, mainly to secure the performance of the borrower's obligations under the loan agreement or related finance documents.

Normally, guarantees are given without what is known as the "*beneficium excussionis*", meaning that, in the event of default on the secured obligation, the creditor may act against the guarantor directly, without first having to take enforcement action against the primary debtor (Article 1944, paragraph two, of the Italian Civil Code).

In practice, in Real Estate as in other fields, lenders tend to prefer another form of personal guarantee that has an atypical nature, meaning that it is not governed by the Italian Civil Code: namely, the autonomous first-demand guarantee, without objections.

This type of guarantee is typically provided by the borrower's shareholders (in which case it is known as a "parent company guarantee"), by other members of the same group of companies as the borrower, or by banks. In every case, the guarantor's undertaking on behalf of the primary debtor and for the benefit of the latter's creditor – *i.e.* to pay a given sum of money upon the simple request of the creditor of the secured obligation, regardless of whether this obligation exists or is valid, and almost irrespective of default by the debtor – is of a much stronger nature than a normal guarantee (*fideiussione*). The only objection that the guarantor can raise in response to the request from the creditor is known as the "*exceptio doli generalis*", which consists of alleging that the request to perform is clearly unlawful or fraudulent, as supported by incontrovertible evidence.

30 Guarantees are governed by Article 1936 et seq. of the Italian Civil Code.

Italian case law[31] holds that autonomous guarantees differ from normal guarantees in the following respects:

a. they are autonomous of the secured obligation, in contrast to the ancillary nature of normal guarantees;
b. the purpose of this form of guarantee is to indemnify the creditor against the consequences of default by its debtor of a general nature, whereas the normal guarantee has a close ancillary relationship to the secured obligation; and
c. the concrete purpose of a first-demand guarantee is to transfer an economic risk, whereas the purpose of a normal guarantee is to secure the full performance of a secured obligation.

Personal guarantees also include "keepwell letters", which, in their various forms ("weak" or "strong"), are considered atypical personal guarantees. Keepwell letters are not frequently used in Real Estate financing deals. However, in some corporate financing transactions, and in transactions involving loans to companies or funds that can be in financial difficulties, lenders often require that keepwell letters be issued by the parent company or equity sponsors.

Where the personal guarantee is subject to Italian law or is granted by an Italian person and also covers future debts, the contract must specify the maximum value of the guarantee (pursuant to Article 1938 of the Italian Civil Code), a limit that is usually set at 150% or 200% of the principal amount of the secured loan. Furthermore, in order for a guarantee to be valid and effective, lenders and their advisers must assess whether any secured obligations are to be excluded, in order to avoid violating mandatory law, such as those requiring a corporate benefit, *i.e.* that guarantees be in the guarantor's interest and consistent with its company object, and the restriction on financial assistance.

16.6.5. Other security arrangements

The "atypical" security arrangement most commonly used in Real Estate finance is the assignment of receivables by way of security.

Assignment of receivables by way of security is an agreement whereby the holder of a claim of a pecuniary nature (normally the borrower, a shareholder of the borrower or another party that has an interest in securing the bor-

31 See the decision of the Supreme Court no. 3947 of 18 February 2010.

rower's debts) assigns that claim to the lenders, typically in order to secure the borrower's obligations under the loan agreement and related finance documents. In order for the assignment to be enforceable on the original debtor and third parties (Articles 1264 and 1265 of the Italian Civil Code), the original debtor must accept the assignment or be served notice of the transfer of the receivable, in each case by a document with a date certain (*i.e.* service by a bailiff of the court or by other equivalent by means, including, among others, a true copy of the notice or acceptance, issued by a notary).

In order for a receivable to be assigned, the contract must permit the assignment, *i.e.* the contract that gives rise to the assigned receivables must not contain express restrictions on the transferability and the assignor must have valid title to the right that it wishes to assign. The receivable must also be capable of being disposed of, meaning that it cannot fall into one of the categories of rights not subject to disposition by nature or by law. Finally, the assignment of future receivables (*i.e.* receivables arising after the deed of assignment is signed) is only enforceable on all parties if, when the receivables arise from a legal standpoint, they are subject to an express declaration of acknowledgement by the parties and, above all, the process of informing the original debtor (notification or acceptance) is repeated.

With regard to the execution methods to conclude the assignment of receivables by way of security, the procedure followed with regard to the contract of pledge of shares also applies, *mutatis mutandis*, with some rare exceptions (*e.g.* deed of assignment by way of security of receivables from the public administration, which must be executed in the form of a public deed or authenticated private agreement). Whether an assignment qualifies as "financial collateral" pursuant to Legislative Decree no. 170/2004 must be decided on a case-by-case basis in light of the circumstances and the parties involved.

In Real Estate Finance transactions, receivables that are assigned by way of security arise from:

a. insurance policies for real properties: the receivables arise from the insurance claims payable to the insured party (which usually coincides with the borrower) in respect of damage sustained by the property or properties involved in the overall Real Estate transaction. The customary arrangement is that, before the occurrence of an Event of Default, or if the amounts do not exceed a pre-determined level, the claims are collected by the assignor, acting as agent of the assignee, and the sums in question are not applied towards mandatory pre-payment of the loan provided that they are used (within six or twelve months, or another period stipulated in the loan agreement) to restore the damaged property. It is customary for the policy that gives rise to the receivables to include a "loss payee clause" whereby the insurer agrees and accepts that claims under the policy will be payable to the lender and assumes a series of specific obligations[32]. The origins of this clause are found in contractual models imported from English-speaking jurisdictions and that it by itself is not sufficient to provide any security to the lenders, unless it is accompanied by assignment by way of security of the insurance claims, signed and rendered enforceable on the insurance company in accordance with the Italian Civil Code;

b. sale and purchase agreements governing the transfer of real properties, shares/quotas of companies or units of Real Estate AIFs: the receivables derive from indemnification clauses in favour the buyer (which normally coincides with the borrower). The account debtor may be the seller or a bank or insurance company that has guaranteed the seller's representations and warranties in the sale and purchase agreement;
c. lease/rental agreements: the receivables refer to the rent due to the assignor/borrower (depending on the duration of the lease, the agreement is to be registered in the local land registry pursuant to Article 2643 of the Italian Civil Code);
d. shareholder or inter-company loans: in such cases, the assignors are typically the shareholders of the borrower or other companies belonging to the same group as the borrower. Where the contracts that give rise to the receivables are governed by the laws of another country (for example, those of England or Luxembourg), the deed of assignment and related formalities will also be governed by that same law;
e. development contracts: the receivables to be assigned are those claimed by the employer (which typically coincides with the borrower) from the contractors that will materially carry out the work financed by the assignees;
f. VAT refunds; and

32 The most significant obligations assumed by the insurer by virtue of a loss payee clause include, for example, obligations to include the same clause, without any changes, in each of the new policies that replace the original, to exclude any liability of the lender in respect of the payment of any premia due in connection with the policy, not to amend the terms and conditions of the policy (e.g, increase of exclusions or exceptions) and to notify the lender of claims filings or non-payment by the insured.

g. hedging agreements entered into in respect of the secured loan (if the hedging agreements are governed by English law, the deed of assignment and related formalities will also be governed by English law).

The other agreements typically entered into between lender and borrower alongside a loan agreement include several documents that, despite not qualifying as guarantees or security, effectively serve to further secure the claim, in a manner that is complementary to the role of the guarantees and security described in the previous sections. Specifically, these are:

a. equity contribution agreements, which set out the terms, conditions and methods for the payment or injection of the residual equity of the Real Estate project by the project's sponsors; and
b. subordination deeds for shareholder or inter-company loans[33], whereby the bank's claim on the borrower is contractually given priority over the claims of the borrower's shareholders (or other members of the same group of companies) on the borrower.

16.7. Bonds and debt securities

Issuing and placing bonds and debt securities is a means of raising finance that in some cases can prove more advantageous than bank loans. Bonds and debt securities grant their holders mere financial rights (in the most elementary form, the right to repayment of principal, plus interest). Holders of bonds and debt securities, despite being exposed to business risk, are not granted administrative rights. In return, repaying their contributions and interest takes priority over providing a return on the equity contributed by shareholders.

Bonds and debt securities can be issued, for example, as a way of financing a Real Estate project, in order to procure financial resources to the special-purpose vehicle responsible for developing the project in question. Alternatively, bonds can be used to permit a company operating in the Real Estate sector to refinance its debt, perhaps at better conditions than offered by banks. In practice, this is the most common use of bonds in the Italian Real Estate market. In the future, in view of various recent tax reforms, it is possible that there may be an increase in the issue of mini-bonds subscribed for by Italian or foreign institutional investors in the context of private placements, in support of specific Real Estate projects or to finance or refinance the acquisition of Real Estate Assets of various kinds.

33 On shareholder loans and inter-company loans, see paragraph 15.11.

The Italian Civil Code permits joint stock companies, including listed and unlisted Real Estate companies ("SIIQ" and "SIINQ"), and limited liability companies to issue bonds and debt securities, respectively, subject to some limits.

In the case of joint stock companies in particular, Article 2412[34] of the Italian Civil Code:

a. sets a quantitative limit on the issue of bonds of twice the sum of (1) the company's share capital, resulting from the latest registrations pursuant to article 2444, first paragraph of the Italian Civil Code, (2) legal reserve and (3) free reserves, according to the most recent approved financial statements; and
b. also requires that, beyond this limit, additional bonds issued may only be subscribed for by professional investors subject to prudential supervision and may thereafter only be transferred to professional investors (since, in the event of transfer to other parties, the transferor would be liable for the issuer's solvency to the transferee).

The following are not subject to the limits:

a. bonds that are intended to be subscribed, even in the context of resale, exclusively by professional investors pursuant to special laws, provided that this provision is among the conditions of the issuance, or to be listed on regulated markets or multilateral trading systems ("Multilateral trading facility" or "MTF");
b. bonds that entitle their holders to purchase or subscribe for shares (convertible bonds); and
c. bonds backed by first ranking mortgages on real property owned by the company, up to two thirds of the value of the properties concerned (it should be noted out that, when the conditions set by the law are satisfied, mortgage-backed debt securities can enjoy the benefits provided by substitute tax (*imposta sostitutiva*) pursuant to Presidential Decree no. 601/1973).

It should also be emphasised, in view of the comments made on mezzanine finance below, that pursuant to Article 2411 of the Italian Civil Code joint stock companies may issue subordinated bonds. Paragraph one of the above

34 As last amended by Law No. 21 of 5 March 2024, published in Italy's Official Gazette No. 60 of March 12, 2024, containing measures to support the competitiveness of capital, as well as a delegation to the Government for the comprehensive reform of the provisions concerning capital markets as set forth in the Legislative Decree No. 58/1998, and the provisions concerning joint-stock companies contained in the Italian Civil Code and applicable also to issuers (so-called DDL Capitali).

article states that the rights of bondholders to the repayment of principal and interest may be subordinated, in whole or in part, to the satisfaction of the rights of other creditors of the issuer. Paragraph two adds that the timing and amount of interest payments may vary according to objective parameters, including the financial performance of the issuer.

In the case of limited liability companies, Article 2483[35] of the Italian Civil Code states that:

a. companies may issue debt securities where their deed of incorporation so provide;
b. debt securities may only be subscribed for by professional investors subject to prudential supervision, who may then transfer them solely to other professional investors or to the shareholders of the company (since the transferor of the debt securities would otherwise be liable to the transferee for the issuer's solvency). The aforementioned limitations do not apply in cases where the debt securities are intended to be purchased exclusively by professional investors pursuant to special laws, provided that such provision is among the conditions of the issuance, without the possibility of modification; and
c. any quantitative issuance limits may be established in the deed of incorporation.

By express provision of the TUF (Article 35-*quinquies* (6)), Real Estate investment companies with fixed capital (SICAFs) cannot issue debt securities.

16.8. Securitisation

Further to numerous reforms of Italian legislation, Real Estate companies can now also benefit from direct financing from special-purpose vehicles pursuant to Law no. 130/1999 ("SPV").

In the past, the most used and, broadly speaking, traditional form of securitisation transactions were carried out through the sale for valuable consideration of, usually, a portfolio of receivables by a party known as the "originator" (and/or seller) to a special-purpose vehicle established pursuant to Law no. 130/1999. The purchase of the portfolio is, in such traditional form of the securitisation transaction, financed through the issuance of securities backed by the underlying receivables ("asset-backed securities" or

35 Again, as last amended by the DDL Capitali, referred to in the previous note.

"ABSs"), which are then placed with investors in a unitranche or in multiple tranches, depending on the risk profile, and thus the ranking, of each class of securities. Recents legislative changes (i.e. art. 1, paragraph no. 214, of the Law no. 178/2020, "Legge di Bilancio 2021") introduced the possibility for the SPV to complete securitisation transactions by using the proceeds of loans granted by third parties (authorised to carry out this "reserved" activity in Italy) according to Law. no. 130/1999 and, therefore, also without the issuance of the ABSs. The ABSs and/or the loans granted to the SPV, and the related interests are paid by applying the cash flows generated by the securitised assets, in a manner fully and exclusively dependent on the collection of the receivables acquired by the SPV[36].

Following certain changes made to Law no. 130/1999 adopted in 2014 the SPV is allowed to grant direct lending[37] to other entities, other than natural persons or microenterprises (*i.e.* those with a balance sheet up to €2,000,000), identified by a bank or financial intermediary, which is required to retain an economic interest in the transaction of at least 5%[38]. All loans must be made using the funds raised by the special-purpose vehicle by issuing and placing the securities with qualified investors[39]. Law no. 145 of

36 The validity and enforceability of assignments of receivables undertaken pursuant to Law no. 130/1999 are subject to specific and different set of rules than those that apply to assignments governed by the Italian Civil Code. In particular: (i) such assignments of receivables become enforceable on the original debtors and third parties when notice of the assignment is published in Italy's Official Gazette and registered with the Companies' register (pursuant to article 4 of Law no. 130/1999, the provisions of article 58, paragraph no. 2, 3 and 4 of the TUB will be applied); accordingly, the original debtor is subject to an obligation to verify whether the receivable has been transferred and cannot discharge its obligation by paying the assignor, even if it does so in good faith; (ii) and the associated charges and security interests are automatically transferred by the simple publication of the assignment of the receivable in Italy's Official Gazette and the assignee may exercise the rights securing the assigned receivable without the need for any further formalities.

37 This possibility was introduced by the amendment to Law no. 130/1999 introduced by Law Decree no. 91/2014 (subsequently converted into Law no. 116/2014). With reference to securitisations of non-performing loans, Law 130/1999, furthermore provides that securitisation vehicles, which are assignees of non-performing loans, may grant loans aimed at enhancing the credit score of the relevant loans and improving the financial profile of the assigned debtor, in compliance with the conditions provided under Article 1, paragraph 1-ter.

38 See the implementing provisions issued by the Bank of Italy on 8 March 2016 concerning the provision of loans by special-purpose vehicles pursuant to Law no. 130/1999, in the form of the 15th update to Bank of Italy Circular no. 285 of 17 December 2013 (*Supervisory provisions for banks*).

39 As defined in Article 100 of the TUF.

30 December 2018 clarified that SPV may grant such loans also at the same time and in addition to the purchase of loan receivables, in the manner better specified under Article 1, paragraphs 1 and 1-bis, as illustrated above. Loans made by SPVs pursuant to Law no. 130/1999 – if they have a duration of more than eighteen months – may benefit from the same security package for Real Estate transactions, and may be subject to the tax regime provided for in Presidential Decree no. 601/1973 in relation to the substitute tax (*imposta sostitutiva*), without the need to register the security interests in the name of the holders of the ABSs (it is sufficient to establish the security interests for the benefit of the special-purpose vehicle).

Direct lending by SPV is an innovative instrument that, at least in theory, permits Italian companies to expand considerably the range of sources of financing available to them as alternatives to bank loans, by enabling them to make use of credit from Italian (and even international) parties not authorised to grant loans to the public[40].

In practice, securitisation transaction implemented pursuant to Law no. 130/1999 is commonly used as a means of syndicating or "repackaging" bank loans secured by Real Estate assets.

Also due to the changes made to the law mentioned earlier, we have seen the first loans directly advanced by securitisation vehicles, also in the real estate field.

16.9. Direct lending by funds and insurance companies

Like securitisation, lending by funds and insurance undertakings represents a recent means of access to credit in addition to the traditional banking sources. Closed-ended alternative investment funds and insurance undertakings in Italy were only recently permitted to invest their assets in direct lending, overturning the previous legal framework, which had been constantly interpreted as incompatible with this option, despite the absence of an express prohibition[41].

40 The Budget Law for 2019 (*i.e.* Law no. 145 of 30 December 2019) has modified Law no. 130/1999, by widening up the scope of application of financing transactions that can be carried out by securitisation vehicles. For a first commentary, see Carrière P., *Le frontiere della "cartolarizzazione" si spingono ancora oltre. Un primo commento all'ultimo intervento di modifica della Legge n. 130 del 1999*, 15 January 2019, in http:// www.dirittobancario.it/.

41 Foremost, Law Decree no. 91/2014, as subsequently supplemented and implemented by a series of other provisions, and in particular: (i) IVASS Regulation no. 24 of 6 June 2016 for in-

The changes were implemented by:

a. adding Articles 46-bis, 46-ter and 46-quater to the TUF, which permit Italian and European alternative investment funds to lend directly to parties other than consumers, under certain conditions; and
b. adding paragraph 2-*bis to Article 114 of the TUB, which states that "engaging in operations other than the issue of guarantees, undertaken solely in respect of parties other than natural persons and micro-enterprises […] by Italian insurance undertakings shall not constitute lending to the public in any form*" subject to certain limits established by the law and the implementing provisions issued by IVASS.

The use of such financing instruments has thus far remained limited on the Italian market, due in part to the cheap funding currently available through Italian and international banks.

The relatively limited significance of direct lending by Italian and European alternative investment funds compared to bank financing, at least until a few years ago, may be attributed to factors including: (i) the concentration limit for each investment/borrower, compliance with which was one of the essential conditions for direct lending by Italian funds and, indirectly, European funds, was set – until the amendment to the "Regolamento della Gestione Collettiva del Risparmio" made by Bank of Italy with act dated 16 February 2021, published in Italy's Official Journal on 2 March 2021 – at too low a level (10%) also in respect of credit funds reserved to professional investors (as a result of the aforementioned amendment, the limit was totally removed for "reserved funds", while it remained unchanged for "retail funds"); and (ii) in order to be able to lend directly in Italy, European funds must not only comply with the requirements established in Article 46-*ter*, paragraph one, of the TUF (which are essentially identical to those applicable to Italian credit funds), but must also submit prior notice to the Bank of Italy, which may, within 60 days, deny permission for the fund to engage in loan origination in Italy, justifying its decision by reference to failure to comply with one or more of the requirements established by Italian law. Since many European credit funds are pan-European investment vehicles, and are

surance undertakings; and (ii) Law Decree no. 18/2016, converted into Law no. 49/2016, and the implementing provisions issued by the Bank of Italy, for credit funds. It is worth mentioning that, IVASS Regulation no. 24 of 6 June 2016 has been amended most recently by the Act no. 131 of 10 May 2023 for adaptation to the sustainable finance provisions of, inter alia, Regulations (EU) 2019/2088 (SFDR) and 2020/852 (Taxonomy), as well as the related Delegated Regulations (EU) No. 2021/1256 and 2021/1257.

structured in such a way as to be able to operate not only in Italy, it is not easy for a European credit fund to satisfy all of the requirements for direct lending in Italy, with severe negative consequences for the liquidity of the Italian market. However, nothing prevents a European credit fund that does not satisfy the requirements for direct lending in Italy – or that simply does not wish to complete the advance notice procedure with the Bank of Italy discussed above – from purchasing bonds or debt securities issued by joint stock companies (S.p.A.) or limited liability companies (S.r.l.) operating in the Real Estate sector, in compliance with applicable laws.

A recent trend to highlight is the establishment, by foreign investors, of domestic credit funds managed by Italian management companies or by EU managers passported into Italy. These initiatives have led to numerous financings by the aforementioned funds in the real estate sector in Italy, often supporting complex real estate developments, predominantly in the residential, hotel, or logistics sectors.

Finally, in view of a written pronouncement provided by the Bank of Italy during the approval of the secondary legislation on European Union credit funds, it is not clear whether such funds may purchase receivables deriving from loans already disbursed to Italian borrowers, on the secondary market, without having to comply with the procedures and requirements set out in Article 46-*ter* of the TUF referred to above. In this author's opinion, the purchase of receivables without the intention of financing Italian debtors – in accordance with the recent reforms of the Italian legal system, all intended to increase the liquidity of the credit market and the circulation of financing – does not fall within the scope of application of Article 46-*ter* of the TUF, the title of which is "*Direct lending by EU AIFs in Italy*"[42]. Clarification on this specific point from the legislator or the Bank of Italy would be welcome and would provide Italian banks and foreign banks operating in Italy – and, indirectly, Italian borrowers – with access to the liquidity offered by the large pan-European credit funds operating in the Real Estate sector.

The limited practice of direct lending by insurance undertakings is primarily due to the stringent requirements established by the secondary legislation applicable to this sector. Firsly, before granting direct loans, insurance undertakings must prepare a "lending business plan", which must then be sent to IVASS and, subject to the express or tacit approval of

42 In favour of this interpretation Guffanti E. and Sanna P., *I fondi di credito*, in *Le Società* 7/2016, p. 860 et seq.

the plan by the authority within 90 days, submitted to the approval of the undertaking's board. Total direct lending may not exceed overall 5% of the total investment of the insurance undertaking. Specific limits are also set in relation to two variables: the financial soundness of the borrower and the origination of the loan through a bank or a financial intermediary. Finally, except by express authorisation of IVASS, the amount of a single loan paid by the insurance undertaking may not exceed: (i) 20% of the net equity of the borrower, as shown in the latest approved financial statements; and (ii) 1% of the total investments of the lender. By contrast, in other European countries, especially in Germany, lending by insurance undertakings in the Real Estate sector is much more widespread and often provides borrowers with access to extensive financial resources at moderate cost.

16.10. Mezzanine finance and hybrid securities

The term "mezzanine finance" refers to financing transactions in which a lender agrees to subordinate its claim ("junior debt") to those of the company's other lenders ("senior debt"), *i.e.* not to demand repayment of its loan until the other more senior creditors have been satisfied.

Mezzanine finance transactions are documented under three main contracts:

a. a senior facility agreement between the senior lender and the borrower governing the essential terms of the financing granted by the senior lender to the borrower;
b. a mezzanine facility agreement between the mezzanine lender and the borrower governing the essential terms of the financing granted by the mezzanine lender to the borrower, which financing will normally mature at a later date and bear interest at a higher rate than the senior financing (in some cases, the interest on the mezzanine facility is compounded in whole or in part, an arrangement known as "PIK interest"); and
c. an intercreditor agreement between the junior creditor, senior creditors (senior lenders and the finance parties to the derivatives contracts pertaining to the senior debt) and the borrower, which establishes the contractual rankings of the various creditors, in addition to specific restric-

tive covenants[43] and affirmative covenants[44], intended to provide further assurance of recovery of the senior lenders' claims.

In mezzanine financing transactions, in return for a lower interest rate, the junior lender is sometimes granted indirect rights over the borrower's equity, linking the mezzanine lender's overall return on investment to the borrower's financial performance (for example, the grant of the warrants or options known colloquially as "equity kickers")[45].

The suite of possible investment instruments available to mezzanine investors also includes "hybrid securities", also known as "non-participative financial instruments", which are conceptually similar to bonds (especially to those known as "pay-if-you-can notes"), the issue of which by joint stock companies (S.p.A.) is permitted by the final paragraph of Article 2411 of the Italian Civil Code ("*The provisions of this section also apply to financial instruments, however designated, that render the timing and amount of repayment of principal contingent on the company's financial performance*").

Hybrid securities are not to be confused with the participative financial instruments governed by the final paragraph of Article 2346 of the Italian Civil Code[46], which are conceptually more similar to equity capital, and the full terms and conditions of which are set out in the company's articles of association.

For various reasons (the law on usury and the prohibition on compounding of interest), mezzanine financing has never become popular in the Italian market, including the Real Estate sector. In Italy, the granting of second ranking security interests, with the exception of mortgages, is uncertain (the most debated, and perhaps most unclear topic, is the second ranking pledge). In addition, in the event of the insolvency of the borrower, neither the classification of second rank security interests other than mortgages by

43 Typically, an obligation for a junior creditor not to demand the repayment of its loan – and a concurrent obligation for the borrower not to repay the junior creditor – until the more senior creditors have been satisfied.

44 Normally, an undertaking by the junior creditor to remit to the senior creditors' payments received from the borrower until the senior creditors have been satisfied and, symmetrically, the right of senior creditors to collect from the borrower the sums due to the junior creditor until the senior creditor has been repaid in full.

45 Solinas, M., *Il finanziamento mezzanino*, in Galgano, F., *Le operazioni di finanziamento*, Zanichelli, 2016.

46 The final paragraph of Article 2346 of the Italian Civil Code permits companies, on the basis of contributions by shareholders or third parties, including contributions in kind of work or services, to issue financial instruments with financial or even administrative rights, not including the right to vote in the general meeting of the shareholders.

the court and insolvency bodies, nor the enforcement of the clauses of the intercreditor agreement are certain (however, if the junior debt is structured as a subordinated bond pursuant to Article 2411 of the Italian Civil Code, subordination would certainly be enforceable on third parties). The problem is most acute for the senior creditors, which do not look favourably on contractual forms of mezzanine finance (contractual subordination), *i.e.* when there is a single, common borrower for both the senior and junior debt. In contrast, senior creditors prefer forms of mezzanine finance of a structural nature (structural subordination), in which the borrower of the junior debt is the parent company of the borrower of the senior debt and the mezzanine funding is transferred to this latter entity in the form of a shareholder loan, which is then assigned to the senior creditors by way of security. However, in this case as well, the finance parties often discuss whether pledge over the share capital of the borrower of the senior loan is to be created not only in favour of the senior creditors but also to secure the claims of the junior lenders, albeit as a junior security interest and, as such, of doubtful enforceability and classification in Italy.

In the United States and in some European countries, due to the success of non-banking lenders (such as credit funds), mezzanine finance is widespread, and permits the use of levels of leverage, in Real Estate and other sectors, that would not be possible otherwise, and financing for Real Estate development projects for which bank debt is not appropriate or sufficient. In the Italian Real Estate market, the development of mezzanine finance and the spread of other quasi-equity instruments seem to be tied to the success of Italian and European credit funds. Accordingly, refer to the discussion of this subject provided above.

16.11. Shareholder and intra-group loans

A shareholder loan is a financing arrangement between the shareholder and its company that is not formally governed in the company's constitutional documents, and that is directly or indirectly intended to procure money or other financial resources to the company in order to meet its financing needs, subject to an obligation to repay the funds received.

Similarly, an intra-group loan (also referred to as "inter-company loan") may be defined as a financial arrangement involving a group company that is intended directly or indirectly to procure money or other financial resources to another company belonging to the same group in order to meet the latter company's financial needs, subject to an obligation to repay the funds received. A classic example of an inter-company loan is a loan granted to a group company by an indirect parent company or another group company under common control (a "sister company" of the borrower), which in some cases is entrusted with the treasury and cash management activities within the group.

These loans are used to procure resources quickly, flexibly and at low cost and are also useful when the borrower is in a state of financial distress, where a third party lender would not be willing to make a loan except under highly restrictive and onerous conditions[47]. Shareholder and inter-company loans may be made under non-market conditions. However, in the case of inter-company loans – especially where disbursed by sister companies of the borrower – the transaction must serve on economic interest of the lender (*i.e.* there must be a "corporate benefit"), and this interest cannot consist simply of belonging to the same group of companies.

In addition, inter-company loans allow cash to be managed centrally, in a consolidated manner, thereby selecting and rationalising the group's financing arrangements[48]. In such cases, the parent company or other group company with the best creditworthiness and longest business history usually interacts with "external" lenders, borrows a loan and then, by using the relevant proceeds, grants inter-company loans to provide the other group companies with the funds needed to meet their financing requirements.

Both shareholder loans and inter-company loans can be arranged in various ways:

a. using the typical contractual form of the loan ("*mutuo*") or credit facility, or, more commonly, through a simple shareholder loan agreement or inter-company loan agreement;
b. as indirect forms of lending (such as the assumption of debt or the granting of specific deferral of payment of receivables due to the lender); or
c. through simple transfers of money subject – in contrast to advance capital contribution payments or similar arrangements – to express repayment of the sums provided.

47 Balp, G., *I finanziamenti dei soci soggetti a postergazione*, in Galgano, F., *Le operazioni di finanziamento*, Zanichelli, 2016.

48 Miola, M., *Finanziamenti intragruppo e tesoreria accentrata di gruppo*, in Galgano, F., *Le operazioni di finanziamento,* Zanichelli, 2016.

Shareholder and inter-company loans can be used in opportunistic ways by a shareholder or parent company, to the detriment of the company's external creditors.

The Italian Civil Code contains some provisions aimed at protecting third party creditors and reallocating risk to those who, due to the equity interest they hold or their capacity to influence the management of the borrower, have the power to select the key business goals and actions of the borrower. In a financial distress situation, shareholder and inter-company loans are still possible, but by law they are subordinated to the claims of third parties.

In particular:

a. Article 2467 of the Italian Civil Code establishes – for limited liability companies and, for some scholars, for joint stock companies as well – a junior ranking for the claims by shareholders towards the company for loans disbursed to this latter, where there is an excessive imbalance between equity and debt or in a situation in which it would have been reasonable to undertake an equity contribution[49]; any deterioration in the financial situation of the borrower after the loan is disbursed is not relevant in such cases; and
b. Article 2497-quinquies of the Italian Civil Code, in respect of management and coordination of company groups, symmetrically establishes, where the same requirements as set out in Article 2467 of the Italian Civil Code have been met, the subordination of loans, irrespective of the form in which they are made, between companies belonging to the same group, regardless of whether the lender holds a direct equity interest in the borrower, and thus also in cases of loans between companies subject to common control (sister companies) or of loans to companies in which the lender holds an indirect equity interest (indirect subsidiaries).

Shareholder and inter-company loans are often used together with bank loans, including in the Real Estate sector. In such cases, in order to protect the bank's claim, the bank loan agreement establishes strict conditions on the contribution of financial resources through shareholder and inter-company loans. In addition, as mentioned briefly above[50], the receivables deriving

49 Accordingly, where the loan disbursed by the shareholder functionally replaces share capital, this provision has the purpose of restoring the lending shareholder to a position essentially analogous to that which the shareholder would have obtained by undertaking an equity contribution.

50 See above, paragraph 15.6.5 (d).

from loans provided by shareholders or members of the same group will be assigned by way of security to the lenders and will be subordinated to the claims of the bank lenders by a subordination deed.

Finally, mention should be made of some aspects to be kept in mind when drafting shareholder or inter-company loan agreements alongside bank debt and contracts:

a. the interest rate on the shareholder loan or inter-company loan and the terms and conditions of payment of interest must be established on the basis of the financial model of the overall financing transaction and the agreements between the parties; any clauses providing for the partial or total compounding of interest ("PIK interest") must be consistent with the restrictions on the compounding of interest established by Article 1283 of the Italian Civil Code;
b. any aspects of an accounting and tax nature – above all with regard to the risk that the loan may be classified as equity in the borrower – must be taken into consideration;
c. c. in the absence of a subordination deed, the subordination of the shareholder or inter-company loans to bank loans must be expressly provided for in the shareholder or inter-company loan agreements; the bank must be a party to such contracts and must expressly declare that it wishes to take advantage of the subordination clauses pursuant to Article 1411 of the Italian Civil Code; the bank may also demand that it shall not be possible to enter into amendments or waivers with respect to the initially signed version of the shareholder or inter-company loan agreements – regardless of whether the bank has signed them – without its prior written consent; and
d. the terms and conditions of shareholder or inter-company loans (for example, clauses that, in various ways, render the claim immediately payable) must be drafted in light of the terms and conditions of the bank loan; the lending bank, which, as stated above, will also be the assignee of the receivables deriving from the shareholder or inter-company loans, must always be capable of implementing an exit strategy, in a situation of distress, without being hampered by the borrower's debt to its shareholders or other group companies. The swiftest exit strategy in the event of a default is enforcement of the pledge of the shares of the borrower, which presumably holds the Real Estate assets. Indeed, in such cases, the bank – due to the aforementioned assignment by way of security and inclusion in the finance documents of other contractual clauses as appropriate –

will not be forced to negotiate with the shareholders or other group companies to reach agreements to waive or amend the terms of the receivable deriving from the shareholder or inter-company loan.

16.12. Vendor Loan

Another method to finance the acquisition of Real Estate assets or companies is the vendor loan. Vendor loans are loans granted to the buyer by the seller to finance the purchase of the asset being sold. Vendor loans take one of two forms:

a. a loan or, more frequently; and
b. a deferral of the payment of the purchase price granted to the buyer.

In addition to their financing purpose, vendor loans may also be intended to reinforce the indemnities in respect of breaches of the representations and warranties rendered by the seller in the sale and purchase agreement. The vendor loan may in fact function as an alternative, or in addition, to other instruments customarily used for such purposes[51]: in the event of breach by the seller-lender, the buyer may promptly "obtain" the sum to which it is entitled under the relevant indemnity by setting off the relevant amount against the amount due by the buyer itself to the seller to repay the vendor loan[52].

Although it is possible to use a vendor loan to finance acquisitions of all kinds, in the Italian market this instrument is sometimes seen in leveraged buy-out transactions, whereas its use in Real Estate finance is still quite limited. Where vendor loans are used together with bank loans, the same precautions protecting the bank, as discussed above in reference to shareholder and inter-company loans, shall be adopted, *mutatis mutandis*: most importantly, the claim of the provider of the vendor finance will be subordinated to the claim of the lending bank towards the buyer-borrower.

51 Typically, the placement of a sum in escrow and the issue of personal guarantees by banks or insurance companies

52 Artoni, L., *Vendor loan: una risposta ai problemi di acquisition financing?*, in *Economia & management*, 2013, p. 6

17. Aspects of the direct and indirect taxation of instruments of property financing

by F. Mantegazza, F. Balza

17.1. Withholding tax on interest payments under the loans. Domestic and treaty law

The withholding tax regime applicable to the interest payable by borrowers of Real Estate loans is an important issue in the field of direct taxation[1].

Pursuant to Article 151, paragraph 1 of Decree 22 December 1986 n. 917 (the "**Italian Income Tax Code**" or "**IITC**"), the overall taxable base of non-Italian tax resident companies and commercial entities "*consists only of the items of income generated in the territory of the State, with the exception of exempt income or income subject to final withholding levied at source or substitute tax*". In the absence of a permanent establishment in Italy of the non-Italian lender, Article 152, paragraph 2 of the IITC provides that "*the various items of income (income from capital, Real Estate income etc.) which contribute to form the overall taxable base are determined according to the provisions* (…) *relating to each relevant category*". In particular, income from capital (among which there are interest payments), if paid by a person with the status of withholding agent (*e.g.* a company tax resident in Italy and or a fund manager on behalf of a Real Estate investment fund established there), is subject to withholding tax pursuant to article 26 of the Decree 29 September 1973 n. 600 ("**Decree 600/1973**")[2]. This latter provision of law provides that a withholding tax agent must apply a withholding tax, by way of deduction from the relevant payment, at the rate of 26% on income from capital arising from a loan. If the recipient[3] is a company tax resident in Italy (*e.g.*

1 Another important aspect of direct taxation is the deductibility of interest for the borrower, but this topic is dealt with in chapter 4.2 of this book.

2 It should be noted that, under Law No. 111 of August 9, 2023, the Italian Government has been granted the authority to reorganize the tax law framework of financial nature income.

3 It is important to note that article 26 of Presidential Decree 600/1973 does not refer to the "beneficial owners" of interest, as it is generally referred to in the conventions on double taxation, but rather to "recipients" of interest. Such circumstance, inter alia, is further analysed in Ruling no. 423 of 24 October 2019 and Ruling no. 569 of 30 August 2021, as discussed infra.

an Italian bank) or is an Italian permanent establishment of a non-Italian tax resident company (a foreign bank operating through an Italian branch) to which the loan is effectively connected, interest received is not categorised as "income from capital", but is included in the taxable "business income", and therefore the withholding tax referred to in Article 26 (5) of Presidential Decree 600/1973 or any other withholding tax is not applicable under Italian laws. If the recipient is a non-Italian tax resident that does not act through an Italian permanent establishment, the withholding is applied by way of final taxation (as opposed to on account of any corporate income tax payable in Italy by the recipient)[4].

Italy's tax treaties may provide for a limitation on the rate of taxation at source on interest payments due by Italian borrowers to non-Italian tax resident lenders. Generally, in tax treaties signed by Italy, the rate of applicable withholding tax is often reduced from 26% to 10%, albeit with certain exceptions[5]. The application of the reduced rates provided for in the tax treaties is subject to conditions, the main ones being that the recipient must be resident for tax purposes in the country which is a party to the treaty with Italy and must be the beneficial owner of the interest payment. These conditions have to be confirmed in writing by the legal representative of the lender through the forms provided for in the act of the Italian Revenue Agency dated 10 July 2013[6] or through similar forms directly agreed upon bilaterally by the Italian tax authorities and the foreign tax authorities.

4 According to some interpretations (partly supported by decision 9197 of 21 April 2011 of the Italian Supreme Court), since the concept of "business "in Italian tax law does not require in itself that the business activity is exercised in the territory of the State, it would derive that "business income" can be generated even when the business activity is entirely carried out outside of Italy and there is no permanent establishment in Italy. It would follow that any interest paid by Italian borrowers to such lender would be excluded from taxation in Italy as the interest payment would qualify as "business income", regardless of the exemption under Article 26 of the Presidential Decree 600/1973. This interpretation is, in our opinion, superseded by the changes in law introduced to articles 151 and 152 of the IITC by the legislative decree 14 September 2015, n. 147, and, is also disregarded by the Revenue Agency in their circulars and resolutions (see for example the mentioned resolution 84 / E Ruling no. 379 of 11 September 2019 and Ruling n. 500 of 21 July 2021, where the foreign borrower is allowed to file a tax return in Italy and apply the lower withholding tax under the Convention) and also in their audit activity. Therefore, such interpretation is not considered further in this book.

5 Some treaties provide for a full withholding tax exemption on interest payments (see inter alia tax treaties with: Hungary, Slovakia, Czech Republic, Bulgaria, United Arab Emirates, Kuwait, Iceland, Congo Georgia and Lebanon), while others set limits different from 10% on the application of the domestic rate of withholding tax, such as at 12.5% or 10%.

6 Available on the Revenue Agency website at the following web page: http://www.agenziaentrate.gov.it.

Besides the reliefs set out in tax treaties, Article 26-quater of Decree 600/1973 sets out a withholding tax exemption that may be applicable to interest payments within corporate groups. This provision of law was introduced in implementation of the EU Directive 2003/49 / EC (the so-called "*Interest and Royalty*" Directive). In brief, under this rule, interest payments paid by a company that is resident in Italy to an "affiliate" company resident in another member state of the European Union and qualifying as beneficial owner (of such interest payments) are exempt from withholding tax. This exemption applies if a number of conditions are satisfied in relation to:

- legal nature of the lender;
- minimum shareholding between the debtor and the lender representing not less than 25% of the voting rights;
- minimum holding period of not less than one year;
- tax residence of the lender in a Member State of the European Union where it is liable to local corporate income tax;
- lender's status as beneficial owner of the interest payments. In particular, the rule provides that the recipient of the interest payments must be the beneficial owner and not a mere intermediary or agent, delegate or trustee of another person;
- the interest is subject to taxation in the hands of the lender/recipient/beneficial owner; and
- delivery by the beneficial owner to the borrower of the documentation certifying the right to the withholding tax exemption under the act of the Revenue Agency of 10 July 2013.

We note that the Italian tax authorities have carried out in the pasttax audits in which they have challenged the status as "beneficial owner" of EU lenders, such as holding companies, *conduit* companies or entities merely interposed between the "mezzanine" lenders and the final lender, thus denying the withholding tax exemption of Article 26 *quater* of Decree 600/1973. This has led to various tax litigation matters. In this regard, Circular March 30, 2016 n. 6/E deals with challenges over the beneficial owner status and the "undue" fruition of the withholding tax exemption under the mentioned Article 26 quarter. The circular confirms that the withholding tax exemption under Article 26 *quater* of Decree 600/1973 is not available in those cases in which an EU lender, parent of the Italian borrower, acts as a conduit between, for example, mezzanine external lenders and the Italian borrower. The circulate states that: "*In this regard, the challenges concerning the lack of the status as "beneficial owner" or the nature as an interposed party of the EU lender are correct, and an audit* *has to be carried out on a case-by-case basis concerning mainly the back-to-back nature of the loans, for example in terms of amount, conditions, rates, payment terms and non-recourse clauses*".

17.1.1. The withholding tax regime applicable to medium-long term loans under Article 26 (5-bis) of Presidential Decree 600/1973

The withholding tax obligations on interest payments (subject to the exceptions under tax treaties, for interest paid on interbank loans and under the "Interest Royalties Directive" as enacted by Article 26 quarter of Decree 600/1973) have been limited, as of June 2014, by a further exemption introduced by Decree Law no. 91 of 24 June 2014, then converted and amended into Law no. 116 of 11 August 2014 (hereinafter referred to as "**Competitiveness Decree**"), which is expressly regulated in the new paragraph 5-*bis* of Article 26. This and the following paragraphs will examine such tax measures provided for in Article 26 (5 *bis*) of Decree 600/1973. The Rule has been widely and authoritatively commented on in legal doctrine, and has been warmly welcomed by operators, as it clearly represents a first step towards a more complete modernization of the legal and tax system governing access to credit.

The aforementioned paragraph 5 *bis* of Article 26 of Decree 600/1973 (in its current version) reads: "*Without prejudice to the provisions regarding the lending towards the public pursuant to Legislative Decree no. 385 of 1 September 1993, the withholding tax obligation referred to in paragraph 5 does not apply to interest and other income deriving from medium and long-term loans granted to enterprises by any credit institutions established in a Member State of the European Union, any institution identified in Article 2 (5) (numbers from 4 to 23) of Directive 2013/36/EU, insurance companies incorporated and authorised pursuant to laws issued by EU Member States or any foreign institutional investors, regardless of whether such investor is liable to tax or not, as referred to in Article 6 (1) (b), of Legislative Decree no. 239 of 1 April 1996, subject to regulatory supervision in the foreign country in which they are established*".

The current formulation of the Rule is the result of various legislative measures following its introduction through the Competitiveness Decree. In particular:

- Decree Law no. 133 of 12 September 2014, converted and amended by Law no. 164 of 11 November 2014 has included among the lenders/beneficiaries of the interest payments eligible to the withholding tax exemptions the "*institutions identified in Article 2 (5) (numbers from 4 to 23) of Directive 2013/36/EU*";

- Decree Law no. 3 of 24 January 2015, converted and amended by Law no. 33 of 24 March 2015 (hereinafter "**Investment Compact**"), has inserted, in the place of funds that do not use financial leverage, "*foreign institutional investors, including those not liable to tax, pursuant to Article 6 (1) (b) of Legislative Decree no. 239 of 1 April 1996, that are subject to regulatory supervision in the foreign country in which they are established*"; and
- Decree Law no. 18 of 14 February 2016, converted and amended by Law no. 49 of 8 April 2016 has specified that the exclusion is applicable "*without prejudice to the provisions regarding the lending towards the public pursuant to Legislative Decree no. 385 of 1 September 1993*".

The rationale for the Rule, as indicated in the parliamentary explanatory notes, is the need to avoid double taxation for Italian companies, taking into account the practice of shifting the withholding tax burden onto the borrower through contractual *gross-up* clauses and, at the same time, to facilitate the access of Italian companies to additional foreign sources of finance (including non-banking lenders).

In principle, the interest payment can be taxed not only by way of a withholding tax levied at source by the borrower but also by the lender by way of filing a tax return in Italy. Therefore, the initial doubt was whether the exclusion from the withholding tax pursuant to Article 26 (5-*bis*) would result in a foreign lender being required to account for Italian tax in another way, *i.e.* by filing an income tax return in Italy (with the consequence that a rule intended to facilitate the procedure would only create further complications for the taxpayer). Any such doubt was resolved in favour of the taxpayer by the Revenue Agency, through Circular Letter n. 6/E of 30 March 2016 and Resolution n. 84/E of 29 September 2016, which reads: "*considering that the exemption provided for in paragraph 5-bis of the aforementioned Article 26 of Presidential Decree 600 of 1973 concerns the withholding tax at source and that the same has the nature of a final tax* (…), *it is believed that the interest payment on the medium to long-term loans received by the bank should not be subject to* [any] *taxation in Italy* [certainly not by way of filing a tax return in Italy]".

17.1.2. Requirements of application of Article 26 paragraph 5 bis of the D.P.R. 600/1973

The withholding tax referred to in Article 26 (5) of Decree 600/1973 does not apply to interest payable to non-Italian tax resident if all the following conditions are met:

- the loan is medium long-term;

- the borrower is an enterprise;
- the loans are granted by one of the following:
  - credit institutions established in the European Union;
  - insurance companies incorporated and authorised pursuant to the legislation of a member of the European Union; or
  - institutions referred to in Article 2 (5) (points from 4 to 23) of Directive 2013/36/EU; or
  - foreign institutional investors established in countries that provide satisfactory information exchange procedures for tax purposes with Italy and are subject to regulatory supervision in the country in which they are established; and
- the provisions of law governing the lending towards the public, if applicable, are not breached.

Below, we examine in greater detail the conditions necessary for the application of the Rule.

17.1.3. Medium-long term loan

Neither Article 26 (5 *bis*) nor Decree 600/1973 sets out a definition of "loan" or the conditions under which a loan is to be regarded as "medium long-term".

With regard to the concept of "loan", this includes any contractual form by which a credit is granted, such as loans, credit facilities, etc., which could generate taxable interest pursuant to Article 26 (5) of Decree 600/1973[7]. Real estate loans fall within the scope of the Rule.

Certain decisions of tax courts (see judgment of the Italian Supreme Court n. 695 of 16 January 2015) have held that "(…) *loans* (…) *are only* (…) *those that result in the possibility of drawing money to be used in productive investments*", thereby excluding the possibility that a loan aimed at refinancing a pre-existing debt (as opposed to a productive investment) qualifies as

7 Article 26 (5-*bis*) of Presidential Decree 600/1973 provides that withholding tax as referred to in Article 26 (5) does not apply to income from capital other than the one provided for in paragraphs from 1 to 4 of article 26. The capital income referred to in paragraphs 1 to 4 (which is not exempt under the provisions of article 26 (5 *bis*)) is interest deriving from: bonds, securities similar to bonds, Italian commercial paper (*cambiali finanziarie*), bank and post office deposit and current accounts, and repos over securities and foreign currency. With respect to some of the latter items of income, the law provides for certain exemptions or exclusions from the tax. See the exemption under article 26-bis of Presidential Decree 600/1973 or the non-territoriality of interest paid to non-residents on Italian bank deposits.

a loan eligible to the withholding tax exemption in question. According to such decision the purpose of such a financing would not be a "*productive investment*", "(…) *but rather the rescheduling of a debt already granted*". Even if the "*productive investment*" requirement has been formulated in respect of a stamp tax governed by Article 15 of Decree no. 601 of 29 September 1973 which has features in common with the withholding tax regime in exam, we believe that the qualification as "*productive investment*" is irrelevant for the application of the withholding tax. In other words, for the purposes of the application of the withholding tax exemption in exam, the fact that the loan is, or is not, aimed at "*productive investment*" is irrelevant.

The loan must be "*medium long-term*" for the withholding exemption to apply. Article 26 (5 *bis*) of Decree 600/1973 does not provide a definition of "*medium long-term*". Resolution no. 76/E of 12 August 2019 has clarified that the loans must "*have a medium or long term contractual maturity, i.e. they must exceed eighteen months, by analogy with the provisions of Article 15 of Presidential Decree No 601 of 29 September 1973 for the purposes of the substitute tax on loans*". Confirmation of this is also found in a resolution of the Revenue Agency (Agenzia delle Entrate)[8], published in the newspaper "Il Sole 24 Ore" on 20 April 2017 (hereinafter the "**Private Letter Resolution**"). In it, the Revenue Agency stated that the loan must have a maturity exceeding 18 months in order to benefit from the withholding tax exemption. This assumes that the definition of "*medium long-term*" must be interpreted in accordance with the requirements of Article 15 of Decree no. 601 of 29 September 1973.

The Revenue Agency recently confirmed the above in Ruling n. 125 of 24 February 2021, affirming that the requirement of "*medium long term*" is fulfilled where the loan has a maturity exceeding 18 months. Precisely, in the case analysed by the Ruling, the loans "*having a maturity of 10 years, (…) could not be anticipately re-turned, neither in the total nor partial amount, prior 18 months and two days from the date of granting*".

The "*medium long-term*" requirement, interpreted in accordance with the provisions, the practice and the relevant court decisions on substitute tax under articles 15 and subsequent of Presidential Decree 601/1973, requires the parties to stipulate a contractual maturity in excess of eighteen months. As regards the computation of this contractual maturity, decision n. 1585 of the Italian Supreme Court of 18 February 1994 stated that "*if the loan is to last more than eighteen months, it means that its minimum maturity must be at*

8 Not embodied into a resolution addressed to the generality of taxpayers.

least one year, six months and one day, and therefore the lender can request repayment, which the borrower must settle, once that term has expired, that is to say on the second day after the end of the eighteen months".

Special care should be paid to any contractual clause that provides for early repayment, because in some cases early repayment implies that the minimum maturity requirement is not met and, therefore, the financing is not "*medium long-term*", whereas in other cases this early repayment does not prejudice the minimum maturity period. In this regard, we summarize below the main principles:

- the lender's right to voluntarily terminate a loan (known as "*ad nutum*" termination) prevents, from the very outset, the establishment of a fixed contractual maturity and is, therefore, incompatible with the qualification of a loan as "*medium-long term*"[9];
- the ex post extension of a short-term loan does not requalify it as a medium long-term loan[10];
- the lender's right to terminate a loan as a result of objective circumstances or events related to the need to protect the credit, or to breaches/default by the borrower (such as for example the non-payment of any amount by the borrower or failure by the borrower to respect a financial covenant set out in the loan agreement) does not prejudice the minimum maturity period and is, therefore, compatible with the qualification of a loan as a "*medium-long term*"[11][12]. In contrast to the majority of court decisions and

9 See, among others, Supreme Court decisions 12928 of 24 May 2013; 26750 of 29 November 2013; and 4792 of 3 April 2002; and: Resolution no. 6/T of 6 July 1998, Circular Letter no. 240/E of 22 December 1999, Ruling n.2/T-25627 of 24 March 2003, and Resolution no. 76/E of 12 August 2019.

10 See Resolution No. 76/E of 12 August 2019.

11 See, with regard to the tax authorities: Resolution no.68/T of 6 July 1998, Circular Letter no.8/T of 24 September 2002; Resolution no. 1/T of 24 February 2003; and Circular Letter no. 6/T of 14 June 2007; and, as regards professional associations: ABI Circular Letter no. 36 of 3 August 1998; ABI Circular Letter no. 15 of 25 October 2002; ABI Circular Letter no. 14 of 27 May 2003; report of the Notaries' Association no. 86/2005; ABI Circular Letter no. 3 of 22 January 2007; and Assonime Circular Letter no. 36 of 15 June 2007.

12 In the Private Letter Resolution the Revenue Agency affirmed that the financing considered is "*medium-long term*" as it has a contractual maturity of more than 18 months and "*in any case, the possibility of making early repayments after at least 18 months and one day*" is not allowed. Similarly, the mentioned Ruling n. 125 of 24 February 2021 states that "*the loans have a maturity of 10 years and, assumed that the loans cannot be anticipately re-turned, neither in the total nor partial amount, prior 18 months and two days from the date of granting, the withholding tax is not applicable*". These last statements could suggest, in the first place, that the loan agreement must

practice, an isolated judgment of the Italian Supreme Court n. 2188 of 6 February 2015, ruled that "*a loan characterized by a termination clause even for "justified reason" at any time and therefore even before 18 months and one day, is incompatible with the definition of "medium long-term*". As noted by some authors[13], the decision of the Court, which is apparently inconsistent with prevailing court case and practice, could be the result of the lack of clarity of some of the clauses in the loan agreement examined by the Supreme Court in that judgment.

We note that it is not unusual in commercial practice of real estate that *medium*-long term loan contracts contain clauses aimed at limiting (to a portion of the outstanding loan) the amounts of the mandatory repayments to be made in the first 18 months and a day; the purpose of these clauses is to confirm, as a precautionary measure, the persistence of the loan for the minimum period required by law (18 months and one day), regardless of the analysis of the merits and nature of such prepayment events (objective, aimed at protect the credit or others);

- the borrower's right to voluntary terminate a mortgage loan go erned by Legislative Decree no. 385 of 1 September 1993 (the "**Italian Banking Act**") does not prejudice the minimum maturity of the loan and is, therefore, compatible with the "*medium long-term*" qualification in order to protect the borrower as the "weaker party" in the loan agreement[14]

not allow any type of repayment in the first 18 months and one day in order to maintain its "medium long term" qualification, thus disavowing the legal practice and court case elaborated over the years. In our opinion, this is not the meaning of the Private Letter Resolution. Indeed, it is certain that a loan is to be regarded as "*medium-long term*" when there is a total or partial prohibition on repayment before 18 months and one day. However, even when there is no such prohibition, a loan may still qualify as "*medium- long term*", but this must be established through a detailed examination of the various cases of early termination (and their justification) in the light of the criteria developed in jurisprudence and legal practice and stated above ("*ad nutum withdrawal*", mandatory or voluntary reimbursement or early repayment etc.). This is also the interpretation of the Tax Authority in Circular Letter no. 6/T dated 14 June 2007.

13 M. Bascelli, L. Pangrazzi "*L'imposta sostitutiva sui finanziamenti alla luce degli ultimi orientamenti della Cassazione*", in dirittobancario.it, 6 July 2015, and A. Pischetola, "*Imposta sostitutiva sui finanziamenti in caso di ripianamento debiti e recesso "per giusto motivo"*", in Il Fisco 2015.

14 See Tax Authority, Circular Letter no. 6/T dated 1 June 2007 concerning mortgage loans. It could be argued that the interpretation set out under Circular Letter no. 6/T does not apply to non-mortgage loans under the Italian Banking Act, or not regulated by Italian law and, consequently, the voluntary prepayment right is not compatible with the medium long-term maturity. For example, in Resolution no. 76/E of 12 August 2019, where the financing is not a mortgage loan under the Italian Financial Act, the taxpayer informs the tax authority that "*Under no circumstances the borrower has the right to repay the loan before a minimum period of 18 months and one*

17.1.4. The borrowers: the qualification as an "enterprise"

As mentioned above, the Rule applies to borrowers that are "*enterprises*". Article 22 of the Competitiveness Decree, which introduced the above provision, is headed: "*Measures in favour of loans to enterprises*". In addition Article 22 of the Competitiveness Decree contains regulatory provisions that allow Italian insurance companies and securitization vehicles established pursuant to Law no. 130 of 30 April 1999 to provide loans to the public. In these provisions, the beneficiaries of the loans, which are intended[15] to be "*enterprises*", are defined as: "*persons other than individuals and micro-enterprises*". Whereas in the Rule regarding the withholding tax exemption, the borrowers of the loans are identified, simply, as "*enterprises*" and not as "*persons other than individuals and micro-enterprises*". We note that the Competitiveness Decree, Article 17 of Decree Law no. 18 of 14 February 2016, converted and amended by Law no. 49 of 8 April 2016[16], set out the procedures for direct lending by EU alternative investment funds (see Article 46-ter of Decree 24 February 1998 n. 58 – the "**Italian Financial Act**"), defining the borrowers as "*persons other than consumers*", and not, therefore, making any reference to "*enterprises*"[17]. Even if reference to "*enterprises*" appears to be inconsistent with other provisions of laws, such "unfortunate" wording was and is, as a matter of fact, used in the Rule and in the subsequent amendments it has not been, so far, changed. With respect to this, Resolution no. 98 of 5 April 2019 states the following: "*Such provision has been added by article 22 of Law Decree no. 91 of 24 June 2014 (so called "Competitivity Decree 2014") to article 26 as an exception to the application of the withholding tax set out under paragraph 5 of the same article, with the aim of facilitating access to credit to the "enterprises". In this regard, it shows that the purpose of the law is not to facilitate financings granted to any "economic organized activity aiming*

day from the disbursement" as loans analysed by the Private Letter Resolution and Ruling n. 125 of 24 February 2021. In this resolution, the Italian tax authorities have taken the view that such financing was a medium long-term one. Based on our experience, voluntary prepayment clauses are rarely limited.

15 Intention that should emerge from the heading of Article 22 of the Competitiveness Decree.

16 This piece of legislation introduced the regulatory requirement in the Rule in question.

17 Conversely, the provision that introduced private enforcement clauses allowing creditors, in the event of a debtor's default, to take ownership of collateral out of court (known as "*pactum marcianum*") refers to debtors that are "enterprises" (see Decree Law 59/2016 – the so-called "bank decree", converted by law 119/2016).

at producing and trading goods or services", but rather only to those entities resident in Italy for tax purposes that undertake a business activity within the meaning of tax law".

Despite the fact that the Rule does not provide for a definition of "*enterprises*", Resolution no. 76/E of 12 August 2019, in line with Resolution no. 98 of 5 April 2019, states that "*financings for which the withholding tax is not applied are exclusively those granted to "enterprises", meaning those who undertake a business activity in the Italian territory. Hence, financings granted to commercial companies and entities and individual entrepreneurs resident in Italy for tax purposes, and permanent establishments in Italy of companies and entities not resident in Italy for tax purposes (as under article 73, paragraph 1, letters a) and b) fall within the scope of the provision*". The Private Letter Resolution and the Resolution no. 76/E of 12 August 2019 clarify that an Italian holding company qualifies as an "*enterprise*" for the purposes of the Rule.

Therefore, the "*enterprises*" that benefit from the withholding tax exemption encompass the following:

- Italian joint-stock companies (*società per azioni*), partnerships limited by shares (*società in accomandita per azioni*), limited liability companies (*società a responsabilità limitata*), cooperatives and mutual insurance entities resident in Italy, even when they are holding companies;
- non-resident companies and entities, with reference to loans taken for the needs of their permanent Italian establishments;
- commercial entities resident in Italy;
- commercial partnerships resident in Italy;
- and individuals carrying out business activities.

Since the introduction of the Rule, there has been speculation on whether a collective investment scheme ("**OICR**") investing in real estate, a major player in the Italian real estate market, can qualify as an "*enterprise*" and thus benefit from the withholding tax exemption. The OICR is defined under the Italian Financial Act as a pool of assets used by an authorised fund manager to supply asset management services on a collective basis. An OICR is the instrument through which a supply of services is made, but it is not itself the supplier of such services, which is the fund manager (the latter being an enterprise). Resolution no. 76/E of 12 August 2019 and Resolution no. 98 of 5 April 2019 clearly state that collective investment schemes do not qualify as "enterprises" and, consequently, they do not benefit from the withholding tax exemption. Moreover, Resolution no. 98 of 5 April 2019 addresses the case where the borrower is a collective investment scheme established in the form of investment company with fixed capital (SICAF). The Resolution denies that the SICAF may benefit from the withholding tax exemption on the grounds that, according to article 1 of the Italian Financial Act, the SICAF itself is a closed-ended undertaking for collective investments in transferable securities, although incorporated in the form of joint stock limited company with fixed capital, whose exclusive business purpose is the collective management of the assets acquired through the offer of its shares and other equity financial instruments. Hence, a SICAF is required to levy the withholding tax on interest paid to an EU bank[18].

17.1.5 The Lenders

The withholding tax exemption applies only if the lender is one of a series of specific entities (see paragraphs from 17.1.5.1 to 17.1.5.4 below). In consideration of the fact that the withholding tax on interest is withheld on a cash basis (*i.e.* when the payment is made, rather than when the payment accrues), it is at the time of the payment that one must ascertain whether the conditions concerning the status of the lender[19] are met or not. Therefore, the use of the term "*grant*" in the text of the law should not have the effect of limiting the withholding tax to those lenders that originally granted the loan and denying the same exemption to any subsequent purchasers of the loan on the secondary market. If the loan is transferred to a party other than the original lender, either by sale of a contract or sale of a receivable, it should be checked if the new lender falls into any of the qualifying categories, rather than referring the analysis to the original lender.

According to the interpretation of the Italian tax authorities, the Rule should not allow a "look-through" approach. Resolution no. 423 of 24 October 2019 expressly reads that: "*as better clarified by the mentioned Resolution no. 76/E of 2019, the Rule does not generally allow to apply the "beneficial owner" principle so as to attribute the interest to the foreign entity that is the final recipient of the income. Rather the Rule exclusively encompasses the entities referred to in the provision of law and having the characteristics described above. In fact,*

18 The Resolution does not clarify whether the SICAF is self-managed or whether an external fund manager is entrusted with the management of the pooled assets. It could be investigated whether the Italian tax authorities could have come to a different conclusion in case of a self-managed SICAF. According to the Italian Financial Act, a self-managed SICAF is not just a pool of assets, but rather a combination of assets and a management activity internally carried out.

19 Specifically, those examined in paragraphs from 12.1.5.1 to 12.1.5.4 of this chapter.

neither the literal wording nor the ratio of the Rule can be interpreted under the light of a look-through approach. Moreover, it should be noted that paragraph 5-bis excludes the applicability of the taxation regime governed by paragraph 5, which explicitly refers to "recipients" of the interest, differently from – inter alia – article 26-quarter of the same Decree (…). In light of the above, given the explicit reference of article 26, paragraph 5-bis, of Presidential Decree no. 600/1973 to the "recipients" of income, it does not appear consistent, in principle, to apply the exemption regime stipulated therein to the final beneficiaries of the income which do not coincide with the recipients themselves". In particular, the Italian tax authorities – with respect to the case examined in Ruling no. 423 of 24 October 2019 – argues that, in order to ascertain whether the withholding tax exemption is applicable, the borrower should consider the position of the lender (the Dutch bank), despite the fact that the latter has signed a sub-participation agreement[20] with an Irish securitization vehicle and transferred to such vehicle part of the interest paid by the Italian borrower. Although such interpretation is open to possible abuses, it is important to notice that, in the case examined by the resolution, the Dutch bank only partly transferred the credit risk with the mentioned sub-participation agreement and such agreement was concluded after the disbursement of the loan. Furthermore, the Italian tax authorities carve out the possibility of a follow-up audit on the grounds of the abuse of law rules. The prior position has been later confirmed by the Revenue Agency in Rulings no. 125 of 24 September 2021, no. 569 of 30 August 2021 and no. 571 of 23 November 2022. Against such interpretation, please refer to the judgment of Provincial Italian Tax Court of Milan no. 4708 of 11 November 2019 and the judgment of Regional Italian Tax Court of Lombardy no. 3324 of 11 August 2022, the latter recently confirmed also by the Supreme Court in judgment no. 4427 of 20 February 2025, in favour of the application of the look-through approach to the exemption under Article 26, para-graph 5-bis of Presidential Decree n. 600/1973. The tax court held that interests paid by an Italian company to a Luxembourg holding company and then retroceded to a supervised Luxembourg UCIT were subject to withholding tax. The Regional Tax Commission of Lombardy in judgement no. 295 of 3 February 2022 and, more recently, the Second-Degree Tax Justice Court of Lombardy in judgement no. 3143 of 30 September 2024, have similarly ruled in favour of the taxpayer. They asserted that "*Article 26, paragraph 5-bis of Presidential Decree*

20 Hence, it is neither a sale of contract, nor a sale of receivable, but rather an agreement to transfer the credit risk deriving from the financing.

no. 600 of 1973 does not preclude the exemption provided therein in cases where interests from loans are received indirectly by the beneficiary. This is because the legislative text does not add any specific requirements and merely states that the interest flow 'received' by certain entities is exempt from withholding tax, using the wording also adopted in the Double Taxation Conventions conforming to the OECD Model, concluded by Italy, which have the similar aim of avoiding double taxation on cross-border interest flows".

For the sake of clarity, in the following paragraphs from 16.1.5.1 to 16.1.5.4 we will examine the requirements that banks, insurance companies, public sector entities and foreign institutional investors must meet in order to fall within the scope of application of the Rule. The analysis is made regardless of whether these lenders are authorised or not to lend into Italy (which is, however, a necessary condition to apply for the withholding tax exemption).

17.1.5.1. Banks

The Rule makes reference to "*credit institutions established in a Member State of the European Union*". The term "*credit institutions*" is derived from Directive 2006/48/EC of 14 June 2006. The Directive defines a "*credit institution*" as: "*an undertaking whose business is to receive deposits or other repayable funds from the public and to grant loans;* ". The **Italian Bank Act** uses the term "*bank*" – rather than "*credit institution*" – which is similarly defined. Therefore here we will use the terms "*bank*" and "*credit institution*" as synonyms.

The bank or credit institution must be "*established*" in the European Union, in order to benefit from the withholding tax exemption. Both the Italian Bank Act and Directive 2006/48/EC of 14 June 2006 use the term establishment in relation to branches of banks. A branch is "*a place of business which forms a legally dependent part of a credit institution and which conducts directly all or some of the operations inherent in the business of credit institutions*" and, therefore, for tax purposes it is, generally, a "*permanent establishment*", *i.e.* a taxable presence.

A bank is "*established*" not only in the EU country in which it owns a branch, but also logically in the country in which it has its registered office (assuming that the operations relating to the banking activity are carried out at that registered office)[21]. The establishment (branch or registered office) is rel-

21 Indeed, for VAT purposes (Presidential Decree 633/1972 and Directive 112/2006) an entrepreneur is considered established where its business is based or where it has a permanent establishment.

evant, in our view, when the loan that generates the interest is effectively connected to that establishment. Conversely, a permanent establishment / branch in the European Union is not sufficient to ensure the withholding tax exemption if no lending is made through such permanent establishment / branch. There follows that the withholding tax exemption is intended to apply to:

- banks having their registered office in a EU member state and lending from that office;
- banks having their registered office in a EU member state and lending from a branch located in another EU member state; and
- banks having their registered office in a non-EU country and lending from a branch located (and authorised) in a EU member state (in compliance with the provisions of the Italian Bank Act on the lending to the public) (see Ruling no. 571 of 23 November 2022).

Banks that have their registered office in a EU member state and that lend from a branch located outside the European Union appear to be excluded from the scope of this withholding tax exemption.

Unlike the banks, for lenders that are institutional investors (see below) the territorial scope extends to the states and territories that allow an adequate exchange of information, at present listed in Ministerial Decree dated 4 September 1996 (published in the Official Gazette no. 220 of 19/09/96) as subsequently amended and supplemented (hereafter the "**White List**"). This geographical area is broader than the area applicable to banks, which coincides with the countries of the European Union. This difference in treatment does not appear to be explained in any document related to the legislation in question.

As of 1 February 2020, the United Kingdom is no longer part of the European Union (so-called *Brexit*). However, the Withdrawal Agreement provided for a so-called transitory period, during which - pursuant to Article 127 of the Withdrawal Agreement - EU law would continue to apply to the United Kingdom until its expiry on 31 December 2020. The Italian Revenue Agency, in its principle of law No. 6 of 9 April 2021 and in an tax Ruling, confirmed that the exclusion from withholding tax continued to apply to UK banks for the entire duration of the tran-sitional period, i.e. until 31 December 2020, as they were estab-lished in a country to which EU law applied. The non-application of the withholding tax exclusion would have resulted in an unjusti-fied breach of the fundamental freedoms protected by EU law, which was still applicable under the Withdrawal Agreement to a UK bank.

As of 1 January 2021, the United Kingdom is no longer consid-ered as a Member State and EU law does not apply. Therefore, it seems that banks established in the United Kingdom will no longer be able to rely on the withholding tax rule, as the new Trade and Cooperation Agreement between the United Kingdom and the European Union does not grant equivalence in the provision of financial services, as stated by the Revenue Agency in Rulings no. 839 of 21 December 2021.

17.1.5.2. Insurance companies

The Rule makes reference to "*insurance companies incorporated and authorised pursuant to laws enacted by Member States of the European Union*". The expression "*incorporated and authorised*" implies that the mere authorisation to carry out an insurance business issued by the relevant authority of a country of the European Union is not sufficient, and that the company must necessarily be incorporated under the laws of a EU member state.

The following are therefore included within the scope of the Rule:

- insurance companies incorporated in a EU member state (generally having their registered office in that country) which are allowed to lend on the basis of an authorisation granted by the competent authorities of that state; and
- insurance companies incorporated in a country of the European Union which grant credits from a branch located in a different EU member state on the basis of an authorisation granted by the authorities of that state.

Given the text of the Rule, insurance companies incorporated and authorised in the European Union (and therefore having their registered office and possibly their branches in EU countries) but also branches in non-EU countries, and which lend from these latter branches, should benefit from the withholding tax exemption.

Conversely, the EU branches of non-EU insurance companies, even though such branches are established and authorised in the European Union, are not included within the scope of the Rule, as the relevant company is incorporated in a non-EU country and does not fall under the legal provision.

The criteria applicable to banks are different from those applicable to insurance companies. No clarifications are given in the explanatory report on the reasons for this difference in treatment.

17.1.5.3. The institutions referred to in Article 2 (5) (4-23) of Directive 2013/36/EU

These are entities to which Directive 2013/36/EU of 26 June 2013 "*on access to the activity of credit institutions and the prudential supervision of credit* *institutions*" does not apply, but which are generally authorised to lend according to special local regulations, given their particular nature as public sector entities or publicly-owned bodies. The illustrative report to the Competitiveness Decree clarifies that they are generally "*development promotion institutions present in EU Member States (equivalent, at European level, to the Italian "Cassa Depositi e Prestiti")*".

17.1.5.4. Regulated Institutional investors

The Rule makes reference to "*foreign institutional investors, even if not subject to tax, as per Article 6 (1-b), of Legislative Decree no. 239 of 1 April 1996, subject to regulatory supervision in the foreign countries in which they are established*".

This formulation was not contained in the original version of the Rule, which made reference to "*unleveraged credit funds*". The Investment Compact decree extended the exemption to institutional investors. The explanatory notes to the Investment Compact decree clarifies that: "*By deleting the reference to unleveraged credit funds, the entities that borrow leverage (e.g. speculative funds) can also have access to the withholding tax exemption, even if they are not subject to tax, provided they have been established in any of the geographical areas mentioned above ("white list" countries)*".

"*Institutional investors*" are identified as "*entities that, regardless of their legal and tax status in the country of residence, carry pout and manage investments on their own or on a third party's account, such as – for example – insurance companies, investment companies, mutual investment funds, SICAVs and pension funds*"[22].

The reference to "*Article 6 (1- b), of Legislative Decree no. 239 of 1 April 1996,* "implies that such investors should be established in "White List" countries.

The reference to being subject to "*regulatory supervision*" can be interpreted on the basis of the clarifications issued by the Italian tax authorities with regard to real estate funds (OICR). According to such clarifications, the regulatory supervision requirement is considered satisfied with respect to a fund "*when advance authorisation is required for the commencement of the fund activities and the fund is subject to continuous mandatory control*

22 See ministerial decree dated 12 December 2001 on the self-certification form to be used for the purposes of Article 7 (2) of Legislative Decree no. 239 of 1 April 1996.

pursuant to the regulatory provisions in force in the foreign state"[23] and such supervision need be exercised on the fund or, alternatively, on the fund manager[24]. The Private Letter Resolution confirms that an institutional investor is considered to be subject to supervision when the fund or the fund manager is subject to supervision. On the subject, Resolution no. 76/E of 12 August 2019 has confirmed that: "*The regulatory supervision may be exercised either on the undertaking or on the asset manager, according to the prudential supervision model adopted in the State where the undertaking has been established (see Circulars no. 2/E of 15 February 2012 and no. 19/E of 4 June 2013).*" It follows that, *inter alia*, an alternative investment fund (hereinafter "**AIF**"), as defined in Directive 2011/61/EU on "*Alternative Investment Fund Managers*" *(which is a collective investment scheme)* and in Legislative Decree no. 44 of 4 March 2014[25], which is managed by an alternative investment fund manager ("**AIFM**") is an institutional investor subject to regulatory supervision, according to the law, since the AIFM must necessarily be supervised.

The Rule requires that regulatory supervision be exercised in the "*foreign countries where the* [investor/undertaking] *is established*". When the supervised entity is the fund manager, and it is not based in the same country where the fund has been set up, the supervision is not carried out in the country where the fund has been set up/established, but rather in the fund manager's country. It is our opinion, however, that the requirement ought to be considered satisfied, in this case, precisely because one of the essential features of Directive 2011/61/EU on "*managers of alternative investment funds*" is the fund "manager's passport", whereby, within the European Union, a fund of a member state can be managed by a manager from another member state. If this situation caused a tax cost, the purpose of the Directive would be partly frustrated. This interpretation seems to be consistent with the guidelines of Circular Letter no. 19/E of 4 June 2013[26] which state that: "(…) *the term "established", used by the legislator in the body of Article 10-ter*

23 See, among the others, the following documents of the tax authority: Circular Letter no. 2/E of 15 February 2012, Act of the Revenue Agency dated 16 December 2011 and Resolution no. 54/E/2013.

24 See the documents cited in the previous note as well as Resolution no. 78/E of 27 June 2017.

25 The mentioned legislative decree amended the Italian Financial Act by inserting the rules on AIFs and AIFMs.

26 Paragraph 2 of article 10-ter of Law n.77 of 1983 states that, with respect to non-harmonized collective investment schemes located in EU member States and in EEA States included in the "white list", the supervisory requirement must be assessed at the level of the fund manager.

(2) of Law no.77 of 1983, [refers] *to the manager that must be subject to supervision in the state where it is established and not in the state where the fund is established*". Resolution no. 76/E of 12 August 2019 contemplates the case of a collective investment scheme established in the United Kingdom and managed by an asset management company under regulatory supervision in Guernsey, which is nowadays a White List country, and the resolution confirmed the withholding tax exemption.

Finally, it should be considered whether the Rule can apply to banks resident in non-EU countries that are included in the "White List"[27]. This question is answered negatively by the Ruling no. 839 of 21 December 2021, which considering whether a bank resident in the United Kingdom (a non-EU state post-Brexit transitional period) may fall within the scope of application of the withholding tax exclusion states : "With respect to this category of subjects potentially benefiting from the exclusion provided for in Article 26, paragraph 5-bis, the letter of the rule does not pose any interpretative doubt, expressly referring to credit institutions established in European Union member states, among which the United Kingdom clearly no longer falls."

17.1.6. The regulatory requirement

Article 17 (2) of Law Decree no. 18 dated 14 February 2016 ("Law Decree 18/2016"), converted with amendments by Law no. 49 of 8 April 2016, added to Article 26 (5 *bis*) of Presidential Decree no. 600/1973 the following language: "*without prejudice to the provisions regarding the granting of loans to the public pursuant to Legislative Decree no. 385 of 1 September 1993*".

The explanatory notes of the Italian Parliament of March 2016 clarify that this change in law is designed to "*make it clear that the withholding tax exemption (…) depends on compliance with the regulatory provisions on lending into Italy to the public, (…) in order to avoid unfair competition to the detriment of domestic operators*". Such position has been confirmed by Resolution no. 76/E of 12 August 2019 and Resolution no. 423 of 24 October 2019.

As far as EU OICRs are concerned, the authorisation and regulatory provisions to be complied with for lending into Italy to the public are not pro-

27 L. Rossi, M. Ampolilla, "*La risoluzione 29 settembre 2016, n. 84/E, e i dubbi che ancora permangono sui presupposti per l'applicazione dell'esenzione di cui all'art. 26, comma 5-bis, del D.P.R. n. 600/1973*" in Bollettino tributario d'informazioni – 2016; e M. Gusmeroli, "*Questioni aperte in tema di esenzione su interessi da finanziamenti a medio e lungo termine*" in Bollettino tributario d'informazioni – 2017.

vided for in Legislative Decree no. 385 of 1 September 1993, *i.e.* the Italian Bank Act, but rather in Article 46-*ter* of the Italian Financial Act. However, failure to make specific reference to the Italian Financial Act should not affect the substance of the requirement (particularly because the quotation from the parliamentary explanatory notes specifically refers to insurance companies and institutional investors): the withholding tax exemption applies if the laws on lending into Italy that apply for that specific lender are complied with, regardless of whether the lender is a bank, an insurance company or a regulated institutional investor. Therefore, if an EU OICR intends to lend into Italy, it must follow the authorisation procedure referred to in Article 46-*ter* of the Italian Financial Act. If such procedure is not followed, not only will the loan be in violation of the laws on lending (a criminal offence), but the withholding tax exemption would not apply.

With regard to insurance companies, the paragraph 2-*bis* of Article 114 of the TUB provides that an Italian insurance company can grant loans to the public within certain limits under the regulations issued by IVASS.

When the lending is not made to the public, but rather to another company belonging to the same group as the lender pursuant to Ministerial Decree no. 53 of 2 April 2015, that lending is allowed under a regulatory point of view and, hence, eligible to the withholding tax exemption (if the other conditions are met). This is the conclusion reached in the Private Letter Resolution, in Resolution no. 76/E of 12 August 2019 and in Ruling n. 125 of 24 February 2021, which take into consideration the loans granted by OICRs established in the European Union and managed by an asset management company under regulatory supervision resident in a White List jurisdiction, to an Italian company indirectly controlled by them. The Private Letter Resolution and the mentioned Resolution state that the interest paid on such loans may benefit from withholding tax exemption.

A further relevant aspect is whether the purchase on the secondary market, by an EU OICR, of a loan originally issued by an EU bank should be regarded as lending and therefore require the EU OICR to complete the authorisation procedure referred to in Article 46-*ter* of the Italian Financial Act. According to one interpretation, it is believed that the purchase of loans on the secondary market, to the extent not aimed at financing Italian borrowers, should not be a form of lending to the public (even if clarification on this point would be desirable). Therefore, according to such interpretation the purchase by an EU OICR of a loan, or tranche thereof, should not require authorisation from the Bank of Italy pursuant to Article 46-ter of the

Italian Financial Act and the purchaser would be entitled to the withholding tax exemption. According to another interpretation - which also takes into ac-count certain clarifications provided in writing by the Bank of Italy during the approval of the secondary rules on European debt funds - even in the event of the purchase on the secondary market, by EU UCITS, of financing granted by EU banks, it is necessary in any case to complete the authorisation procedure and meet the requirements set out in Article 46-ter of the TUF[28]. The Revenue Agency has addressed similar matters through a private letter resolution in the first half of 2016 which has not been made public. Such resolution examines the withholding tax regime with regard to interest on a loan initially granted by a EU bank and subsequently acquired by a French fund *commun de titrisation* whose manager was subject to supervision. The resolution takes into consideration the regulatory requirement and affirms that the latter must be deemed satisfied as the loan was originally disbursed by an EU bank, and therefore the interest is exempt from withholding tax.

No rules governing the operation of non-EU credit funds are provided for in the laws or regulations. In the absence of a specific regime, such non-EU funds should not be allowed to lend into Italy to the public[29], unless it occurs within a group. Therefore, even if a non-EU fund is established in a White List country, it should not benefit from the withholding exemption, unless the lending is made within the same group of companies.

Also worth of mention are "IBLOR" (Italian Bank Lender of Record) or "fronting" structures, whereby a "lender of record", generally an Italian bank or an Italian branch of a European bank, grants a loan to an Italian entity and transfers the credit risk in whole or in part to other lenders

28 See: "https://www.bancaditalia.it/compiti/vigilanza/normativa/consultazioni/2016/gestione-collettiva-risparmio/Resoconto_consultazione.pdf). On the occasion of the pub-lication of the amendments to the "Collective Investment Management Regula-tion" of 23 December 2016 and the report of the consultation on this regulation, the Bank of Italy was asked "[...] to clarify whether the purchase of debt claims for consideration may be freely carried out by AIFs, including EU AIFs which have not changed their requirements and/or have not been authorised to invest in debt claims out of their own assets". The reply of the Bank of Italy was as follows: "Given that the interpretation of legal provisions is beyond the competence of the Bank of Italy, it is noted that the Consolidated Banking Act and its implementing measures rec-ognize within the scope of the reserve of lending activities also the purchase of loans for consideration, within the limits of the provisions of Ministerial Decree 53/2015. In this sense, it seems consistent with a logical and systematic interpretation of Ar-ticle 46-ter of the Consolidated Law on Finance to make the objective scope of ap-plication of this provision coincide with the activity of granting financing referred to in Article 106 of the Consolidated Law on Banking"

29 See also G. Guffanti e P. Sanna "la nuova disciplina dei fondi di credito" in "Le Società" 8-9 2017.

(known as "*credit support providers*" or "*participants*") by entering into guarantee agreements backed by cash deposits or (through agreements called "*participation agreements*". In this regard, leaving the civil law and criminal law aspects aside (see Supreme Court of Cassation, criminal section, no. 12777 of 22 March 2019), from a mere fiscal perspective Resolution no. 76/E of 12 August 2019 and Rulingsno. 423 of 24 October 2019 and no. 569 of 30 August 2021 deny that the Rule allows a "look-through" approach based on the "beneficial owner" concept. According to such documents the borrower should assess whether the withholding tax exemption applies or not, having regard to the recipient of interest rather than to the beneficial owner, save for an eventual analysis concerning the abuse of law or similar provisions.

17.2. The withholding tax regime of interest and income from bonds and similar securities under D. Lgs. 239/96

17.2.1. The definition of bonds and similar securities for tax purposes

For the purposes of direct taxation, bonds and similar securities are identified as (1) mass securities (2) that contain an unconditional obligation to pay at maturity an amount no lower than the value stated at issue, with or without the payment of periodic income, and (3) which do not attribute to the holders any right of direct or indirect participation in the management of the issuing company or the business in relation to which they were issued, nor of control over the management itself[30].

The notion developed for tax purposes is consistent with the essential features of the bonds provided for in Article 2411(1) and (2) of the Italian Civil Code whereby bonds incorporate a financing operation under which the subscriber has the right to receive back the sum lent in addition to an agreed remuneration that may consist of a fixed annual interest or of the discount between the nominal repayment value and the issue price.

Therefore, the definition of bonds and similar securities includes securities that, first of all, guarantee the repayment of their nominal value at maturity date. This condition also applies to subordinated bonds, i.e. bonds in which the right of the bondholder to receive repayment for the principal

30 Article 44 (2) (c) of the Consolidated Income Tax Code. In this sense, Circular Letter of the Revenue Agency no. 306/E of 23 December 1996 and Circular Letter of the Revenue Agency no. 4/E of 6 March 2013.

and interest may be fully or partially subordinated to the satisfaction of the rights of the other creditors of the company, holding true the priority right to repayment of the bondholders with respect to the shareholders. Subordinated bonds can be considered part of the category of bonds provided that the subordination clause does not distort the right of the bearers of the securities to obtain repayment for the capital lent[31].

The principle that bonds are identified on the basis of the right to repayment of the principal as the minimum assured value holds true. The repayment can be made in different ways: early, on the due date or through repayment plans. A bond must always have a maturity, which does not need to be a specific deadline and can be linked to the duration of the company or its liquidation if the company is established for an indefinite period.

For a security to be assimilated to a bond, it must not grant management rights, in the sense of controlling powers of the bondholder over the activity of the issuer.

The timing and extent of interest payments may vary depending on objective parameters, which may in turn depend on the company's economic performance, as happens in the case of parametric variable-yield bonds or with certain particular forms of interest indexation. The payment of periodic interest can be combined with the right to participate in a periodic draw of premiums (as for premium bonds) or with a clause granting, at maturity, a sum that takes into account the monetary write-downs of the investment or the performance of specific parameters (as for indexed bonds) or even with a clause granting a share in the company's profits (as for participating bonds).

Another essential condition is that the remuneration of the security must not entirely consist of (and therefore does not depend for its existence and amount on) a share in the economic results of the issuing company or other companies in the same group, or of the business in relation to which the securities and the financial instruments have been issued. The securities that offer these remuneration methods cannot be included in the category of "bonds and similar securities", whereas they are comprised in the category of "securities similar to shares" pursuant to Article 44 (2) (a) of the Italian Consolidated Income Tax Code.

This information is particularly relevant with reference to the provisions of Article 2411 (3) of the Italian Civil Code on financial instruments, how-

31 In this sense, Circular Letter of the Revenue Agency no. 306/E of 23 December 1996 and Circular Letter of the Revenue Agency no. 4/E of 6 March 2013.

ever denominated and other than the bonds referred to in the previous two paragraphs of the cited article. In their case, not only the timing but also the amount of the capital repayment can be influenced by the business performance of the companies, without prejudice to their being subject to the statutory provisions governing bonds. From the point of view of their purpose, these financial instruments are defined by their financing function and are characterized by the absence of "participation" rights of an administrative nature (such as the right to participate in meetings, challenge resolutions, etc.). If securities provide that the contributed capital fully or partially shares the issuer's enterprise risk, and therefore the related repayment may not be certain, they cannot be classified as bonds and similar securities for tax purposes.

17.2.2. Bonds and similar securities subject to the withholding tax regime pursuant to Article 26 (1) of Presidential Decree no. 600/73

Interest and other proceeds deriving from bonds and similar securities issued by companies resident for tax purposes in Italy pursuant to Article 73 of the Italian Consolidated Income Tax Code[32] with shares that are not traded on regulated markets or in multilateral trading systems are in principle subject to the withholding of tax at a rate of 26% pursuant to Article 26 (1) of Presidential Decree no. 600/73.

Amounts withheld from a payment to individual entrepreneurs (when the security is held as part of the business), companies and partnerships are considered as payments on account of the recipient's tax liability. In any other case (including payments made to taxpayers who are exempt from corporate income tax (hereinafter also "IRES")) the withholding tax represents a final tax payment. Differently from the regime in force in the past, the withholding tax is applied at a rate of 26% on bonds and similar securities irrespective of their term and of the actual rate of return attributed to them[33].

32 As withholding agents, pursuant to Article 23 of Presidential Decree n. 600/73.

33 Prior to the entry into force of Legislative Decree no. 138 of 13 August 2011 - which unified the rate of taxation of financial income - Article 26 of Presidential Decree no. 600 of 1973 provided that withholding tax agents were required to make withholdings of 27% on the interest and other proceeds arising from bonds and similar securities issued by them. That rate would, however, be reduced to 12.50% for bonds and similar securities with at least 18 months maturity and for commercial paper issued by companies and entities other than banks or companies with shares traded on regulated markets in a EU Member State or parties to the Agreement on the European

The withholding tax does not apply to interest and other proceeds from bonds and similar securities paid to an undertaking for collective investment (hereinafter UCI) set up in Italy or in a EU Member State, whose assets are invested for more than 50% in such securities and whose shares are held exclusively by qualified investors under Article 100 of Legislative Decree no. 58/98. Categories of assets and types of investors must result from the regulations of the UCI. No withholding of tax is required on interest and other proceeds paid to securitization companies set up pursuant to Law no. 130/99 issuing notes that are held by the above-mentioned qualified investors, as defined above, and whose assets are invested by more than 50% in such bonds, similar securities or commercial papers[34].

Interest and other proceeds paid to investors who are not resident for tax purposes in Italy are, in principle, subject to the withholding of tax as provided for in Article 26 of Presidential Decree no. 600/1973. The withholding tax can be levied at a reduced rate in application of the provisions of any agreement against double taxation entered into between Italy and the beneficiary of the interest, if the relevant subjective, objective and procedural conditions are satisfied.

The presence of this form of taxation at source can represent a clear disincentive for foreign investors wishing to subscribe or acquire these securities, and this usually gives rise to requests for higher rates of return to compensate for the effect. This potential deterrent to the issue of bonds has been addressed over time by regulatory measures designed to broaden the scope of application of Legislative Decree no. 239/96 and therefore the list of securities that may be exempted from the requirement to withhold taxation at the source.

The scope of application of the withholding tax regime under Legislative Decree no. 239/1996 has been amended several times over the years with a view to limiting the regulatory, statutory and fiscal restrictions to

Economic Area (EEA) included in the list of States ensuring exchange of information for tax purposes. The 12.5% rate applied, on condition that the effective rate of return did not exceed the following proportions: a) twice the official reference rate for bonds and similar securities traded on regulated markets in the States mentioned above, or offered to the public in the terms provided by the regulations in force at the time of issue; b) at the official reference rate plus two-thirds for bonds and similar securities not falling in the previous category. It was also provided that, should bonds and similar securities with a term of maturity of at least eighteen months be redeemed before reaching that term, the issuer would have to pay an amount equivalent to 20% on the interest and other proceeds accrued up to the time of the early redemption .

34 Pursuant to Article 32 (9-bis) of Decree Law no. 83/2012 as amended by Article 21 (2) of Decree Law no. 91/2014.

the issuance of bonds by unlisted companies. These restrictions have in fact hindered the access of unlisted companies and, in particular, of small and medium-sized enterprises, to the capital market, as an alternative and complementary source of financing compared to collection from shareholders or borrowing from the banking channel. Legislative measures have attempted to encourage the entry of professional investors in the production system of small and medium-sized Italian companies.

17.2.3. Bonds and similar securities subject to the withholding tax regime pursuant to Legislative Decree no. 239/96

The withholding of tax as provided for in Article 26 (1) of Presidential Decree no. 600/73 does not apply to interest and other proceeds arising from:

- bonds and similar securities issued by banks, joint stock companies with shares traded on regulated markets or multilateral trading systems of EU Member States and States that are party to the Agreement on the European Economic Area included in the list of States that allow an adequate exchange of information (known as White List[35] countries);
- bonds and similar securities issued by public sector entities on the basis of legal provisions;
- bonds and similar securities traded on regulated markets or multilateral trading facilities of EU Member States and States that are party to the Agreement on the European Economic Area included in the White List issued by companies other than those referred to in paragraph 1 or, if the bonds, similar securities and commercial papers are not traded, held by one or more qualified investors pursuant to Article 100 of Legislative Decree no. 58/98.

In the cases listed above, the substitute tax regime under Legislative Decree no. 239/96 applies. For the purposes of this study, the tax regime provided for by Legislative Decree no. 239/96 is therefore applicable to interest and other proceeds from bonds and similar securities issued by companies whose shares are not listed on regulated markets, subject to either of the following conditions:

35 The "White List" which includes all the countries or territories that allow an adequate exchange of information on tax matters is contained in the Decree of the Ministry of Finance dated 4 September 1996 (amended by Decree of the Ministry of Economy and Finance dated 23 March 2017) to be amended by the decree to be issued in accordance with Article 11 (4) (c) of Legislative Decree no. 239/96.

- the bonds are traded on regulated markets or multilateral trading systems of EU or EEA States included in the White List; or,
- if the bonds are not traded on regulated markets or multilateral trading facilities, the bonds must be held, or subscribed and outstanding[36], exclusively by eligible investors pursuant to the definition provided in Article 100 of Legislative Decree no. 58/98.

This latter case is comprised in the scope of application of Legislative Decree no. 239/96 with a view, in particular, to facilitating the taxation of private placement operations, widely spread on international markets, making the debt issued by Italian small and medium-sized enterprises an attractive investment tool also for institutional investors and private debt[37] funds.

For the purposes of the application of the regime referred to in Legislative Decree no. 239/96 and the verification that the "trading" requirement is met, regulated markets and multilateral trading systems are considered equivalent. The latter are trading systems alternative to regulated markets and are exclusively conducted by investment firms, banks and managers of regulated markets.

Legislative Decree no. 239/96 provides for the application of a 26% substitute tax in place of the tax withheld pursuant to Article 26 of Presidential Decree no. 600/73. According to Article 2 (2) of Legislative Decree no. 239/96, substitute tax is applied: (i) at the time of the collection of the proceeds, on the occasion of both the payment of the coupons and the redemption of the securities (original issue discounts, implied interests of the *zero coupons*); (ii) at the time of the "transfer"[38] of the securities, that is to say of the assignment or any other deed, for a consideration or none, which involves the change of legal title of the security.

Substitute tax is applied by securities depository intermediaries on the proceeds paid to certain categories of investors known as "*nettisti*" (natural persons, persons referred to and defined in Article 5 of the Italian Consolidated Income Tax Code, excluding general partnerships ("società in nome

36 According to the interpretation contained in the Revenue Agency Circular no. 29/E of 26 September 2014.

37 As stated in the explanatory report to Decree Law no. 91/2014.

38 As clarified by the Resolution of the Italian Revenue Agency of 2 October 2001, no.147/E, the concept of "*transfer*" refers to a transaction carried out under express instructions by the customer and does not include the transfer of securities as a direct consequence of transactions that exclusively concern the organizational structure of intermediaries, such as, for example, mergers, de-mergers and other extraordinary transactions.

collettivo"), limited partnerships ("società in accomandita semplice")[39], taxpayers exempt from corporate income tax) whereas the proceeds received by investors other than the above, known as "*lordisti*"[40], are paid out gross of the tax. Substitute tax does not apply to UCIs (including funds and SICAFs investing in transferable securities and in immovable properties and SICAVs set up in Italy) nor to the pension schemes referred to in Article 17 of Legislative Decree no. 252/2005 and, therefore, the interests, premiums and other proceeds derived from these bonds are collected by the relevant investors in their gross amount[41].

Article 6 of Legislative Decree no. 239/96 provides for the applicability of a specific exemption regime for the following beneficial owners of the interest and other proceeds:

- taxpayers not resident in Italy for tax purposes, provided they are resident in countries that allow an adequate exchange of information and are included in the *White List*;
- international institutions or organizations established under international agreements enforceable in Italy (such as EIB, BIRS, EBRD, BIS, ECSC, EURATOM, Council of Europe, North Atlantic Treaty Organization and other international institutions and organizations established under international agreements enforceable in Italy), regardless of whether they benefit from total exemption from the generality of taxes in Italy by virtue of founding treaties or other relevant agreements[42];
- foreign institutional investors, even if not subject to tax, established in countries included in the *White List*;

39 Pursuant to Article 73 (1) (c) of the Consolidated Income Tax Code.

40 Any interest, premiums, and other proceeds from securities not deposited with intermediaries received upon expiry of any coupons or securities, regardless of who receives them, are always subject to substitute tax, which is operated by the intermediary who pays them out. If the proceeds are paid directly by the person who has issued the security, the substitute tax is applied by the latter.

41 As clarified by Resolution no. 43/E of 2 July 2013 of the Revenue Agency, the UCIs that satisfy the requirements of Article 73 of the Italian Consolidated Income Tax Code are included as persons liable to corporate income tax, even if they benefit from a special tax regime, and as corporate income tax payers cannot be considered exempt from tax from a subjective point of view.

42 These institutions or organizations can be identified with reference to the list of organizations contained in Revenue Agency Circular no. 11/E of 28 March 2012, which is not, however exhaustive. The Circular emphasizes that the list can be supplemented on the basis of the applications sent to the Revenue Agency by the organizations interested to join, by prior confirmation of their eligibility by the relevant offices of the Ministry of Foreign Affairs.

- central banks or organisations that also manage the official reserves of a State.

With reference to the persons listed under point (a) above, it should be noted that the residence is not to be verified according to conventional rules but according to the internal laws of the foreign country of residence. When a person can be considered resident in more than one State, the general criteria to be taken into account are those indicated in the OECD model treaty, which consider relevant, for individuals who are taxable persons in a State, the existence of a permanent habitual residence or, in the event of a dual residence, the place in which the individual has their centre of vital interests and, for taxpayers other than individuals, the place of effective management[43].

The definition of institutional investors given in paragraph (c) refers to institutions subject to forms of supervision in the foreign countries in which they are established, as well as entities that, although not subject to forms of supervision, possess specific expertise and experience in the transaction of financial instruments, declared in writing by the legal representative of the institution[44].

Based on the explanations provided by the Revenue Agency[45], foreign institutional investors are entities that, regardless of their legal status and the tax treatment to which their income is subject in the country in which they are established, have as their object to make and manage investments on behalf of their own or third parties. More specifically, this definition includes the following categories of investors.

- Institutions that are subject to forms of supervision in the foreign countries in which they are established.
- Institutions not subject to forms of supervision but that possess specific expertise and experience in transactions in financial instruments, as expressly certified in writing by the legal representative of the institution. According to the indications of the Revenue Agency, this concept does not comprise institutions specifically set up for the purpose of managing investments made by a limited number of participants, although their institutional purpose is the managing and making of in-

43 In this sense, see Circular Letter of the Revenue Agency no. 23/ of 1 March 2002.

44 Circular Letter of the Revenue Agency no. 20/E of 27 March 2003.

45 In particular, Revenue Agency Circular no. 20/E of 27 March 2003, which incorporates the clarifications previously provided in Circular 23/E of 1 March 2002.

vestments, such as those known as "Luxembourg holding companies of 1929", trusts and partnerships. The concept includes, on the other hand, by way of example, insurance companies, investment funds, SICAVs, pension funds and asset management companies, all of which are specifically included in the category of "qualified" investors, as they are subject to forms of supervision in the foreign countries in which they are established[46]. With reference to foreign institutional investors presenting a limited number of participants, a useful element in establishing whether an investor is entitled to benefit from the exemption regime regardless of the actual number of participants, provided the other required conditions are met, is the existence of genuine capital raising and marketing policies.

It should be noted that, despite the clarifications provided in the tax guidance issued by the Revenue Agency, some interpretative effort may be necessary to establish whether a non-resident person falls within one of the categories referred to in Article 6 of Legislative Decree no. 239/96. It seems reasonable to assume that, even in the absence of a specific law provision in this respect, a foreign participant can certify possession of the requisites for inclusion in the definition provided by Article 6 of Legislative Decree no. 239/96[47].

If the proceeds are received by participants not resident in Italy who do not fall within the classes referred to in Article 6 of Legislative Decree no. 239/96, and therefore do not benefit from the exemption provided for by Italian laws, a final withholding tax of 26% is generally applied, unless a reduced rate applies pursuant to a double tax treaty.

As provided for by Article 7 of Legislative Decree no. 239/1996, for the purposes of the non-application of withholding tax, foreign entities must deposit the securities in a bank or a resident securities intermediation company, or a permanent establishment in Italy of non-resident securities intermediation companies or banks. The bank or the securities intermediation company must acquire a self-certification from the actual beneficiary of the proceeds of the securities that certify the possession of the requisites necessary for exemption from substitute tax. With regard to institutional investors

46 The Revenue Agency refers to Article 1 (1) (h) of the Decree of the Treasury Ministry no. 228 of 24 May 1999.

47 For this purpose, the participant should be able to use the self-certification scheme set out in the Decree of the Ministry of Economy and Finance of 12 December 2001.

who are not taxable persons, the institutional investor is considered to be the ultimate beneficial owner and the self-certification must be rendered by the relevant management body.

In the absence of a deposit of the securities, intermediaries are required to apply substitute tax pursuant to Article 5 (2) of Legislative Decree no. 239/1996 on the income they pay, regardless of the nature of the recipient, and on the entire amount of the coupon or original issue discount, regardless of the investor's holding period.

17.2.4. Deductibility of interest from bonds and similar securities

17.2.4.1. The general rule

Interest expense from bonds and similar securities can be deducted by the issuing company according to the general criteria set out in Article 96 of the Italian Consolidated Income Tax Code, on the basis of which interest expense and similar charges are deductible in each tax period up to the amount of interest income and similar proceeds. Any surplus is deductible within the limit of the sum of 30 percent of the gross operating profit (GOP) of the core business of the fiscal period and 30 per cent of the GOP of the core business carried forward from previous fiscal years[48]. In this respect, the 30 per cent of GOP of the core business of the fiscal year is firstly used and, if the case, the 30 per cent of the GOP carried forward from previous fiscal years, starting from the less recent fiscal year. Interest expense and the similar non-deductible financial charges in a given tax period can be deducted from the income of subsequent tax periods for an amount equal to the positive difference between (a) the of interest income and similar proceeds of the fiscal year and 30 per cent of GOP of the core business; and (b) interest expenses and similar charges of the fiscal year[49]. If during a fiscal year the amount of interest income an simi-

48 The term gross operating profit means the difference between the value and costs of production within the meaning of paragraphs (A) and (B) of Article 2425 of the Civil Code, with the exclusion of the items referred to in number 10 (a) and (b), and of the financial lease rent for operational assets, taken into account in the measure arising from the application of provisions for the calculation of the taxable business income; for persons who prepare financial statements on the basis of international financial reporting standards, the corresponding profit and loss account items are considered.

49 The specific limitation that was previously provided for by Article 3 (115) of Law 549/95 on the deductibility of the interest expense relating to bonds and similar securities for the issuer no longer applies. Based on the provisions in force before the repeal of Article 3 (115) of Law no. 549/1995, interest payable on bonds and similar securities was deductible provided that, at the

lar proceeds of the fiscal year is higher then the sum of interest expenses and similar charges of the fiscal year and the interest expenses and interst charges carried forward from previous fiscal years, the exceeding amount may be carried forward to the following fiscal years. If the 30 per cent of GOP of a fiscal year is higher than the sum of teh amount deductible within the limit of 30 per cent of GOP and the interest expenses and simimlar charges carried forward from previous fiscal years, the exceeding amount may be carried forward to increase the GOP of the following five fiscal years.

17.2.4.2. Profit participating bonds

Profit participating bonds are subject to specific statutory and tax provisions set out in Article 32 (19 to 26) of Decree Law no. 83/2012.

The legislation introduces provisions covering the issue of profit participating and subordinated bonds by companies that do not issue financial instruments that are listed on regulated markets or multilateral trading systems (other than banks and micro-companies) that fall within the statutory definition of bonds. Bonds which include clauses for the participation in company profits and subordination clauses and which are issued by unlisted companies can qualify for statutory purposes as real bonds falling within the scope of Article 2411(1) and (2) of the Italian Civil Code, only if they meet the following conditions: (a) the duration may not be less than thirty-six months; (b) the subordination clause must provide for a right of refund subordinately to the

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time of issue, the effective rate of return did not exceed : a) twice the official reference rate, for bonds and similar securities traded on regulated markets of EU Member States and of the States party to the Agreement on the European Economic Area included in the White List or placed by public offering in accordance with the regulations in force at the time of issue; b) the official reference rate plus two thirds, for bonds and similar securities other than the bonds mentioned above. If the effective rate of return on issue is higher than the limits mentioned above, the interest expense exceeding the amount resulting from the application of these rates is not deductible from corporate income. Article 32 (8) of Decree Law no. 83/2012 excludes from the scope of application of these provisions,: i) commercial paper and (ii) bonds and similar securities issued by companies with unlisted shares (other than banks and micro-enterprises) provided that the commercial paper, bonds and similar securities were traded on regulated markets or in multilateral trading systems of countries of the European Union or of countries adhering to the Agreement on the European Economic Area included in the white list. The provision could be disapplied even for unlisted commercial papers, bonds and similar securities only if all the following conditions were met: a) the securities were held by eligible investors, as identified by Article 100 of Legislative Decree no. 58/98; b) said investors did not hold, whether directly or indirectly or through trust companies or third parties, more than 2% of the capital or the assets of the issuing company; c) the beneficial owner of the proceeds was resident in Italy or in a State or territory that allows an adequate exchange of information.

other creditors of the company, maintaining the subordination of the right to repayment only with respect to the shareholders; (c) the remuneration must necessarily consist of a fixed part and a variable part and the interest rate paid to the bearer of the security and recognized as a fixed part of the consideration cannot be lower than the current official reference rate pro-rated over time. The variable part of the consideration must be commensurate with the financial result of the issuing company and be calculated in proportion to the operating profits for the year of the issuing company[50].

The company issuing profit participating bonds is required to pay, on a yearly basis and within 30 days of the approval of the financial statements, to the lender, as a variable component, a sum proportional to the financial result for the year in a percentage indicated at the time of issue. This sum must be proportional to the ratio between the nominal value of the profit participation bonds and the sum of the share capital, increased by the legal reserve and the available reserves shown the latest financial report, and of the same value of the aforementioned obligations. The rules for calculating the variable portion of the consideration are set at the time of the issue, cannot be changed for the entire duration of the issue, are dependent on objective elements and cannot derive, in whole or in part, from corporate resolutions in each relevant year.

It is important to note that variability of the consideration regards the yield on the investment and does not apply to the right of repayment of the capital of the issue.

From the point of view of taxation, Article 32 (24) of Decree Law no. 83/2012 establishes that, if the profit participating bonds also contain a subordination clause and a restriction on not distributing the share capital other than within the limits of the dividends on the profit for the year, the variable component of the consideration (i) is subject to specific provisions for charges on the profit and loss account of the issuing company; (ii) represents a cost; (iii) for the purposes of applying income taxes, the variable component is accounted for as a deduction of the income for the relevant accounting period, provided that the consideration must not consist entirely of it.

As stated by the Revenue Agency, the regulatory provision is aimed at strengthening the capital of the issuer through the subordination clause –

50 See Revenue Agency Circular letter no. 4/E of 6 March 2013, which refers to the contents of Circular Letter no. 26/E of 16 June 2004 with reference to the interpretation of the term "financial result" in the context of the reform of IRES corporate income tax.

which defines the subordination terms of the bearer of the security to the rights of other creditors of the company (with the exception of the subscribers of the capital alone) – and the limitation on the distribution of share capital. This provision allows the issuer to deduct, when computing business profits, also the proceeds from these securities that are linked to the economic results of the company. In this sense, the provision is a derogation from Article 109 (9) (a) of the Italian Consolidated Income Tax Code according to which, in principle, the portion of any type of remuneration due on the securities and financial instruments however denominated referred to in Article 44 of the Italian Consolidated Income Tax Code, that directly or indirectly involves the participation in the economic results of the issuer, a group company or a business, may not be deducted.

The Revenue Agency has also confirmed that the rule departs from the contents of Article 107 (4) of the Italian Consolidated Income Tax Code, which prohibits deductions for accruals other than those expressly considered in the provisions of the Italian Consolidated Income Tax Code and the general accruals basis for the deduction of costs set out in Article 109 (1) of the Italian Consolidated Income Tax Code, recognizing the deductibility of the variable part of the remuneration as a cost in the tax period in which the profit is produced without having to wait for the financial year in which the payment of the remuneration occurs.

Paragraph 24-bis of Article 32 of Decree Law no. 83/2012 establishes that the deduction regime described above be applied on condition that profit participation bonds with a subordination clause are subscribed by the investors referred to in paragraph 8 of the same Article 32 of the Decree Law no. 83/2012[51]. However, since the aforementioned paragraph 8 has been abrogated by Article 4 (3) of Legislative Decree no. 147/2015, it must be considered no longer applicable and therefore it seems that the deductibility is no longer subordinated to any personal characteristics of the investor.

A relevant issue that concerns the applicability of the limit referred to in Article 96 of the Italian Consolidated Income Tax Code to the deductibility of the variable component of the consideration deriving from subordinated

51 The reference was to the qualified investors for the purposes of Article 100 of the Consolidated Finance Law (TUF), who did not hold, directly or through trust companies or third parties, more than 2 percent of the capital or the assets of the issuing company and provided that the ultimate beneficial owner of the proceeds was resident in Italy or in the States and territories that allow an adequate exchange of information.

and participation bonds. On the one hand, one interpretative solution could be to prefer a symmetrical treatment of the remuneration of issuer and receiver and, considering that it would represent interest for the latter, opt for the applicability of the limit stated above. On the other hand, a different solution opting for the non-application of the limit under Article 96 of the Italian Consolidated Income Tax Code would appear to be more consistent with the wording of the provision which seems to qualify the component as a mere element to be deducted "from the income for the year in which it is generated" and therefore not assuming any possibility that the deduction may take place in any period other than the one to which it relates, as a result of the carry forward from the year of accrual depending on the capacity of the GOP. This solution would seem even more consistent with the observation that the securities in question have characteristics that make them partly more similar to a joint profit sharing agreement with an equity contribution rather than a loan contract. In this perspective, Article 96 of the Consolidated Income Tax Code would not apply, insofar as it does not refer to joint profit sharing agreements (which do not produce similar interests or charges) and insofar as a different line of reasoning would lead to a tax treatment that would be unfavourable compared to the one that applies to joint profit sharing agreements. Even if this second line of interpretation appears preferable, the interpretative doubt remains standing, in this regard[52].

52 See Assonime Circular Letter no. 39 of 16 December 2013. This solution appears to be consistent also with the considerations of the Italian Revenue Agency, Resolution no. 102/E of 28 July 2017 commenting on the exemption rules provided for by Article 32 (13) of Decree Law no. 83/2012 according to which the issue costs of bond loans "*are deductible in the financial year in which they are incurred regardless of the criterion for allocation in the financial statements*". The Italian Revenue Agency affirmed that the derogations in question prevails over the ordinary rules on the deductibility of interest expense and similar charges provided for by Article 96 of the Italian Consolidated Income Tax Code insofar as "*the application of Article 96 of the Italian Consolidated Income Tax Code to the case in question would not be entirely consistent with the* ratio *of the facilitations provided for by the rule. In particular, the irrelevance of the methods for the accounting of such expenses is expressly approved in the regulatory provision and, therefore, even accounting for such expenses on the basis of the amortized cost method and recognizing them among financial charges cannot limit in time their deductibility due to the application of Article 96 of the Italian Consolidated Income Tax Code. In fact, the application of Article 96 of the Italian Consolidated Income Tax Code - if the GOP is insufficient for deductibility purposes - would allow for the deductibility of such expenses in tax periods subsequent to the one in which they are incurred*". Therefore, given the *underlying rationale* of the provision in question, the aim of which is to provide an incentive, "*it is considered that issue costs are fully deductible in the financial year in which they are incurred, as the limitations referred to in Article 96 of the Italian Consolidated Income Tax Code do not apply*".

17.2.5. Deductibility of the costs of issuing bonds and similar securities pursuant to Legislative Decree no. 239/96

Up until the fiscal year running as at 31 Dcember 2018, article 32 (13) of Decree Law no. 83/2012 provided for the possibility for the issuer to apply a system of deductibility of the costs of issue of bonds and similar securities pursuant to Article 1 (1) of Legislative Decree no. 239/1996 in the year in which they were incurred regardless of the criterion for the allocation in the financial statements. This provision assigned tax relevance to the costs incurred by the issuer on an accruals basis and therefore regardless of their recognition in the profit and loss account, thus allowing them to be deducted in advance of the latter.

The Italian Revenue Agency had stated that the rule should have been widely applied, as it covered not only small and medium-sized companies that issue bonds, but also "large issuers", that is to say banks and companies whose shares are traded, even if only with reference to the securities issued after the entry into force of Decree Law no. 82/2012. The costs referred to here are those incurred for the issuance of bonds on the market, including legal and notary fees, tax and other expenses associated with each issue[53].

These expenses were therefore deductible in the financial year in which they were incurred irrespective of the criterion for recognition in the financial report, and the allocation of such expenses in the financial report according to the accruals principle, in application of accounting standards, is not significant.

As explained by the Italian Revenue Agency, the deductibility of these cost elements on a cash basis was to be considered an option and not an obligation, in line with the aim of the law to afford relief. Given the foregoing, the Italian Revenue Agency also clarified[54] that the assessment of whether said expenses fall within the scope of application of article 96 of the Italian Consolidated Income Tax Code a distinction had to be made between the following two cases: (a) exercise of the right to deduct the expenses on a cash basis; (b) non-exercise of the right to deduct the expenses on a cash basis.

In the first case, the derogating provisions prevailed over the ordinary provisions on the deductibility of interest expense and similar charges set out in Article 96 of the Italian Consolidated Income Tax Code. Therefore,

53 Circular Letter no. 29/E of 26 September 2014.

54 Resolution no. 102/E of 28 July 2017.

the issue costs were fully deductible in the period in which they were incurred, as the limitations set forth in Article 96 of the Italian Consolidated Income Tax Code did not apply.

In the second case of non-exercise of the right granted by paragraph 13 of Article 32 of Decree Law 83/2012, in order to establish whether these expenses fall within the scope of application of Article 96 of the Italian Consolidated Income Tax Code, the financial nature of the expenses needed to be investigated[55].

According to the Italian Revenue Agency, the expenses considered in accounting terms as described above were included within the scope of application of Article 96 of the Consolidated Income Tax Act, as they refer to the issue of a debenture loan, that is to say a transaction having a financial purpose. The clarification of the Italian Revenue Agency also confirmed that the issue costs "*will contribute to the formation of the amount of interest expense and similar charges deductible within the limits of the GOP on the basis of the correct temporal recognition in application of the depreciated cost method set out in IAS 39*".

The above-mentioned tax regime was part of the measures enacted over time with the aim to amend the company law and tax regime of interest arising from financial instruments issued by Italian smal and medium enterprises and make the debt instruments more attractive if compared to shareholders' financing and bank financing or for the purpose of facilitate the refinance of already existing debt. However, the special regime set out by article 32 (13) of Decree Law no. 83/2012 has been abolished by article 14(3) of Legislative Decree no 142/2018 with effects starting from the fiscal year following the fiscal year running as at 31 December 2018.

17.3. Indirect taxation of medium/long-term loans and the corresponding guarantees

17.3.1. Introduction

Articles 15 ff. of Italian Presidential Decree no. 601/73 govern the substitute tax levied at a rate of 0.25% on medium and long term loans, that is to say on those loans contractually stipulated for longer than eighteen months[56].

55 Italian Revenue Agency, Circular Letter no. 19/E of 21 April 2009.

56 See Article 15, paragraph 3, of Italian Presidential Decree no. 601/73: the tax is governed by

The application of the substitute tax means that all regulations, deeds, contracts and formalities pertaining to the financing transaction, to its execution, amendment and discharge, to guarantees of any form, provided by anyone and at any time, and to any subrogation, replacement, postponement, parcelling and cancellation of such guarantees, including those of a partial nature, including transfers of receivables stipulated in relation to the loan, and to the subsequent transfer of the corresponding contracts or receivables, and the transfers of the guarantees relating to them, are exempt from registration tax, stamp duty, mortgage taxes and cadastral taxes, and taxes on governmental concessions[57].

The optional nature of the tax permits the evaluation of the convenience or otherwise of the substitute tax compared to tax charges applicable to the deed and the corresponding guarantees.

The beneficial nature of the provision is appreciable if one considers that the ordinary indirect tax regime of guarantees connected to the loan entails, for example, that the deeds granting the guarantees, if they do not come within the scope of VAT may be subject to registration tax at a rate of 0.5%[58], unless the deeds are not subject to compulsory registration and were stipulated by correspondence or abroad, in which case the contract would have to be registered "in the event of use"[59]. The regime also applies

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Title IV, "*Tax concessions for the credit sector*", of Italian Presidential Decree no. 601/73, bearing the heading "*Regulation of tax concessions*". The standard tax rate is 0.25% pursuant to Article 18 of Italian Presidential Decree no. 601/73. Other tax rates are provided for: for example, for medium and long term loans stipulated by individuals for the purchase, the construction or the renovation (for non-commercial purposes) of dwellings and their respective pertinences, a substitute tax of 2% is applied if the borrower does not meet the so-called "first home requirements", or if compliance with such requirements has not been certified by the borrower at the time of stipulation of the loan (Article 18, paragraph 3, of Italian Presidential Decree no. 601/73). For land loans granted to building cooperatives and to the former IACPs (Independent Institutes of Social Housing – now ATER) for the purpose of building affordable and social housing, the substitute tax rate is fixed at 0.125% (Article 19, paragraph 3, of Italian Presidential Decree no. 601/73). In the case of expert credits of a duration of more than eighteen months, where the substitute tax rate is set at 0.05% (Article 10, paragraph 2-bis, of Italian Decree Law no. 70 of 14 March 1988, converted, with amendments, into Italian Law no. 154 of 13 May 1988).

57 The judicial deeds relating to the transactions indicated therein are subject to the aforementioned taxes on the basis of the ordinary regime.

58 Article 6, Tariffs Part One attached to Presidential Decree no. 131/86. With the exception of a guarantee offered by the borrower to cover its own obligations, for which registration tax is applied in fixed amount.

59 Article 1, point a), Tariffs Part Two attached to Presidential Decree no. 347/90.

to deeds that follows the granting of guarantees, such as, for example, the postponement, subrogation or cancellation of such guarantees. For the sake of example once again, consider that mortgage tax is due at a rate of 2%[60] in the case of endorsement for succession or subrogation in the registration, for transfers of receivables covered by a mortgage, the establishment of a pledge on a secured loan, and the extension of the guarantee on the basis of a new legislative source of such guarantee. The tax is applied at a rate of 0.5% in the case of endorsement for postponement or assignment of priorities or mortgage order[61], limitation of mortgage[62] and "cancellation or reduction of mortgage or lien[63].

The substitute tax regime comes within the framework of the provisions designed to facilitate access to credit from the viewpoint of the indirect taxation concerning, in particular, the so-called "taxes on deeds".

Application of the regime, however, is dependent on certain requirements being met, namely: subjective, objective and territorial requirements.

17.3.2. The subjective requirement

The subjective requirement conditioning application of the substitute tax, concerns the qualification of the entity granting the loan. Loans granted by the following entities may be eligible for the preferential tax regime:

- the banks referred to in Article 10 of Italian Legislative Decree no. 385/93 and in other special laws, that provide medium and long term credit facilities[64], in accordance with legal, statutory and administrative provisions, to which the Italian branches (permanent establishments) of foreign EU and non-EU banks authorised to operate in Italy, and referred to in Article 13 of Legislative Decree no. 385/93, are equated;
- EU banks operating in Italy under the regime of "free provision of services" pursuant to Directive 89/646/EC, and thus without availing themselves of a permanent establishment[65], for transactions carried out in Italy;

60 Article 9, Tariffs attached to Presidential Decree no. 347/90.

61 Article 10, Tariffs attached to Presidential Decree no. 347/90.

62 Article 12, Tariffs attached to Presidential Decree no. 347/90.

63 Article 13, Tariffs attached to Presidential Decree no. 347/90.

64 Pursuant to Article 15 of Presidential Decree no. 601/73, the scope of the substitute tax does not include loans disbursed by entities other than banks operating in the financial sector and referred to in title V of Legislative Decree no. 385/93.

65 According to the Revenue Agency, the failure to extend the scope of the preferential tax

- securitization companies set up in accordance with Law no. 130/99, insurance companies established and authorised under the laws of EU States, and undertakings for collective investment (UCIs) established in Member States of the European Union, and in States that are signatories to the Agreement on the European Economic Space and are included on the so-called White List[66];
- entities, institutes, funds and social security funds, for the loans referred to in Article 1813 of the Italian Civil Code, granted to their own employees or members, and for loans for the specific purpose of purchasing a home[67];
- Cassa Depositi e Prestiti S.p.A. in relation to financing transactions for those works referred to in Article 5 (7 b) of Italian Decree Law no. 269/2003[68].

17.3.3. The objective requirement

The regime applies not only to lending in the form of loan agreements and corresponding attachments[69], but also in general to any provision of funds understood as the possibility to obtain money at any moment in time, in virtue of a undertaking by the credit institute, with the obligation to repay said money by the contractual deadline and regardless of the contractual form adopted[70]. Thus the notion of financing eligible for the regime also comprises the opening of a current-account credit facility[71], and discount business[72].

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regime to such entities resulted in undue discrimination between them and Italian entities, in breach of the principle of competitive parity that EU banks are bound to comply with when operating in the EU. Circular no. 246/E of 8 October 1996.

66 Pursuant to Article 17-bis of Presidential Decree no. 601/73.

67 Pursuant to Article 2, paragraph 1-bis, of Decree Law no. 220/2004. In this regard, see Circular no. 19 of 9 May 2005 and Resolution no. 1/T of 17 April 2008.

68 The works, systems, networks and supplies intended for projects of public benefit, together with investments in research, development, innovation, protection and valorisation of the cultural heritage, also in virtue of the promotion of tourism, the environment and energy efficiency, also with reference to those concerning mountain and rural areas through investment in the green economy, preferably financed jointly by credit institutions, and in any case using funds deriving from the issue of securities, from the tasking on of loans and from other financial transactions, without the guarantee of the State and without raising demand funds .

69 See Resolution no. 251188 of 12 October 1978.

70 See Court of Cassation ruling no. 4611 of 29 March 2002.

71 See Resolution no. 260292 of 16 July 1990.

72 See Resolution no. 251267 of 1 December 1977.

The concept of "financing transaction", on the other hand, should not include financial lease transactions, in that the ground for a leasing agreement is to be found in the use of the good constituting the subject-matter of the agreement, rather than in the provision of a loan.

The substitute tax is applicable provided that the contractual duration of the loan is set at over eighteen months[73]. For the purposes of application of the regime, therefore, the duration of the loan as per the loan agreement is important, while specific attention must be paid to any elements that may determine the early termination of the contractual obligation.

As far as regards identification of the day that the contractual duration of the loan is to be calculated from, the day in question is the one on which the loan agreement was executed, regardless of whether the loan was actually provided on that occasion[74].

Compliance with this time requirement shall be verified having regard to the contractually-established duration, regardless of whether the actual duration of the loan exceeds eighteen months, and thus the regime shall continue to apply even in the event of termination of the contractual relationship prior to the minimum duration. In practice, the evaluation of compliance with the time requirement must refer to the duration that the parties stipulated in the agreement, and not to the actual duration of the loan measured *ex post*[75].

The borrower's early repayment of the loan, insofar as this is a circumstance that falls within the scope of ordinary fulfilment of the contractual obligation, shall not result in non-compliance with the time requirement

73 According to the Court of Cassation, for loan agreements to be considered medium and long term they must run for more than eighteen months. Their duration must be at least eighteen months and one day, and thus compliance with this obligation may only be requested the second day following termination of the period of eighteen months. See the Court of Cassation's ruling no. 1585 of 18 February 1994.

74 See Circular no. 8/T of 24 September 2002 and Circular no. 12/T of 27 December 2002.

75 See, in this regard, Resolution no. 250220 of 2 June 1980, and more recently Circular no. 3/T of 27 April 2001. See also the Court of Cassation's ruling no. 1585 of 18 February 1994, according to which "*the contractual duration requirement […] only applies if the duration of the loan transaction, which is to be deduced from the contract subject to taxation and not from the subsequent development of the relationship outside of and beyond the contractual provisions, exceeds eighteen months by at least one day*". See circular no. 8/T of 24 September 2002, according to which "*there appears to be no doubt that the evaluation of the duration of the loan agreement, for the purpose of establishing the benefits of such, must be performed ex ante, that is, with regard to the moment at which the contractual obligation arose, while any objectively verifiable actual circumstances, provided for by specific clauses of the agreement, which may result in an early amendment to the set deadline following withdrawal or termination for breach, remain irrelevant*".

established by Article 15 of Presidential Decree no. 601/73[76]. On the other hand, the provision of the credit institution's right of withdrawal *ad nutum* precludes application of the substitute tax regime[77].

There does not appear to be any conflict between the contractual duration requirement and the merely precautionary contractual clauses, that is, those clauses that subject the lender's withdrawal to the presence of certain circumstances or specific conditions expressly identified in the contract and accepted by the beneficiary of the loan[78]. For example, those clauses providing for a demand for immediate repayment in the event of any one of the circumstances referred to in Article 1186 of the Italian Civil Code (that is, circumstances capable of affecting the borrower's assets/liabilities and its financial and economic position), or those claus-

76 In this sense, see Resolution no. 250220 of 2 June 1980 and Circulars no. 3/T of 27 April 2001 and no. 6/T of 14 June 2007, together with the Court of Cassation's rulings no. 4470 of 4 July 1983 no. 1585 of 18 February 1994. This question was raised once again in the Court of Cassation's ruling no. 9931 of 16 April 2008, which confirmed that the borrower always has the right to discharge its compensatory obligation, with no time limit, and exercise of this right does not entail exclusion from entitlement to preferential tax treatment.

77 See Resolution no. 211544 of 13 August 1968, and Circular no. 240/T of 22 December 1999. The prevailing view is based on the rationale of the regime itself. In the legislator's view, in fact, loan transactions permit the promotion of the development of economic-entrepreneurial projects, particularly when accompanied by the minimum time requirement of "*more than eighteen months*". This limit is seen as specifically permitting the borrower to carry out its own investment programme over a sufficiently long period of time, without running the risk that the lending institute unexpectedly calls for repayment of the loan.

78 See Resolution no. 68/T of 6 July 1998, Circular no. 240/T of 22 December 1999, Circular no. 8/T of 24 September 2002, and Resolution no. 1/T of 24 February 2003, which explained that entitlement to preferential tax treatment the presence of clauses providing for termination of the contract or the demand for immediate repayment, and thus in theory for a contractual duration shorter than the minimum duration provided for by law, in regard to "*cases of contractual breach or of the borrower's non-compliance with its contractual obligations*". Circular no. 8/T of 24 September 2002 explains that the time requirement, "*cannot be deemed to exist in those cases where the early termination of the agreement is not connected to the occurrence of certain objective circumstances, but exclusively to decisions taken by the contractual parties at their own discretion, over and above any objectively identifiable circumstances that in themselves are not capable of depriving the loan of the necessary stability (see, in this regard, the most recent decision by the 5th Chamber of the Court of Cassation, ruling no. 04792, 3 April 2002; see also, the Court of Cassation's rulings nos. 4470/83, 1585/94, 11240/94 and 2304/94)*". Furthermore, see the Court of Cassation's rulings nos. 439 of 1972, 2891 and 2191 of 1971, 826 of 1974, 937 of 1973, and 3155 of 1971, which are also mentioned in Circular no. 8/T of 24 September 2002. The Court of Cassation's ruling no. 2188 of 6 February 2015 does not appear to propose any general principle that conflicts with what is affirmed above: said ruling was in favour of the non-application of the substitute tax in the presence of a "justified reason" for the lender's withdrawal.

es governing cases of withdrawal pursuant to Article 1456 of the Italian Civil Code.

17.3.4. The territorial requirement

In addition to the subjective and objective requirements, there is a further requirement of a territorial nature which affects the applicability of the substitute tax to loans, and as a result of which the place of stipulation of the contract becomes important[79].

In fact, given the reference in Article 20 (5) of Presidential Decree no. 601/73 to the rules governing registration tax[80], the optional substitute tax regime only applies to loan agreements stipulated in Italy, and thus not to such agreements stipulated outside of Italian territory.

17.3.5. The intended use of the loan

The applicability of the substitute tax is not legally conditional upon the existence of conditions pertaining to the intended use of the loan, and thus appears to be independent from the use that the borrower makes of the loan. The rationale underlying the regime is exclusively related to the need to facilitate access to credit by increasing the applicant's chances of obtaining fresh credit; therefore, if the subjective and objective conditions are met, the substitute tax should be applied regardless of the actual use made of the sums provided by the lender[81].

79 The reference to territorial requirements is already present in Resolution no. 45/E of 10 April 2000, according to which "*following the clear connection the legislator has made between substitute tax and registration tax, and in view of the fact that the latter tax hits the formal deeds of the Italian State, the substitute tax regime shall not be applied to loan transactions conducted by Italian credit institutes outside of Italian territory, which on the other hand shall be subject to the tax regime in force in the foreign State concerned*". Consequently, any consequent deeds or guarantees pertaining to loans stipulated abroad shall be subject to the ordinary indirect taxes.

80 In particular, Article 2 of Italian Presidential Decree no. 131/86 (the consolidated law on registration tax) establishes that "*registration is due in the cases of […] a) those deeds indicated in the tariff if they are drawn up in writing in the territory of the [Italian] State*".

81 The cases in which the intended use of the sums is of importance for the applicability of the regime, as identified by law, and include, for example: (a) medium and long term loans stipulated by individuals the purchase, the construction or the renovation (for non-commercial purposes) of dwellings and their respective pertinences, for which a substitute tax of 2% (instead of the ordinary rate of 0.25%) is applied if the borrower does not meet the so-called "first home requirements", or if compliance with such requirements has not been certified by the borrower at

This line of interpretation is challenged by the position taken by the Court of Cassation, according to which the substitute tax regime can only be applied to loan transactions intended for the purpose of the achievement of a "*productive investment*", in that the basis of the substitute tax would need to be found in the benefit that the legislator wishes to grant "*to productive investments, with the expectation that they create new wealth on which tax can be more appropriately charged*"[82]. From this point of view, the preferential tax regime would only be applied for transactions creating "*new financial resources*" which result in the borrower seeing its "*own liquidity increased*"[83].

The aforementioned approach adopted by case law had raised doubts concerning the interpretation of the fact that the substitute tax could only be applied in regard to financing transactions resulting, in fact, in productive investments capable of creating new wealth, and thus those loans applied for to cover past debts remained outside of the scope of the said tax regime.

In this regard, the Tax Authorities pointed out that "*the fact that the loan has to be intended for specific purposes does not seem important, generally speaking. In fact, the tax legislator did not intend to specify the actual use*

the time of stipulation of the loan (Article 18 (3) of Italian Presidential Decree no. 601/73); (b) land loans granted to building cooperatives and to the former IACPs (Independent Institutes of Social Housing – now ATER) for the purpose of building affordable and social housing, where the substitute tax rate is fixed at 0.125% (Article 19 (3) of Italian Presidential Decree no. 601/73); (c) expert credits of a duration of more than eighteen months, where the substitute tax rate is set at 0.05% (Article 10, paragraph 2-bis, of Italian Decree Law no. 70 of 14 March 1988, converted, with amendments, into Italian Law no. 154 of 13 May 1988).

82 See the Court of Cassation ruling no. 5270 of 5 May 2009. The case in question concerned a medium/long term loan covered by a mortgage, which had been reclassified as an act of mere deferral of a debt following the previous overdrawing of a current account, in regard to which the bank had granted an amendment to the initially agreed means and terms of repayment of past debts, without any fresh funding being granted in relation to the operation. With regard to this case, the Court of Cassation asserted that "*in the case of a situation where it is presumed that the loan has already been disbursed and the corresponding sum invested, while the subject matter of the agreement is the deadline for the repayment of the loan, the contract in question does not concern a loan as such but rather the means and timescale of recovery of the amount owed*" See also the Lombardy Regional Tax Commission's decision no. 119 of 5 November 2009, which concerned the case of the replacement of a short-term loan with a new medium/long-term loan, the disbursement of which was expressly aimed at settlement of the preceding debt. With regard to this decision, see the National Council of Notaries, Tax Studies Commission, Study no. 189-2009/T of 12 November 2009.

83 See the Court of Cassation's ruling nos. 18317 of 10 September 2004, 4530 of 28 March 2002, 4611 of 29 March 2002, and 7482 of 22 May 2002. It should be noted that these decisions utilise the concept of "productive investment" to justify application of the substitute tax to any technical form of loan, above and beyond the characteristic types of loan agreement.

that is to be made of the sums disbursed by the lending institute". Thus, "*a loan agreement stipulated in order to acquire actual liquidity comes within the scope of the substitute tax*", also in the case of "*loans stipulated for the purpose of discharging existing debts*". As the Tax Authorities have pointed out, the Court of Cassation's affirmation refers to the case in which the substitute tax cannot be applied in that, as a result of the new contract the borrower is not granted actual liquidity, as the new contract simply reformulates the means and terms of repayment of a loan already disbursed, since in such cases the beneficiary does not actually receive new financial resources[84].

Thus, in the case of a loan where funds are actually disbursed to discharge an existing debt, the substitute tax would be applicable, both in the case where said discharge is of a short-term indebtedness, and all the more so when used to refinance an existing medium/long-term debt.

This conclusion would appear valid notwithstanding the fact that the Court of Cassation then subsequently proposed a more restrictive interpretation, according to which the substitute tax would not be applicable in the case of "*the provision of finance purely to enable a company to discharge its existing short-term debts, on the explicit understanding that such finance is not to be used to pursue the company's corporate purpose*". This Court's stance would in fact appear to be based on the absence of any actual disbursement of money to be employed in productive activities, and on the unacceptable framing of the case as an agreement "*the object of which is not a loan in the sense referred to by the provision of law, but rather the means and timescale of the recovery of a previously disbursed loan, thus falling outside of the scope of the preferential regime invoke*d", and which is thus interpreted as the "*extension of the repayment of debts, not utilisable for productive purposes*"[85]. The existence of "*new financial resources*", in fact, would appear to be confirmed even when the financial resources are used to discharge previous loans, there being no doubt that obtaining a medium/long-term loan in place of another loan (whether short-term or medium/long-term) in fact enables the resulting financial re-

84 See Resolution no. 121/E of 13 December 2011. This Resolution makes reference to the opinion given by the General Attorney's Office which, when questioned by the Revenue Agency, pointed out that the preferential tax regime was designed to "*encourage the financing of business activities, and thus has no reason to operate if no loan has been provided, but simply an agreement reached through the adoption of due guarantees, regarding a repayment plan for debts incurred in the past*". The Resolution also makes reference to the stance adopted in the Territorial Agency's Circular no. 240 of 22 December 1999.

85 See the Court of Cassation's ruling no. 695 of 16 January 2015.

sources, which would otherwise be used to discharge the debt, to be utilised for those productive purposes specifically referred to with regard to the preferential tax regime.

On the other hand, the concept of a loan does not include mere debt restructuring or debt consolidation operations, that is, those operations characterised by the absence of fresh credit and the mere establishment of a debt repayment schedule, in that "*this situation […] presupposes that the loan has already been disbursed and the corresponding sum invested, whereas what becomes the object of the contract is the time schedule for its repayment; the contract in question does not concern a loan, but rather the means and timescale of recovery of the receivable*"[86].

17.3.6. Structured finance such as issues of bonds or similar securities

Article 20-bis of Italian Presidential Decree no. 601/73 establishes that the substitute tax regime shall also apply to guarantees of any kind, granted by anyone and at any time, in relation to structured loan transactions such as the issue of bonds or similar securities referred to in Article 44, paragraph 2(c) of the Consolidated Law on Income Tax, stipulated by whosoever, and to any subrogation, replacement, postponement, parcelling and cancellation of such guarantees, including that of a partial nature, including transfers of receivables stipulated in relation to such loans, and to transfers of guarantees including those resulting from the assignment of the aforesaid bonds, and to any amendment or termination of such transactions.

Unlike what happens in the case of medium/long-term loans, in the case in question there is no subjective requirement concerning the persons underwriting the bonds[87].

86 See Resolution no. 121 of 13 December 2011. Think of the case of a short-term unsecured loan which is modified through its rescheduling, accompanied by the obtainment of guarantees covering due compliance with the new repayment plan established at that time. See the Court of Cassation's ruling no. 5270 of 5 May 2009, which is in line with the position adopted by the Territorial Revenue Agency's in its Circular no. 240/T of 22 December 1999, according to which the preferential tax regime referred to in Article 15, is designed to *"[…]stimulate credit transactions in favour of business undertakings, and thus has no reason to operate when no form of loan has been arranged, but simply an agreement has been reached, with the adoption of guarantees, for a repayment plan concerning previously-accrued payables"*.

87 With regard to the range of exemptions resulting from application of the substitute tax on structured loans such as bond issues, according to *Assonime* (Circular no. 17/2014) there is no exemption from registration tax or stamp duty for "*deeds other than those instituting, amending*

As regards the question of objective scope, the reference to Article 44, paragraph 2(c) of the Consolidated Law on Income Tax means that the substitute tax is applicable not only to bonds, but also to the issuance of debt securities in series which: (a) provide for the unconditional obligation to repay the principal amount upon maturity; (b) do not grant "*holders any right to directly or indirectly participate in the management of the issuing undertaking or of the transaction in relation to which the securities were issued, or any right of control over said management*"; (c) give rise to proceeds that are not completely related to the sharing of the issuer's profits[88].

A doubt exists as to whether or not the bonds need to have a duration of more than eighteen months, as is the case of loans. In this regard, it could be argued that the minimum duration requirement does not apply to bonds, given the generic reference that Article 20-bis of Presidential Decree no. 601/73 makes to Articles 15 to 20 of Presidential Decree 601/73 regarding both medium/long-term loans and those special loans with no specific duration, although it could also be argued to the contrary; that is, that bonds and similar securities should meet the time requirement. This interpretative doubt could be of secondary importance if the structural characteristics of the transaction mean that the time requirement has been met nevertheless.

It should be pointed out that the preferential tax regime specifically extends exemption to the transfer of guarantees also as a consequence of the assignment of bonds, bearing in mind the natural circulation of securities.

The option to apply the regime in question must be exercised in the issuance resolution, or in a similar authorising provision. The tax is due by the financial intermediaries appointed for promotion and placement, on in their absence, from the issuer. The borrower is always jointly liable, together with the aforementioned intermediaries, for payment of the tax".

or terminating guarantees covering the loan – first and foremost the resolution authorising the issue – even though such taxes and duties do not have any substantial impact on the costs of the transaction". According to Assonime the reason for this is that the formulation of Article 20-bis does not extend as far as Article 15 of Presidential Decree no. 601/73, since the phrase "*all provisions, deeds, contracts and formalities pertaining to the transactions*" has not been included.

88 See Circular no. 26/E of 6 June 2004, Article 2.5.

17.3.7. Tax base, tax return and payment

The tax base for calculation of the substitute tax is generally represented by the capital amount disbursed pursuant to the loan transaction. In specific terms, the tax base of the substitute tax is represented by the total amount of the loans disbursed in each tax year, by the entity of the credit line (in the case of financing through the opening of a current account credit line, or on any other technical form), and by the amount of the bonds placed in the case of a structured loan transaction such as the issue of bonds or similar securities.

The obligations regarding declaration and payment of the substitute tax are, as a rule, the responsibility of those entities disbursing the loan, and which generally pass the corresponding charge on to the borrower.

Article 20, paragraph 5, of Presidential Decree no. 601/73 establishes that the provisions concerning registration tax shall also apply to the substitute tax as regards adjustment of the tax base, the mandatory verification of any omitted assets, penalties for incomplete or inaccurate tax returns, collection of the tax, litigation, and anything else concerning application of the substitute tax.

18.
Tax treatment of interest expenses in Leverage Buy-Out (LBO) operations of Real Estate companies

by M. Leo, G. Formica

18.1. Leverage Buy-Out (LBO) operations

Developed with increasing strength since the late sixties of the last century, Leverage Buy-Out (LBO) is one of the most widespread investment techniques in the private equity market, sometimes used for the acquisition of listed companies in the view of their delisting (that is, the withdrawal of their shares from stock exchange)[1]. In particular, despite the variety of forms that such an operation can take, LBO, in its basic scheme, consists in the acquisition of a target company through a significant portion of debt, obtained by leveraging, as a guarantee, on the assets of the acquired company and on the ability of the latter to generate sufficient prospective cash flows to repay debt used for the purchase.

The economic foundation of LBO is therefore to be found in the intensive use of financial leverage. Indeed, based on economic theory of the optimal debt/equity ratio, return on equity is increased by using debt for an investment, as long as cost of debt is lower than the expected return on the investment itself[2]. Moreover, empiric evidence confirms a strong correlation between the frequency of LBO operations and conditions applied on the debt market[3].

1 See R. Trehan, *The History of Leveraged Buyouts*, 2006.

2 See Baldi F., *The Economics of Leveraged Buyouts*, 2016, Giappichelli.

3 See De Maeseneire, *What drives leveraged buyouts? An analysis of European leveraged buyouts' capital structure*, 2012, Journal of Accounting and Finance.

18.1.1. The basic scheme

Generally, LBO operations involve the establishment of a special purpose vehicle (SPV)[4] company by one or more investors[5], minimally capitalized and aimed at the leveraging purchase of the target company. In a more complex and widespread scheme –Merger Leverage Buy-Out (MLBO) – the operation is completed with a (direct or reverse) merger between the SPV and the target. Such a merger – which represents a merely possible step, yet very frequent – constitutes the natural completion of this kind of transactions, as it brings lenders closer to assets used as a collateral for debt contracted for the acquisition and, above all, makes it simpler and less expensive the transfer of cash flows from the target companies to repay debt contracted by the SPV.

Definitely, LBO/MLBO are techniques for the acquisition of shareholdings, whose peculiarity consists in the fact that the debt contracted for the purchase of shares is repaid using cash flows generated by the same target company. This happens, in case of LBO, through the destination to debt repayment of cash resulting from the distribution to the SPV of dividends generated by the business of the target. However, since this could be a precarious financial balance (because of timing, constraints and governance of profit distribution), it is very common that the same lenders, especially if they are third parties[6], require a merger between the SPV and the target (MLBO) in order to make their investment more guaranteed. In this way, it becomes automatic, for the company resulting from the merger, the aforementioned enslavement of operating cash flows generated by the business of the target company to repay debt contracted by the SPV (to purchase the target itself). Moreover, such a merger, by bringing debt closer to the assets of the acquired company, ensures that such assets can be placed as a guarantee for lenders[7].

4 Sometimes investors use existing vehicles, which negotiate new debt for the acquisition.

5 Investors can be, for example, industrial operators, institutional investors (e.g., banks, investment funds) (*institutional LBO*), the management of the target company (*management buyout*), its employees (*employee buyout*) or a new group of managers (*management buyin*).

6 Debt capital could also be provided by shareholders of the SPV.

7 Moreover, in the basic scheme of MLBO operations, the SPV firstly contracts a short-term bridge loan to obtain cash for the acquisition and, once the merger with the target company is completed, refinances the aforementioned bridge loans through medium-term financing guaranteed by the assets of the target company (e.g., mortgage on real estate properties) and by its cash flows, while eventually asking also additional loans.

Finally, it should be noted that, especially in the practice of transnational investments by institutional entities (e.g., private equity funds), these operations are sometimes carried out using a "double NewCo" or a "double holding" structure, consisting of a first intermediate vehicle (NewCo1), which controls a second vehicle (NewCo2) used for purchasing shares of the target company and typically located in the same country of the target. In reality, as we will see better below, financial structure of such transnational operations is often very complex and involves a lot of lenders and financing schemes.

18.1.2. LBO/MLBO and Real Estate

From the above it emerges the intrinsic riskiness of this kind of operations, given the high percentage of debt capital used for the purchase. Success of a LBO/MLBO operation depends crucially on the features of the target company and, in particular, on its ability to generate sufficient cash flows to repay debt through ordinary business or because of the disposal of assets deemed no longer strategic after the acquisition (*asset stripping*). Furthermore, for the lender, availability to provide loans depends strongly on the features of the patrimony of the target company, in terms of assets that can be used as collateral and/or for asset stripping transactions.

The nature and quality of assets of the target company, as well as the stability of its financial flows, are therefore a crucial factor for lenders' choices.

In this perspective, real estate companies are a possible candidate for acquisitions through LBO/MLBO, both because of the mortgage guarantee to lenders and of the eventual stability of expected cash flows, for example in case of real estate properties leased with medium-long term contracts and highly predictable structural costs. Indeed, according to economic theory, the ideal target company is one operating in mature markets (e.g., with sufficiently low growth rates) and producing goods/services not particularly sophisticated (e.g., non-technological products) that, however, guarantees sufficient stability of cash flows.

Furthermore, autonomous disposability of real estate properties on the market makes possible alternative exit strategies for investors; this reduces risk perception of acquisitive initiatives, for example those made by international private equity funds.

Finally, the existence, in the target's assets, of latent values not yet sufficiently emerged – typical feature of real estate activities – makes the acquisition scheme at hand particularly appealing in the real estate sector.

Moreover, in such a sector, because of the importance of material assets in the value creation process, acquisitions can take place in the simplest variant of asset sale, consisting in financing by debt the purchase of a set of assets forming a specific branch of a company (a building used as a shopping mall or as hotel with the relative licenses), instead of purchasing shares of the real estate target. These assets are then placed as a direct guarantee for lenders, with a similar outcome of that resulting from a MLBO transaction of the real estate company that holds the same branch.

18.2. Deduction of interest expense in LBO/MLBO operations

In Italy, the widespread use of LBO/MLBO has been conditioned for a long time by an incomplete and discouraging legal framework, both in terms of civil law and – for what it's important here – in terms of tax impact. Indeed, it is known that legal certainty constitutes a precondition for the realization of investments[8] and investors choose, if they are convenient, those ventures that ensure greater predictability of regulatory consequences, primarily fiscal ones.

18.2.1. Civil law profiles (mentions)

As regards civil law profiles, prior to the 2003 reform of company law (so-called "Vietti reform", there was not a specific discipline of LBO/MLBO and this regulatory void has generated considerable uncertainty on lawfulness of this kind of operations, in particular in relation to their compatibility with the prohibition of financial assistance dictated by Articles 2358 and 2474 of the Italian Civil Code (ICC).

In fact, the typical modification of the financial structure of target companies, following a LBO/ MLBO, can damage lenders and remaining shareholders: the former are conditioned by a possible reduction of their guarantees of debt repayment and the latter by a possible value decrease of their shares. Moreover, the same reasons justify the limits provided by the Italian legislation for the purchase of treasury shares and for the granting of loans or guarantees to this aim.

In the past, some scholars had claimed, therefore, the possible violation of such limits imposed by the Articles 2358 and 2474 ICC, in case of acquisi-

8 See Baldi F., *The Economics of Leveraged Buyouts*, 2016.

tions carried out through loans guaranteed or contracted by the same target company, especially in the form of a MLBO. Also Italian jurisprudence had not expressed a unanimous position on the lawfulness of this kind of operations, increasing legal uncertainty, hence discouraging the use of these acquisition techniques[9].

Exactly in order to solve such uncertainties[10], the Legislative Decree no. 6 of January 17th, 2003 introduced in the ICC the Article 2501-bis[11], which regulates the operations of "*merger following an acquisition by debt*" (as reports the same heading of the mentioned article) and implicitly confirms lawfulness of LBO/MLBO operation in a civil law perspective, while just subordinating their completion to certain conditions and procedural limits.

In particular, paragraphs from 2 to 5 of Article 2501-bis ICC require, as a condition for the validity of a MLBO transaction, that:

- the merger plan accurately indicates financial resources aimed at repaying loans contracted for the acquisition of the company resulting from the merger;
- the directors' report identifies the reasons of the operation, also through an economic-financial plan (including the analysis of the source of financial resources) and a clear indication of the objectives to be achieved;
- the experts' report required by Article 2501-sexies ICC certifies the reasonableness of the merger plan;
- a report by statutory auditors report of the target or the buyer company is attached to the merger plan.

Defenitly, in order to assure stakeholders' rights, the Italian law imposes reinforced transparency, with particular reference to the financial conditions as long as to the economic and business reasons for the operation at stake.

9 For an analysis of civil law profiles before the 2003 reform, see A. Frignani, *Il leveraged buy-out nel diritto italiano*, in Giur. Comm., 1989; P. Montalenti, *Il leveraged buy-out*, Milano, 1991; A. Morano, *Il leveraged buy-out*, Milano, 1992; A. Martone, *Le operazioni straordinarie di leveraged buy out tra liceità civilistica ed elusione fiscale*, in Il Fisco no. 25/2013.

10 The Government Report to the Senate on the Legislative Decree no. 6 of 2003 expressly clarifies that Article 2501-bis ICC has been introduced "*to overcome some interpretative controversies that emerged in jurisprudence, but also in legal doctrine, regarding lawfulness of leverage buy-out transactions*".

11 For a complete analysis of civil law profiles after the 2003 reform, see P. Montalenti, *Il nuovo diritto societario. Commentario,* directed by Cottino *et al.*; M. Perrino, in *Società di capitali. Commentario,* edited by Niccolini e Stagno d'Alcontres.

In this way, external lenders can better assess possible damages due to the MLBO operation, for an informed exercise of their right to oppose[12].

18.2.2. Tax law profiles

For a long time, also the fiscal framework of the operations at hand has been uncertain, especially regarding the inherence and, therefore, the tax deductibility of interest expenses on the debt contracted for the acquisition, as well as regarding the possible tax avoidance/abuse of right profiles of these operations. Tax and civil law (see above) uncertainties have certainly affected negatively the use of LBO/MLBO operations in Italy; indeed, the economic theory on the topic has qualified the tax shield (in terms of deduction of interest expenses generated by the leveraged purchase) as one of the main possible reasons for the worldwide spread of these operations[13].

In general, Article 96 of the Presidential Decree no. 917 of December 22nd, 1986 or Italian Tax Consolidated Act ("ITCA") provides that interest expenses (and similar charges) are deductible from tax base for an amount equal to interest incomes (and similar incomes) and, for the surplus, within the limit of 30 percent of EBIT (Earning Before Interests and Taxes)[14]. Any further surplus and any EBIT excess (not used in the fiscal period of generation) can be carried forward in subsequent tax periods[15]. Such a discipline has been revised by the Legislative Decree no. 142 of November 29th, 2018 ("ATAD Decree"), implementing the Directive EU/2016/1164 (Anti-Tax Avoidance Directive or ATAD), that has introduced, on one hand, a time

12 F. Di Sabato, *Diritto delle società*, 2011, Giuffrè.

13 see. Kaplan, S. N., *Management Buyouts: Evidence on taxes as a source of value*, 1989, Journal of Finance; Kaplan, S. N. – Stromberg, P., *Leveraged Buyouts and Private Equity* , 2008, National Bureau of Economic Research (NBER), working paper no. 14207. The deduction of interest expenses, by lowering the tax base and, so, the tax burden, generates higher cash flows and, therefore, a higher value of the company. The recourse to debt increases the value of the company, due to tax shield, so that the use of new debt is advisable as long as such a tax effect is not exceeded by the consequent increase in marginal costs of default (e.g., worsening of credit rating, hence raising interest rates applied by lenders).

14 The discipline for individual entrepreneurs and partnerships is contained in the Article 61 of ICTA, according to which interest expenses are deductible for the part corresponding to the ratio between: i) the amount of revenues and other incomes included in the income tax base or excluded by such a base (e.g., dividends) and ii) the total amount of all revenues and income (that is, including taxable, excluded and exempted incomes).

15 For a complete analysis, see M. Leo, *Le imposte sui redditi nel Testo Unico*, 2018, Giuffrè; G. Andreani – G. Ferranti, *Testo unico imposte sui redditi*, 2017, IPSOA.

limit (five years) to carry forward EBIT excesses and, on the other hand, has allowed, differently from the past, the chance to carry forward, without time limits, any surplus of interest incomes[16].

When the option for tax consolidation is exercised (based on Article 117 and following of ICTA), surpluses of interest expenses produced by individual participants can be deducted, within the fiscal unit, by using ROL surpluses not used individually by other participants[17].

For more details on this subject, please refer to chapter 4 of this book.

18.2.2.1. Previous challenges on tax treatment of LBO/MLBO operations

As anticipated, on the tax side, LBO/MLBO operations entail the generation of deductible interest expenses on loans contracted for the purchase of the target company. In case of MLBO transactions, these interest expenses, which are potentially non-deductible for the SPV that contracts loans (the latter is typically a newly-established entity, without taxable profits, as well as without operative business and, therefore, potentially without sufficient EBIT to deduct interest expenses pursuant to Article 96 of ICTA), they can be compensate with the taxable income generated by the target company, thus reducing the overall tax burden on the investment.

Compensation is an automatic consequence of the completion of the merger between the SPV and the target company, since it implies the confusion of assets of both companies, a common financial flow, a single income and, therefore, a unique tax base. Even when interest expenses are deductible, they could give rise to tax losses that cannot be used by the newly formed SPV (due to its lack of taxable income) without merging with the target.

In the case of a LBO, however, the same outcome can be achieved if both companies (the target and the SPV) exercise the option for the fiscal unit regime. However, since, for the option to be adopted, it is necessary that one company controls the other or both are subject to common control of a third company[18], the aforementioned outcome can be obtained, evidently, only in

16 For an analysis of the new discipline of interest expense deduction after the approval of the ATAD Decree, see L. Gaiani, *Interessi passivi: verso nuove regole in vigore dal 2019*, Il Fisco no. 36/2018; L. Gaiani, *Definitive le modifiche al regime degli interessi passivi in vigore dal 2019*, Il Fisco no. 1/2019.

17 To this end, surpluses have to be produced during the validity period of the tax consolidation option and not already accrued in tax periods prior to the entry into the group taxation regime.

18 Article 120 of ITCA provides that a qualified control occurs in case of a direct or indirect participation to share capital or income for more than 50 per cent, to be quantified by considering, in case of indirect shareholdings, the percentage reduction due to control chain.

case of purchase transactions at the end of which the control condition required by law is satisfied.

For a long time, tax implications mentioned above, whose limits of lawfulness have been recently clarified by the Italian Tax Revenue Agency or "ITRA" (see below), have generated uncertainty among investors, due to a past strongly restrictive position of the Italian financial administration.

In some cases, ITRA challenged tax deductibility for the SPV, the target company (as a result of the merger) or within the fiscal unit regime, of interest expenses generated in a LBO/MLBO transaction, for an alleged lack of inherence of interests themselves (that is, for lack of inherence of the underlying debt)[19]. Since interests would be borne by the SPV (eventually after the merger with the target) as a mere agent and in the exclusive benefit of the target's shareholders (real beneficial owners of the purchase), they could not be deductible for the SPV, according to the past position of ITRA, because paid for the sole benefit of other parties.

In other situations, the Italian financial administration has affirmed that, against interest expenses due to lenders, the SPV would have had to account (and tax) revenues for services rendered to the investors[20], to be subjected, in case of shareholders not resident in Italy, to the transfer pricing discipline pursuant to Article 110 of ICTA, on the basis of OECD interpretation of such a discipline (see below). Taxation of these positive income components would have had the effect of offsetting the corresponding negative components (that is, interest expenses) generated by the LBO/MLBO transaction, annulling, in fact, the impact on the tax base of the deductibility of these last negative components.

Finally, in many cases, fiscal lawfulness of LBO/MLBO transactions has also been challenged with reference to possible tax avoidance /abuse of right profiles, generating a significant litigation between the Italian financial ad-

19 To be sure, the issue of the relevance of the inherence judgement for the deduction of interest expenses is the focus of an historical debate in Italy; a part of scholars and of jurisprudence affirms that the Article 96 of ITCA identifies a legal and predetermined criterion of inherence for deductible interest expenses, without any need for an analysis in the merit; differently, some others consider that the Italian legislation fixes the maximum amount of deductible interests, without prejudice to the necessity of verifying their inherence. For a complete analysis see G. Ferranti, *L'inerenza degli interessi passivi: una questione da risolvere*, in Il Fisco no. 15/2016; ASSONIME, circular letter no. 46/2009.

20 According to this thesis, the SPV should be qualified as service provider in favor of foreign investors, so that it should tax revenues (for these services) at least equal to deducted interest expenses paid because of the purchase made in the interest of the investors themselves.

ministration and taxpayers. The alleged undue tax savings were identified, absent valid non-tax significant reasons, in the higher deduction of interest expenses on loans contracted for the acquisition; these costs would have been potentially non-deductible for the SPV (usually a new-established entity, without taxable profits, operating business and, therefore, potentially without EBIT) in case of no merger with the target (or in case of no exercise of the option for tax consolidation). The same arguments have been used in the past with reference to the use of tax losses of the SPV otherwise not possible.

18.2.2.2. Recent clarifications from ITRA

Previous challenges of the Italian financial administration have been overcome after the publication of an appreciable and well-considered position of ITRA. Indeed, fiscal as well as civil law lawfulness of the transactions at stake have been analyzed by ITRA in the circular letter of March 30th, 2016, no. 6/E, which deals with all reasons of past challenges described above, as regards tax avoidance/abuse of right, inherence of interest expenses and possible setting of infra-group services (to be subject to the transfer pricing regulation).

In particular, with reference to the inherence issue, ITRA has definitively overcome past remarks, declaring fully inherent interest expenses incurred in the context of LBO/MLBO transactions, since, in these cases, loans are aimed at the acquisition of the target company: this conclusion is valid both in case of a MLBO and in case of a LBO followed by the exercise of the option for the fiscal unit between the target and the SPV[21]. Indeed, the purpose and the object of the SPV is the acquisition itself, so it would be meaningless to consider loans contracted for this purpose as extraneous to the target company's mission and, therefore, to its physiological process of value creation and taxation. Since they are inherent, these interest expenses are deductible within the limits fixed by Article 96 of ITCA, save the application of the arm's length principle, in case of lenders that are non-resident controlling shareholders.

As for the configurability of a provision of services, the same circular letter no. 6/E of 2016 confirms, in application of OECD Guidelines on transfer pricing, that this may occur just in the event that who set up the Italian SPV (or en-

21 Of course, in case of loans granted by lender belonging to the same group, deductibility has to be subjected to specific limits fixed by transfer pricing regulation, where applicable.

tities controlling it) have themselves collected financial resources outside the group, and then made them available to the vehicle resident in Italy, in order to complete the LBO/MLBO operation: in this case it emerges an infra-group service not put in place by the vehicle company, but for the benefit of the same, to be subject to transfer pricing regulation pursuant to Article 110, paragraph 7, of ITCA. However, the same conclusion does not apply in the different case in which the SPV has itself found and obtained, from third-party lenders, financial recourses to complete the acquisitive operation, possibly constituting a pledge, to this end, on the shares of the target company.

Finally, the circular letter at hands deals with the more delicate issue of tax avoidance/abuse of right, confIrming, on this point, the position emerging in the tax jurisprudence[22], which has repeatedly stated the non-abusiveness (of right) of LBO/MLBO transactions.

In this regard, it is important to remind that, pursuant to Article 10-bis of the Taxpayers' Rights Statute (Law no. 212 of 2000), "*one or more transactions without economic substance that (...) essentially achieve undue tax advantages*" constitute an abuse of right. The following paragraph 2 of such an Article specifies that "*are considered without economic substance those facts, acts and contracts, also linked each other, unsuitable to produce significant effects other than tax advantages*"; however, the rule at stake admits, in paragraph 3, an exemption from the application of abuse of right legislation, if the taxpayer is able to demonstrate valid non-marginal reasons of the overall operation.

Therefore, allegations of abuse of right presuppose basically three cumulative requirements, namely: 1) an "undue" tax benefit (consisting in "*benefits, even if not immediately realized, in contrast with the purposes of tax regulations or with the principles of the tax framework*"); 2) the absence of "economic substance" for the realized operation (that is, its unsuitability "*to produce significant effects other than tax advantages*"); 3) the essentiality of the achievement of a "*fiscal advantage*". Furthermore, even when the aforementioned cumulative requirements are fulfilled, transactions justified by valid non-marginal reasons (including organizational or management ones, that involve structural or functional improvements of the company) cannot be considered abusive of right.

As clarified by ITRA, LBO/MLBO transactions lack the conditions to be challenged for abuse of right, because, "*since they pursue extra-fiscal pur-*

22 See M. Antonini - A. Di Dio, *Legittimità fiscale delle operazioni di "merger leveraged buyout" per modifica dell'"assetto proprietario"*, in Corriere Tributario no. 14/2016.

poses, recognized by the Civil Code and, often imposed by third-party lenders, they could be hardly considered as essentially aimed at obtaining undue tax advantages". In this regard, the circular letter does not distinguish, for such conclusions, the most widespread transactions ending with the merger between the target and the vehicle (MLBO) from those which, in the absence of a merger (LBO), produce, as said, the same tax outcome because of the tax consolidation option.

Finally, the economic basis of these transactions is recognized by ITRA: it consists in the use of debt as a "financial leverage" to realize an acquisitive transaction and, with regard to the merger, in the recourse to debt push-down techniques, to transfer obligations of debt and interest payment on assets and cash flows of the target company. The transfer of debt toward the target – as said, often understandably imposed by the same lenders[23] – avoids the "structural subordination" of loans occurring when debt is guaranteed by second level assets, that is by assets held indirectly, through a company controlled by the lender.

Therefore, it has been noted that, since MLBO operations are expressly regulated by the Italian law (Article 2501-*bis* of ICC), it appears difficult to support claims regarding transactions that are fully legitimized in the national legal order[24].

However, the overcoming of past challenges of tax avoidance/abuse of right is not limitless, as ITRA expressly excludes, from its conclusions, individual cases of LBO/MLBO characterized by "artificial" features, as those in which "*the same subjects who directly or indirectly control the target company participated the operation*"[25]. The Italian financial administration reserves the right to deny the deduction of interest expenses (and tax losses) in case of operations deemed as "artificial", thus asking for a case by case analysis of the lawfulness of individual transactions in terms of tax avoidance/abuse of right.

23 This is another extra-fiscal reason to support the lawfulness of such a kind of operations.

24 G.M. Committeri, *Le operazioni di leveraged buy out dopo i chiarimenti delle Entrate*, 2016, in La gestione straordinaria delle imprese, Eutekne no. 3/2016.

25 Cfr. G. M. Committeri, *Operazioni di Leveraged Buy Out: nella circolare molte luci e qualche ombra*, in Il Fisco no. 18/2016; M. Antonini - R. A. Papotti, *Luci e ombre dei chiarimenti dell'Agenzia sulle operazioni di "Leveraged Buy-Out"*, in Corriere Tributario no. 20/2016.

18.2.3. LBO/MLBO and abuse of right

The conclusions of the circular letter above commented seem to radically change the perspective angle from which assessing possible remarks of abuse of right. The organizational needs and the economic reasons for these operations – as a condition to exclude the abuse of right pursuant to Article 10-bis of the law no. 212 of 2000 ("Taxpayers' Rights Statute") – are considered verified when the operation does not present "artificial" profiles as those described by ITRA, with particular reference to cases in which the LBO/MLBO operation implies a real change in the shareholding of the target company.

In this regard, it is crucial to understand under what conditions this change actually occurs, since a formalistic reading of the conclusions of circular letter no. 6/E would imply the possible extension of "artificiality" claims even when the outcome of a LBO/MLBO is a real transformation in the control structure of the target company.

Therefore, in the following we propose a possible interpretation, while waiting for confirmations at least from the jurisprudence in the subject at stake.

18.2.3.1. LBO/MLBO transactions without change of control

To be sure, the statement by the Italian financial administration about the general non-tax-avoidance aims of LBO/ MLBO transactions appears unequivocal if the purchaser of the shares, through the SPV, does not participate, directly or indirectly, the pre-existing shareholding structure of the target company. In this case, the use of leverage allows an acquisitive operation, probably impossible otherwise, which is justified by the economic reasons described in the first paragraph, also with reference to the eventual final step of merger, required by lenders to bring debt closer to the target's asset and to its cash flows.

The conclusions of such a circular letter are more ambiguous when buyers (even through the SPV) are already direct or indirect shareholders of the target company. In fact, the sentences used in the circular no. 6/E – where ITRA affirms eventual claims (of tax avoidance/abuse of right) in the presence of "*other specific profiles of artificiality*", such as, for example, when participated by "*the same subjects who, directly or indirectly, control the target company*" – have significant margins of interpretative uncertainty, already outlined in the literature[26].

26 It has been observed that ITRA's position on the point is expressed in a way "*so generic that*

Without doubt, the formal reference to pre-existing "control" situations leads to exclude "artificiality" claims in all cases in which investors involved are minority shareholders in the pre-LBO/MLBO target company, as it happens when, following similar transactions, a (minority) pre-existing shareholder passes from a minority to a (direct or indirect) control position or just integrates its equity stake, yet remaining in a non-controlling position (neither jointly) also after the LBO/MLBO operation. This cannot be disputed, given that, in absence of pre-LBO/MLBO control position (neither jointly), pre-existing shareholders cannot realize tax-avoidance aims through acquisition of new shares by debt.

On the contrary, when pre-existing shareholders start from a control position (joint or individual, direct or indirect), answers become more complex. Indeed, in this case, the circular letter at hand seems to deny relevant economic purposes, while affirming undue tax advantages (that is, in terms of higher deduction of interest expenses on loans contracted for the acquisition and in terms of carrying forward of tax losses), since the LBO/MLBO transaction does not result in a significant change in the shareholding profile of assets involved and no change of control effectively occurs.

However, even in such cases, taxpayers can counter tax avoidance/abuse of right claims by demonstrating not marginal non-tax reasons justifying the venture. Otherwise said, the presumption of "artificiality" affirmed by ITRA in the hypothesis of operations without change of control can always be overcome, pursuant to Article 10-bis of the Taxpayers' Rights Statute (see above), by showing, in the specific case, the organizational, industrial or financial aims of the operation or, at least, reasons related to shareholders' relationships.

Having said that, to better understand the conditions under which a LBO/MLBO transaction could be challenged as tax avoidant/abusive of right, it seems appropriate to describe some simple examples[27].

Consider the case of a target company X, directly controlled by A, whose shares are sold to a newly established company Y (newco), also totally owned by A, using debt for the purchase. In this case, both when X and Y merge

could reduce, if not better explained, beneficial effects of clarifications provided" (G.M. Committeri, *Acquisizione con indebitamento: il focus si sposta su finanziatori e investitori non residenti*, in Il Fisco no. 31/2016).

27 F. Dezzani, *Deducibilità degli interessi passivi da Leveraged Buy Out per gli operatori del private equity*, in Il Fisco no. 18/ 2016.

(MLBO) and when they do not (LBO), at the end of the transaction A remains the controlling shareholder – direct in the first case (MLBO) and indirect in the second one (LBO) – of the target company X, however benefiting from higher deductible interest expenses compared to the pre-existing situation.

A similar operation could integrate a case of abuse of right under Article 10-bis of the Taxpayers' Rights Statute, unless it is justified by significant non-tax economic reasons. In fact, in this case a leveraged cash-out operation occurs, since debt is used (by also producing deductible interest expenses) to assure the anticipated distribution of dividends in the form of capital gains[28]; in such a hypothesis, the Italian financial administration has frequently doubted about the inherence of interest expenses.

A similar conclusion would also apply when the SPV (Y) is participated by A and a new partner B, with the latter having a minority shareholding (e.g., 10 per cent). Also in this case, there would not be a substantial change of A's individual control over the target company X, since A would pass from a 100 percent pre-LBO/MLBO shareholding to a 90 percent post-LBO/MLBO shareholding, without any change of control.

Finally, no control change occurs even when the target X is already controlled by A before the LBO/MLBO operation, but not entirely (for example, 60 percent shareholding) and, after the transaction, A acquires, through the SPV (Y), the entire share capital of X; also in this hypothesis, the control of A on the target company does not change, but is only strengthened (from 60 to 100 percent shareholding) because of the LBO/MLBO operation, so that such an operation falls back into the presumption of "artificiality" stated by ITRA. However, in this case, it is always possible to avoid tax avoidance/abuse of right claims giving evidence of valid extra-fiscal reasons, such as the existence of disagreements between A and the old partner (at 40 percent), hence the need for A to "get rid" of him[29].

18.2.3.2. LBO/MLBO transactions with change of control

A different case is when the operation – participated also by previous (direct or indirect) shareholders of the target – involves a real change in the share-

28 This is a re-leveraging of the company by its shareholders, with anticipated distribution of dividends for the latter, who collect money, thanks to a debt allocated on the operating company and repaid with its own cash flows.

29 With reference to a similar case, Regional Tax Court of Milan, in judgment no 36 of April 13th, 2011, has, moreover, stated that "*the operation was carried out for valid economic reasons such as the expulsion of a member (not appreciated)*".

holding structure of the target itself[30]. In other words, it is always possible the participation of subjects already holding controlling shares in the target when the final outcome of the LBO/MLBO operation is anyway a change of control of the target, for example because the aforementioned subjects pass from control to a minority position[31] or from an individual control to a joint one with a new partner (joint venture) or, finally, in the opposite direction, when such subjects pass from a joint control to an individual one[32].

In such cases, the entrepreneurial profiling of the overall operation appears suitable to allow economic and organizational purposes that would be otherwise unfeasible: LBO/MLBO, rather than being the "aim" of the operation, appears the "tool" through which achieving certain goals (that is, purchasing an asset, modifying the shareholding structure, achieving a reorganization)[33].

Going back to the first example described above, in which the target company X was fully controlled by A, if the SPV Y is set up as a joint venture between the pre-existing (100 percent) controlling shareholder of the target and a new joint partner B, the purchase, through the vehicle Y, of the entire capital of X, realizes a real change of control of the target company, since the latter passes from the individual control of A in the pre-LBO/MLBO phase to the joint venture between A and B after the LBO/MLBO transaction. The same change occurs in the opposite case in which the target company X is originally a joint venture between A and B, before being sold to a newly established SPV participated by only one of the aforementioned two share-

30 The change of corporate shareholding as a valid economic reason for such an operation has been expressly affirmed by Italian tax judges (see Regional Tax Court of Milan, judgement of July 6th, 2016, no. 3985/38/16).

31 Moreover, the tax avoidant nature of such an operation has been denied, even before the publication of the ITRA's circular letter no. 6/E of 2016, from the Italian jurisprudence, according to which "*The change in the ownership structure cannot be deemed as merely marginal, since controlling subjects of the company are different from those previously identified. The permanence of subjects already present in the shareholding structure before the operation under scrutiny, is certainly not sufficient to support the thesis of the Tax Office, given that these subjects have preserved just minority stakes*" (Milan Provincial Tax Court, decision of December 10th 2015, no 9999).

32 See G. Formica - P. Formica, *La svolta sull'"LBO" vale per le joint venture*, Il Sole 24 Ore, July 8th, 2016.

33 When, viceversa, at the end of the overall transaction, shares, previously already available to certain subjects, is "placed" in a newly established company, controlled, even indirectly, by the same subjects, but indebted to get a tax advantage (that is, in terms of higher deduction of interest expenses), it may be assumed, save the possible demonstration of different valid non-tax reasons, that the LBO/MLBO transaction represents the "aim", more than the "tool" for the acquisition.

holders, which passes from a joint control position pre-LBO/MLBO to an individual control post-LBO/MLBO.

In conclusion, it can be stated that the LBO/MLBO transactions – which are not generally unchallengeable as tax avoidant/abusive of right – could be deemed as an "artificial" operation only as long as the same subjects already controlling the pre-LBO/MLBO target preserve the same position as a result of such an operation[34]. However, such a judgement of "artificiality" should not cover the case of LBO/MLBO transactions that involve shareholders previously not controlling the target. Nor it could cover the hypothesis in which the pre-LBO/MLBO control position of subjects participating in such transactions changes significantly, as a result of a transition from an individual to a joint control and vice versa, or when the LBO/MLBO implies the loss of a previous control position (jointly or individually) of an old shareholder just preserving a minority stake, or, finally, when implies a change of identity of the joint partner[35].

In brief, the lowest common denominator of such hypotheses of not "artificiality" is the change of control, also in the form of a transition from an individual to a joint control and vice versa. This is the same criterion to subject acquisitive transactions (exceeding certain thresholds) to antitrust regulation on mergers and acquisitions (M&A) and, therefore, to the ex-ante control, depending on specific cases, of the competent UE (EU Commission) or national authority (AGCM)[36]. The starting of antitrust procedures

34 See G. Formica - M. De Nicola, *Change of control ed elusività delle operazioni di LBO/MLBO*, in Il Fisco no. 41/2016.

35 This conclusion seems to find support in a recent judgement of the Italian Supreme Court (no. 868 of January 16th, 2019), where the Judge, using similar arguments to those exposed here, has found not tax-avoidant/abusive of the right a MLBO operation aimed at replacing two previous partners with a new one, maintaining constant the other member's 50 percent shareholding. For a comment, see E. Zanetti, *Fusione previo LBO legittima se il 50% della compagine rimane la stessa,* in Eutekne.info on January 17th, 2019.

36 According to Article 3 of Regulation (EC) no. 139 of 2004, "*A concentration shall be deemed to arise where a change of control on a lasting basis results from: (a) the merger of two or more previously independent under- takings or parts of undertakings, or (b) the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings*". This change in the control also occurs in case of creation of a joint venture, because, under the same article 3, "*The setting-up of a joint venture which permanently exercises all the functions of an autonomous economic entity shall be considered as a concentration within the meaning of paragraph 1 (b)*". Moreover, the abovementioned Regulation (EC) no. 139 of 2004 considers also *de facto* control, since, based on the same Article 3, second subparagraph, "*there is control in the presence of rights, contracts or other means that confer, alone or jointly, and taking into account the factual or legal circumstances, the possibility of*

may represent, in this sense, an indirect index of real changing purposes of the transaction, which should exclude the "artificiality" of the LBO/MLBO transaction, as it is aimed at a change of control on the target company.

Having said that, to complete previous observations, we need a final observation, potentially relevant for the conclusions above, regarding the identification of differences between individual and joint control. In fact, according to the Italian financial administration, such a distinction cannot be inferred, *sic et simpliciter*, from the existence of equal shareholding.

Indeed, for other purposes, ITRA has clarified that *"(...) it is useful, however, to specify that the notion of control pursuant to Article 2359 of the Civil Code, does not exclude necessarily the possibility that even in the presence of an equal shareholding in the company (50 percent each) a control position can be identified for one of the two shareholders (...) In fact, the extent of the concept of control of Article 2359 of c.c. necessarily requires an in-depth analysis of all the relationships between subjects involved in order to verify if one of them exercises on the other a dominant influence by virtue of particular contractual constraints*" (resolution no. 376/E of 2007). Therefore, a factual and contractual verification is necessary, considering all situations based on which it is possible to infer a potential or current exercise of a significant influence on business decisions (circular letter no. 32 of 1980).

This means that the concrete analysis of the change of control in cases of post-LBO/MLBO transition from an individual to a joint control and vice versa should be assessed, in concrete, taking into account not only shareholding percentage, but also any element revealing the real economic influence on business decisions, such as the right to appoint members of the board of directors, the exclusive sale of products manufactured by one of the partners and, in general, all situations that allow to exercise potentially or effectively an influence on entrepreneurial choices[37].

Therefore, if, for example, the "old" 100 percent partner – through a LBO/MLBO transaction – sell a 50 percent shareholding to a new partner in the target, but preserves the rights to decisively influence business decisions, no effective change of control occurs, hence lacking the prerequisite to deny *ex se* the tax

exercising decisive influence over the activity of an enterprise". Similar provisions are also envisaged at national level (law no. 287 of 1990) for the *ex-ante* control of merger and acquisitions by the competent Italian authority (AGCM); these national provisions should be interpreted in accordance with UE regulation and jurisprudence.

37 See, on the point, Italian Supreme Court, April 22nd, 2016, judgement no. 8130.

avoidant/abusive nature of right of the overall operation. Vice versa, where the same decisive rights are left to the new 50 percent partner, the opposite conclusion applies, since, in such a case, the LBO/MLBO operation involves an effective change of control in favor of the latter: as such, it has been considered not "artificial" and, therefore, not driven by tax avoidance purposes.

18.2.3.3. Final remarks

In conclusion, the circular letter of ITRA no. 6/E of 2016 has clarified tax lawfulness, at least in general, of LBO/MLBO operations in terms of abuse of right, dissolving uncertainties that, in the past interpretative void, had generated significant litigation, also discouraging such vital transactions for the private equity sector and the general economic system.

However, residual profiles of interpretative uncertainty still remain. In fact, the conclusions on non-tax-avoidant nature appear unequivocal with reference to LBO/MLBO operations made by only subjects not involved in the share capital of the pre-LBO/MLBO target company. Conclusions are less clear-cut when this does not occur, although such a situation is very frequent for such operations, since the new shareholders themselves often request – to be adequately guaranteed also on the stability of company operations – a presence (at least minoritarian) of already existing shareholders. An excessively formalistic view could extend claims of "artificiality" and, therefore, of tax avoidance/abuse of right in all cases of even partial identity among the shareholders of the target company pre- and post-LBO/MLBO. However, this view would be asystematic, since tax avoidance concerns should be limited only to those transaction that do not modify control of the target company.

Moreover, the most recent jurisprudence of the Italian Supreme Court, emerged also after the commented ITRA's circular letter, has already expressed an opener approach, judging not abusive of right even MLBO operations not necessarily aimed at modifying previous control profile of the target company or operations involving previous shareholdings of the target[38].

38 Lastly, see, for example, the recent judgment of the Italian Supreme Court (no. 868/2019, of 16th January 2019) in which it's deemed non-tax-avoidant a purchase operation of 100 percent of a company, through a SPV also participated by a 50 percent shareholder of the target company, followed by the merger between the latter and the SPV. The MLBO transaction analyzed by the Italian Supreme Court was aimed at replacing two previous partners with a new one, maintaining constant the other member's 50 percent shareholding, hence without changing significantly control structure of the target company, while admitting the participation of the old principal shareholder of the latter company.

18.2.4. Possible further limits for the deduction of interest expenses in case of MLBO operations

18.2.4.1. Limits on carrying forward of interest expenses in case of merger

In the event of a merger, Article 172, paragraph 7, of ITCA provides for certain possible limitations on carrying forward of excesses of interest expenses not deducted and excesses of tax losses for companies participating to a merger, depending on the degree of capital and operative strength of such companies.

In particular, previous tax losses and excesses of interest expenses of merging companies may be deducted from the taxable income of the company resulting from the merger (or of the acquiring entity, in case of merger by absorption) only up to the amount of respective net equity book value, resulting from the last financial statement (or from an interim balance sheet, pursuant to Article 2501-*quater* of ICC), excluding contributions and equity payments made in the last 24 months (so-called "equity test"). Furthermore, it is also necessary to verify the economic vitality of the parties involved in the merger, since the carrying forward of past losses and interest expenses it is allowed only in the case the merging companies have achieved revenues and incurred labour costs, in the last financial year, higher than 40 percent of the average amount of the two previous years (so-called "vitality test").

Calculations also include the interest expenses and any tax loss accrued in the fraction of the financial year in which the merger takes place (that is, from the starting date of the tax period in which the merger takes place to the date of legal effect of the merger itself), regardless of the backdating or not of fiscal effects (see ITRA's resolution no. 116/E of 2008, ITRA's resolution no. 143/E of 2008 and ITRA's circular letter no. 9/E of 2010).

The last period of the same paragraph 7 of Article 172 of ITCA, however, grants the possibility of disapplying the aforementioned limitations through a specific ruling request to ITRA, pursuant to paragraph 2 of Article 11 of the law n. 212 of 2000. More specifically, the submission of the ruling request does not represent a "strictly speaking" obligation for merging companies, since the omitted submission does not preclude, for taxpayers, to demonstrate reasons for not applying the provisions at hands during any subsequent eventual tax audit; it only involves the application of penalties[39].

39 Administrative penalties for omitted submission of the ruling request ranges from a minimum of 2,000 euros to a maximum of 21,000 euros, to be doubled if, during the tax audit, the

18.2.4.2. Limits on carrying forward of interest expenses in case of MLBO

Based on the foregoing, it is evident how limits set by Article 172 of ITCA could theoretically penalize MLBO operations, since carrying forward of past excesses of interest expenses (and tax losses) accrued by the SPV before the merger, and their use to offset positive taxable incomes of the target company, to be merged with the SPV, could be prevented by such a rule. In fact, it is quite possible that the latter company does not pass neither "vitality test", nor "equity test", because, in most cases, the vehicle company is a newly established entity, lacking an history of vitality (and with no financial statements on which tests have to be calculated) as well as having a small book value of net equity, when subtracting contributions and equity payments of the last 24 months, as required by the law.

In any case, despite the limits of the Article 172, it is always possible, through a specific tax ruling to ITRA, to ask for non-application of these provisions and its limits on carrying forward of past excesses of interest expenses and tax losses, by demonstrating the absence, in the specific case, of tax avoidance concerns that justify the rule under scrutiny. It's also to be noted that, according to the Italian tax administration, lacking of previous financial statements does not necessarily prejudice the possibility of proving otherwise (that is, on the basis of different information and documentation) the economic viability of the vehicle company, for which, moreover, such a condition can be demonstrated by the very fact of carrying out a mission that is instrumental to the acquisitive operation. The same applies to the equity test, because, in case of MLBO, initial equity injections to the vehicle are physiological (see ITRA's circular no. 9/E of 2010) and certainly not aimed at passing the test at stake for carrying forward surpluses of interest expenses (and losses); therefore, these injections should be included in the calculation of net equity, even if they occurred in the last 24 months.

Moreover, these conclusions were also endorsed by ITRA itself in the aforementioned circular letter no. 6/E of 2016, where it is concluded that "*in all the cases in which it is shown that the excesses of non-deductible interest expenses and losses (of which the carrying forward is requested) are exclusively those relating to loans obtained by the SPV to implement a LBO acquisition, the requests for non-application of the provision of article 172, paragraph 7, of ITCA may be accepted*".

Some authors claimed that, given the aforementioned conclusions, it

Italian financial administration denies disapplication of limits stated by Article 172, paragraph 7, of ITCA.

would have been better for ITRA to explicitly state the non-necessity, in this case, of the submission of a tax ruling, at least for surpluses of interest expenses and tax losses of the SPV generated before the merger and accrued on debt contracted to purchase the target company, then merged[40]. Although tax ruling is not a duty *stricto sensu* (the disregard of article 172 of ITCT can be argued also during a possible future tax audit), however, the omission implies, as mentioned, the application of penalties.

18.2.5. Interest expenses generated within transnational LBO/MLBO operations

18.2.5.1. Transnational LBO/MLBO operations

A deeper analysis, as regards tax deduction of interest expenses, is needed when dealing with LBO/MLBO transactions carried out by investors located abroad through a SPV resident in Italy. Consider, for example, operations involving foreign institutional investors, such as private equity funds, typically established in the form of limited partnerships, professionally managed by a general partner and collecting resources among a variety of investors (limited partners).

International private equity funds usually operate through more complex structures, in particular by using more intermediate vehicles. In a typical "double-holding" scheme, funds create, using resources collected from investors, a first holding company (or SPV) located abroad, typically in a white list country and the latter, in turn, constitutes a second holding company in Italy, partly by equity and partly by shareholders' loans. Further resources needed for the acquisition are obtained by this second holding by directly finding loans on the marketplace (that is, from banks or other to third-party lenders), thus obtaining sufficient money to purchase the target company. The subsequent merger between the latter and the second holding company or, alternatively, the exercise of the option for the tax consolidation regime between them, allows for intersubjective compensation and, therefore, for the deduction of interest expenses accrued on loans contracted for the acquisition.

40 See G.M. Committeri, *Le operazioni di leveraged buy out dopo i chiarimenti delle Entrate*, 2016, in Dottrina Eutekne.

18.2.5.2. Withholding taxes on outbound interest expenses

As regards loans obtained on the marketplace by the second holding company, they are typically provided by third parties, often non-residents. Actually, a typical scheme used for this purpose, and often disputed (under certain conditions) by the Italian financial administration, is the so-called Italian Bank Lender of Record (or IBLOR). In short, an Italian bank (or a bank operating in Italy through a permanent establishment) (so-called bilateral lender) provides financing to the holding company resident in Italy and, at the same time, such a bank enters into an agreement with other non-residents subjects (banks, funds, etc.) (so-called credit support providers). Under this agreement, the bilateral lender obtains guarantees and funds from credit support providers, to be repaid in a way that is linked – as for methods, timing and amount – to the repayment of loans (and related interest expenses) to the bilateral lender.

The scheme at hands can be either "transparent" or "opaque", depending on whether, respectively, the relationship between Italian financed entities and foreign credit support providers is relevant or not. In the case of "transparent" IBLOR, the financed entities pay interest and apply outgoing withholding tax on the flow belonging, as beneficial owners, to individual credit support providers (while recognizing to the Italian bilateral provider only its part of interest flow). In case of "opaque" IBLOR (that is, when financed entities do not take into account the presence of non-residents subjects), instead, the borrower pays interests only to the resident bank (or to the bank operating in Italy through a permanent establishment), without applying any withholding tax.

In such a second hypothesis, however, omitted withholding taxes could be challenged by the Italian financial administration pursuant to article 26, paragraph 5, of the Presidential Decree no. 600 of 1973, on the assumption that the bank resident (or located) in Italy actually acts as a mere intermediary of real non-resident lenders, hence not being the "beneficial owner" of the outflow of interests[41]. This clearly depends on the structure of the overall operation and on the analysis of the specific contractual clauses, from which

41 For an in-depth analysis of the notion of "beneficial owner", see D. Marini, *La nozione di beneficiario effettivo, tra onere della prova e scelta del regime convenzionale applicabile*, in Il Fisco no. 30/2011; A. Ballancin, *Nozione di 'beneficiario effettivo' nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, in Rassegna tributaria no. 1/2006; M. Piazza - C. Resnati - A. Trainotti, *Concetto di beneficiario effettivo: l'analisi di Assonime sulle numerose incertezze*", in Il Fisco no. 3/2017.

it can be deduced, on a case by case basis, the mere conduit role of the bank resident in Italy (or operating in Italy through a permanent establishment), intended only for money collection from financed companies and for the subsequent back to back turnaround to real foreign lenders.

Similar and equally questionable outcome could be achieved when the role of formal lender is not played by an Italian bank, but by a associated entity of the Italian SPV set up in an EU country or, in any case, benefiting from the application of the Interest and Royalties Directive (Directive 2003/49/CE) or from other favorable conventional withholding tax regimes provided in the tax treaty between Italy and the country in which such an entity is located. Also in this hypothesis the exemption regime from outgoing withholding tax based on UE Directive or the use of other treaty advantages could be challenged by ITRA, when, in the specific case, the formal lender is not the "beneficial owner" of interests, as it plays a mere intermediary role in the collection and turnaround of interests (back to back). Indeed, the beneficial ownership clause is precisely aimed at avoiding international arbitrage and aggressive tax planning, in order to erode national tax bases[42].

However, it should be noted that these possible claims by the Italian financial administration, which were really frequent in the past and are still possible now, when the above conditions are met, encounters a limit today in case of transactions falling within the application of paragraph 5-bis of article 26 of the Presidential Decree no. 600 of 1973, as introduced by the Law Decree no. 91 of 2014 and then amended several times. Based on this rule no withholding tax is levied on interest and other incomes from medium and long-term loans provided to Italian companies by "qualified" foreign lenders and, more specifically, by: *i)* credit institutions established in EU Member States (identified in article 2, paragraph 5, numbers 4) to 23), of Directive 2013/36/EU); *ii)* insurance companies established and authorized pursuant to regulations of EU Member States; *iii)* foreign institutional investors of article 6, paragraph 1, letter b), of Legislative Decree 1st April 1996, no. 239, subject to supervision in the foreign countries in which they are established.

As confirmed by ITRA in the aforementioned circular letter no. 6/E of 2016 "*any claim concerning the correct application of withholding taxes to IBLOR structures or to the absence of actual beneficial ownership status are to be considered unsustainable as far as that non-residents subjects* (*in*

42 See G.M. Committeri, *Operazioni di Leveraged Buy Out: nella circolare molte luci e qualche ombra*, in Il Fisco no. 18/2016.

other words Credit Support Providers or entities who have provided the funding to the group company) *fall within the scope of the aforementioned law*" (that is, paragraph 5-bis of article 26 of the Presidential Decree no. 600 of 1973).

18.2.5.3. Loans granted by foreign shareholders

Finally, a last observation should be made with reference to the case in which resources for the acquisition of the target company are made available to the SPV through loans by foreign shareholders. In this regard, consider the "double-holding" scheme described above (paragraph II.5.1.), in which the first foreign holding company grants loans to the second Italian holding company, rather than just equity.

In this case, interest expenses on shareholders' loans are subject to the ordinary rules for determining corporate income in intra-group transactions, including transfer pricing discipline. Therefore, it is not excluded the possibility for the Italian financial administration, also on the basis of OECD Guidelines on the subject, to qualify shareholders' loans as equity injections, with consequent denial of the nature of deductible interests to their remuneration. This could happen when there is a mismatch between the legal form of the transaction and its economic substance and, in particular, when factual and objective indices make clear that money contributions by shareholders were not intended as loans, but a disguised form of equity injections. For example, according to ITRA, these conclusions apply in case of contractual clauses postponing the repayment of shareholders' loans (for principal and interests) after the reimbursement of third-party lenders or fixing conditions for the payment of shareholders' loans (and interests) similar to restrictions on dividends and reductions in capital (and capital reserves).

Although this conclusion has been heavily criticized[43], in such circumstances the Italian financial administration could disregard interest expenses and, therefore, deny their deductibility, while also imposing the application of the discipline on outgoing dividends.

43 According to ASSONIME (circular no. 17 of 2016), this conclusion is not compatible with the typical LBO/MLBO operations realized through loans provided (at least in part) by shareholders, which are generally, and understandably, characterized by specific clauses to safeguard and protect the position of third party lenders (e.g., posting clauses). In any case, shareholders' loans are physiologically riskier than those granted by third-party institutions and, therefore, can have a higher interest rate, because of the higher risk.

18.3. The deduction of interest expenses in LBO/MLBO transactions of Real Estate companies

Tax issues described in the previous paragraph II, although general in scope and therefore also valid for LBO/MLBO of companies operating in the real estate sector, present, however, in this latter case, some profiles of high specificity. The question of interest expense deductibility that, in most cases, led ITRA to a prudent attitude, imposes further remarks when target companies of LBO/MLBO operations operate in the real estate market, given that these companies can benefit from a special preferential regime for interest expense deductibility.

Indeed, as already noted previously in this book, Article 1, paragraph 36, of the law 24th December 2007, no. 244 (so-called "Budget law 2008") allows, for real estate companies[44], full deduction of interest expenses on mortgages loans guaranteed on leased immovable properties (that is, without the application of quantitative limits stated in the Article 96 of ITCA). This special rule had been abolished in the context of the implementation of the ATAD Directive (Legislative Decree n. 142 of 2018), but was reintroduced by the Budget law 2019 (Article 1, paragraph 7, of Law 31st December 2018, no. 145)[45].

For more details, including the analysis of objective and subjective application conditions, please refer to the previous chapter 4 of this book.

Having said this, the aforementioned special regime of interest expense deductibility could be "transmitted", in a MLBO transaction and as a result of the final merger, from the target company to interest expenses accrued on loans contracted by the SPV, also when the vehicle could not benefit individually from such a regime, since it's not a real estate entity and, in any case, lacks legal requirements for this regime to apply[46]. Therefore, such a

44 Article 1, paragraph 36, of the Budget law 2008, in the current text following the Legislative Decree of September 14th 2015, no. 147, reserves the special regime at stake (full deductibility of interest expenses on mortgage loans guaranteed by leased immovable properties), only to "*companies that perform effectively and prevalently real estate activity*", meaning those that satisfy a double cumulative requirement, namely companies: 1) with asset value mostly consisting in the value of leased immovable properties (capital requirement) and 2) with revenues represented, for at least two thirds, by rentals (economic requirement).

45 See L. Gaiani, *Decreto Atad in Gazzetta ma per le immobiliari interessi deducibili al 100%*, in Il Sole 24 Ore of December 29th, 2018; P. Meneghetti, *Immobiliari di gestione, sparisce il test del Rol sugli interessi passivi*, in Il Sole 24 Ore of December 31st, 2018; G. Odetto, *Passo indietro sugli interessi ipotecari*, in Eutekne.info, December 27th, 2018

46 The same issues do not arise in LBO transactions without merger between the target and the SPV, while they could affect the purchase by debt of real estate branchs; this latter case, as

circumstance urges for specific and further observations on MLBO transactions having real estate companies as targets, that is entities that qualify for the special regime mentioned above.

The typical case concerns the acquisition of shares of a real estate target (that is, a company satisfying the relative definition in paragraph 36 of the Budget law 2008 (as modified by the Internationalization Decree) through a newly established vehicle, which obtains initial bridge loans for the acquisition and then proceeds, once the merger with the target company has been completed, to refinance bridge loans with a mortgage loan guaranteed by immovable properties of the target itself leased to third parties.

In this way, the merger step ensures that loans contracted for the acquisition can be secured by leased immovable properties of a real estate company and debts (and related interests) pass through to a subject (that is, the one resulting from the merger) benefiting from the special regime of the aforementioned paragraph 36. For this purpose, as stated above, the latter subject must obviously satisfy capital and economic requirements for the special tax regime under scrutiny (see previous footnote n. 44), as well as must lease mortgaged properties to third parties.

The fact that loans are originally aimed at purchasing shares should not cause doubts about compliance, in this case, with the condition (for the special regime introduced by the Budget law 2008) that loans should have been contracted to purchase (or build) mortgaged properties, leased to third parties. Indeed, a leveraged acquisition of shares of a real estate target, essentially, realizes the acquisition of real estate properties of the target company: therefore, it can be considered that loans are actually contracted, since the beginning, to buy the real estate assets of the target. These assets are then used as collateral once that original loans are refinanced after merger, thus also integrating the additional requirement of mortgage guarantee.

Therefore, one could conclude that the mortgage refinancing of the post-merger entity, both if it is deemed as a new loan, and if it just replaces and inherits – as it would be more appropriate – the purpose of the original refinanced loan[47], can be considered as intended for the purchase of mort-

mentioned (see paragraph I.2), produces similar outcomes to those of a MLBO acquisition (that is, with a final merger between the target and the SPV).

47 For the possibility to "transmit" interest expense tax regime pursuant to Article 1, paragraph 36, of the budget law 2008 from mortgage loans originally contracted for the purchase/construction of immovable properties to possible refinancing of such loans, see the circular letter of ASSONIME no. 16 of 2016, which reproduces the content of an answer of ITRA on a request of

gaged and leased immovable properties, so that paragraph 36 of the Budget law 2008 can be applied to interest expenses.

The same general conclusions of the previous paragraph II are also valid in case of real estate target companies, as regards both the inherence of interest expenses and to the absence of tax avoidance/abuse of right concerns regarding MLBO transactions, especially if they involve a change of control. On this last point, as mentioned, ITRA's statement on the general lack of tax-avoidance concerns is based on the recognition of valid non-marginal reasons for these transactions, so that tax advantage of MLBO operations is in general not undue. These reasons consist in the use of debt to finance an acquisition otherwise impossible or, in any case, in the exploitation of "leverage effects" of debt and, with reference to the final merger (between the SPV and the target), in the lenders' express request to avoid "structural subordination", bringing debt closer to assets and cash flows of the target company (*debt push-down*).

These reasons do apply also when the target is a real estate company, so that, also in this case, tax advantage cannot be considered undue because of the mere fact that the MLBO transaction allows to exploit the typical favourable regime of interest expense deduction provided for such a kind of company. These conclusions were also shared by ASSONIME in the circular letter n. 16 of 2016.

Finally, to confirm the foregoing, it should be noted that deductibility of interest expenses on the basis of the special regime introduced by the Budget law 2008 is certainly admitted if, instead of shares of the real estate company, it's purchased, by debt, directly a real estate branch, guaranteeing lenders with a mortgage registered on properties thus purchased (and leased to third parties). Since the latter operation could be hardly challanged as tax-avoidant, it would be meaningless to get a different conclusion for a MLBO of a real estate target that – compared to the first transaction – it's absolutely equivalent for purposes, final outcome, economic substance and non-tax reasons.

legal advice submitted by this Association. This is also confirmed by the illustrative report to the Internationalization Decree which, as mentioned, has modified the aforementioned paragraph 36. See G. Andreani - G. Ferranti, *Testo Unico Imposte sui redditi*, 2017, IPSOA.

19.
Hedging interest rate risk

by G. D'Aversa, P. Gilardi

19.1. Preliminary remarks

This paragraph wishes to offer the reader an overview of the major changes introduced by the recent EU regulation 2019/834 (known as "**EMIR REFIT**") which entered into force on *17 June 2019* amending Regulation (EU) 648/2012 of the European Parliament and the Council dated 4 July 2012 ("EMIR"). Aim of the regulation is to streamline certain regulatory obligations and requirements set out in the previous EMIR legislation, with particular reference to non-systemically important counterparties.

19.1.1. Financial Counterparty: yes or no?

The recent EMIR REFIT regulation contains a new **definition of financial counterparty** ("FC"), which encompasses **all those counterparties that may pose significant systemic risk to the financial system**.

Specifically, the following are <u>to be considered as FCs</u>:

i. **alternative investment funds** (as defined in Article 4 (1) (a), of Directive 2011/61/EU) ("AIF") established in the European Union or managed by an alternative investment fund manager ("AIFM") authorised in accordance with the aforementioned Directive and its AIFM established in the European Union (previously, under EMIR, only AIFs managed by AIFM authorised or registered in accordance with Directive 2011/61 could be regarded as FCs).

ii. **central securities depositories** (e.g. Monte Titoli)

The following may <u>not be regarded as FCs</u>:

i. AIFs established in the Union or managed by AIFMs authorised in accordance with Directive 2011/61 and set up for the exclusive purpose of serving share purchase plans for employees, and securitisation special purpose entities, and, if relevant, whose AIFM is established in the EU.

ii. undertakings for collective investment in transferable securities ("UCITS") or AIFs created for the exclusive purpose of serving employee share purchase plans; and

19.1.2. Clearing obligation and mandatory exchange of variation margins

The most important change introduced by EMIR REFIT concerns the review of clearing obligations. The main provisions are set out below:

Option to choose whether to calculate existing derivative positions.

With the previous EMIR regulation all FCs were subject **to a *clearing obligation*** regardless of the actual volume of their operations in derivatives. **Non-financial counterparties** (also known as "NFC-") **were an exception** as they were subject to a clearing obligation only when the derivative transactions exceeded certain thresholds set out in Article 10 (4) (b).

Under the new EMIR REFIT regulation, FCs and NFCs that take positions in OTC derivative contracts may calculate their aggregate month-end average position every 12 months for the previous 12 months.

The clearing obligation applies to all the FCs and NFCs:

- **that choose not to proceed with the calculation, or**
- **whose calculation result is in excess of certain thresholds provided for in Article 10 (4) (b) (commonly referred to as "Thresholds"**).

In particular, FCs and NFCs that do not proceed to the calculation or that exceed the Thresholds will be required to:

i. notify it immediately to ESMA and to the national authority having jurisdiction over the matter, and
ii. enter into the relevant clearing agreements within 4 months from receipt of the notification.

While FCs must include in the calculation all existing OTC derivative contracts (whether they qualify as hedges or not) entered into by them or by other entities of the group they belong to, NFCs must include in the calculation (as already provided for in the previous EMIR regulation) only OTC derivative contracts entered into by themselves or by other group NFCs for purposes other than hedging.

The new EMIR REFIT provisions introduce the possibility for some FCs (designated as "***Small financial counterparties*** or **FC**-) to be exempted from the exchange of variation margins where they can prove they have a modest volume of derivative operations. The exchange of variation margins would only apply to OTC derivative contracts belonging to a category that has been declared subject to the exchange of variation margins and:

a. concluded between counterparties (whether FCs or NFCs) whose operations exceed the thresholds or that have chosen not to perform the calculation and
b. entered into or novated starting from the date the obligation to exchange variation margins has become effective provided that on the date they are entered into or novated both counterparties satisfy the conditions set out under letter (a)

19.1.3. FCs vs NFCs: what is and what is not subject to Exchange of Variation Margins

One more change affecting FCs is that exchange of variation margins are now extended to all the classes of OTC derivative contracts that are declared to be subject to the requirement to exchange (even if an FC is above the Threshold in only one of the classes). With regard to NFCs, on the other hand, they will be segregated depending on whether they have chosen to carry out the calculation or not. With regard to NFCs that have opted for the calculation, the exchange of variation margins will apply only to OTC derivative contracts that belong to the classes for which the Threshold has been exceeded. With regard to NFCs that have opted not to carry out the calculation, the exchange of variation margins will apply to OTC derivative contracts falling within any of the categories declared to be subject to the exchange of variation margins.

The EMIR REFIT regulation provides that the burden of proving to the competent authority that the calculation of the aggregate month-end average position does not lead to a systematic underestimation of such position remains with the FCs and NFCs. The EMIR REFIT provides that the counterparty must be able to demonstrate that its operational dynamics are not such as to lead to an underestimation of the positions, for example by providing the relevant authorities with the data concerning the positions in the course of each month.

19.1.4. FCs consisting of UCITS and AIF

With reference to these types of counterparties, the EMIR REFIT regulation provides that the calculation of OTC derivative positions must be carried out at the level of each individual fund. In addition, UCITS management companies that manage more than one UCITS and AIFM that manage more than one AIF must be able to prove to the relevant authority that the calculation of positions at fund level does not lead to: (a) an underestimation of the positions of any of the funds they manage or of the manager's positions; (b) avoidance of the exchange of variation margins.

19.1.5. Exemptions and final considerations

Lastly, the EMIR REFIT regulation provides for the temporary exemption from the exchange of variation margins originally provided for by EMIR for pension schemes with regard to transactions concluded for hedging purposes (and expired on 17 August 2018) for a period of two years from the date the EMIR REFIT regulation came into force. The Commission has the right to extend this deadline beyond that date.

The EMIR REFIT regulation has removed the "***frontloading***" requirement provided for by the EMIR regulation, which subjected to the exchange of variation margins any transactions existing before the effective date of the obligation (i.e. contracts entered into or novated before the effective date of the obligation). At the same time, the "***backloading***" obligation (reporting of transactions that are no longer in existence when the reporting obligation comes into force) will be removed.

Lastly, within the scope of transactions in OTC derivative contracts in which UCITS are a party, the responsibility, including legal liability, of reporting and ensuring the accuracy of the data reported is attributed to the relevant management company. A similar responsibility is provided for AIFMs with regard to the reporting of data of OTC derivative contracts in which the managed AIFs are a party. Such responsibilities will therefore be appropriately set out in the relevant contractual agreements delegating rep. activities.

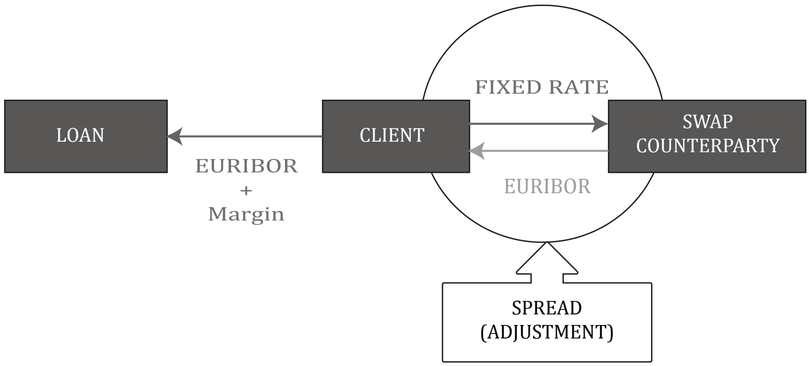
19.2. Principal hedging instruments used in the Real Estate Sector

19.2.1. Interest Rate Swap

The Interest Rate Swap (IRS) is a financial derivative instrument in which two parties (the Company and the Bank) undertake to **exchange**, for a fixed period of time and with a predetermined frequency, interest rate cash flows, by applying different interest rates to the same **specified nominal amount**.

One party pays a **floating rate** (Euribor), while the other party pays a **fixed rate**. An IRS contract allows to indirectly modify the financial liability floating indexation, without amending the underlying loan agreement.

The Company continues to pay interest on the debt based on Euribor rate, while it receives a monetary adjustment if Euribor is higher than the fixed interest rate, or pays a monetary adjustment if Euribor is lower than the fixed rate.



Main features of a Swap:
Notional amount or Reference amount

- Start Date
- Final Due Date
- Fixed rate
- Floating rate
- Euribor fixing frequency
- Interest periods/ fpayment frequency
- Calculation base

In order to calculate the interest accrued from time to time, the duration of the reference period is counted as a fraction of a year on the basis of certain conventions. As a rule, the convention for interest calculation is expressed as "X" divided by "Y", where X specifies the method of calculating the days constituting the reference period, while Y specifies the method of calculating the days of the year.

The interest accrued during the Reference Period is calculated as follows:

$$\boxed{\text{Annual Interest Rate}} \; \text{x} \; \boxed{\text{Reference Amount}} \; \text{x} \; \boxed{\frac{\text{Number of days in the Period}}{\text{Number of days in the year}}}$$

The commonly used conventions are:

- Actual/360
- 30/360
- Actual/365
- Actual/Actual

In case of the *Actual/360* convention, the actual days constituting the period are counted, while the year is considered to be one of 360 days. This convention is normally used when calculating interest on monetary market instruments (such as deposits).

In case of the *30/360* convention, the days in the period are counted on the basis of a year with 12 months of 30 days, while the year is considered to be of 360 days. This convention is commonly used to calculate the coupons on fixed-rate bonds.

In case of the *Actual/365* convention, the actual days in the period are counted, while the year is considered to be of 365 days regardless of the presence or otherwise of leap years.

In case of the Actual/Actual convention, the actual days in the period are counted, while the duration of the year is measured on the actual number of days (and thus leap years affect the result).

Example:

The flows exchanged under the Interest Rate Swap sterilise the effect of the fluctuation of interest rates, "by switching" the rate paid on the hedged underlying from floating to fixed.

LOAN

Capital	1,000,000 Euro
Duration	5 years
Periods	Half-year
Interest rate	6M Euribor + 2.00% **no minimum value**

IRS

Notional amount	1,000,000 Euro
Duration	5 years
Periods	Half-year
Client receives	6M Euribor
Cliente pays	**0.30%**

6M Euribor = 0.05%

LOAN	
1,000,000 x (0.27%+2.00%) x 182/360	-8.746
IRS	
1,000,000 x (0.05%) x 182/360	-1,365
1,000,000 x (0.45%) x 182/360	-1,517
	-2,882
Net interest	-11,628

6 M Euribor = 1.00%

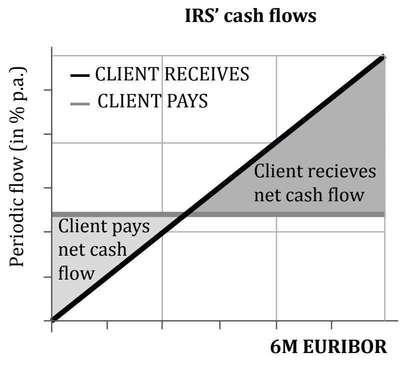
LOAN	
1,000,000 x (1.00%+2.00%) x 182/360	12,639
IRS	
1,000,000 x (1.00%) x 182/360	+2,528
1,000,000 x (0.45%) x 182/360	-1,517
	+1,011
Net interest	-11,628

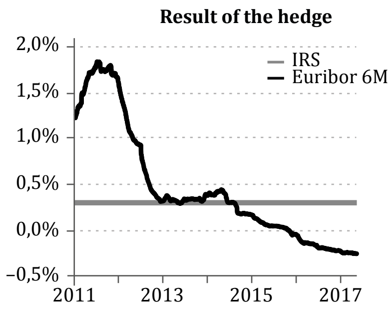
Advantages

The Client **can with certainty predetermine** the total payments due during the entire life of the floating-rate loan, thus avoiding the exposure to interest rate hikes.

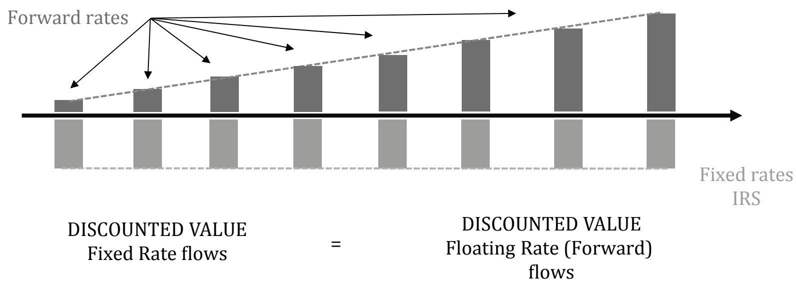
Disadvantages

- The fixed rate is (usually) higher than the current value of short-term rates
- The financing cost does not decrease in the event of a reduction in the floating market rates
- the early unwinding of the IRS may entail a cost/gain (should its market value be negative/positive at the time of early unwinding)
- Should the fixing of Euribor rate be negative, the Company shall pay the Bank, in addition to the amount calculated on the basis of the fixed rate, a further interest amount calculated on the basis of the absolute value of Euribor rate, and the interest amount that the Company receives from the Bank shall be considered as zero. Furthermore, if the loan hedged through the IRS includes a minimum rate clause, the benefit that the Company gains from the Bank under the loan in relation to the negative fixing of the Euribor, shall also be deemed to be zero. In this case, therefore, the total financing cost increases.



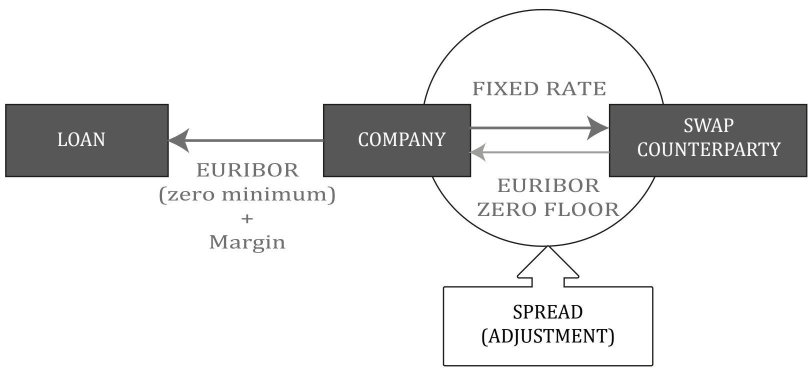


The market fixed rate for an IRS transaction with a specific maturity, is the interest rate at which the **discounted value** of the interest flows calculated at the floating market rate, is equal to the discounted value of the periodic interest flows calculated at the fixed interest rate. **The floating rates** for future interest periods are estimated using the **forward rates** (or implicit rates). The interest flows at the various maturities are discounted using the respective **discount factors. Forward Rates** and **Discount Factors** are obtained from the **market rates curve**.



19.2.2. Floored IRS

A Floored IRS, like an Interest Rate Swap, allows the Company to pay a fixed rate and to receive a floating rate indexed to Euribor, on a predetermined nominal amount. Unlike a traditional Interest Rate Swap, if Euribor falls below a certain value established beforehand, the interest rate that the Company receives from the Bank remains constant. The transaction enables to switch the debt floating indexation into a fixed rate, when the loan agreement establishes a lower limit for Euribor rate (a zero floor). The Company pays a fixed rate that is higher than the traditional IRS; however, if Euribor rate is negative, the flows paid under the IRS transaction do not rise.



The flows exchanged under a Floored IRS sterilise the effect of interest rate fluctuation, "by switching" the floating rate paid on the underlying debtinto a fixed rate, for each Euribor scenario (including the negative one)

Example:

LOAN

Capital	1,000,000 Euro
Duration	5 years
Periods	Half-year
Interest Rate	6M Euribor + 2.00% 6M Euribor **minimum value 0.00%**

FLOORED IRS

Notional amount	1,000,000 Euro
Duration	5 years
Periods	Half-year
Client receives	6M Euribor if positive 0.00% if negative
Client pays	**0.45%**

6M Euribor = -0.27%

LOAN	
1,000,000 x (0.00%+2.00%) x 182/360	-10.111
FLOORED IRS	
1,000,000 x (0.00%) x 182/360	0
1,000,000 x (+0.45%) x 182/360	-2.275
	-2.275
Net interest	-12.386

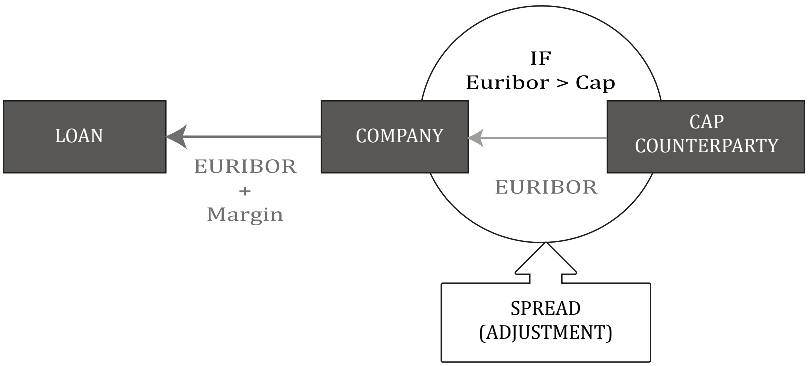
6M Euribor = +1.00%

LOAN	
1,000,000 x (1.00%+2.00%) x 182/360	-15.167
FLOORED IRS	
1,000,000 x (+1.00%) x 182/360	+5.056
1,000,000 x (+0.45%) x 182/360	-2.275
	+2.781
Net interest	-12.386

19.2.3. Cap Option

The purchase of **a Cap option guarantees protection** against any increase of the floating rate above a predetermined threshold. The Company pays **an initial premium** in order to receive, at each interest period, an interest amount equal to the difference (**if positive**) between the fixing of the floating rate (Euribor) and the threshold rate (Strike Cap).

A Cap option, if combined with a debt indexed to Euribor, protects against interest rate increases without switchingthe floating rate paid on the underlying liability into a fixed rate.



The flows exchangedunder a Cap Option sterilise the effect of interest rate fluctuation above the Strike of the Cap Option, by establishing an "upper limit" on the rate paid under the hedged underlying.

Example:

LOAN		
	Capital	1,000,000 Euro
	Duration	5 years
	Periods	Half-year
	Interest rate	6M Euribor + 2.00%

CAP		
	Notional amount	1,000,000 Euro
	Duration	5 years
	Periods	Half-year
	Strike Cap	**0.45%**
	Cliente pays	**13,000 EUR (1.3% upfront)**

6M Euribor = 0.45%

LOAN	
1,000,000 x (0.45% + 2,00%) x 182/360	- 12,386
CAP OPTION	
1,000.000 x (0,00%) x 182/360	+0
Net interest	- 12,386

6M Euribor = 1.00%

LOAN	
1,000,000 x (0.60% + 2.00%) x 182/360	- 13,144
CAP OPTION	
1,000,000 x (0.60% - 0.45%) X 182/360	+ 758
Net interest	- 12,386

6M Euribor = 1.50%

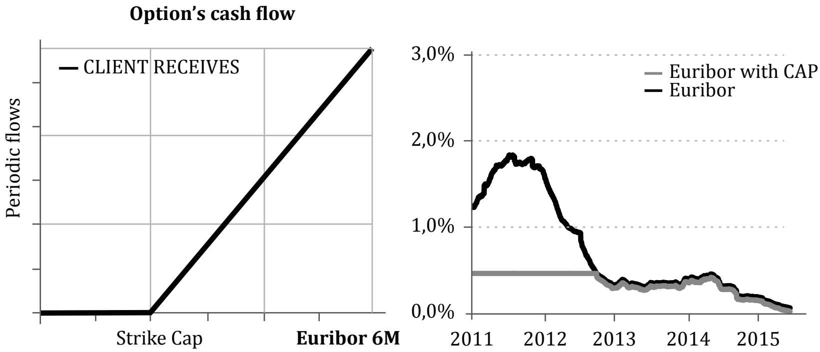
LOAN	
1,000,000 x (1.00% + 2.00%) X 182/360	- 15,167
CAP OPTION	
1,000,000 x (1.00% - 0.45%) X 182/360	+2,781
Net interest	- 12,386

Advantages

- The Company decides beforehand the maximum amount of flows to be paid during the life of the floating-rate loan (insurance cover)
- The transaction cannot have a negative market value

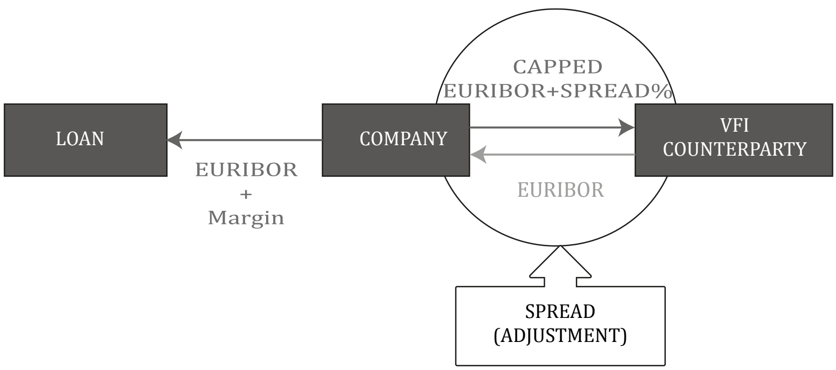
Disadvantages

The hedge has an up-front cost equal to the option premium



19.2.4. Deferred Premium Cap

A deferred premium cap consists of the purchase of a Cap option, with the premium paid in installments over the life of the transaction. The instrument allows to protect against a rise of Euribor above the Cap strike, by periodically paying a fixed Spread. The Client avoids to carry the opportunity-cost associated to the IRS (i.e. a fixed rate greater than Euribor), but undertakes to pay the Spread (the lower the Strike of the Cap option, the higher the Spread) for the entire duration of the transaction.



The flows exchanged under a Variable Floored IRS sterilise the effect of interest rate fluctuation above the Strike of the Cap Option, by establishing an "upper limit" on the rate paid under the hedged underlying.

Example:

LOAN

Capital	1,000,000 Euro
Duration	5 years
Periods	Half-year
Interest Rate	6M Euribor + 2.00%

VARIABLE FLOORED IRS

Notional	1,000,000 Euro
Duration	5 years
Periods	Half-year
Client receives	6M Euribor
Client pays	**6M Euribor + 0.26%** **0.71% if the 6M Euribor > 0.45%**

6M Euribor = 0.45%

LOAN	
1,000,000 x (0.45%+2.00%) x 182/360	-12.386
VARIABLE FLOORED IRS	
1,000,000 x (0.45%) x 182/360	+2,275
1,000,000 x (0.45% + 0.26%) x 182/360	-3.389
	-1.314
Net interest	-13.700

6M Euribor = +1.00%

LOAN	
1,000,000 x (+1.00%+2.00%) x 182/360	-15.167
VARIABLE FLOORED IRS	
1,000,000 x (1.00%) x 182/360	+5.056
1,000,000 x (0.71%) x 182/360	-3.589
	+1.467
Net interest	-13.700

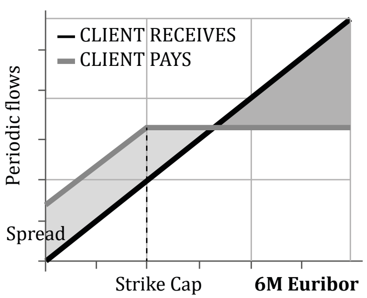
Advantages

- The Company can benefit from the current level of floating market rates
- The Company fixes an upper cost limit in the event of an interest rate hike

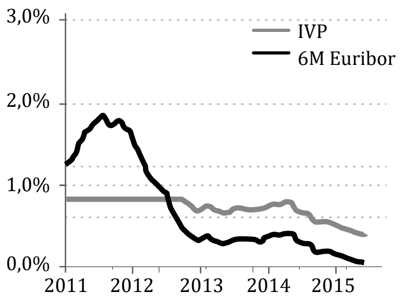
Disadvantages

- Should Euribor rise above a certain level, the rate to be paid by the Company under the Variable Floored IRS would be higher than the fixed rate of an IRS

VFI Cash Flows



Hedge result



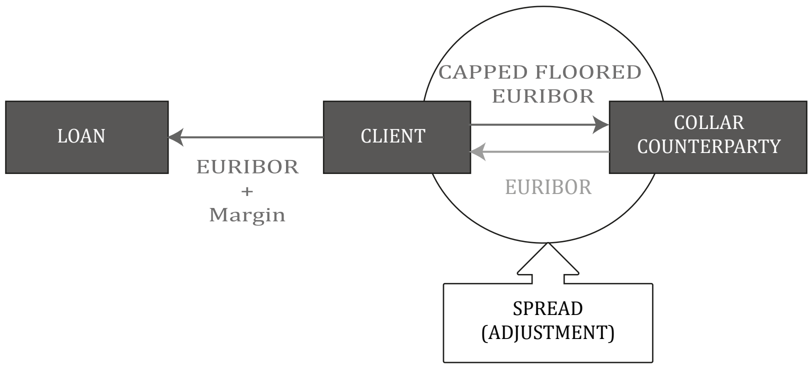
19.2.5. Interest Rate Collar

An Interest Rate Collar is an OTC derivatives transaction whereby the Company and the Bank exchange, at certain regular dates, interest flows calculated by applying two different interest rates to the same nominal amount denominated in Euro.

The interest flows the Bank pays to the Company are calculated by applying Euribor rate to the nominal amount.

The interest flows the Company pays to the Bank are calculated by applying Euribor rate to the nominal amount, in case Euribor fixing is in a range between a minimum value (Floor) and a maximum value (Cap). If Euribor rate exceeds the Cap, the interest flow paid by the Company is calculated by applying the Cap interest rate. Should Euribor rate fall below the Floor, the interest flow paid by the Client is calculated by applying the Floor rate.

An Interest Rate Collar transaction, combined with a Floating rate debt, enables the Company to predetermine the maximum and minimum levels of financing cost, thus sterilising the risk of interest rates rising above the Cap, while at the same time loosing the benefit of any interest rate decrease below the Floor rate. Within the range included between Cap and Floor, the Company continues to be indexed to the floating rate.



Example:

LOAN

Capital	1,000,000 Euro
Duration	5 years
Periods	Half-year
Interest Rate	6M Euribor + 2.00%

VARIABLE FLOORED IRS

Notional	1,000,000 Euro
Duration	5 years
Periods	Half-year
Client reveives	6M Euribor
Client pays	**0.00% if the 6M Euribor<0.00%** **6M Euribor if 0.00%<6M Euribor<0.90%** **0.90% if the 6M Euribor>0.90%**

6M Euribor = -0.10%

LOAN	
1,000,000 x (-0.10%+2.00%) x 182/360	-9.606
INTEREST RATE COLLAR	
1,000,000 x (-0.10%) x 182/360	-5065
1,000,000 x (0.00%) x 182/360	0
	-506
Net interest	-10.112

6M Euribor = +1.00%

LOAN	
1,000,000 x (+1.00%+2.00%) x 182/360	-15.167
INTEREST RATE COLLAR	
1,000,000 x (1.00%) x 182/360	+5.056
1,000,000 x (0.90%) x 182/360	-4.550
	+ 506
Net interest	-14.661

Advantages

- The Company financing remains indexed to the floating rate within the range between the Floor and the Cap
- The Company fixes a maximum cost in the event of an interest rate hike above the Cap
- The Company is protected against the risk of interest rate rises without having to pay a periodic spread
- As a rule, the Interest Rate Collar does not entail any initial cost for the Company (the so-called "zero-cost collar")

Disadvantages

- Should interest rates fall below the Floor rate, the Company will not benefit from such decrease
- If Euribor rate rises beyond the fixed rate of an IRS with the same features (maturity, Euribor fixing frequency, interest periods), then the interest rate paid by the Company under the Interest Rate Collar transaction would be higher than the IRS fixed rate.

19.2.6. Swaption

The **Swaption** is an OTC derivative transaction which, in return for the payment of an upfront premium, gives the purchaserthe right, but not the obligation, to enter into an Interest Rate Swap (IRS) with predetermined details (reference amount, final maturity, floating rate index, interest payment periods) and fixed rate.

Depending on the underlying IRS, there are two different types of Swaption:

- **a Receiver Swaption**: the option buyer has the right to enter into an IRS where he receives the fixed rate and pays Euribor rate
- **a Payer Swaption:** the option buyer has the right to enter into an IRS where he receives Euribor rate and pays the fixed rate
- Depending on how the option is exercised, two types of Swaption can be defined:
- **a European Swaption**: the option can be exercised only at a predetermined date
- **a Bermuda (or Bermudan-type) Swaption:** the option can be exercised at different predetermined dates

The purchase of a **Payer Swaption,** in anticipation of a future floating-rate **loan**, enables a Company to convert future interest flows from floating to fixed if, at the exercise date the underlying IRS is more convenient than the market fixed rate of an IRS with the same details.. In this way, the Payer Swaption buyer is protected against any **increase in interest rates**.

The purchase of a **Receiver Swaption**, in anticipation of a future floating rate **investment**, enables a Company to convert future variable inflows into fixed if at the exercise date the underlying IRS is more convenient than the market fixed rate of an IRS with same details. In this way, the Receiver Swaption buyer is protected against any **reduction in interest rates**.

The fundamental features of a Swaption are as follows:

- **Buyer**: the party that purchase the right to enter into the underlying IRS transaction
- **Seller**: the party that sells the right to enter into the underlying IRS transaction
- **Exercise Date(s)**: the date or dates when the Buyer can exercise the Swaption, subject to notification to the Seller
- **Premium**: the monetary amount paid by the Buyer to the Seller of the Swaption at the Premium Payment Date

Premium Payment Date: generally the second business day following the Swaption trading date.

Furthermore, the fundamental terms of a Swaption include the details of the underlying IRS transaction:

- Notional or Reference Amount
- Start Date
- Final Maturity
- Fixed rate
- Floating rate
- Floating rate fixing Frequency
- Interest periods/ Payment Frequency
- Calculation base

Factors determining the Premium amount:

The following are the principal factors contributing to the Premium amount calculation:

- the longer the tenor, the higher the Premium, since this factor increases the uncertainty about the swap rate trend
- the higher the volatility of the benchmark swap rate, and thus the greater the range of possible fluctuations, the higher the Premium
- the lower (higher) the fixed rate of a Swaption Payer (Receiver), the higher the Premium, since the probability of the option to be exercised increases
- the greater the number of Exercise Dates, the higher the Premium

Result at Maturity:

In case of **Payer Swaption**, at the Maturity Date the following results can occur:

a. if the IRS market rate is higher than the Swaption Fixed Rate, the Buyer will exercise the Swaption by entering into an IRS whereby the Buyer pays the Fixed Rate to the Seller
b. if the IRS market rate is lower than the Swaption Fixed Rate, the Buyer will not exercise the option and the agreement shall have no further effect.

In case of a **Receiver Swaption**, at the Maturity Date the following results can occur:

a. if the IRS market rate is lower than the Swaption Fixed Rate, the Buyer will exercise the Swaption by entering into an IRS whereby the Buyer receives the Fixed Rate from the Seller
b. if the IRS market rate is higher than the Swaption Fixed Rate, the Buyer will not exercise the option and the agreement shall have no further effect.

Example:

On 31 July 2017, a Client, in anticipation of a future floating-rate debt, buys a Payer Swaption at the following indicative conditions:

Exercise Date:	15 January 2018
Premium:	5,000 Euro
Premium Payment Date:	2 August 2017

The details of the underlying IRS are as follows:

Notional amount:	1,000,000 Euro
Interest periods:	semi-annually
The Company pays:	0.40%
The Company receives:	6M Euribor
Start Date:	15 January 2018
Final Maturity:	15 January 2023

Assuming two possible scenarios, the following events may occur at the Exercise Date:

Scenario A	**Scenario B**
5-years IRS rate 0.30%	5-years IRS rate 0.50%
The Company does not exercise the Swaption	The Company exercises the Swaption

The Swaption purchase cost is definitivefor the Buyer, regardless of whether or not the option is exercised upon maturity.

The Swaption Seller is exposed to the risk of entering into an IRS where the Fixed Rate exchanged with the Buyer is worse then the market fixed rate IRS, in case the Buyer exercise the Swaption The Swaption Mark-to-Market moves – depending on the swap rates curve in the Euro Zone – during the period from the trading date of the Swaption to the final date for exercise.

19.2.7. Collar Swaption

A Collar Swaption is an OTC derivatives transaction whereby at the same time the Company buys from the Bank the option of entering into an Interest Rate Swap, and sells to the Bank the option of entering into an Interest

Rate Swap. The two underlying Interest Rate Swap (IRS) agreements the, have the same start date, interest periods and floating index, but different fixed interest rates.

The twp options have the same maturity date and, depending on the economic benefit deriving, could be exercised either by the Bank, by the Company, or indeed by neither party.

Depending on the type of underlying Interest Rate Swaps, a Collar Swaption may consist of:

- the purchase of a Payer Swaption and the sale of a Receiver Swaption
- the purchase of a Receiver Swaption and the sale of a Payer Swaption

The fixed rate of the IRS underlying the Payer Swaption is higher than the fixed rate of the IRS underlying the Receiver Swaption.

A Collar Swaption transaction guarantees the Company minimum and maximum levels of the fixed rate at which the interest flows from a floating rate debt/investment may be converted, at a future execution date.

The fundamental features of a Collar Swaption are as follows:

- **Exercise Date(s)**: the date on which the Company or the Bank can exercise its right to enter into the underlying IRS, subject to notification to the other Party

Furthermore, the fundamental terms of a Swaption contract include the details of the underlying IRS transaction:

- Notional or Reference Amount
- Start Date
- Final Maturity
- Fixed rate
- Floating rate
- Floating rate fixing frequency
- Interest periods/ payment Frequency
- Calculation base

Result at Maturity:

In case of Payer Swaption purchase combined with the Receiver Swaption sale, at the Maturity Date:

a. if the benchmark fixed rate is higher than the maximum rate, the Buyer will exercise its right to enter into an IRS where it will pay the maximum fixed rate (exercise of the Payer Swaption by the Client)
b. if the benchmark fixed rate is lower than the minimum rate, the Buyer will be bound to enter into an IRS where it will pay the minimum fixed rate (exercise of the Receiver Swaption by the Bank)

In case of Receiver Swaption purchase combined with the Payer Swaption sale, at the Maturity Date:

a. if the benchmark fixed rate is higher than the maximum rate, the Buyer will be bound to enter into an IRS where it will receive the maximum fixed rate (exercise of the Payer Swaption by the Bank)
b. if the benchmark fixed rate is lower than the minimum rate, the Company will exercise its right to enter into an IRS where it will receive the minimum fixed rate (exercise of the Receiver Swaption by the Client)

Example:

On 31 July 2017, a Company, in anticipation of a future floating-rate debt, enters into a Collar Swaption at the following indicative conditions:

Exercise Date:	8 January 2018

The Company has the right to stipulate an IRS with the Bank at the following conditions:

Notional amount:	1,000,000 Euro
Interest periods:	semi-annually
The Company pays:	0.60% (Maximum Rate)
The Company receives:	6M Euribor
Start Date:	15 January 2018
Final Maturity:	15 January 2023

The Bank has the right to stipulate an IRS with the Client at the following conditions:

Notional amount:	1,000,000 Euro
Interest periods:	semi-annually
The Company pays:	0.25% (Minimum Rate)
The Company receives:	6M Euribor
Start Date:	15 January 2018
Final Maturity:	15 January 2023

Assuming three possible scenarios, at the Exercise Date the following events may occur:

Scenario A	Scenario B	Scenario C
5-years IRS rate 0.10%	5-years IRS rate 0.50%	5-years IRS rate 0.75%
The Company is bound to enter into an IRS where it pays 0.25%	The transaction produces no effect	The Company exercises its right to enter into an IRS where it pays 0.60%

A Collar Swaption transaction exposes the Company to the risk of entering into an Interest Rate Swap transaction, where the Fixed Rate results disadvantageous compared to the market IRS rate, following the exercise of the option by the Bank at the Exercise Date.

The Collar Swaption mark-to-market moves depending on the curve of swap rates in the Euro Zone, during the period from the trading date to the final date for exercise.

19.2.8. Extendable Swap

The Extendable Swap is an OTC derivatives transaction where, as in the case of the Interest Rate Swap, the Company and the Bank undertake to exchange at predetermined dates, interest flows calculated by applying two different interest rates to the same specified nominal amount:

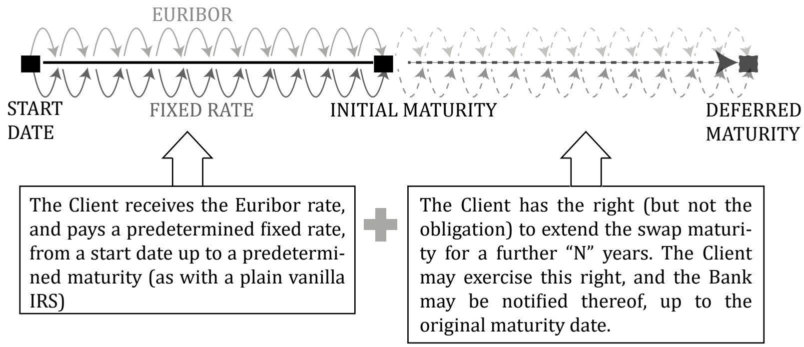
- the interest paid by the Bank to the Company is calculated on the basis of **Euribor rate**
- the interest paid by the Company to the Bank is calculated on the basis of a **Fixed Rate**

Unlike in the case of an IRS, the Company can obtain the right to defer the transaction maturity to a predetermined date

By combining the Extendable Swap with a debt indexed to Euribor rate, the Company achieves two aims:

- as per a plain vanilla IRS, it allows to switch the financing cost from a floating rate to a **fixed rate**
- it immediately predetermines the future hedging cost, should the Company decide to **refinance the debt at a floating rate** at the repayment date

The fixed rate of an Extendable Swap transaction **is higher than the fixed rate of IRS transaction** of the same duration



Advantages

- The Company **neutralise interest rate risk** by switchingthe financing cost from a floating rate to a fixed rate
- The Company has the right to extend the effects of the hedge in case of debt **refinancing,** for a further "N" years

Disadvantages

- The Client carry an higher cost with respect to the choice not to hedge the underlying risk
- The fixed interest rate paid is higher than the fixed rate of a traditional hedge with an IRS of the same duration

Possible scenarios at maturity:

- A Company has negotiated a 4-years floating-rate debt and has hedged the interest rate risk by enteringo into a4 years Extendable Swap with the option to extend this maturity to a predetermined date in the future (e.g. 3 years after the end of the original 4-years maturity)
- Prior to the original maturity date (by, and no later than, the fifth business day prior to the maturity date), the Company may opt for one of the following actions:

	NON-REFINANCED DEBT	REFINANCED DEBT
FIXED MARKET RATE HIGHER THAN EXTENDABLE RATE	The Client terminates the Extendable Swap and receives the positive MtM	The Client exercises the extension right by extending the hedge at a fixed rate higher than the market rate
FIXED MARKET RATE LOWER THAN EXTENDABLE RATE	The Client lets the transaction come to its natural conclusion, without exercising the extension option	The Client lets the transaction come to its natural conclusion, and enters into a new IRS at a better rate

19.3. Pre-hedging

19.3.1. Introduction

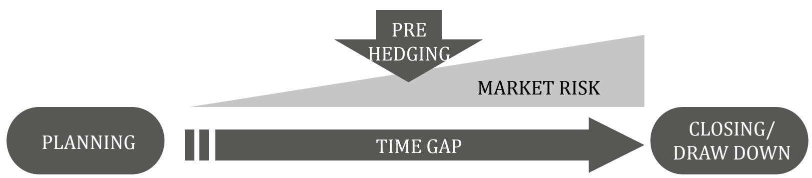
A company that is planning to issue debt to finance a new investments or expects to refinance its existing debt on a future date is exposed to the risk that **yields move higher** before the planned bond is actually brought to market or a new loan is signed, thus affecting the long-term borrowing cost.

The borrowing cost can be split down in two components:

- a credit spread that may change over time in response to both general credit conditions and company specific factors
- a reference rate such as EURIBOR (floating rates loans) or Swap rates (benchmark for pricing fixed-rate bonds/loans)

Pre-hedging might be used by companies to protect against rising interest rates in the period before the securities are priced or the loan is signed. The most common derivative instruments that may be effective for pre-hedging the interest rate risk are:

- Forward starting Interest Rate Swap
- Flexi Interest Rate Swap
- Purchase of a Payer Swaption
- Collar Swaption



19.3.2. Forward Starting Interest Rate Swap

A **Forward start Interest Rate Swap** is a structure wherein the swap does not begin until a specified future date. A borrower may use it to hedge an exposure to rising rates in the period between the trade date and the issue date of the debt.

The impact of the variability of interest rates before the debt is issued (increase / decrease of the future borrowing cost) will be offset by the change in market value of the swap.

A borrower might early terminate the swap to cash-in (or pay-out) its market value; in general, borrowers would early terminate the swap on the date of issuance of a fixed rate debt, because interest payments would be no longer exposed to rising interest rates.

Advantages:

- It allows to lock-in the base cost of a future financing without having to wait until the issuance of the new debt
- No upfront cost

Considerations:

- If the debt issue does not happen the company is still committed under the terms of the Interest Rate Swap with risk of unwind cost (negative mark-to-market) if swap rates have declined since the trade date
- The company won't be able to benefit from any favorable market movement in the period before the debt issue

19.3.3. Flexi interest rate Swap

A **Flexi Interest Rate Swap** (IRS) is a contract where one party exchanges fixed interest payments for floating interest payments (EURIBOR) during the life of the contract but, unlike a standard interest rate swap, one party has the option to choose the notional outstanding under the swap within predetermined buckets of notional amounts.

A construction company that is allowed to draw down funds gradually on a facility as portions of a project are completed might enter into a Flexi Interest Rate Swap to hedge its exposure to rising rates with the possibility to adjust the notional outstanding during the draw down period.

Advantages:

- The company locks in the interest rate on future drawdowns
- The company can choose the notional amounts during the step-up period avoiding the risk of over-hedging (or underhedging) if the actual loan drawdowns don't match the estimated drawdown profile
- No upfront cost

Considerations:

- If the Financing is not completed for any reason, the company is still committed under the terms of the swap with risk of unwind costs (negative mark-to-market)

- The company won't be able to benefit from any favourable market movement
- Higher fixed rate compared with a standard Interest rate Swap

19.3.4. PAYER SWAPTION (mentions)

The payer swaption has been already described in paragraph 16.2.6 on Swaption. Consequently this paragraph includes only a few remarks on the use of this instrrumenst as a pre-hedging product.

A Payer Swaption is an OTC derivative contract that gives to the buyer the right but not the obligation to initiate a swap at a pre-set rate (strike price) on a future date.

A company that wishes to take out a loan in the future may use a Swaption to hedge its exposure to rising rates in the period between the trade date and the issuance of the debt.

If interest rates rise before the debt is issued, the increase in debt expenses (higher coupon paid to issue a fixed rate debt or to swap a floating rate debt into fixed) will be capped at the strike price of the Payer Swaption.

A Swaption that is *in-the-money* at expiration may be either physically settled (the company enters into the swap to pay fixed rate and receive floating rate) or cash-settled (the company receives the market value of the Swaption). If the debt issued is fixed rate, borrowers would cash-settle the Swaption because interest payments would be no longer exposed to rising interest rates.

Advantages:

- It allows to lock-in the maximum base cost of a future financing
- The contract is not binding for the company, thus eliminating the risk of a naked hedge if the financing does not complete, whilst allowing the company to benefit if interest rates are lower on the issue date.

Considerations:

- The company must pay a premium for buying protection against adverse interest rates movements

96.3.5. COLLAR SWAPTION (mentions)

The collar swaption has been already described in paragraph 19.2.7. Consequently this paragraph includes only a few remarks on the use of this instrrumenst as a pre-hedging product

A Collar Swaption is a combination of two interest Rate Option: the purchase of a Payer Swaption and the sale of a Receiver Swaption.

A Collar Swaption performs similarly to an Interest Rate Collar, limiting the fluctuations of the underlying swap rate within specified upper and lower boundaries (a maximum rate and a minimum rate).

A company might enter into a Collar Swaption to pre-hedge its exposure to rising rates in the period between the trade date and the date when a future financing is expected to occur.

If one of the two Swaptions is *in-the-money* at expiration, the company would enter into an Interest Rate Swap at the corresponding fixed rate. If none of the Swaptions is in-the-money, the derivative does not produce any effect and the company might enter into an Interest Rate Swap at the prevailing market price.

Advantages:

- It allows to lock in the maximum base cost of a future financing, while leaving some downside room before the borrower is forced into a fixed rate
- A Collar Swaption allows to reduce (down to zero) the premium paid for pre-hedging the risk

Disadvantages:

- If the financing does not occur and interest rates have declined since the execution of the Collar Swaption, the company may incur a loss to terminate the unwanted hedge
- The company won‘t benefit from a potential reduction in the funding cost if swap rates fall below the lower boundary (i.e. the strike price of the Receiver Swaption) in the period ahead of the financing

19.4. Hedging Coordination

Via a Hedge Coordination large swap transactions with several hedging banks are handled smoothly in a structured manner.

A company appoints a bank as Hedge Coordinator, which is instructed to arrange the desired transaction (set-up the documentation, collect the commitment of potential hedging banks, handle a credit spread auction and coordinate the execution of the swaps).

In the context of the execution, the Hedge Coordinator and the Client enter into a swap on the hedged amount and immediately afterwards the

Hedge Coordinator novates tranches of the swap to the hedging banks selected by the Client.

Additionally, the Hedge Coordinator provides each hedging bank with a market hedge.

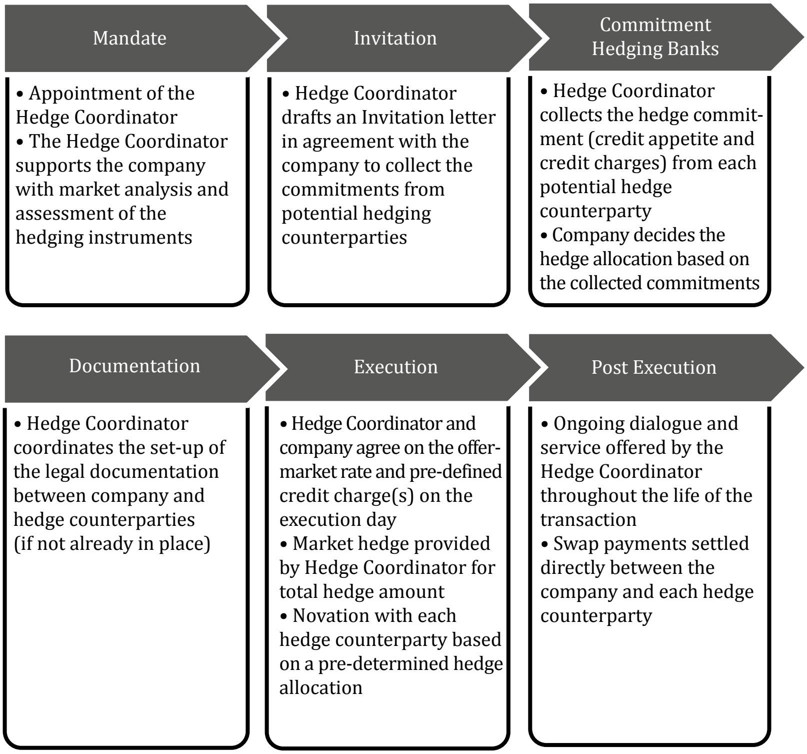
The advantages of Hedge Coordination are the following:

- Same base level for hedging due to: credit spread auction, pre-agreed mid-offer spread and a uniform market environment
- Mitigation of the execution risk of the hedging transaction due to a coordinated hedging process
- Significant reduction of complexity regarding the coordination process between the Client and the hedging banks
- Reduction of documentation effort for the Client due to a uniform documentation
- Efficient execution and a potential cost savings in comparison to individual transactions with each hedging bank
- Avoidance of potential negative impact on price which might occur if several banks access the market at the same time to hedge the risk

Key take-aways:

- Appointing a Hedge Coordinator has become the state-of-the-art market practice for various large-scale transactions
- Splitting and pre-determining the market and credit elements of the swap pricing provides full pricing transparency
- The Hedge Coordinator provides the company with administrative support in organizational and legal issues

Basic Steps of an Hedge Coordination:



19.5. EMIR rules and collateralization requirements for Alternative Investment Funds (AIFs)

We shall now examine the recently introduced requirements regarding the exchange of collateral – also known as initial margin and variation margin – in over-the-counter derivatives contracts (hereinafter “**OTC Derivatives**”) not cleared through a central counterparty (hereinafter “**CCP**”), pursuant to Regulation (EU) no. 2012/648 (hereinafter “**EMIR**”). Such Regulation as recently supplemented by Delegated Regulation (EU) no. 2016/2251 (hereinafter the “**Delegated Regulation**”), entered into by Financial Institutions and alternative real-estate investment funds (hereinafter “**Funds**”) managed by an Asset Management Company (hereinafter “**AMC**”), pursuant to Directive 2011/61/EU (hereinafter the “**AIFMD**”).

In accordance with the AIFMD, as implemented by Italian legislators, the investment policy of the real-estate Funds foresees that such Funds invest mainly, through the AMC, in real estate assets, in rights to real estate, in stakes in real-estate companies, and in parts of other real-estate funds.

In pursuing this investment policy, the AMCs often stipulate, together with banks (hereinafter the "**Lending Banks**"), loan agreements duly guaranteed by a set of securities, supporting the timely repayment of the mortgage loan (such as, but not limited to, a mortgage lien, a pledge on ad hoc accounts, the assignment of rents, and the assignment of insurance policy receivables).

The aforesaid loan agreements are also characterised by the following features:

- interest indexed to the floating rate;
- a *pari passu* clause;
- a *Loan To Value* (hereinafter, "**LTV**"), that is, the ratio between the principal of the loan contract and the property value, which on average is between 50% and 60%.

Furthermore, in order to hedge interest rate risk of the financings, AMCs usually stipulate OTC derivatives contracts, having as underlying the corresponding loan contract, with banks (hereinafter the "**Hedging Banks**") which are often also lender. Such contracts, which generally take the form of plain vanilla derivatives (e.g. Interest Rate Swaps or Caps), are designed to guarantee the hedging of the risks of fluctuation in the interest rates applicable to the loans, in order to preserve the profitability deriving from the lease agreements on properties owned by the Fund.

OTC derivatives contracts, like loan contracts, are usually supported by the same securities provided in the case of the aforesaid loan contracts. OTC derivatives contracts, hedging the aforementioned loan transactions entered into by two financial counterparties pursuant to the EMIR, are bound to exchange collateral as established by the Delegated Regulation.

Give these premises, the stipulation and renegotiation of hedging agreements between Banks and Funds, in compliance with the new provisions, could generate potential issues for the banks also in regard to the *pari passu* clauses, and to the accepted practice of the pro rata sharing of the securities, through the so called *Intercreditor Agreement*s.

Regulation (EU) no. 648/2012 (EMIR) and the supplement Delegated Regulation (EU) no. 2016/2251 (hereinafter, the "**Regulation**"), establish, among other things, the following:

a. as from 1 March 2017, the obligation to calculate the variation margin on OTC derivative contracts not cleared by a central counterparty ("**CCP**"), with the consequence that such derivative contracts are collateralized, consisting in the exchange of the so-called “Variation Margin”, hedging the Market Value of the underline instrument;

b. as from 21 June 2019, category 3 counterparties (including AIFs) shall be bound to clear through a central counterparty (CCP) in case they trade an *interest rate swaps* and/or other OTC derivative contracts listed on the ESMA website (see “*Public Register for the Clearing Obligation under EMIR*” – latest update: 1 June 2017);
c. the obligation to report to *trade repositories* in regard to any derivatives traded in the EU, in compliance with the requirements of the ESMA Technical Standards.

In order to finance the investments of the real-estate funds they manage, AMCs utilise bank loans, which as a rule are granted on a floating interest rate basis (Euribor), they hedge with derivative instruments against the risk of fluctuation of Euribor; these instruments take the form of interest rate swaps or caps. As said the use of such instruments is necessary to duly cover the cash flows generated by the revenue produced by real estate, with the payment floating-rate interest due on the mortgage loans. Such loans are generally guaranteed by a series of securities which the Hedging Bank has access to by means of specific Intercreditor Agreements. Furthermore, should the AMCs carry out investments outside of the Euro Zone (e.g. in the UK), they utilise foreign exchange risk hedges (e.g. FX Forwards, Options, etc.), as the managed AIFs are denominated in Euro (although the obligations of such AIFs will only come into force in 2018).

As things stand, the Regulation does not provide for any form of exemption and/or disapplication of the collateralization obligations concerning the aforementioned hedging transactions. In fact such obligations, particular in light of the securities that usually assist loans, seem to create significant problems in terms of the payment waterfall and compliance with the principles of priorities in making payments.

It should also be pointed out that as things stand, the organization of the AMCs does not enable them to manage the new collateralization requirements themselves, as such requirements appear to have been specifically designed for financial institutions.

In the light of the foregoing considerations, and of the negotiation of the first CSA (Credit Support Annexes), the direction currently taken by AMCs seems to use solely cash to comply with the EMIR Regulation.

Moreover, from a strictly operational point of view insofar as regards the obligations deriving from the Regulation and from the CSA, the possible alternative solutions available to AMCs are the following:

- *Internal management*: this activity entails the daily presence of staff in the office, with the task of handling notification, any disputes that may arise, and the arrangement of the cash money transfer. This implies the presence of company representatives with signatory power to execute cash transfer (for instance company business holidays cannot be taken into consideration). The activity also requires the AMC to implement a model for the daily calculation of the MtM of the derivative contracts stipulated.
- *Outsourced management*: the activity could be outsourced to a service provider with expertise in the EMIR, by opening an ad hoc account for collateral management. The costs associated with this activity would be charged to the fund, and such added to the costs of the loan contract. The activity also requires the AMC to implement an internal model with which regularly check the MtM calculation as sent by the service provider.

At present, the outsourcing option appears to be the more feasible one, as the AMC are willing to comply with the obligations established by the Regulation (as requested by the Bank of Italy's circular of 24 March 2017, mentioned above).

Furthermore, the proposed amendment of the EMIR Regulation 648/2012 (ESMA meeting of 4 May 2017), in regard to clearing obligations, at points 3.3 ("*impact assessment*") and 4 ("*options*") states that "*the category of small financial counterparties (SFCs) should be defined in such a way that very small financial counterparties for which central clearing is not economically feasible because of their small volume of activity, are not subject to the clearing obligation. This will lighten the burden on those SFCs that deal with a small volume of derivatives […]*".

More specifically, an examination of Delegated Regulation (EU) 2015/2205 of 6.08.2015 highlights the following:

- Recital (6) contains the provision that "the level of activity in OTC derivatives should serve as a basis to differentiate the degree of legal and operational capacity of financial counterparties, and a **quantitative threshold should therefore be defined to differentiate the second from the third category on the basis of the aggregate month-end average notional amount of non-centrally cleared derivatives**. That threshold should be set out at an appropriate level to differentiate smaller market participants, while still capturing a significant level of risk under the second category. The threshold should also be aligned with the threshold agreed at international level related to margin requirements for non-centrally cleared derivatives in order to enhance regulatory convergence and limit the compliance costs for counterparties.";

- Article 2, paragraph 2, point c, offers a definition of category 3 comprising "*counterparties not belonging to Category 1 or Category 2 which are any of the following: (i) financial counterparties; (ii) alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties*"*;* paragraph 3, moreover, states that: "*Where counterparties are alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU or undertakings for collective investment in transferable securities as defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council (3),* ***the EUR 8 billion threshold referred to in point (b) of paragraph 1 of this Article shall apply individually at fund level***."

The foregoing considerations should lead to an evaluation of whether to consider all AIFs, in regard to which the volume of OTC derivatives is much smaller than the month-end average outstanding gross notional amount of 8 billion Euro, within the category of *Small Financial Counterparties*. The latter, as pointed out in the proposed amendment of EMIR Regulation 648/2012 of 04/05/2017, should in turn benefit from exemption from the central counterparty clearing obligation and from exemption from variation margin exchange obligations. In fact such Small Financial Counterparties (including AMC) should be instead, in substance, assimilated to *NFC-* (*Non-Financial Counterparties minus*).

20.
Accounting and tax treatment of hedging derivatives

by F. Bellotto, J. Calella, M. Foresti, P. Negri

20.1. The OIC 32 accounting standard

The national legislator, through Legislative Decree no.139 of 18th August 2015 (the "Decree"), implemented the contents of Directive 2013/34/EU, relating to the financial statements, consolidated financial statements and related reports of certain types of companies, which amended Directive 2006/43/EC and replaced the previous Directives 78/660/EEC and 83/349/EEC.

The Decree amended the Civil Code, as well as Legislative Decree no. 127/91 concerning annual and consolidated accounts, to align the rules on financial statements and consolidated financial statements with the provisions of Directive 2013/34/EU.

Article 12 of Legislative Decree no. 139/2015, in particular, provided that the Italian Accounting Body ("OIC") updated the national accounting standards referred to in Article 9 bis, paragraph 1 of Legislative Decree no. 38 of 28th February 2005, on the basis of the provisions contained in the Decree itself.

Pursuant to the provisions of Article 12 referred to above, the OIC developed a new national accounting standard on derivative financial instruments, the so-called OIC 32 "Derivative financial instruments" ("OIC 32"), which replaced the provisions of OIC 3 "Information on financial instruments to be included in the notes to the financial statements and in the management report", providing for the first time in our legal system an organic treatment of the subject.

Among the various provisions, the Decree introduced the valuation at fair value of derivative financial instruments, including those incorporated into other financial instruments, and their recognition in the financial statements.

The changes introduced or confirmed by Legislative Decree no. 139 of 18th August 2015 on the presentation of derivatives in the financial statements can be summarized as follows:

- provision of specific items relating to derivative financial instruments in the balance sheet and income statement;
- obligation to measure all derivative contracts at fair value;
- possibility of activating two accounting hedge institutions, if hedge is considered to exist in the presence, from the outset, of a close and documented correlation between the characteristics of the hedged item or transaction and those of the hedging instrument (hedging of the cash flows of another financial instrument or of a planned transaction and hedging of fair value);
- definitions of "financial asset", "financial liability", "financial instrument", "derivative financial instrument", "fair value" and "generally accepted model and technique", for which a specific reference is made to the international accounting standards adopted by the European Union;
- equivalence to a derivative contract of those contracts relating to commodities which confer on one or other contracting party the right to proceed with the liquidation of the contract itself in cash or by other financial instruments, except in the case where certain conditions are met at the same time ((i) a contract concluded and maintained to meet the needs of the company preparing the purchase balance sheet, sale or use of the goods, (ii) contract intended for this purpose from its conclusion, (iii) contract performed by delivery of the goods);
- spin-off of derivatives embedded in other financial instruments;
- methods of measurement at fair value, determined as (i) market value, for financial instruments for which an active market can be easily identified; (ii) market value derived from that of the constituents or of the similar instrument where the market value is not easily identifiable for an instrument, but can be identified for its constituents or for a similar instrument; (iii) value resulting from generally accepted valuation models and techniques, for instruments for which an active market cannot be easily identified.

The scope of the changes introduced also required a series of accounting rules to be regulated to supplement the provisions of the regulatory provisions, including guidelines for the measurement at fair value of a derivative contract, methods for spin-off the derivative incorporated into a financial instrument, as well as rules for the identification of hedged items and eligible hedging instruments, the eligibility criteria for accounting hedges, their subsequent measurement, methods for activating, accounting for and terminating fair value hedges and expected cash flow hedges, identification of a simplified method for the so-called simple hedging relationships.

This activity was carried out in line with the significant integration of the rules of the Civil Code, carried out by the national legislator, in a context in which the reference to the approach, logics and techniques provided for by the IAS/IFRS international accounting standards became more and more present. This approach, however, should not be understood as a substantial transposition of IAS/IFRS into OIC 32 because, although the basic rules have several similarities to those provided for by international accounting standards, the national accounting standard has its own peculiarities in relation to the fact that the rules included therein are aimed at the generality of Italian companies with the sole exclusion of micro-enterprises, this led to the need to make accounting institutions that were particularly complex more comprehensible, to favor simplifying solutions (e.g. spin-off or hedging) where possible, and to introduce streamlined accounting models for hedging for simple hedging transactions.

The text of accounting standard OIC 32, issued in December 2016, was applicable to companies that prepared financial statements in accordance with the provisions of the Italian Civil Code, with reference to financial statements for financial years beginning on or after 1st January 2016 and was subsequently updated to incorporate the amendments published on 29th December 2017, on 28th January 2019 and 4th May 2022.

20.2. Derivative financial instruments

20.2.1. Definition of the derivative contract

The definition of "derivative financial instrument", provided for in OIC 32, takes into account the provisions of international accounting standards, to which the new Article 2426 of the Italian Civil Code expressly refers.

In this regard, a derivative is defined in paragraph 11 of OIC 32 as "a financial instrument or other contract that possesses the following three characteristics:

a. its value varies as a result of changes in a given interest rate, price of financial instruments, price of commodities, exchange rate, price or rate index, Rating or other variable, provided that, in the case of a non-financial variable, such variable is not specific to one of the contractual counterparties (sometimes called the underlying);
b. does not require an initial net investment or requires an investment that is less than it would be requisite for other types of contracts from which a similar response to changes in market factors would be expected;
c. is settled at a future date".

In turn, similar to IAS/IFRS, a financial instrument is defined in paragraph 10 of the national accounting standards as "any contract that gives rise to a financial asset for one company and a financial liability or equity instrument for another company".

Consequently, in all cases where a given financial instrument or contract meets the three requirements set out above, it will be a derivative contract, even if it is incorporated into another financial instrument or contract.

The definition of a derivative financial instrument, as specified in Appendix A to OIC 32, refers to non-financial variables that are not specific to a party to the contract.

A derivative financial instrument, as specified in Appendix A to OIC 32, usually has a nominal value (e.g. an amount in currency or other units specified in the contract), the interaction of which with the underlying variable contributes to determining the settlement amount of the derivative financial instrument itself; a derivative financial instrument could alternatively assume a fixed payment or the payment of a variable amount (not proportional to the change in the underlying instrument), as a result of a future event not linked to a nominal amount. However, there may be cases of derivative financial instruments in which both the nominal value and the payment forecast are absent: an example could be traced back to a derivative financial instrument in which the parties agree to fix the exchange rate of one currency against another and in which the amount of currency to be converted is linked to the company's sales volumes; in this case, there would be two underlying variables, one financial (exchange rate) and one non-financial (sales volume).

The second characteristic mentioned concerns the fact that the initial net investment is zero or less than what would be required for other types of contracts that are supposed to have a similar "reaction" to changes in market factors: an options contract satisfies this definition as the premium is lower than the investment that would be required to obtain the underlying financial instrument to which the financial option is linked.

Contracts that fall within the scope of the definition of "derivative" can also be divided into financial derivatives and credit derivatives. In particular, the former can be classified into the following main categories:

a. forward contracts, mainly attributable to forward and futures contracts, i.e. contracts that provide for the exchange between two parties of a specific asset at a future date and at a price set at the time of signing the contract (the subject of the contract can be commodities, financial instruments, stock market indices or currencies);

b. options, represented by instruments that give the buyer the right, but not the obligation, to buy (in the case of call options) or sell (in the case of put options) financial assets (stocks, bonds, currencies, derivative financial instruments) or real assets (commodities and commodities) at a fixed price (strike price) on a certain date (European option) or by the same date (American option). The right is granted by the seller to the buyer against the payment of a premium representing the maximum potential loss that the buyer could incur;
c. swaps, represented by instruments through which two parties undertake to exchange cash flows with each other on predetermined dates according to an agreed scheme.

Credit derivatives, on the other hand, are contracts that pursue the purpose of transferring the underlying credit risk to a given asset from the person who buys protection to the person who sells protection. These contracts can be divided into:

a. credit default swaps, contracts in which the protection seller must fulfil the obligation under the contract upon the occurrence of a certain event;
b. credit spread swaps/options, in which the protection seller's obligation to comply depends on the market performance of a reference entity;
c. total rate of return swaps, in which the buyer and the protection seller exchange the amount of cash flows generated by a reference entity and those linked to a market interest rate increased or decreased by a given spread.

20.2.2. Initial Enrollment and Subsequent Evaluation

Paragraph 38 of OIC 32 provides that derivative financial instruments are initially recognised in the accounting system when "the company becoming a party to the contractual clauses, i.e. on the date of signing the contract, is subject to the related rights and obligations".

Pursuant to the provisions of Article 2426, paragraph 1, number 11-bis, of the Italian Civil Code, derivative financial instruments, even if incorporated into other derivative financial instruments, are recorded at fair value, both at the initial recognition date and at each balance sheet date; the change in fair value compared to the previous year is recognised in the income statement in the section "Value adjustments to financial assets and liabilities", respectively in items D) 18) d) "revaluation of derivative financial instruments" and D) 19) d) "write-down of derivative financial instruments", provided for in Article 2425 of the Italian Civil Code, unless such instruments are designated as hedging instruments.

Article 2424 of the Italian Civil Code also provides for specific items in the balance sheet in which derivative financial instruments and the reserve for hedging expected cash flows are presented. Specifically, the classification of the assets of the balance sheet, in the event that the financial instrument has a positive fair value at the measurement date, is between:

- "Financial fixed assets" in item B) III 4) derivative financial instruments;
- "Financial assets that do not constitute fixed assets" in item C) III 5) derivative financial instruments;
- considering the fact that a non-hedging derivative financial instrument must be classified as current assets, while a derivative financial instrument hedging the cash flows or fair value of an asset follows the classification of the "hedged object".

On the other hand, the classification of liabilities in the balance sheet is:

- in "Shareholders' equity", item A) VII - reserve for hedging expected cash flows;
- under "Provisions for risks and charges" in item B) 3) – passive derivative financial instruments;

where item A) VII "Reserve for hedging of expected cash flows" includes changes in the fair value of the effective component of derivative financial instruments hedging cash flows (the ineffectiveness component is recognized in section D of the income statement), while item B) 3) – "Derivative financial instruments liabilities" includes derivative financial instruments with a negative fair value at the measurement date.

Therefore, in the event that the fair value of the derivative financial instrument is positive in the assets of the Balance Sheet called "derivative financial instruments" included within the macro-item "Financial fixed assets" or "Financial assets that do not constitute fixed assets" depending on the covered subject matter to which it relates, as defined in paragraph 28 of OIC 32. On the contrary, in the event that the fair value of the derivative financial instrument is negative, it must be recorded in the liabilities of the Balance Sheet, under the item "Derivative financial instruments liabilities" included in the "Provisions for risks and charges".

Fair value, as defined by international accounting standards (specifically IFRS 13.9), represents the "price that would be received for the sale of an asset or that would be paid for the transfer of a liability in a regular transaction between market participants at the measurement date".

OIC 32, again borrowing from IFRS 13, in line with the provisions of Article 2426 of the Italian Civil Code, operationally sets out the rules for determining fair value, indicating that it must be calculated by maximizing the use of relevant observable parameters and minimizing the use of non-observable parameters according to a hierarchy consisting of three levels in line with the provisions of international accounting standards:

a. Level 1 fair value: refers to the (unadjusted) market value of derivative financial instruments, subject to measurement, for which an active market can be easily identified. The valuation techniques that make use of these inputs are defined as mark-to-market as they provide a measure of fair value directly from official market prices, without the need for any modification or adjustment (such as, for example, those determined by the Cassa di Compensazione e Garanzia, a company of the Borsa Italiana group that ensures, among other things, the clearing and conclusion of contracts entered into on derivatives markets);
b. Level 2 fair value: the prices of similar instruments on active markets are taken as a reference or, in their absence, market valuation models based on observable parameters are used. Valuation methods that use these inputs are also called mark-to-matrix because in order to provide a measure of fair value they cannot make direct use of these inputs, but rather they need to be "adjusted" and "processed". This is the case, for example, of two counterparties (one of which is a banker) that enter a derivative financial instrument (e.g. an interest rate swap in which one receives a fixed rate and pays a floating rate) based on a benchmark (e.g., 3-month Euribor rate), which can be verified by an infoprovider (e.g. Reuters, Bloomberg) for the entire period covered by the contract;
c. Level 3 fair value: to be used in the absence of the conditions for the application of level 1 and 2 fair value, reflecting the assumptions that market participants would use in determining the price of the derivative financial instrument, including assumptions about the risk inherent in the valuation techniques and the parameters used in the valuation technique. In such a case, on the basis of the provisions of OIC 32, in developing unobservable parameters, all reasonably available information taken by market participants, which could also include the company's own data, should be taken into account. When developing unobservable metrics, a company may start from its own data, but must adjust it if reasonably available information indicates that other market participants would use different data or if there are specific elements of the company that are not available to other market participants. In this case, we are in the presence of valuation techniques called mark-to-model because, before obtaining

a measure of fair value, it is necessary to insert these inputs into complex mathematical models developed internally by the company. It follows that the reliability of the value thus obtained depends greatly, indeed almost exclusively, on the type and validity of the model used. This is the case, for example, of two counterparties entering into a complex derivative financial instrument (e.g. "Bermudian" options, "exotic" derivative financial instruments or derivative financial instruments with particular knock-in or knock-out barrier clauses) whose value will have to be determined on the basis of data that is not directly observable.

It is reasonable to assume that in most situations the fair value of unlisted financial instruments is level 2, while the use of level 3 fair value should be limited to residual and/or specific cases.

20.2.3. Hedging transactions and eligible instruments

The main use of financial instruments by real estate operators is related to the assumptions of risk management of adverse fluctuations related to the variable indexation parameter of the interest rate (Euribor) paid on medium/long-term loans. For more details, see paragraph 20.3. "Examples of accounting for hedging financial instruments".

Although the subscription of a derivative financial instrument is carried out for risk management purposes, the application of the accounting model provided for hedging transactions is subject to the fulfilment of precise requirements, as established by Article 2426 of the Italian Civil Code and set out in OIC 32.

Before describing the peculiar methods of hedge accounting, it should be considered that there is no obligation of application of these rules, even in the presence of "economic" coverage, and the directors may, consequently, freely decide not to make use of this option.

However, a failure to activate hedging accounting (in the presence of "economic" hedges) may result in a valuation asymmetry deriving from:

- changes in the fair value of the derivative are recognized in the income statement;
- the economic effects related to the covered object will follow the own rules of competence provided for the covered object itself.

Administrators must therefore carefully weigh the advantages and disadvantages of applying the accounting models for hedging transactions.

In fact, the application of this option makes it possible to obtain less volatile income statements in the face of greater operational complexity and documentary commitment, while the decision not to use the option, in the face of greater simplicity of application, could lead to greater variability in economic results.

In this regard, it should be noted that, with reference to hedging transactions, the OIC has deemed it necessary to introduce some simplifications in the standard with respect to international accounting standards, in the case of non-complex derivative financial instruments that have characteristics corresponding to or closely aligned with those of the hedged item (so-called "simple hedging relationships").

20.2.4. Hedging accounting models (cash flow hedges)

Accounting standard OIC 32 provides for two distinct accounting models depending on the following circumstances:

- hedging changes in fair value (fair value hedge);
- cash flow hedge.

Typical hedging relationships for derivative financial instruments used between real estate operators for "economic" hedging of real estate loans are generally attributable to the cash flow hedge model. This accounting model can be used when the strategic objective of the company's management is to stabilize the expected cash flows of a hedged item (for example, in the case of payment of future cash flows on a floating-rate loan).

As stated in Article 2426, paragraph 1, number 11-bis, of the Italian Civil Code, changes in fair value are recognized "if the instrument hedges the risk of changes in the expected cash flows of another financial instrument or a planned transaction, directly to a positive reserve or negative equity reserve; this reserve is recognized in the income statement to the extent and within the time frame corresponding to the occurrence or change in the cash flows of the hedged instrument or to the occurrence of the hedged transaction",

Changes in the fair value of the derivative financial instrument, if classified as hedging having met the specific requirements, will therefore have to be accounted for in a specific equity reserve ("Expected cash flow hedging reserve") which will be issued and reclassified to the income statement when the hedged cash flows have an effect on profit or loss for the year.

The definition of a "hedged item" under OIC 32 is "an asset, liability, irrevocable commitment, highly probable planned transaction that (a) exposes the company to the risk of changes in fair value or future cash flows and (b) is designated as hedged."

In the specific case of cash flow hedges, the "hedged object" is attributable to a cash flow or a series of future cash flows deriving from:

a. a contract (e.g., floating interest on a loan taken out by the company) or
b. a highly probable planned transaction (e.g., future receipts from the sale of goods in foreign currency).

20.2.5. Eligibility criteria for hedging operations and supporting documentation

For the purposes of accounting for hedging transactions according to the specific model, OIC 32 provides for specific conditions, which must be met jointly:

1. the hedging relationship consists only of eligible hedging instruments and eligible hedged items;
2. the existence of a close and documented correlation between the characteristics of the hedged instrument or transaction and those of the hedging instrument, pursuant to Article 2426, paragraph 1, number 11-bis, of the Italian Civil Code;
3. compliance with the effectiveness requirements of OIC 32.

These conditions will be described in more detail in the following paragraphs.

20.2.5.1. Hedging instruments and eligible hedged items

With reference to the first condition, paragraph 56 of OIC 32 provides that one or more derivative financial instruments may be designated as hedging instruments.

As a general rule, the entire derivative should be designated for hedging, however the accounting standard allows for some exceptions as it is possible to designate only a part of the underlying value of the derivative, such as 50% of its notional, as a hedging instrument: such a provision is necessary to ensure that companies that do not have the possibility to enter into derivatives with a notional amount identical to that of the hedged item, they can still apply the accounting of accounting hedges by designating a part of the notional, even if they have entered into derivatives with a higher notional than the hedged item.

In addition, the accounting standard provides that only the intrinsic value component of a forward contract or option may be designated as a hedging instrument, in order to prevent the designation, even if provided for by the standard, of a forward contract or option in its entirety, thus also including the time value, from generating the ineffectiveness of the hedge, to be recognised in the income statement, which in circumstances where it is particularly significant, may result in the need to interrupt the hedge.

In addition, the designation of a sold option as a hedging instrument is not permitted unless it is combined with a purchased option; in fact, a sold option generates an exposure to risk for the company since, at maturity, the right to exercise it is in the hands of the holder and therefore not under the control of the company.

On the other hand, with regard to eligible covered items, paragraph 61 of OIC 32 specifies that the following are eligible, both individually and in groups:

- assets and liabilities recorded in the financial statements;
- irrevocable commitments;
- highly likely scheduled operations.

Conversely, the company's equity items can never be hedged.

OIC 32 provides for the possibility to designate cash flows on groups of assets/liabilities or net positions as hedged items, provided that the specific eligibility criteria for such hedges are met.

20.2.5.2. The need for a close correlation

The second condition necessary for the accounting of hedging transactions, namely the concept of close correlation, requires verification that, at the time when the hedging relationship is entered into and subsequently, the derivative allows the risk to be hedged to be reduced.

In this regard, it should be noted that hedging transactions may only be booked for interest rate risk, exchange rate risk, price risk and credit risk (excluding the company's own credit risk).

To meet this condition, there must therefore be a designation and formal documentation of the hedging relationship, the company's risk management objectives and hedging strategy at the beginning of the hedging relationship. Such documentation must include, in addition to the identification of the hedging instrument, the hedged item and the nature of the hedged risk, how the company will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio).

Specifically, OIC 32 requires compliance with the following three rules (effectiveness requirements), which represent the third necessary condition for accounting purposes, to verify the "close correlation" between the characteristics of the hedged instrument or transaction and those of the hedging instrument:

1. the existence of an economic relationship between the hedged item and the hedging instrument. This implies that the value of the hedging instrument will have to change in the opposite direction to the change in the value of the hedged item, in relation to the risk being hedged;
2. the non-prevalence of the counterparty's credit risk over the changes in value resulting from the economic report of the derivative financial instrument and the hedged item, where the credit risk is not the risk hedged;
3. the definition of the coverage ratio, determined as the ratio between the quantities of derivative financial instruments used and the quantities of hedged items. Normally this ratio is 1:1 (a derivative financial instrument covers exactly the hedged item), although in some cases it may be different. The calculation of the coverage ratio must be such that it does not result ex ante in the ineffectiveness of the hedge (e.g. in the case of coverage of a notional amount higher than that of the hedged item).

The verification of the presence of the economic report must be carried out at least at each balance sheet date, assessing the existence of the requirements analysed at the time of setting up the hedging relationship (including the verification of the counterparty's credit risk). This verification can be carried out both in "qualitative" terms (in the event that the hedging transactions concern derivative financial instruments with characteristics that correspond to or are closely aligned with those of the hedged item, so-called "simple hedging relationships"), and in "quantitative" terms.

20.2.5.3. Supporting documentation

As previously described, in order to activate hedging accounting, the hedging relationship must be formally documented. This requirement is also enshrined in art. 2426 of the Italian Civil Code and operationally declined by OIC 32.

From the outset, such documentation must include at least the identification:

- of the hedging instrument;
- of the covered element;
- the nature and origin of the risk covered;
- the methods used to assess the effectiveness requirements of the hedging;
- the ability of the report to achieve the defined risk management objectives, including the identification and analysis of possible sources of ineffectiveness and the definition of how the coverage ratio is determined.

The information to be included in the documentation supporting hedging relationships can therefore be classified as:

- general, procedural and methodological information;
- specific information relating to each hedging relationship.

Starting from the assumption that the obligation to formally document the hedging relationship also exists in the case of "simple hedging relationships", the first category of information is normally present within the company regulations, i.e. within specific documents such as risk management strategies or policies, approved by the company's administrative body, while the second category of information is usually documented through specific documents, each relating to a specific coverage relationship.

20.2.5.4. Quality assurance

In the event that there are simple hedging relationships and the derivative financial instrument is entered into at market conditions (e.g. a forward or swaps that have a fair value close to zero), at the initial recognition date the accounting of such transactions may be based on a purely qualitative analysis in accordance with paragraph 72 of OIC 32 and does not require the development of a quantitative test.

This qualitative analysis assumes the following:

1. the hedging relationship consists only of eligible hedging instruments and eligible hedged items;
2. there is a formal designation and documentation of the hedging relationship, the company's risk management objectives, and hedging strategy.

In the presence of the above conditions, the hedging relationship is considered effective simply by verifying that:

- the main elements of the hedging relationship (nominal amount, settlement date of cash flows, maturity and underlying variable of the hedging instrument and the hedged item) correspond to or are closely aligned, and
- the credit risk of the counterparty is not such as to materially affect the fair value of both the hedging instrument and the hedged instrument.

The verification of the correspondence of the load-bearing elements will have to be carefully evaluated in order to be able to make use of the purely qualitative verification option provided for hedging relationships. In addition, particular attention should be paid to the verification of credit risk, which if significant, it could lead to the termination of the hedging relationship, in addition to the monitoring of further possible causes of ineffectiveness identified.

The methods for monitoring and verifying the above must be described in detail in the coverage report.

20.2.5.5. Quantitative verification

If the contractual conditions are not such as to permit the use of the simple hedging approach, a quantitative analysis will have to be carried out.

For a quantitative evaluation of the economic relationship, it is possible to use various methodologies, including statistical ones, normally used in companies in risk management activities.

The existence of a “statistical” correlation between two variables, understood as a relationship such that each value of the first variable corresponds with a “certain regularity” to a value of the second, is a useful indication that there could be an effective economic relationship between the hedging instrument and the hedged item. In some circumstances, especially in the presence of different underlying variables between the hedged item and the hedging instrument, it may be necessary to corroborate the mere statistical analysis with other quantitative evaluations such as the techniques used to determine the level of ineffectiveness or other methodologies such as, for example, sensitivity studies.

The determination of ineffectiveness can be made through the use of the hypothetical derivative method, a technique that estimates the value of the hedged item assuming that it is in the presence of a derivative contract having all the riskiness characteristics of the hedged item. The use of the hypothetical derivative is therefore not a method in itself, but a mathematical expedient that can only be used to calculate the value of the hedged element.

The quantitative assessment of the economic relationship can therefore be used to calculate the hedge ineffectiveness component to be determined for cash flow hedges.

In addition, OIC 32 provides that periodically (at least on each date of preparation of the financial statements) the presence of:

- significant changes in the economic relationship between the hedged item and the hedging instrument, or
- a (possible) significant increase in credit risk.

In the event that one of the two above conditions were met, it would be necessary to apply the rules for the termination of a hedging relationship as the hedging relationship would give rise to a significant amount of ineffectiveness; in principle, there is no provision for a quantitative threshold beyond the which it is necessary to cease coverage, but the principle requires that review the hedging ratio whenever there have been changes in the economic relationship between the hedged item and the hedging instrument.

Techniques for revising the report (hedging rebalancing) are as follows:

- increase in the quantities of the covered element designated for hedging;

- reduction of hedging instrument quantities designated for hedging;
- increasing the hedging instrument quantities designated for hedging;
- reduction of the quantities of the covered element designated for hedging.

In any case, when the coverage ratio is revised, it is necessary to calculate the ineffectiveness of the hedge, charging it to the income statement for the year, before prospectively adjusting the hedge ratio.

20.2.5.6. Termination of the hedging relationship

The hedging relationship shall end prospectively from the date on which the hedging relationship (or part of it) ceases to meet the eligibility criteria, i.e. if:

- the hedging instrument expires, is sold or discontinued, unless the replacement of the hedging instrument by another hedging instrument is provided for in the original hedging strategy or is the consequence of existing laws or regulations or the introduction of laws or regulations;
- the hedge no longer meets the three criteria for accounting for hedging ("eligibility criteria");
- in a hedging of a scheduled transaction, the scheduled transaction is no longer highly probable.

The principle does not allow for a voluntary termination of the relationship if the substantive and documentation requirements continue to be met, but to assess its appropriateness in relation to the risk management objectives.

From the date of termination of the hedging relationship, both the derivative and the hedged object resume being measured according to the rules set out in their respective accounting standards.

In the event that the accounting of the cash flow hedging transaction is stopped, the amount accumulated in the item "Reserve for hedging expected cash flows" must be accounted for as follows:

- if future cash flows of the hedged item are expected to occur, the amount must remain in item A) VII "Reserve for hedging operations of expected cash flows" until future cash flows occur;
- if future cash flows are no longer expected or the planned transaction is not expects that it is highly likely, the amount of the reserve will have to be reclassified immediately in section D) of the income statement as the amount of the reserve will have become ineffective.

On the other hand, with regard to the hedging of changes in fair value, when the hedging transaction ceases:

- the adjustment of the hedged item is retained in the Balance Sheet and considered a component of the cost of the asset (within the limits of the recoverable amount), or of the liability, even arising from the realization of the irrevocable commitment;
- where the hedged item is a financial asset or liability, the cumulative adjustment of the hedged item shall be progressively recognized in the income statement over the life of the hedged item. If the hedged item is a financial asset or liability measured at amortized cost, this cumulative adjustment is recognized in the income statement on the basis of the effective interest rate established by OIC 15 "Receivables", OIC 19 "Payables" and OIC 20 "Debt securities".

20.3. Examples of accounting for hedging financial instruments

20.3.1. IRS accounting to hedge interest rate risk

Context:
- on 30.09.2020 a floating rate loan of €100,000 was disbursed, with a duration of 4 years and a spread of 200 bps;
- at the same time, an Interest Rate Swap (IRS) contract is signed with a notional and maturity aligned with the loan disbursed, in which the company collects the floating rate (equal to the base rate recognized on the loan) and pays a fixed rate of 0.18%;
- since the characteristics of the hedging instrument are the same as those of the hedged object, it is possible to apply the accounting model provided for by OIC 32 for simple hedging relationships;
- for simplicity's sake, neither the time effect nor the fiscal effect have been taken into account, and the interest rate curve is assumed to be flat.

Hypothesis:

Scenario
30.09.2020 Financing and IRS coverage agreement, duration 4 years 31.12.2020 Balance sheet closure 30.09.2021 payment of the first instalment and first differential

Interest rate assumptions - flat curve scenario			
	30.09.2020	**31.12.2020**	**30.09.2021**
€uribor 12-month spot rate	0,10%	0,20%	0,30%

Rate €uribor 12 m on 30.09.2021	0,16%	0,25%	0,30%
Rate €uribor 12 m on 30.09.2022	0,20%	0,35%	0,40%
Rate €uribor 12 m on 30.09.2023	0,26%	0,48%	0,60%
Equivalent fixed rate (average)	**0,18%**	**0,32%**	**0,40%**

Item Covered			
	30.09.2020	**31.12.2020**	**30.09.2021**
Nominal	100.000	100.000	100.000
Rate	0,10%	0,10%	0,30%
Spread	2,00%	2,00%	2,00%
Total Interest Rate	2,10%	2,10%	2,30%
Days of interest accrual		92	365

Hedging instrument (no discounting)			
	30.09.2020	**31.12.2020**	**30.09.2021**
Notional	100.000	100.000	100.000
IRS Floating Rate	0,10%	0,10%	0,30%
IRS Fixed Rate	0,18%	0,18%	0,18%
Fixed Market Rate	0,18%	0,32%	0,40%
Fair value	-	560	660
Days of interest accrual	-	92	365

<u>Accounting records:</u>

30-sept-2020 – Recognition of the takeout of the loan, as the hedging financial instrument is characterized by zero fair value

0.1 – Loan takeout			*DEBIT*	*CREDIT*
Cash	@	Payables to banks (Loans)	100.000	100.000

31-dec-2020 – Accrual of interest on the loan and IRS and adjustment to IRS *fair value*

1.1 - Accrual of interest on loans			*DEBIT*	*CREDIT*
Interest and other financial charges	@	Payables to banks (Loans)	529	529
1.2 - Recognition of accrual differentials on the IRS				
Interest and other financial charges	@	Active derivative financial instruments	20	20
1.3 - IRS fair value adjustment				
Active derivative financial instruments	@	Reserve for OCFFA	580	580

The recognition of interest on the loan (€529) is determined by multiplying the total interest rate (2.10%) by the amount disbursed (€100,000) by the reference period (92 days).

The IRS differential (€20) is determined by multiplying the interest rate delta traded (floating rate 0.10% minus fixed rate 0.18%) to the notional rate (€100,000) for the reference period (92 days).

31-dec-2020 – Statement of financial position and profit or loss

Balance sheet 31.12.2020			
Cash	120.000	Share capital	20.000
		Reserve for OCFFA	580
Active derivative financial instruments	560	Profit (loss)	(549)
		Payables to banks (Loans)	100.529
Income statement 31.12.2020			
Interest and other financial charges	549		
Profit (loss)	549		

30-sept-2021 – Accrual of interest on financing and IRS, settlement of payments

			DEBIT	*CREDIT*
2.1 - Accrual of interest on loans				
Interest and other financial charges	@	Payables to banks (Loans)	1.571	1.571
2.2 - Recognition of accrual differentials on the IRS				
Interest and other financial charges	@	Active derivative financial instruments	60	60
2.3 - IRS fair value adjustment				
Active derivative financial instruments	@	Reserve for OCFFA	80	80
2.4 - Settlement of payables to banks in payment				
Payables to banks (Loans)	@	Cash	2.100	2.100
2.5 - IRS Differential Settlement Accrued				
Active derivative financial instruments	@	Cash	80	80

The recognition of interest on the loan (€1,571) is determined by multiplying the total interest rate (2.10%) by the amount disbursed (€100,000) by the reference period (273 days).

The IRS accrual differential (€60) is determined by multiplying the interest rate delta traded (floating rate 0.10% minus fixed rate 0.18%) to the notional rate (€100,000) for the reference period (273 days).

30-sept-2021 – Statement of financial position and profit or loss

Balance sheet 31.12.2021

Cash	117.820	Share capital	20.000
		Reserve for OCFFA	660
Hedging derivatives	660	Profit (loss) 31.12.2020	(549)
		Profit (loss) 30.03.2021	(1.631)
		Payables to banks (Loans)	100.000

Income statement 31.12.2021

Interest and other financial charges	1.631	
Profit (loss)	1.631	

20.3.2. CAP accounting to hedge interest rate risk

<u>**Context**:</u>

- on 01.01.2020 a floating-rate loan of €10,000,000 was disbursed, with a duration of 3 years and a spread of 200bps;
- at the same time, an interest rate CAP is purchased with a notional and maturity aligned with the loan disbursed, in which the company collects the difference, if positive, between the variable rate (equal to the base rate recognized on the loan) and the strike, equal to 8%;
- the Company has exercised the right to exclude changes in the value of the time value from the hedging relationship;
- for the sake of simplicity, neither the time effect nor the fiscal effect have been taken into account, and the interest rate curve is assumed to be flat.

<u>**Hypothesis:**</u>

Scenario	
01.01.2020	(i) taking out a three-year variable-rate mortgage for €10 million at the variable: Euribor + 200 bps + (ii) purchase of an Option for €300 thousand *Interest Rate Cap,* for which, if the Euribor exceeds 8%, the company receives: €10 mln x (Euribor - 8%)
31.12.2020	Closing of the year, recording of the entries on the *cap* and on the loan.
31.12.2021	Closing of the year, recording of the entries on the *cap* and on the loan.
30.09.2022	closure of the derivative and extinguishment of the loan,

Euribor trend *assumptions*					
Date	**Badger Euribor**	**Amounts cleared annually on the cap**	**Interest on the mortgage**	**Net Amount Paid**	**Net Rate Paid**
2020	7,0%	-	900.000	900.000	9,0%
2021	9,0%	100.000	1.100.000	1.000.000	10,0%
2022	10,0%	200.000	1.200.000	1.000.000	10,0%

Performance and change in *fair value* of the intrinsic and temporal element of the *cap*					
Date	**Fair Value option *cap* (*)**	**Cap Intrinsic Value (*)**	**Cap Time Value**	**Change in Fair Value *Cap***	**Change in Cap Time Value**
01.01.2020	300.000	-	300.000	-	-
31.12.2020	280.000	-	280.000	(20.000)	(20.000)
31.12.2021	350.000	200.000	150.000	70.000	(130.000)
31.12.2022	200.000	200.000	-	-	(150.000)

(*) The amounts shown relate to the situation immediately preceding the settlement and closure of the relevant accounting period

Accounting records:

01.01.2020 – Recognition of the loan and the premium paid

			DEBIT	*CREDIT*
0.1 - Recognition of financing				
Cash	@	Payables to banks (Loans)	10.000	10.000
0.1 - Registration of the premium paid				
Financial derivative assets	@	Cash	300	300

31-dec-2020 – Allocation to the income statement of the portion of the premium for the year, recognition of the change in the time component of the CAP and interest on the loan

			DEBIT	*CREDIT*
1.1 - Recognition of the deferral of the premium for the year				
Write-down of derivative financial instruments	@	Deferrals	100	100
1.2 - Detection of the change in the time value of the option				
Deferrals	@	Active derivative financial instruments	20	20
1.3 - Recognition of interest accrued on the loan				
Interest and other financial charges	@	Cash	900	900

31-dec-2020– Statement of financial position and profit or loss

Balance sheet 31.12.2020

Cash	13.800	Share capital	5.000
		Profit (loss)	(1.000)
Active derivative financial instruments	280		
		Payables to banks (Loans)	10.000
		Deferrals	80

Income statement 31.12.2020

Interest and other financial charges	900	
Write-down of financial instruments Derivat	100	
Profit (loss)	1.000	

31-dec-2021 – Recognition in the income statement of the portion of the premium for the year, recognition of the change in the time component of the CAP, the change in the fair value of the intrinsic value and the interest on the loan

			DEBIT	*CREDIT*
2.1 - Recognition of the deferral of the premium for the year				
Write-down of financial instruments Derived	@	Deferrals	100	100
2.2 - Detection of the change in the time value of the cap				
Deferrals	@	Active derivative financial instruments	130	130
2.3 - Recognition of changes in the fair value of the cap				
Active derivative financial instruments	@	Reserve for OCFFA	200	200
2.4 - Recognition of accrued interest				
Interest and other financial charges	@	Cash	1.100	1.100
2.5 - Cash flow hedge reserve reversal on an accrual basis				
Reserve for OCFFA	@	Interest and other financial charges	100	100
2.6 - Settlement of the differential on the cap				
Cash	@	Active derivative financial instruments	100	100

31-dec-2021 – Statement of financial position and profit or loss

Balance sheet 31.12.2021

Cash	12.800	Share capital	5.000
		Reserve for OCFFA	200
Active derivatives	350	Retained earnings (loss)	(1.000)
		Profit (loss) 31.12.2021	(1.100)
		Payables to banks (Loans)	10.000
		Deferrals	50

Income statement 31.12.2021

Interest and other financial charges	1.000	
Impairment of fin. Derivative instruments	100	
Profit (loss)	1.100	

31-dec-2022 – Recognition in the income statement of the portion of the premium attributable to the year, recognition of the deferral of the 2022 accrual component of the CAP, interest on the loan, closing of the loan and settlement of the derivative

			DEBIT	*CREDIT*
4.1 - Recognition of the deferral of the premium for the year				
Write-down of financial instruments Derived	@	Deferrals	100	100
4.2 - Detection of the change in the time value of the cap				
Deferrals	@	Active derivative financial instruments	150	150
4.3 - Closure of the derivative (settlement)				
Cash	@	Active derivative financial instruments	200	200
4.4 - Recognition of interest accrued on the loan				
Interest and other financial charges	@	Cash	1.200	1.200
4.5 - Cash flow hedge reserve rollover on an accrual basis				
Reserve for OCFFA	@	Interest and other financial charges	200	200
4.6 - Recognition of loan repayment				
Payables to banks	@	Cash	10.000	10.000

31-dec-2022 – Statement of financial position and profit or loss

Balance sheet 31.12.2022

Cash	1.800	Share capital	5.000
Active derivatives	-	Retained earnings (loss)	-
		Profit (loss) 31.12.2021	(2.100)
		Payables to banks (Loans)	(1.100)

Income statement 31.12.2022

Interest and other financial charges	1.000	
Impairment of derivative financial instruments	100	
Profit (loss)	1.100	

20.4. The tax treatment of derivative financial instruments

20.4.1. Principle of enhanced derivation and the amendments made by Article 13-bis of the "Milleproroghe Decree"

As is well known, Legislative Decree no. 139 of 18th August 2015, implementing European Directive 34/2013/EU, has profoundly modified the criteria for preparing the financial statements of companies that adopt national accounting standards. In particular, among the areas affected by the aforementioned reform, the new rules for accounting for derivative financial instruments are of particular importance. These rules have been extensively outlined in the previous chapter, to which reference is therefore made in full.

As far as tax aspects are concerned, the new methods of accounting for derivative financial instruments have made it necessary to extensively restyle the tax legislation with the aim of coordinating the accounting changes introduced by Legislative Decree no. 139 of 18th August 2015 with the rules for determining the IRES and IRAP taxable amount.

To this end, the legislator has provided for this through the introduction of Article 13-bis of Legislative Decree No. 244 of 30th December 2016 called "Coordination of the rules on IRES and IRAP with Legislative Decree No. 139 of 2015" (so-called "Milleproroghe Decree").

In particular, paragraph 2 of the aforementioned provision amended Article 83 of Presidential Decree No. 917 of 22nd December 1986 (T.U.I.R.) extending, also to entities that adopt national accounting standards, the principle of enhanced derivation on the basis of which the qualification, temporal allocation and classification criteria provided for by the new OIC accounting standards are recognized, for the purposes of determining the IRES taxable amount, and also by way of derogation from the provisions of business income[1].

In addition, pursuant to letter f) of the aforementioned Article 13-bis, Article 112 of the T.U.I.R. has been profoundly modified, starting with the same heading, eliminating the phrase "off-balance sheet transactions" to make room for and take into account the new rules for the recognition of derivative financial instruments as defined by the new Article 2426, paragraph 2 of the Civil Code and by OIC 32.

1 In the absence of a regulatory intervention in this sense, a double track would inevitably have been determined, civil and fiscal, given the so-called "Constitutional Law". financial invariance clause contained in Article 11 of Legislative Decree no. 139 of 18th August 2015.

In general, the amendments to Article 112 of the T.U.I.R. concerned, on the one hand, the tax discipline applicable to speculative (or non-hedging) derivative instruments through the recognition, pursuant to paragraph 3-bis of Article 112 of the T.U.I.R., of the full tax relevance of the negative components recorded on the basis of the correct application of national accounting standards, on the other hand, the definition of the hedging relationship which, pursuant to the new paragraph 6, now provides, for all companies, that "the derivative financial instrument is considered to be for hedging purposes based on the correct application of the accounting principles adopted by the company".

That being said, the tax treatment applicable to the so-called derivative financial instruments will be dealt with separately below speculative and hedging activities.

20.4.2. The tax discipline of the so-called speculative derivative financial instruments

With regard to the tax treatment of speculative derivative financial instruments (hereinafter, speculative derivatives), paragraph 2 of Article 112 of the T.U.I.R. provides that the positive and negative components resulting from the valuation of speculative derivatives at the end of the financial year contribute entirely to the formation of income.[2]

2 Transitional arrangements: as established by paragraph 5 of Article 13-bis of Legislative Decree no. 244 of 30th December 2016, the amendments introduced to the tax rules relating to derivative financial instruments apply with regard to income and balance sheet components recognised in the financial statements starting from the year following the year in progress as of 31st December 2015, while the income and equity effects on the financial statements of the aforementioned year continue to be subject to the tax rules in force, and of subsequent transactions that "are differently qualified, classified, valued and allocated for tax purposes compared to the qualifications, classifications, valuations and temporal allocations resulting from the financial statements for the year in progress as at 31st December 2015".
However, an express exception is provided for the tax discipline applicable to so-called derivatives. speculative (and not, i.e. for hedging derivatives), according to which the previous rules continue to apply to those derivatives already recorded in the financial statements in the year in progress as at 31st December 2015. In this case, therefore, the limitations contained in paragraph 3 of Article 112 of the T.U.I.R. will also apply. On the other hand, for speculative derivatives already entered into before 2016, but not yet recorded in the financial statements, the tax relevance of the valuation components is postponed to the time of realization, thus crystallizing the tax effects resulting from the new accounting method at the (subsequent) time of extinction of the derivative instrument.

Following the reform of Article 112 of the T.U.I.R., the recognition of valuation components (fair value) is complete, as the limitations contained in paragraph 3 below do not apply , according to which "the negative components referred to in paragraph 2 may not exceed the difference between the value of the contract or service at the date of conclusion or at the end of the previous financial year and the corresponding value at the end of the financial year [...]".

In this regard, paragraph 3-bis of Article 112 of the T.U.I.R. which, in the previous formulation, established the full relevance of negative fluctuations in fair value and, therefore, full deductibility, only for entities that prepare the financial statements in accordance with international accounting standards (IAS/IFRS), now also applies to entities that prepare the financial statements in accordance with the UCIs.

The current wording of paragraph 3-bis provides, in fact, that "by way of derogation from paragraph 3, for entities that prepare financial statements on the basis of international accounting standards referred to in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19th July 2002, and for entities, other than micro-enterprises referred to in Article 2435-ter of the Civil Code, that prepare the financial statements in accordance with the provisions of the Italian Civil Code, the negative components charged to the income statement on the basis of the correct application of these principles are also relevant for tax purposes".[3]

20.4.3. The tax discipline of hedging derivative financial instruments

With regard to the tax aspects related to hedging derivative financial instruments (hereinafter also hedging derivatives), the most significant amendment made to Article 13-bis of Legislative Decree 30th December 2016, no. 244 focused on the tax notion of the hedging relationship.

In this regard, the new paragraph 6 of Article 112 of the T.U.I.R. establishes that "the derivative financial instrument is considered to be for hedging

3 The limitation referred to in paragraph 3 of Article 112 of the T.U.I.R. remains, therefore, only for the so-called "S.S. micro-enterprises referred to in Article 2435-ter of the Italian Civil Code. However, it should be noted that such an exclusion would be superfluous since the so-called "exclusions" are not necessary. In any case, micro-enterprises are not required to recognise derivative financial instruments in the financial statements. In addition, that limitation would appear to remain valid for insurance undertakings, since they are not required to assess the *fair value* derivative financial instruments.

purposes on the basis of the correct application of the accounting principles adopted by the company".

Therefore, the reference to the notion of hedging relationship contained in the OIC 32 accounting document (or in IAS/IFRS, if the taxpayer adopts international accounting standards) is clear and immediate. As outlined in the previous chapter, to which reference is therefore made in full, this reference determines new documentary burdens for the taxpayer to demonstrate the purpose of hedging the derivative financial instrument subscribed.

Apart from the above-mentioned amendment, the tax regime for hedging derivatives has remained substantially unchanged.

In this regard, it should be noted that the applicable tax regime differs depending on whether the derivative financial instrument is subscribed to hedge changes in the fair value of a given item in the financial statements (so-called "derivative financial instrument" fair value hedge) or is subscribed to hedge the risk of variability of expected flows, thus covering interest-bearing assets and liabilities (so-called "fair value hedges" cash flow hedge).

Fair value hedge derivatives

The tax rules applicable to so-called fair value hedge derivatives can be found in paragraph 4 of Article 112 of the T.U.I.R., according to which for such derivative instruments "the related positive and negative components deriving from valuation or realization contribute to the formation of income according to the same provisions that govern the positive and negative, arising from the valuation or realization, of the hedged or hedged assets or liabilities respectively".

The above-mentioned tax discipline is based on the so-called principle of symmetry, such that changes in the fair value of the derivative instrument adopt the same tax regime as for the positive and negative components of the hedged asset or hedging liabilities. Where, therefore, the derivative instrument is effective, the components (positive or negative) deriving from the valuation or realization of the derivative financial instrument and those, symmetrically opposed, of the hedged asset or liability, will be neutralized, keeping the tax effect null.

Cash flow hedge derivatives

On the other hand, in the case of derivative financial instruments subscribed to hedge the risk of variability of cash flows (i.e., interest-bearing assets or liabilities), the tax treatment is governed by paragraph 5 of Article 112 of the T.U.I.R., pursuant to which, if the derivative financial instruments "are recorded in the financial statements for the purpose of hedging risks relating to interest-bearing assets and liabilities, the related positive and negative components contribute to forming income, according to the same criterion for the allocation of interest, if the transactions are aimed at hedging risks related to specific assets and liabilities, or according to the duration of the contract, if the transactions are intended to hedge risks related to sets of assets and liabilities".

To better understand the tax treatment mentioned above, it is noted that, with reference to specific hedging operations of interest-producing assets or liabilities (for example, an interest rate swap to hedge a variable rate loan), the new accounting settings specify that the effective portion of the changes in the derivative instrument is allocated to a specific reserve, in the cash flow hedge in the balance sheet, passing instead to the income statement only when it becomes necessary to integrate the economic flow that it is intended to cover.

Therefore, the tax relevance of fluctuations in the fair value of the derivative instrument is postponed to a later date (i.e. the allocation to the income statement), as also clarified by Article 7 of the Ministerial Decree of 8th June 2011 (applicable, today, also to OIC adopters) according to which, "in the event of hedging of cash flows, the gains or losses generated by the instrument for hedging purposes, contribute to the determination of the taxable amount at the time of allocation to the income statement, according to the provisions of paragraph 5 of art. 112 of the Consolidated Act".

Therefore, and concluding the above-mentioned example of interest rate swaps to hedge floating-rate loans, the portion that will pass through the income statement will contribute to the formation of the taxable income and, since the same rules apply as for interest (income and payable), it will be subject to the limitations contained in Article 96.

PART IV
ESG principles in real estate investment

21.
The legal and regulatory framework

by L. Bovo and A. Scarfone

21.1. The 'ESG Criteria': introductory profiles

21.1.1. Foreword

As is now well known, the acronym ESG refers to the three English-speaking terms whose specific scope is still being debated today: Environmental, Social and Governance. These are the three fundamental factors used to verify, measure, control and maintain the commitment in terms of 'sustainability'[1] of a given company or institution, including its acquisition of 'sustainable' products or investment choices that are driven by sustainability profiles.

The ESG phenomenon, which is well known and debated beyond the financial world, is primarily a series of measurement indices and standards that, in many cases, are still being developed. These indices measure not only the environmental, but also the social and *governance* activities of an institution (whether public or private). These criteria take the form of a set of operational practices designed to inspire corporate models to achieve certain environmental, social and corporate *governance* objectives. They are used by investors to guide their investment choices, enabling them to see what their sustainable investment strategies have in common with a specific company. It is well known that the three factors have become both building blocks of companies' objective function and parameters for their evaluation in the markets.

1 For further discussion on sustainability, see, among others, R. Lener and P. Lucantoni, *Sostenibilità ESG e attività bancaria*, in *Banca, borsa e titoli di credito*, fasc. no. 1 2023; M. Lembo, *Servizi di investimento e sostenibilità ESG: il nuovo assetto normativo alla considerazione della più recente disciplina comunitaria*, in *Rivista del diritto commerciale,* fasc. no. 1 2023.

As mentioned above, the three ESG factors are:

a. environmental (denoted by the letter 'E' - '*Environmental*'), including climate change mitigation and the transition to climate neutrality, i.e. to a zero-emission economy, as well as the preservation of biodiversity, pollution prevention and the circular economy. These environmental criteria are used to assess how a company 'behaves' towards its environment and how environmental issues are reflected in the company's own policies;
b. social (denoted by the letter 'S' - '*Social*'), including inequalities (gender, age, etc.), diversity and inclusion, labour relations, investment in training, community welfare and respect for human rights. The criteria therefore relate to the social impact that the institution may have on its territory, employees, people, suppliers, customers and more generally the communities in which it operates or with which it interacts; and
c. governance (denoted by the letter 'G' - '*Governance*'), which pertains to the corporate governance of institutions, both public and private, and which is known to play a key role in ensuring that the social and environmental considerations outlined *above* form part of the respective decision-making processes.

Paying attention to sustainability profiles (as determined above) makes commercial sense: a large body of economic literature notes that:

- good sustainability practices are generally associated with better economic and financial *performance*;
- attention to ESG factors has a positive effect on the containment of legal and reputational risks for institutions, on their operating results, as well as on the perception of company-specific risk; and
- the criteria help reduce the risk premium and cost of capital, with considerable benefits in terms of financial performance[2] .

A financial investment that shows a company also cares about ESG factors means, therefore, investing in institutions that make sustainable business choices that are consistent *first with* the principles of the United Nations Global Compact (relating mainly to human rights, labour standards, environmental protection and the fight against corruption), with the objectives of the United Nations 2030 Agenda for Sustainable Development and, finally, with the Paris Agreement on climate change. Principles that, as discussed in the following paragraphs, also underpin the European sustainability framework and ESG factors.

2 For a more detailed discussion of the topic, see Chapter 22.

21.1.2. ESG and Real Estate

Having said that, we should point out that for some time now in the *real estate* field the issue of sustainability has been the centre of attention for *real estate* operators[3] to varying degrees, from the impact on individual buildings to the context of reference.

In fact, investors, both local and international, are paying ever greater attention to environmental (and other) sustainability issues than they did a few years ago. In particular, an increasing number of operators, especially institutions[4], are adopting an *asset* management approach based on compliance with ESG criteria (such as energy efficiency, with a view to bringing their properties in line with the highest *standards of* environmental sustainability). In order to assess the veracity of their claims and compliance with these factors, it is now customary to carry out a 'ESG *due diligence*' exercise.

The impact of ESG parameters in the real estate sector is evident in two distinct market profiles: on the one hand, banks and/or institutional investors seem to be increasingly willing to finance projects and transactions that relate to developments and/or real estate whose design and implementation is in line with ESG principles, while tenants, as companies also commit to ESG criteria, are moving towards sustainable real estate solutions.

With regard to the first profile, given the current difficult economic situation and its impact on access to credit, investors prefer projects and operations that are sustainable both socially and environmentally. In this context, it seems that sustainability certifications are not only an advantage in the market, but also an entry requirement. This trend manifests itself in two distinct ways: on the one hand, buyers tend to use financial instruments linked to sustainable performance and objectives (*e.g. green loans*, *green bonds, sustainable bonds*)[5], directing their investment capacity towards sustainable projects; on the other hand, sellers are more inclined to acquire a '*green*'

3 For further discussion on ESG in the real estate sector, see, among others, C. Turotti, E. Molinaro, L. Cordischi and L. Toscano, L'*impatto dei parametri ESG sul settore immobiliare*, in *Contratti - La Rivista*, February 2023, no. 8; O. Tronconi, *"Criteri ESG"; cosa sono, come nascono e come si concreti nel settore Real Estate*, in *Consulente Immobiliare,* 30 September 2023, no. 1167.

4 Please note that many investment funds, since their incorporation, now pursue ESG principles in the selection and management of investments. This inevitably implies a new approach both in the analysis phase of the technical-legal documentation preparatory to the acquisition and in the negotiation phase of the financial documentation.

5 For an effective discussion of sustainable financial instruments, see section 22.2.2.

property (perhaps with environmental certifications) as it represents 'liquid' and 'bankable' property. It is well established that new real estate projects that do not have high sustainability aspirations struggle to be absorbed by the market, as they do not meet demand expectations.

Regarding the second profile, more and more market players are included to choose 'certified' properties, with landlords' and tenants' concerns about ESG issues directly reflected in the rental contract. These contracts include the parties' obligations to cooperate and identify the most appropriate strategies for energy efficiency of the property and the tenant's obligations with respect to the training of its employees in the adoption of best practice in terms not only of energy or water saving or reduction of CO2 emissions, but also appropriate waste management.

The proliferation of ESG issues in the real estate sector is further evidenced by the considerable number of investments that have been (and continue to be) made in the recent period in four specific sectors that exemplify the *Social* principles: the *healthcare* sector, *senior housing*, *social housing* and *student housing.* In fact, the upgrading of accommodation facilities in these sectors promotes not only the objective of providing a service that is increasingly attentive to the new needs of users, but also helps ensure better social integration and wellbeing (which includes housing) of users.

21.2. International and European regulatory framework

21.2.1. The international context: the Global Compact, the 2030 Agenda and the Paris Agreement

In recent decades, the international order has contributed to crucial regulatory initiatives aimed at shaping the future of our planet. Three of these initiatives qualify as fundamental pillars of global sustainability: the UN Global Compact, the 2030 Agenda and the Paris Agreement. In this short section we explore the synergy between these initiatives and their impact on professionals (including real estate professionals) involved in promoting sustainability.

The United Nations Global Compact[6] (United Nation Global Compact), which launched on 16 July 2000, is a global pact between business and the Unit-

6 For a detailed examination of the principles underlying the Global Compact, see V. Balocco, *UN Global Compact: what it is and why it matters for business*, available at www.esg360.it.

ed Nations aimed at encouraging companies worldwide to promote a sustainable global economy. It is based on ten universal principles centred on sustainability, covering human rights, labour, environment and anti-corruption. These principles provide an ethical framework for companies, which are called on to integrate them into their daily strategies and practices. Professionals are instrumental in driving this integration, by ensuring that organisations adhere to the Global Compact principles and thus contribute to sustainable development.

The reference points of the *Environmental*, *Social* and *Governance* logic are also identified in two other major events: the UN 2030 Agenda for Sustainable Development and the Paris Agreement, both finalised in 2015.

The 2030 Agenda is an ambitious plan of action adopted in 2015 by all 193 Member States of the United Nations. The agenda is embodied in the Sustainable Development Goals (SDGs), a set of 17 global goals aimed at ending poverty, protecting the planet and ensuring prosperity for all, which are to be achieved by all Member States by 2030.

The Paris Agreement, finalised in 2015 during COP 21, marks a further milestone for the planet's sustainability issues and is the first major universal and legally binding understanding on climate change. Its main goal is to limit the global average temperature rise to less than 2 degrees Celsius above pre-industrial levels and to continue efforts to limit it to 1.5 Celsius by 2050.

Integrating the Global Compact, the 2030 Agenda and the Paris Agreement presents challenges and opportunities. The synergy between these initiatives could maximise the positive impact of organisations on the planet. However, it is crucial to deal with the challenges in this virtuous journey, including the need to measure and communicate the impact transparently, the complexity of international regulations and the resistance to change in some organisations.

Market players, especially in the *real estate* sector, play a key role in steering organisations towards global sustainability. These players have the potential to be catalysts for change and pioneers of this transformation, by adopting innovative strategies and collaborating with stakeholders. In this way, they could contribute not only to the success of their organisations, but also to the creation of a sustainable world for future generations.

21.2.2. The European Directive 2014/95 (NFRD)

In the international context discussed in the previous paragraph, it is worth mentioning that the European Union is also working to integrate sustainability considerations into the European regulatory framework and to introduce specific rules aimed at achieving sustainable finance, among other things. In the following paragraphs, the regulatory acts introduced by the European legislator will be analysed, including their scope, objectives and key factors, as well as potential problems and the possible solutions adopted by market participants.

The first act introduced by the European Union with the aim of managing the transition to a sustainable EU economy, combining long-term profitability, social justice and environmental protection, is the European Directive 2014/95, commonly known as the NFRD (*Non-Financial Reporting Directive*). This piece of legislation represents a major step forward in the integration of social, environmental and governance dimensions into corporate reporting. The underlying *rationale* is to enable all *stakeholders* to have access to a range of information regarding the company's social and environmental impact, i.e. the impact the company itself has on ESG factors. It is only by making this information available to the market that investors will be able to assess not only a company's financial *performance, but* also its 'non-financial' *performance*, thus allowing them to factor both into their investment choices[7] . In pursuit of this aim, the aforementioned legislation introduces a *disclosure* requirement for large companies that are public interest entities with an average of more than 500 employees, or public interest entities that are parent companies of a large group, with an average of more than 500 employees on a consolidated basis. The NFRD therefore applies mainly to listed companies that are known to be public interest entities and requires them to provide non-financial information in addition to their traditional annual financial statements.

The two main aspects of the disclosure obligations introduced by the NFRD are the disclosure of the company's *diversity policy*, and its *non-financial disclosure.* Basically, the first obligation is aimed at ensuring greater transparency on corporate governance and encouraging diversity in the composition of its administrative and/or control bodies; the second obliges companies to disclose a statement containing "at least environmental, social, personnel, human rights, and anti-corruption information to the extent necessary for an understanding of the company's performance, its results, its situation and the impact of its activities"[8] .

7 See R. Ibba, *L'introduzione di obblighi concernenti i fattori ESG a livello UE: dalla direttiva 2014/95 alla proposta di direttiva sulla corporate sustainability due diligence*, in *Banca, borsa, titoli di credito*, 2023.

8 See Article 1 of this Directive.

The European legislator does not impose a specific *disclosure* standard, but rather allows individual companies the choice of relying on national, EU or international *reporting* models or they may choose not to use any of the standards. Furthermore, the "*comply or explain*" mechanism is provided for, which does not provide for sanctions if the omission is justified.

Finally, it should be noted that, given the breadth and vagueness of the content of the disclosure obligation identified in the wording of the Directive, audit firms are only given a formal control to verify the disclosure of non-financial information. On the other hand, the European legislator does not impose any obligation to check the content of the declaration, let alone its truthfulness and/or completeness. Moreover, in the event that the institution fails to release the information when due, the Directive leaves it to the individual Member States to identify the appropriate sanctions[9] .

The European Directive 2014/95 represents a key opportunity for European companies to demonstrate *leadership* in sustainability. Professionals should embrace this challenge as a means to improve corporate governance, create sustainable value and contribute positively to society and the environment. Proactive adoption of NFRD would not only foster regulatory compliance, but also position companies on the path towards long-term sustainability.

21.2.3. The European Directive 2017/828

The non-financial disclosure obligation was followed by the European Directive 2017/828, whereby the EU legislator intends to facilitate and incentivise greater long-term shareholder engagement by imposing new rules and obligations regarding corporate *governance* and transparency between companies and investors.

The Directive's main objective is to strengthen shareholders' rights and improve transparency within listed companies. In particular, it aims to deal with the challenges of short-term investment management by promoting a long-term view in the interests of companies and their shareholders. According to the European legislator, one incentive that could promote the

9 On this point, with Legislative Decree No. 254/2016 implementing the Directive, the Italian legislator provided for a fine of between EUR 20,000 and EUR 100,000 for entities that fail to publish the non-financial statement, identifying CONSOB as the authority in charge of detecting violations and imposing the relevant sanctions.

adoption of decisions based on a long-term ESG perspective is the greater involvement of shareholders in the corporate *governance of* the company, as defined under Recital 14 of the Directive in question. This involvement must entail the proper transmission of relevant information to those exercising voting rights, in order to facilitate transparency, awareness and the proper exercise of those voting rights. Moreover, given that institutional investors are now increasingly the reference shareholders of listed companies, the Directive imposes an obligation on them to communicate their investment strategies to the public, thereby ensuring consistency in a long-term perspective, so that everyone, including the final beneficiaries, can be aware of these aspects. The scope of the Directive, therefore, also extends to institutional investors who have invested in shares admitted to trading on a European regulated market and *asset managers* who have invested in such shares on behalf of investors.

Greater shareholder involvement is also expressly required with respect to the remuneration policy regarding directors of listed companies. On this point, the Directive requires that the shareholders' right to vote is guaranteed; the vote may be binding or merely advisory, at the discretion of the individual Member State.

In conclusion, the European Directive 2017/828 represents a milestone in strengthening corporate governance and promoting responsible practices within listed companies. Industry professionals should fully understand its scope, purpose and key aspects to comply with the new regulations and contribute to the creation of a more stable and sustainable financial environment in Europe.

21.2.4. European Regulation 2019/2088 (SFDR)

The European Regulation 2019/2088, commonly known as the SFDR (*Sustainable Finance Disclosure Regulation*), represents a significant step towards promoting sustainability and transparency in the financial sector. This regulation, which focuses on sustainability disclosure in the financial services sector, defines the transparency requirements for green investments and substantially amends the European Regulation 2016/1011 (the *Benchmark* Regulation).

In force as of 10 March 2021 and in full force as of 1 January 2023, the SFDR aims to promote market disclosure by financial service providers and investment recommendation providers, with a focus on the integration of ESG factors. The scope of application of the Regulation is extensive and involves a wide range of financial industry players, such as fund managers, financial advisors, insurers and other financial entities offering investment products. It applies also to non-financial companies with more than 500 employees, requiring them to disclose sustainability information in their annual reports.

Like any transparency regulation, it concerns conduct to be observed and documents to be delivered or made available to the client. Clearly, the common denominator is the implementation of ESG risks in investment processes. Its main focus is the definition of sustainable investments[10] and the principle of not doing 'significant' damage to ESG objectives.

In general, the primary aim of the SFDR is to encourage the flow of investments towards sustainability by reducing information asymmetries through the creation of a European standard of 'ESG *disclosure*', which requires all actors to adopt the same terminology. Furthermore, the SFDR aims to prevent '*greenwashing*', i.e. the practice of misrepresenting financial products as more sustainable than they actually are[11] .

In summary, the European Regulation 2019/2088 is a crucial regulatory tool that pushes the financial sector towards greater sustainability and transparency. Industry professionals should adopt a holistic perspective when integrating sustainability factors into their daily practices, while ensuring accurate and comprehensive disclosure to guide investors towards more informed and responsible decisions.

21.2.5. The European Regulation 2019/2089 and the European Regulation 2020/852 (Taxonomy Regulation)

As discussed in the previous paragraphs, the first three acts promulgated by the European Union focused on disclosure obligations for (i) large listed companies, (ii) the most important shareholders of those companies, and (iii) all financial market participants. With these three acts, the European legislator aimed to bring about a change in the behaviour of market participants with regard to sustainability, not through the coercive imposition

10 To this end, the Regulation differentiates between financial products that are *mainstream* (non-sustainable), *light green* (where sustainability factors play a relevant role in investment choices, even if no specific sustainability objective is pursued) and *dark green* (where internal assets are used in pursuit of a specific sustainable investment objective).

11 For a detailed examination of the phenomenon of *greenwashing* and the associated risk profiles, see sector 23.1.

of an obligation forcing greater corporate social responsibility, but through the exploitation of the competitive market mechanism, which, according to this legislative strategy, should benefit the most sustainable players. The legislator's hope was thus as follows: once sustainability information had been made public, companies and other market players would have to voluntarily assume a greater social commitment by virtue of the fact that they would be rewarded by the market, both in reputational terms and in terms of greater financial stability and better long-term results.

However, for this approach to work, it is necessary to accompany the various *disclosure* requirements with the standardisation of this information and its reliability. To this end, only by using reference indices is it possible to assess and compare the activities promoted as sustainable within the market, and this is one of the reasons to which Regulation 2019/2089 and Regulation 2020/852 (the Taxonomy Regulation) respond.

European Regulation 2019/2089 was promulgated in the light of a multitude of categories of indices and *benchmarks*, promoted as sustainable indices, that have been created and used in the market. In this context, the regulation in question seeks to ensure as harmonised a perspective as possible in the use of these *benchmarks*, in order to avoid confusion among the operators using them. The regulation, in fact, sets common minimum requirements for the development and construction of a specific category of *benchmarks*, intended as reference indices of the Climate Transition Union and aligned with the Paris Agreement.

The Taxonomy Regulation aims to define what constitutes a "sustainable economic activity", openly condemning *greenwashing* practices as activities that discourage investors from investing in environmentally sustainable financial products. The underlying need that prompted the promulgation of this act stems from the effective lack of a common definition of 'sustainable investment', and was also fuelled by the absence of a common *reporting* standard to define whether an activity is sustainable or not. To overcome these problems, the European legislator has worked on an unambiguous definition of which economic activities and investments can be defined as sustainable, harmonising this concept throughout the EU. In particular, the regulation focuses on the definition of environmentally sustainable activity and identifies six environmental and climate objectives[12] . In this sense, an

12 Specifically, the objectives referred to in the Regulation are: (i) climate change mitigation; (ii) adapting to climate change; (iii) sustainable use and protection of water and marine resources; (iv)

economic activity is considered environmentally sustainable if it contributes substantially to at least one of the six objectives, without causing further significant harm to the others (the "*do no significant harm*" principle).

Alongside the environmental taxonomy mentioned above, there is also the social taxonomy. This too is inspired by the model of the Environmental Taxonomy and is identified as a classification system that aims to define social objectives and at the same time identify the activities that contribute substantially to their achievement. In order to identify such socially sensitive activities, the European Commission mandated the *Platform on* Sustainable Finance (a group of experts who assist the European body in developing policies for sustainable finance) to identify an unambiguous concept of socially sustainable investment within the European Union. The Social Taxonomy, based primarily on regulatory sources, aims to ensure both decent working conditions and adequate standards of living and wellbeing for consumers and users of products and services.

The European Regulation 2019/2089 and the Taxonomy Regulation are redefining the way companies operate and the way they are evaluated. Market participants must adapt to this new environment, by embracing sustainability as a fundamental pillar of their activities. This transformation not only meets the regulatory requirements, but also offers opportunities for innovation and long-term value creation.

21.2.6. The European Directive 2022/2464 (CSRD)

The European Directive 2022/2464, commonly known by its acronym CSRD (*Corporate Sustainability Reporting Directive*), represents a major step forward in promoting sustainable and transparent business practices in the European Union. This body of legislation introduced environmental and social reporting obligations for companies, significantly complementing the previous NFRD and establishing even more detailed sustainability reporting requirements. In fact, the CSRD replaces the term 'non-financial statement' used in the previous legislation with the more specific term 'sustainability information'. The amendment is not merely terminological: it underlines the idea that sustainability information not only qualifies as 'non-financial', but also has a clear impact on the company's financial plan.

transition to a circular economy; (v) prevention and reduction of pollution; (vi) protection and restoration of biodiversity and ecosystems.

Finally approved at the end of 2022 and coming into force at the beginning of 2023 (with effective application from January 2024), this Directive's ambitious goal is to strengthen the existing regulatory framework for corporate reporting and push companies to increasingly integrate sustainability into their strategies and operations.

The NFRD applies to a wide range of entities, including large companies and corporate groups that are public interest entities with at least 500 employees and net revenues exceeding €40 million, corporations listed on regulated markets in the EU (excluding listed micro-enterprises), and foreign companies that have a secondary office in the EU and a turnover in the EU of more than €150 million. The scope of this Directive appears to be broader than that of the NFRD, and *disclosure* requirements are thereby made more stringent in order to combat *greenwashing* more effectively, although their introduction is very gradual[13] . The choice of gradual application is determined by the awareness of the effort required especially from SMEs to structure not only their reporting, but also above all, their upstream processes.

Further novelties introduced by the CSRD concern both the format of the declaration (as the non-financial declaration of the NFRD has been replaced by an integrated sustainability report) and the adoption of drafting standards. With respect to the latter, the CSRD Directive prescribes the use of the *European Sustainability Reporting Standards*, indices drawn up by the *European Financial Reporting Advisory Group* (*EFRAG*), with the aim of re-

13 In this regard, please note that the rules introduced by the CSRD will be applied progressively over time. In particular, they will be applicable as of the financial statements for the financial year:
(i) 2024, for companies already obliged to publish the non-financial character statement (NFRD);
(ii) 2025, for other large companies;
(iii) 2026, for listed SMEs; and
(iv) 2028, for branches of non-EU companies.
Member States are meanwhile obliged to transpose the Directive by 6 July 2024. It should be noted that, in Italy, Legislative Decree No. 125/2024, which came into force on 25 September 2024, has transposed the CSRD Directive, expanding the range of Italian companies subject to the previous regulations on non-financial reporting and requiring that companies' non-financial data be communicated according to certain uniform reporting standards (*European Sustainable Reporting Standards - ESRS*) and with the same rigor typical of financial data. Such sustainability information is subject to a compliance attestation requirement and must be published together with the related compliance report prepared by a statutory auditor or an auditing firm (drawn up in terms of "*limited assurance*"). Therefore, these sustainability reporting obligations will necessitate a redefinition of corporate governance models and will introduce new compliance profiles and consequent potential liability for directors. For a more in-depth discussion on the topic of director's liability profiles, see paragraphs 23.2 and 23.3.

ducing reporting costs in the medium and long terms and facilitating the comparability of information.

The issue of sustainability therefore plays an increasingly important role in business decisions and thus occupies an increasingly prominent position on the agenda of a company's board of directors. Indeed, it is precisely the board of directors that assumes responsibility for what is stated in the sustainability report, as well as being subject to *due diligence* and *accountability obligations*, i.e. the fundamental obligation to be informed[14] .

With regard to the subject of the *body of* information to be disclosed, the Directive applies the criterion of *double materiality.* This approach obliges the *report* to note on the one hand, together with the financial impact, the impact of the sustainability risk – and in particular climate change – on the company's financial *performance* and business positioning (*inside-in perspective) and*, *on the* other hand and vice versa, the impact of the company on the community and the environment (*inside-out* perspective). In accordance with the dual criterion, therefore, both the impact of the company on sustainability and the impact of sustainability on the company are subject to disclosure[15] .

The main aim of CSRD is, therefore, to improve the quality and consistency of sustainability information provided by companies. It seeks to ensure that companies fully and comparably report on their environmental, social and governance (ESG) impacts. Furthermore, the CSRD aims to promote greater transparency and accountability, enabling investors, regulators and the public to better assess the sustainable performance of companies.

In conclusion, CSRD presents itself as a key catalyst for change in corporate reporting, pushing companies to integrate sustainability into their decision-making processes and to share transparent and verifiable information with the public. Its implementation will require significant commitment on the part of companies in the near future, but it promises to contribute substantially to sustainable and socially responsible economic growth in the European Union.

14 On the subject of directors' liability profiles with respect to ESG factors, see paragraphs 23.2 and 23.3.

15 See M. Cossu, *Sostenibilità e mercati*, in *Banca, borsa e titoli di credito,* fasc. 4 2023.

21.2.7. The European Directive 2024/1760 (CSDD)

The *Corporate Sustainability Due Diligence Directive*, together with the previous legislative acts mentioned above, represents a fundamental pillar for the implementation of the European plan on sustainable economy and finance. This piece of legislation is part of a broader regulatory framework and aims to promote responsible and sustainable best practices by imposing new environmental and human rights *due diligence* obligations on companies operating in the European market.

Specifically, this Directive concerning the duty of care of companies for sustainability purposes was adopted by the European Parliament on 24 April 2024, published on 5 July 2024, in the Official Journal of the European Union, and came into force on 26 July 2024. Member States should transpose the CSDDD into their national law by 26 July 2026.

The version most recently approved by the European Parliament presents a much narrower scope compared to the one originally proposed, envisioning a gradual implementation approach over five years for EU companies and non-EU companies that meet certain revenue thresholds within the borders of the European Union. More specifically, the Directive will apply:

- from 2027, to companies with over 5000 employees and a global turnover exceeding 1.5 billion euros;
- from 2028, to companies with over 3000 employees and a global turnover of 900 million euros; and
- from 2029, to all remaining companies falling within the scope of the Directive, i.e., those with over 1000 employees and a global turnover exceeding 450 million euros.

Furthermore, the CSDDD provides for its application to companies with franchising or licensing agreements in the EU that ensure a common corporate identity with a global turnover exceeding 80 million euros, of which at least 22.5 million euros are generated from royalties. Non-EU companies, parent companies, and companies with franchising or licensing agreements in the EU that meet the same turnover thresholds in the EU will also be covered. Small and medium-sized companies are not directly affected by this regulation but may be indirectly involved, for example, as suppliers to large companies subject to these obligations.

The provisions of the CSDDD therefore oblige large companies to implement risk-based due diligence, with the aim of identifying, assessing, preventing, mitigating, and remedying potential and actual negative impacts on human rights and the environment, in relation to their business operations, those of their subsidiaries, and their business partners within their "value chain." The concept of "negative impact" is fundamental to understanding the scope of the due diligence obligations provided by the CSDDD, as it refers to the impacts that the obligations require companies to identify, prevent, mitigate, and cease. In general, negative impacts will be identified as adverse consequences resulting from the abuse of a person's human rights or the violation of an environmental protection measure. In this sense, it seems that European legislative policy is currently moving towards demanding cooperative behaviour from companies in respect of the general interest objectives we have mentioned so far[16] .

An additional relevant aspect is the fact that the Directive in question is the first binding due diligence instrument that provides for two complementary enforcement mechanisms: on the one hand, Member States will have to identify a public supervisory authority to verify compliance and impose effective and proportionate administrative sanctions; on the other hand, the CSDDD aims to introduce a form of fault-based civil liability, in order to provide access to justice for victims of negative impacts. With reference to the first mechanism, the Directive requires Member States to appoint one or more national supervisory authorities, of public law and independent, in order to monitor compliance with transposition laws. The designated supervisory authorities will have the power to request information from companies, as well as to follow certain compliance orders and investigate compliance with the rules, imposing administrative sanctions and provisional measures. These authorities may act on their own initiative or in response to any reports. In this context, in addition to practical issues related to resources and the willingness to investigate very large companies that pay taxes in their own country, another uncertainty concerns companies from non-EU countries. Since public authorities cannot conduct investigations outside the EU territory, for example, at the headquarters of a company based in

16 Please note that the Italian legal system is also moving in the direction of promoting cooperative behaviour, as is attested by the rediscovery of the principle of solidarity *ex* art. 2 of the Incorporation and its declination both in art. 9, and especially in the new art. 41 paragraph 2 of the Incorporation, which with specific respect to the exercise of free economic initiative now prescribes that "it cannot be carried out in contrast with social utility or in such a way as to damage health, the environment, security, freedom and human dignity". For a more detailed discussion of the new Art. 41 of the Incorporation and sustainability profiles, see F. Fimmanò, *Art. 41 della Costituzione e valori ESG: esiste davvero una responsabilità sociale dell'impresa?*, in *Giurisprudenza Commerciale*, fasc. 5 2023.

Switzerland, the United States, or Eastern countries, it is questionable how a Member State can monitor and sanction a company abroad and effectively enforce a monetary penalty. With reference to the second mechanism, the Directive introduces the concept of civil liability whereby companies can be held liable for damages caused by non-compliance with due diligence obligations. The inclusion of the civil liability mechanism is a particularly appreciable feature, however, it contains some limitations that may restrict the ability of claimants to use it in practice, to assert certain claims, including those for environmental damages or collective rights. Furthermore, companies will be required to establish complaint mechanisms accessible to a wide range of stakeholders. Although the inclusion of such mechanisms is appreciable, they will only provide a partial solution to the lack of remedies often encountered by rights holders. This will most likely make it necessary to resort to complementary mechanisms of access to justice, outside the new provisions introduced by the CSDDD itself.

The main purpose of the CSDD is, therefore, to promote respect for human rights and environmental protection by major companies in terms of their own activities, the activities of their subsidiaries and throughout the *value chain in* which they participate, through the improvement of corporate *governance* particularities and integration of ESG risk management and mitigation processes. It seeks to avoid fragmentation of *due diligence* obligations in the single market, in order to foster legal certainty and expected accountability in the value chain. It is clear that, in order to comply with the *due diligence* obligation, companies will be required to integrate *due diligence* into their corporate *policies*, identify actual or potential adverse effects on ESG factors (again, according to the principle of dual materiality), prevent or mitigate potential effects, establish and maintain a whistle-blowing procedure, monitor the effectiveness of *due diligence policies* and measures, and publicly report them.

All of this will significantly expand the existing (numerous) responsibilities and duties of company directors; therefore, in order to correctly prepare the entry into force of the new Directive, major companies should be proactive in promoting certain activities, such as the mapping of existing *due diligence* policies and processes, value chain mapping, identification of direct and indirect business partners, and identification of any new real or potential risks to the environment and human rights.

21.2.8. Problems and future prospects

Numerous criticisms and concerns have been raised by market participants with regard to the legislative acts outlined above. Since it is difficult – given the purpose of this contribution – to dwell on every single criticism, the main general limitations of the legislative measures analysed above are considered below.

With reference to the first five acts, i.e. the NFRD, the European Directive 2017/828, the SFRD Regulation, the European Regulation 2019/2089 and the Taxonomy Regulation, the main criticism that could be made is that these regulations introduce mere transparency duties for operators, without imposing any obligation to amend their behaviour with regard to compliance with ESG factors. In fact, in these regulations, the consideration of ESG factors in *corporate governance* is based on a purely voluntary approach (through the *comply or explain* mechanism). A further limitation that has emerged is the vagueness and indeterminate nature of the specific disclosure obligations required by the regulations, as they contain lacunae and are unclear. Moreover, these *disclosure* obligations have been imposed without providing for an unambiguous reporting methodology to be followed in communicating the required information to the market. Not only that, but the scope of application of the aforementioned disciplines (in particular of the NFRD) appears to be very narrow, with the aforementioned disclosure obligations being imposed only on a limited number of companies. The controls on compliance with these obligations are seen as particularly weak: a merely formal control is not, in fact, able to assure the users of the information that it is complete and reliable. Finally, it was pointed out that, with respect to the breach of disclosure requirements, it is left to the Member States to determine both the competent authorities responsible for verifying such a breach and the applicable sanctions. This condition may generate a distortion of competition in the market since, depending on the Member State in which the company has its registered office, the sanction regime envisaged in the event of non-compliance will be more or less onerous.

Most of the critical aspects that have been mentioned so far seem to have been taken into account by the European legislator, who has tried to mitigate the criticisms received and transpose them *first* into the CSRD Directive, and *second* into the CSDD Directive. In fact, in these latter regulatory provisions, an attempt has been made to make particular changes to the European regulations in force, not only with respect to the imposition of a true and proper sustainability *reporting* obligation (and not so much with respect to 'non-financial' statements, thus giving financial relevance to this aspect), but also concerning the scope of application of the various disciplines (extending it in the terms identified above), with respect to the content of the *disclosure*, the *reporting* methodology, the controls and the new responsibilities and sanctions provided for.

Furthermore, the CSDD Directive marks a strong change in the approach of the European Union's strategy towards the issue of sustainability. In fact, previously, the objective seemed to be to bind companies to disclose information to the market with respect to their sustainability impact, leaving the competitive mechanism to companies themselves to operate with a view to making more and more operators adopt spontaneous behaviour that respects ESG profiles. Today, however, the European legislator's perspective seems to have changed, based on the fact that mere transparency has not brought the hoped-for results in terms of voluntary adoption of sustainability policies by companies. Indeed, the Corporate Sustainability Due Diligence Directive, advocated by the European legislator, is based precisely on the recognition of the failure of traditional voluntary measures, which have not succeeded in significantly changing the way of companies manage their social and environmental impact, nor have they been able to provide any adequate remedy for the negative impact on human rights resulting from their business activities. Hence the willingness to introduce a real duty for companies, not only to identify negative impacts and publicly mention them, but also to provide for their prevention and reduction through an *ad hoc* strategy; a strategy that, once defined, will have to be correctly implemented in decision-making processes, on pain of exposure to liability.

Despite implementation challenges and uncertainties, the CSDD Directive marks an important evolution in the European Union's approach to sustainability, pushing companies to progressively integrate social and environmental responsibility into their strategies and operations.

21.3. ESG rating

As has been extensively discussed above, sustainability and corporate responsibility has been high on the agenda of investors and companies in recent years. In this regard, ESG (Environmental, Social and *Governance*) *rating is* also beginning to establish itself as a crucial tool for assessing a company's performance from a sustainability perspective. In this section we explore what ESG *rating is*, how it is currently implemented, the role of rating agencies and the European regulatory environment that is shaping its future.

The ESG *rating* (or sustainability rating), a term which already exists and which originated in the financial and *real estate* spheres, can be defined as a synthetic judgement, complementary to that used for traditional *ratings,* which certifies the soundness of an organisation from the point of view of environmental, social and *governance* aspects, in order to determine the sustainability of an investment in the medium-to-long term. Consequently, these criteria go beyond mere financial profitability, and include sustainable business impacts and practices. Investors, increasingly attentive to ESG aspects, use these assessments to make informed decisions on their capital allocations. These ratings are issued by rating agencies[17] (private or public) specialising in this field, whose key characteristic is that they are external to and independent from the entity they are rating.

In the absence of an unambiguous discipline in the market, the ESG scores assigned by several *providers* may diverge from each other, sometimes even excessively, as a result of the various approaches used by providers to construct their *ratings*. The result is a rather heterogeneous picture, which can thereby make it difficult for investors to correctly assess the risk associated with companies with a high ESG *rating.*

The ESG *rating* sector is set to expand in the short term due to its undoubted potential, but it must be emphasised that, given the absence of shared methodologies, a system for comparing the various indicators and a common definition, as well as the existence of multiple ESG *ratings* or *scores*, the likely consequence is great uncertainty.

Therefore, in the renewed strategy for sustainable finance, the EU legislator committed itself to taking measures to improve the reliability, comparability, and transparency of ESG *ratings*. More specifically, in June 2023 the European Commission presented a proposal for a regulation on 'transparency and integrity of environmental, social and *governance* (ESG) rating activities'. The objective of this proposal was to improve the quality of information on ESG *ratings*, through greater transparency of the characteristics and methodologies used, ensuring greater clarity on the activities of providers and preventing possible conflict of interest risks among providers themselves. From this proposal, on 12 December 2024, the European Regulation

17 These include MSCI, Bloomberg, Sustainalytics, Moody's ESG Solutions, Ethical Investment Advice, Ethispere Institute, Innovest, Integrate, Morningstar and many further.

2024/3005 on the transparency and integrity of environmental, social, and governance (ESG) rating activities was published in the Official Journal of the European Union, Series L.[18]

The new Regulation aims to intervene in this sector to ensure transparency, consistency, and quality in the assessment of ESG factors, thereby strengthening the trust of investors, companies, and financial markets and providing them with a reliable evaluation of the sustainability profile of a company or financial instrument. The purpose of the aforementioned Regulation, as stated therein, is "*contribute to the smooth functioning of the internal market, while achieving a high level of consumer and investor protection and preventing greenwashing and other types of misinformation, including social washing, by introducing transparency requirements related to ESG ratings and rules on the organisation and conduct of ESG rating providers.*"[19]

Specifically, ESG *rating* providers based in the EU will be subject to an authorisation and supervision regime managed by the *European Securities and Markets Authority* (the ESMA). Conversely, rating providers located outside the EU must obtain approval from entities authorized by the EU itself or be recognized in the EU register through equivalence decisions. This measure aims to ensure that such entities operate independently and in compliance with regulatory requirements, promoting consistency and comparability in ratings on a global scale. The Regulation also establishes, as a general principle, that ESMA, the Commission, and the public authorities of the Member States should not interfere with the content of the ratings and the related methodologies, while still allowing ESMA the possibility to adopt one or more supervisory and/or sanctioning measures (including the temporary prohibition of providing or publishing ratings, the suspension or revocation of authorization or recognition, and the imposition of financial penalties) should an ESG rating provider fail to comply with the obligations imposed by the aforementioned Regulation.

Furthermore, this regulation stipulates that, in order to ensure a high level of information for investors and other users, information on ratings and rating providers must be made available through the European Single Access Point (known as ESAP), eliminating any interpretative discrepancies among the various providers.

18 Please note that the Regulation came into force on 1 January 2025, and will apply within the Member States starting from 2 July 2026.

19 See Article 1 of EU Regulation 2024/3005.

Another fundamental aspect of the Regulation is the mandatory separation, for ESG rating providers, between rating activities and commercial activities, in order to prevent conflicts of interest and ensure the integrity of the rating process. These rules aim to guarantee the impartiality of the providers, so that ESG rating providers do not face undue pressure from the entities being rated or other market actors.

Since ESG *ratings* and underlying data are used for investment and capital allocation decisions, the overall objective is to improve the quality of indices to enable traders to make the most informed investment decisions possible with respect to the sustainability of the company.

As importantly, an ESG *rating* can act as a bulwark against *greenwashing* practices, as defined in the Regulation itself, providing a clear and objective picture of corporate performance in relation to environmental, social and *governance* aspects. The harmonisation of ESG criteria through *rating* helps to create a level playing field, and ultimately allows investors to make decisions based on reliable data.

In conclusion, ESG *rating* emerges as an indispensable tool for professionals wishing to assess the sustainability impact of companies. With the support of the European Regulation 2924/3005, ESG *rating emerges* as a key tool in curbing *greenwashing* and promoting responsible business practices, creating a more sustainable business environment for all stakeholders and enabling sustainable investment choices.

22.
ESG and its key relevance Real Estate Finance

by M. Monterosso

22.1. Sustainability and transition challenge

21.1.1. Sustainable Development

The United Nations has developed the 2030 Agenda for Sustainable Development[1], with the clear aim to guide the transition towards a sustainable and inclusive economy. Sustainable development is an integrated concept based on three pillars: economic, social and environmental, and the 17 sustainable development goals (SDGs, further detailed into 169 targets) identified by the United Nations are aimed at stimulating action over the 2015-2030 period in areas of critical importance for humanity and the planet. SDGs can be classified and clustered as follows[2]:

Economic Goals

- Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.
- Goal 9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation.
- Goal 10: Reduce inequality within and among countries.
- Goal 12: Ensure sustainable consumption and production patterns.

Societal Goals

- Goal 1: End poverty in all its forms everywhere.
- Goal 2: End hunger, achieve food security and improved nutrition and promote sustainable agriculture.

1 United Nations, UN Sustainable Development Goals – Transforming our world: the 2030 Agenda for Sustainable Development, 2015.

2 J. Rockström, P. Sukhdev (2016), New way of viewing the sustainable development goals and how they are all linked to food, Stockholm Resilience Centre, Stockholm University, 2016.

- Goal 3: Ensure healthy lives and promote well-being for all at all ages.
- Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.
- Goal 5: Achieve gender equality and empower all women and girls.
- Goal 7: Ensure access to affordable, reliable, sustainable and modern energy for all.
- Goal 11: Make cities and human settlements inclusive, safe, resilient and sustainable.
- Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.

Environmental goals

- Goal 6: Ensure availability and sustainable management of water and sanitation for all.
- Goal 13: Take urgent action to combat climate change and its impacts.
- Goal 14: Conserve and sustainably use the oceans, seas and marine resources for sustainable development.
- Goal 15: Protect, restore and promote sustainable use of terrestrial ecosystems sustainably manage forests, combat desertification, halt and reverse land degradation and halt biodiversity loss.

Overall Goal

- Goal 17: Strengthen the means of implementation and revitalize the global partnership for sustainable development.

Corporates increasingly refer to the SGDs to express their commitment to sustainable developments and illustrate their own progress and actions. In doing so, many companies first refer to those goals that best fit their business model and activities. However, the 17 SGDs and 169 targets can also be used as holistic set of aims and activities to guide and review companies' approaches[3] and benchmark how ambitious a company can be vs competitors in the same peers group.

3 R. Hahn, Sustainability Management, Block Services, 2022.

21.1.2. Transition challenges

Climate change is one of the largest environmental risks affecting society. Starting at the Earth Summit in Rio de Janeiro in 1992, the United Nations Framework Convention on Climate Change (UNFCC) is an international environmental treaty to stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system[4]. The parties of such convention have met annually from 1995 in Conference of the Parties (COP) to assess progress in dealing with climate change. In the 2015 Paris Agreement (COP 21), countries reconfirmed the target of limiting the rise in global average temperatures relative to those in the pre-industrial to 2 degrees Celsius and to pursue efforts to limit the temperature increase to 1.5 degrees Celsius in 2050[5].

The linear production and consumption system is based on extraction of raw materials (take), processing into products (make), consumption (use) and disposal (waste). Traditional business models centered on a linear system assume the ongoing availability of unlimited and cheap natural resources, ignoring the fact that non-renewable resources such as fossil-fuels, minerals and metals are increasingly under pressure, while potentially renewable resources, such as forests and rivers, are declining in their extend and regenerative capacity. Moreover, the use of fossil fuels in the linear system overburdens the Earth system with baseline scenarios without mitigations for climate change resulting in global warming projected in a range from 3.7 to 4.8 degrees in 2100 compared to the pre-industrial level[6]. The planetary boundaries of climate change, land-system change (deforestation and land erosion), biodiversity loss (terrestrial and marine) and biochemical flows (nitrogen and phosphorus) have been crossed[7].

The model of a linear economy, in which it is assumed that there is an unlimited supply of natural resources and that the environment has an un-

4 United Nations, UN Framework Convention on Climate Change, 1992.

5 United Nations, UN Framework Convention on Climate Change – Adoption of the Paris Agreement, 2015.

6 Intergovernmental Panel on Climate Change, Climate Change 2014: Synthesis Report, 2014.

7 W. Steffen, K. Richardson, J. Rockström, S. Cornell, I. Fetzer, E. Bennett, R. Biggs, S. Carpenter, W. de Vries, C. de Wit, C. Folke, D. Gerten, J. Heinke, G. Mace, L. Persson, V. Ramanathan, B. Reyers, S. Sörlinet, Planetary boundaries: guiding human development on a changing planet, Science 347 (6223), 2015.

limited capacity to absorb waste and pollution, is dismissed[8]. A timeline transition towards a more circular economy based on a sustainable production and consumption, promoting use of renewable energies and reuse of materials is a must have to mitigate risks to the stability of the Earth system. Global economy is currently only 7.2% circular[9]. Very recent studies and projections highlight that the task for humanity is thus very concrete: a 50% reduction in our climate footprint by 2030, compared with 2019 levels, if we want to keep alive the scenario of limiting global warming to 1.5 degrees by the year 2050[10]. This means that a business or organization but also individuals running those institutions and all citizens, can only morally justify a commitment to achieve "net zero" by 2050 if they also commit to achieve the intermediate milestone of minus 50% by 2030[11].

22.2. The role of the financial system and Sustainable Finance Instruments

22.2.1. The role of financial system and the evolution of Sustainable Finance

Economic models were developed in the age of resources abundance, when natural resources were plenty and carbon emissions were limited. No environmental concerns were factored into these models, only labor and capital. Likewise, financial theory does not account value to natural resources beyond their near term cashflows. Possibly fatal depletion of resources is ignored. These models are still widely used, but no longer tenable as we are now in a transition to a low carbon and more circular economy to overcome environmental challenges. Finance needs to play a leading role in allocating investment to sustainable corporates and projects and thus accelerate the transition to a low carbon and more circular economy. In the financial sector, banks can define their strategy regarding which sectors and projects are eligible for lending and which not. Similarly, investment and asset managers

8 T. Cooper, Creating an economic infrastructure for sustainable product design, Journal of sustainable product design, 1999.

9 Circle Economy, The Circularity Gap Report, 2023.

10 Intergovernmental Panel on Climate Change (IPCC), Sixth Assessment Report (ar6), Synthesis Report, March 2023, and , Science Based Targets Initiative (SBTI), 2023.

11 R. Mees, Understanding Ourselves in Times of Climate Change, University of Groningen Press, 2023.

set their allocation strategies which directs in which assets investing. The financial sector can thus play an increasingly important role in the transition to a low carbon and a more circular economy. If the financial sector chooses to finance sustainable companies and projects, they can accelerate the transition in a tangible and decisive way. Sustainable Finance looks at how finance (investing and lending) interacts with economic, social and environmental issues. In the allocation role finance can assist in making strategic decisions to the trade-offs between sustainable goals. Moreover, investors can exert influence on the corporates in which they invest. In this way, long-term investors can steer corporates towards sustainable businesses practices. Finally, finance is a good at pricing risk for valuation purposes and can thus help dealing with the inherent uncertainty about environmental issues, such as the impact of carbon emissions on climate change. Finance and sustainability both look at the future. The thinking about sustainable finance has gone through different stages over the last decades, whereby the focus is gradually shifting from short-term profit towards long-term value creation[12].

A relevant step was taken in 2018 in Katowice (COP 24), when five international banks committed to measure the climate alignment of respective lending portfolios and to progressively steer financial flows through lending strategies towards the goals of the Paris Agreement[13]. Through this statement these primary financial institutions committed to institutionally engaging their clients to take action and to meet the target of holding the increase in the global average temperature to well below 2 degrees Celsius above preindustrial levels, recognizing that this would significantly reduce the risk and impacts of climate change. This commitment shows that banks have to take seriously the moral obligation to do justice to future generations by going beyond their traditional role description and work on mitigating climate change not only within their own organization (Scope 1 and 2), but mainly through engaging their retail and corporate clients to reducing their environmental footprint (Scope 3)[14].

12 D. Schoenmaker, W. Schramade, Principles of Sustainable Finance, Oxford University Press, 2019.

13 COP 24 commitment by BBVA, BNP Paribas, ING, Société Générale and Standard Chartered, Katowice, 2018.

14 Scopes definition following the GHG Protocol Corporate from World Resources Institute. Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

In April 2017, a consortium of 16 banks led by ING and Philips introduced a lending product that couples the interest rate on a loan to the business client's sustainability achievements, which was labelled as sustainability improvement loan[15], therefore emphasizing that the business client's commitment to do better on sustainability is most important. This marked the first deal in the syndicated loan market where the pricing is linked to an ESG related rating. Companies can use these loans for their corporate purpose in general and not just to finance exclusively ring-fenced and specific environmentally friendly projects. When the borrower's sustainability performance improves, the interest rate decreases. On the other hand, when the borrower's sustainability performance deteriorates, more interest is due. The product makes use of the assessment of a company's sustainability achievements by an independent, specialized environmental, social and governance (ESG) rating agency. Subsequently, the Loan Market Association (LMA) has labelled this form of loans as sustainability linked loans with the aim to promote the development and to preserve the integrity of the sustainability linked loan products by providing guidelines capturing the fundamental characteristics of these loans[16] and such finance instruments have been increasingly linked either to ESG external independent ratings, or to a robust set of specific corporate or project related KPIs on environmental, social and/or governance targets, to be rigorously set, measured and periodically audited. The increased volumes of sustainability linked instruments means that banks have been gradually shifting their priority towards increasing volumes with counterparties willing to invest in sustainable business processes and decreasing lending to clients with little plans for a credible transition or sustainable course of action. Engaging with business clients on improving their sustainability achievements and facilitating taking sustainable action by providing loans linked to those sustainability achievements serves the purpose of living up to the commitments of steering the bank lending portfolios towards the Paris Agreement.

15 ING, 2017 www.ing.com/Newsroom/News/ING-and-Philips-collaborate-on-sustaina-ble-loan.htm and Philips, 2017 www.philips.com/a-w/about/news/archive/standard/news/press/2017/20170419-philips-couples-sustainability-performance-to-interest-rate-of-its-new-eur-1-billion-revolving-credit-facility.html

16 Sustainability Linked Loan Principles, Loan Market Association, London, 2019.

A fundamental question is whether providing sustainable finance instruments also have an impact from an economic point of view, both for financial institutions and corporates/borrowers. Although more empirical evidence is needed to reach more definite conclusions, steering activities, businesses, capex and financing towards sustainable targets is likely to bring benefits both for corporates (more ample access to credit and better financing conditions achievable[17]) and banks (more solid capital ratios and long-term returns while steering loan books towards decarbonization pathways and engaging/selecting clients based on ESG performance). Differences are increasingly expected to emerge between companies that strive for a green future and companies that do not take the required measures in time, as assets of the latter group might likely need to be written off before their economic life ends, potentially causing an accelerated depreciation of the banks' loans financing respective companies and causing an increased need of capital (and in turn lower returns)[18].

Central Banks are also increasingly putting accent on the risks related to climate change and on the active role of supervised financial institutions related to financing transition. Most of the Central Banks have adopted some form of climate action plan which explicitly codifies their approach to climate change and climate financial risks (as monetary policy setter and/or as financial supervisor), the main exception to this being the Fed. Most frequently, such plans entail (i) the setting up of internal structures or bodies that are specifically entrusted with different kind of tasks in the area of climate change and (ii) the carrying out of stress-testing or scenario analysis with the purpose of assessing the exposure of the banking and financial system to climate-related financial risks[19]. Just to name a few, in 2018 Benoît Coeuré, then ECB's Executive Board Member, delivered a speech focused entirely on the role of central banks in respect to climate change, arguing that it is within their current mandate and powers to mitigate the financial and economic consequences of climate change. In her position of ECB's President, Christine Lagarde expressed analogous remarks first in 2019, and then

17 M. Kim, J. Surroca, J. Tribo, Impacto f ethical behavior on syndicated loan rates, Journal of Banking and Finance Vol. 38, 2014.

18 R. Mees, Sustainable Action and Motivation, Pathway for Individuals, Institutions and Humanity, Ruthlegde, London, 2019.

19 P. Spolaore, Scientific and Regulatory Approaches to "Green" Central Banking: The State of The Art from a Legal Perspective, Rivista di Diritto Bancario, October/December 2023.

several times in 2020 and 2021. With respect to monetary policy mandate, in 2021 the ECB's Governing Council presented an action plan to include climate change considerations in its monetary policy strategy. The measures aim to reduce financial risk related to climate change on the Eurosystem's balance sheet, and the secondary objective of supporting the green transition of the economy in line with the European Union's climate neutrality objectives. In July 2022, the ECB decided to include climate change considerations in the corporate bond purchases in its monetary policy portfolios, tilting these holdings towards issuers with better climate performance. Moreover, it decided to include these climate considerations in the assets it accepts as collateral in its provision of liquidity to credit institutions[20].

22.2.2. The main Sustainable Finance instruments

The range of Sustainable Finance ESG instruments and products structured by banks and adopted by corporates across different sectors and geographies has significantly evolved through the years. Sustainable Finance instruments can be defined as any form of financial service that integrates environmental, social and/or governance (ESG) criteria into business or investment decisions for the lasting benefit of both clients and society at large. It consists of many different financial instruments, such as labeled use of proceeds loans and bonds, sustainability-linked loans, revolving credit facilities, bonds and recently even working capital solutions or financial markets derivatives instruments. Below a concise list of main instruments currently available on the market.

Green and Social Loans

Corporates or SPVs can access to green, social or sustainability loans, either in the form of bilateral or syndicated facilities. Use of proceeds is strictly linked to green projects and detailed below[21]:

- Green loans: the funds are committed to environmental or climate projects, such as investment in ESG labelled buildings or renewable energies.

20 M. Delgado, The role of central banks in sustainable finance, 11th Funseam International Business Symposium, Sustainable Finance: challenges and opportunities, February 2023.

21 Green Loan Principles and Social Loan principles provide a consistent methodology for use across the green and social loan markets www.lma.eu.com

- Social loans: the funds are committed to social impact projects, such as training people with disabilities to improve employability.
- Sustainability loans: the funds are committed to a mix of green and social impact projects or to a set of UN Sustainable Development Goals as mentioned above.

Use of Proceed Bonds

Corporates and Issuers of use of proceed bonds agree to allocate the funds raised to finance or refinance eligible projects or assets within specific categories. Use of proceeds bonds, similar to loans, are strictly linked to projects and can be further clustered as[22]:

- Green bonds: the funds from these debt instruments are committed to environmental or climate projects such as investing in a prime energy efficient properties or renewable energy projects.
- Social bonds: the funds are committed to social impact projects whose purpose is to address a common problem and help most vulnerable people, e.g. individuals with restricted access to housing market.
- Blue bonds: the funds are specifically committed to marine or water projects, such as investing in the transition to sustainable fish stock.
- Sustainability bonds: the funds are committed to a mix of social and green impact projects.

Sustainability Linked Loans and Sustainability Linked Bonds

Unlike use of proceeds loans and bonds, the proceeds from sustainability linked loans (SLL) and sustainability linked bonds (SLB) can be used for general corporate purposes and thus enhances more flexibility while also granting companies not directly linked to green related businesses and sectors an adequate access to the sustainable finance market and to a more diverse spectrum of capital markets and investors[23]. These instruments are linked to the achievement of predetermined sustainability performance targets, which should be ambitious, relevant to the borrower or issuer specific

22 The International Capital Market Association (ICMA) outlines the requirements for green, social and sustainability bonds www.icmagroup.org

23 The Sustainability Linked Loan Principles and the Sustainability Linked Bond Principles provide guidelines and recommendations around structuring features, disclosure and reporting www.lma.eu.com

operations and sustainability structure. These targets can be either in the form of (i) a set of robust, measurable and audited corporate specific key performance indicators (KPIs), with one or more sustainability performance targets (SPTs) calibrated for each KPI prior to the loan or bond issuance, or (ii) ESG synthetic ratings provided by independent and reputable third parties[24].

More specifically and in terms of structure, for a SLL the interest rate of the loan may increase in case the borrower fails to achieve the agreed and set performance target, and vice versa. Revolving credit facilities can also be included in this category. Symmetrically for a SLB, the bond's coupon rate will increase, or the issuer may pay a penalty at maturity, should the company fail to achieve sustainability set KPIs or specific ESG rating scores.

22.3. ESG priorities in Real Estate

22.3.1. ESG reshape Real Estate with compliance challenges, rental and capital values

ESG topics are particularly relevant for the Real Estate sector, especially from an "E" (Environmental) angle as 37% of global CO2 emissions and 34% of total energy consumption are attributed to the real estate sector worldwide. The buildings and construction sector is not on track to achieve decarbonization by 2050 and the gap between the actual climate performance of the sector and the decarbonization pathway is widening[25]. The major challenge is to connect all parties involved — including regulators, public sector, contractors, architects, developers, institutional and private investors as well as financiers — in such a way that energy consumption, and thus CO2 and greenhouse gas emissions, can be reduced as quickly as possible. JLL's Research reveals that 81% of occupiers and investors agree that a strong partnership between cities, occupiers and investors will be instrumental to pushing the net zero carbon agenda. By leaning into an ecosystem, governments, businesses, investors and communities can more easily adopt and scale innovations, bridging the gap between intention and action. For many compa-

24 Main rating agencies focused on sustainability metrics being currently S&P Global ESG Rank, Eikon-Reuters ESG Score, Sustainalytics Risk score, Bloomberg ESG score, ISS EGS score, CDP Climate score, Ecovadis, MSCI Rating.

25 UN Environment Programme, Global Status Report for Buildings and Construction, 2022.

nies, individual progress will be unaffordable and unachievable without this strong collective approach, one which will have to heavily involve national and city governments. Notably, cities' levels of commitments on decarbonization might heavily determine organizations' decisions to stay or invest in the future. Investors recognize that pursuing carbon reduction through green strategies and certifications will also support value creation within their portfolio: 73% of investors say that green strategies and certifications drive higher occupancy, higher rents, higher tenant retention and overall higher value[26].

The "S" (Social) component of Real Estate is also gaining increasing attention from stakeholders. Compared to other asset classes, Real Estate is tangible and unique being an integral component of neighborhoods and communities, occupied by a broad range of users (including families, students and workers). Properties cannot be physically moved and influences the value and character of surrounding properties and land uses. With properties being essential to the economic health of a region and the productivity to all who use it, they have profound social impact on the communities in which they are located. The meanings ascribed to urban sustainability have concrete consequences for the lives of everyday urban dwellers, for the environment, and especially for social justice and equity[27]. Addressing the "S" alongside the "E" considerations is a unique opportunity to maximize return on investment and to future-proof assets while delivering lasting positive change for communities and cities where companies and investors operate and allocate their capital in.

ESG certified buildings[28] provide a competitive advantage in the market and can experience increased occupier demand from firms adhering to corporate sustainability targets. Looking at office space as the main contributor in terms of commercial real estate stock, Savills' rental growth analysis indicates that prime rents (reflecting the highest achievable rents) are outperforming the top quartile of MSCI rents. Comparing 2023 to 2019, the top quartile of MSCI rents have grown by an average of 6%, while Savills average

26 JLL, Decarbonizing the Built Environment, 2021.

27 C. Isenhour, G. McDonogh, M. Checker. Sustainability in the Global City, Cambridge University Press, 2015.

28 Currently, the most widely-used certifications in real estate are: GRESB (Global Real Estate Sustainability Benchmark), BREEAM (Building Research Establishment Environmental Assessment Method), LEED (Leadership in Energy and Environmental Design) and GBC (Global Building Council).

prime rents have grown by an average of 15%[29]. Clearly, the definition of 'prime' is becoming more selective in key European cities as demand intensifies for the very best space. Whilst at the country level, governments will introduce their own regulation, corporate occupiers will demand a minimum green rating as part of their ESG strategy, which will impact office space in all geographies. As a result, the percentage of take-up of ESG-compliant buildings is expected to increase over the years and investors will be able to anticipate this by increasing the availability of these kinds of properties. Certainly, investors view properties that have achieved the highest green rating as more resilient due to their faster leasing velocity, future-proofed against further tightening regulations, ability to secure debt and lower liquidity risk upon disposal. This increased demand and competition among occupiers to sign for such buildings can lead to higher rental growth in markets where there is a lack of availability, causing rents to diverge from non-compliant assets[30].

22.3.2. Energy Performance of Building Directive

The European Union established a strategic agenda to tackle climate change and transform the EU economy into a climate-neutral, green and fair society. The European Climate Law enforced in 2021 marked a major commitment to the transition by making the EU's greenhouse gas (GHG) emission reduction by at least 55% by 2030 a legal requirement. To reach this target, a set of proposals to revise and update the EU legislation was introduced through the "Fit for 55" package. The legislation proposed amendments in 12 different policy areas ranging from land use and forestry to aviation and maritime transport. One of the most contingent points is the review of the Energy Performance of Building Directive (EPBD)[31], as it contains economic, social and financial characteristics.

The theme of ESG is increasingly present within the real estate sector, and in 2024, we expect this to heighten, as 85% of EU buildings were built

29 Savills, European Office Outlook, December 2023.

30 Savills, European Property Themes, 2024.

31 European Commission, Energy Performance of Building Directive, December 2023 https://energy.ec.europa.eu/topics/energy-efficiency/energy-efficient-buildings/energy-performance-buildings-directive_en#revised-energy-performance-of-buildings-directive

before 2000 and amongst those, 75% still have a poor energy performance[32]. Acting on the energy efficiency of buildings is therefore key to saving energy and achieving a zero-emission and fully decarbonized building stock by 2050. The EPBD is most important regulation affecting European investors and landlords in the industry, being an EU-wide legislation requiring member states to reduce the energy consumption of buildings in a bid to meet net-zero targets. The revised directive will increase the rate of renovation, particularly for the worst-performing buildings in each country. It will also support better air quality, the digitalisation of energy systems for buildings and the roll-out of infrastructure for sustainable mobility. Recognising the differences across EU countries in factors such as the existing building stock, geography and climate - the directive allows governments to decide on the renovation measures best-suited to their specific national context. Countries can also exempt various categories of buildings from the rules including historical buildings and holiday homes. Crucially, the revised directive will facilitate more targeted financing to investments in the building sector, complementing other EU instruments and fighting energy poverty by supporting vulnerable consumers. EU countries will also have to ensure that there are safeguards for tenants, such as through rent support or caps on rent increases. To ensure that buildings are fit for the EU's enhanced climate ambition under the European Green Deal, the revised directive will contribute to the objective of reaching emission reductions of at least 60% in the building sector by 2030 compared to 2015 and achieving climate neutrality by 2050. Improving the energy performance of buildings not only saves energy and reduces energy bills, thereby reducing energy poverty and making Europe more energy independent, it also benefits the health and wellbeing of citizens by bringing living standards up to the 21st century for everyone. Furthermore, investments in energy efficiency help stimulate the economy and create more green jobs. The EU's construction industry contributes around 9.6% of the EU's value added and employs almost 25 million people in 5.3 million firms. Small and medium-sized enterprises (SMEs) in particular benefit from a boosted renovations market, as they make up 99% of EU construction companies and 90% of the employment in the sector.

After months of negotiations, a provisional agreement was reached on 7 December, 2023. The last step of the legislative process will be for the Euro-

32 European Environment Agency, Annual European Union greenhouse gas inventory 1990–2019 and inventory report, 2021.

pean Parliament and Council to vote on the provisional agreement to formally endorse it. If the vote is successful, the policy should be enforced in 2025. Below the main changes compared to previous iterations[33]:

- Renovation goals: Starting with residential buildings, the provisional agreement states that each Member State (MS) will adopt their own national trajectory to reduce its building stock's average primary energy use. This should be in line with the 2030, 2040, and 2050 targets contained in the MS building renovation plan and should identify the number of buildings, building units, and floor areas to be renovated annually. The agreement states that the reduction in average primary energy use should be 16% by 2030 and 20-22% by 2035 relative to 2020 levels. Furthermore, the EPBD review specifies that at least 55% of the decrease in average primary energy use should stem from the renovation of the worst-performing buildings nationally. Moving to non-residential buildings, the agreement keeps the reduction target as proposed before the negotiations. Non-residential buildings will, therefore, need to follow Minimum Energy Performance Standards (MEPS) set by Member States. This gradual improvement should lead to the renovation of at least 16% of the worst-performing buildings by 2030 and 26% of those by 2033. Member States will be able to express this threshold in either primary or final energy use.
- Energy Performance Criteria (EPC): Indeed, the current labelling system significantly varies across countries. These differences make it very difficult for the Union to set harmonised minimum energy performance goals. It also hinders the building stock comparison between Member States. The provisional agreement states that EPCs shall be based on the common EU template with common criteria. The scale shall be between letters A and G, with A corresponding to zero-emission buildings and G to the worst-performing building of the national building stock at the time of enforcement. Classes B to F must have an appropriate distribution of energy performance indicators among each class.
- National Building Renovation Plans: To ensure that MS reach the emission reduction targets, national Building Renovation Plans will be enforced. These must, on the one hand, have a stronger focus on financing the renovation and, on the other hand, ensure the availability of skilled

33 ING, Think Economic and Financial Analysis, Energy Performance of Buildings Directive: A step closer to the finish line, January 2024.

workers to proceed with the sustainable renovations. Thus, member states are expected to share an outline of financial measures, investment needs and administrative resources to reach their national renovation milestones. MS will also have to set up building renovation passport schemes. These documents will provide tailored roadmaps for the renovation of specific buildings in several steps to significantly improve energy performance. It would give the opportunity to clearly map, through expert certifications, what can be done to improve the energy performance of a specific building.
- Energy topics: The EPBD recast also includes articles to gradually phase out fossil fuel boilers and a legal basis for MS to implement regulation on heat generators. The EU wants to completely phase out boilers powered by fossil fuels by 2040. The agreement also states that MS must ensure that new buildings are solar-ready and fit to host rooftop photovoltaic or solar thermal installations.

22.3.2. The increasingly active role of financial institutions

Changes stemming from the EPBD review will affect both society and financial institutions as these will have to play a major role in financing renovation. The EPBD recast states that financial institutions should be mobilized to further incentivize building renovation. Furthermore, MS should encourage banks to promote targeted financial products, grants, and subsidies to improve the energy performance of vulnerable households and owners of the worst-performing building stock. Some countries already see the presence of an energy premium on their housing and real estate market. For example, in Belgium, ERA, the country's largest real estate agent, showed that Flemish homes with an EPC score of A or B became 1.5% more expensive in 2023. In contrast, homes with a lower score (E or F) see a price decline of 1.6% over the same period. These energy efficiency premiums to widen in the coming years[34]. The generalization and growing importance of EPCs will, therefore, have an impact on the overall market price.

Financial institutions accelerated the structuring and offering of Sustainable Finance instruments over the last few years, with Green Loans, Green Bonds, Sustainability Improvement Loans, Sustainability Improvement

34 ING, Think Economic and Financial Analysis, Belgians more open to buying homes in need of renovation, January 2024.

Bonds, as defined before, being the most frequent instruments observed in the institutional Real Estate finance market , with particular focus observed on the “E” component in the ESG formula characterizing the value chain, volumes.

The purpose of Green Loans and Bonds recently arranged and provided between the main banks and the investment and asset managers active in the institutional property market is to finance the construction or (re)finance the acquisition of properties that have already been completed and that meet robust sustainability criteria at the time the loan contract is signed. This means, among others, that the property has a “Class A” energy certificate, is EU taxonomy-compliant or alternatively has a sustainability certificate such as DGNB Gold, LEED Gold, BREEAM Very Good or better.

On the other hand, Sustainability Linked Loans and Bonds serve as a suitable financing element to support improvement of sustainable profile of corporates or underlying portfolios through transition and modernization, and increasing volumes have been observed across this cluster of instruments too. Banks and sponsors/borrowers define ambitious sustainability criteria and measures, which are firmly agreed in the loan agreement and regularly checked during the term. These so-called Key Performance Indicators (KPIs) have a direct effect on credit costs. If the KPIs are (over)fulfilled, the credit costs fall and vice versa. The KPIs are always defined under the premise of “increasing energy efficiency”. All measures such as renewal of the heating and cooling systems, intelligent building controls, facade insulation, replacement of lighting with LEDs, etc. at the property/portfolio level are planned by the client and verified by an independent third parties.

22.4. Case Study – Eurocommercial Properties

22.4.1. Eurocommercial Properties and its ESG commitment

A tangible and recent case of commitment towards ESG, both in terms of strategy and access to sustainable finance instrument, is the one concerning Eurocommercial Properties N. V. and its Italian subsidiary Eurocommercial Properties Italia S.r.l. The Group was founded in 1991 and is listed on Euronext Amsterdam and Euronext Brussels with a broad shareholder base. The Company is owner and manager of shopping centers with a portfolio of almost Eur4 billion comprising 24 prime assets in Italy, France, Sweden and Belgium. The Company has developed a broad ESG vision and strategy to be able to meet global challenges and the future demands from visitors, tenants and employees and is also committed to regularly report on its ESG performance[35].

The abovementioned 17 Sustainable Development Goals (SDGs) and 169 targets as set by the United Nations address the major sustainability challenges faced globally and The Company applies the SDGs as an overarching framework to shape its sustainability strategy and specifically elected four SDGs to focus its efforts on, along with key actions to contribute to their achievement:

- Goal 7: Ensure access to affordable, reliable, sustainable and modern energy for all. The company commits to Generate more renewable energy on-site, like, for example, solar energy. Reduce energy consumption by operating more efficiently, also through an active environmental management systems in our assets. Increase the focus on green energy from our providers and adopt green leases with its tenants.
- Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all. Partner up with organisations providing training courses for our employees and those of our retailers (on-site), an example is the established Eurocommercial Retail Academy®. Organise job fairs and education events in our shopping centres.
- Goal 11: Make cities and human settlements inclusive, safe, resilient and sustainable. Reduce energy and carbon emissions (see 7), and have mitigation and adaptation plans in place in case of extreme weather events. Educate tenants and visitors about climate change.
- Goal 13: Take urgent action to combat climate change and its impacts. Provide facilities for sustainable transportation options for visitors and create attractive, green environments in-and outside the shopping centres.

The Company's ESG governance has been established since 2021, through a ESG Committee and a ESG Workgroup. The ESG Committee is responsible for the Company's ESG strategy, including all members of the Board of Management and the Group Director Legal, and reports directly to the Supervisory Board. The ESG Workgroup is responsible for implementing the ESG strategy and directing initiatives in the local countries and sharing information and best practices. The ESG Working Group is composed of the Group Director Legal (chairman), a diverse group of employees responsible

35 Eurocommercial Properties NV, Green Finance Framework, January 2023.

in their respective countries for implementing the ESG strategy and steering initiatives and of the Group Economist who is responsible for collecting ESG data and sharing information between countries. The Chair of the ESG Committee reports to the Supervisory Board (at least) twice a year regarding ESG issues of key ESG topics (vision, strategy, initiatives taken) and ESG performance (performance against targets, benchmarking scores etc.).

22.4.2. Eurocommercial Properties and its Green Finance Framework

The Green Finance Framework ("the GF Framework") aims to support the Company's strategy and its transition towards a low carbon economy. Through its GF Framework, the Company intends to contribute to the growth of the Green Financing market, to the increased use of several Green Finance Instruments and to address investors' willingness to finance sustainable green buildings existing or under development.

This GF Framework is established as an overreaching platform under which the Company intends to issue Green Finance Instruments - which may include bonds (also through private placements), commercial paper, bank loans, promissory notes and any other finance instruments in various formats and currencies - to finance and/or refinance green projects with an environmental benefit.

The Company's GF Framework is aligned with the International Capital Markets Association ("ICMA") Green Bond Principles ("GBP"), 2021 version (with June 2022 Appendix) and Loan Market Association ("LMA") Green Loan Principles ("GLP"), 2021 version. These voluntary process guidelines are developed in multi-stakeholder processes involving issuers, investors, financial institutions and NGOs, with a view to promoting the development and integrity of Green Finance Instruments. The GF Framework reflects requirements from the EU Taxonomy Regulation the EU Taxonomy Climate Delegated Act and the EU Green Bond Standard, on a best effort basis. The Company's GF Framework has four core components:

- Use of Proceeds
- Process for Project Evaluation and Selection
- Management of Proceeds
- Reporting

This GF Framework and the four components outlined above will apply to any Green Finance Instrument issued by the Company and will be in force as long as any Green Finance Instrument is outstanding. As the Green Finance market continues to evolve, the GF Framework (which includes the green bank loans, of which the Company is a party) may be subsequently revised or updated to remain consistent with shifting market expectations, best market practices and the regulatory landscape.

22.4.3. Eurocommercial Properties recent sustainable finance transactions on the Italian market

The Company, being since the Nineties very active in the Italian market, currently the main geography where it operates in its core business of investment and asset management of a portfolio of food-anchored shopping centres, closed a set of sustainable finance transaction in Italy. These new loans qualify as green loans, as the relevant proceeds are used to refinance two green assets, and also as sustainability linked loans, since the margins are linked to two sustainability KPIs at Group level and to two sustainability KPIs agreed at asset level. If the Company achieves or exceeds these KPIs, the margin will be slightly reduced, if it misses these targets, the margin will be slightly increased.

More specifically, in April 2022 the Company, through its subsidiary Eurocommercial Properties Italia S.r.l. entered into a new 5-year loan of Eur 66.5 Mln with ING to refinance two existing loans on the Curno Shopping Centre, Italy. In June 2022, the Company also entered into a new 3- year loan of Eur50 Mln with ABN AMRO bank to refinance an existing loan on the CremonaPo Shopping Centre, Italy[36]. The set of KPIs part of the Curno Shopping Centre facility, closed with ING, is composed by a total of four targets, of which two at Company level (KPI 1 and KPI 2) and two at specific financed property level (KPI 3 and KPI 4), as follows:

- KPI 1: Renewable energy (measured in % of total electricity used)
- KPI 2: Waste to Landfill (measured in weight %)
- KPI 3: Green Lease (measured in # of green lease contract)
- KPI 4: GHG emissions intensity (measured in tonnes CO2e/m2)

36 Eurocommercial Properties, 2022 annual report.

23.
Environmental, Social and Governance Factors and Litigation Risks

by L. Bovo

Introduction: how the perception of the ESG phenomenon has changed globally

The previous chapters have shown how the pressing challenges of climate change and the imperative need for companies to adopt effective sustainable investment practices are currently at the forefront. New laws are being enacted, both nationally and globally, with the aim (among others) of curbing corporate emissions, enhancing the financial reporting standards of companies and refining the communications companies make to the market about the sustainability characteristics of the products and services they offer. As a result, companies are facing heightened legal scrutiny regarding their accountability and contributions to climate change, leading to an increase in Environmental, Social, and Governance (**ESG**) litigation. This leads companies to expose themselves to a "widespread" scrutiny, so to speak, from the user and consumer public, through the various media used to promote their business. It is a fact that, beyond environmental organisations, a chorus of voices is rising in activism, including consumers, investors, shareholders and local communities. Indeed, as early as 2022, the *Intergovernmental Panel on Climate Change* recognised the importance of ESG litigation in influencing the direction and purpose of sustainable development regulation.

However, it is crucial to point out that the dynamics of the ESG phenomenon are also influenced by global geopolitical balances. A significant example is the profound change that the United States is going through in this area following the inauguration of the new president (Donald Trump). Indeed, it is no secret that among the 100 executive orders signed by the new president on the first day of his second administration is the withdrawal of the United States from important international agreements, including the Paris Climate Agreement. In addition, two more executive orders were issued: the first repeals regulations introduced to encourage the adoption of electric cars, the second temporarily suspends federal approvals for new *offshore* wind projects.

The agenda promoted by the new president appears to be in partial contrast to the orientation of the previous administration, thus influencing the investment market. The new administration, in fact, tends to favor the fossil fuel sector, using the well-known slogan '*drill, baby, drill*'. Nevertheless, it should be noted that the global demand for sustainable investments continues to grow. According to Bloomberg, ESG assets could reach $50 trillion by 2030, regardless of regulatory (and, we might add, non-regulatory) obstacles.[1] The growing demand for sustainable investments inevitably also leads to an increase in litigation related to ESG factors. According to the latest analysis conducted by the Grantham Research Institute on Climate Change and the Environment, at least 233 new ESG litigation cases were filed in 2023. Many of these seek to hold governments and private entities accountable for their anti-ESG actions. It is also true that the amount of pending litigation increased less rapidly during 2023 than in previous years, which may suggest a consolidation of ESG litigation in the areas of greatest impact. It should also be noted that 129 out of 233 litigations were filed in the United States, although such litigations are rapidly spreading to various parts of the globe.[2]

The main objective of ESG Litigation is to induce a behavioural shift within companies. It calls for companies to transition towards a refined, qualitative, and transparent climate policy that safeguards the rights of individuals and communities (as well as the ecosystem at large). According to a recent study conducted on a sample of enterprises, 27% of respondents have seen their exposure to ESG-related controversies increase in the last 12 months, which is higher than the 24% recorded in the previous year. The same 27% also expect their exposure to such disputes to increase over the next year. Nearly 75% of respondents say that environmental issues could pose significant challenges during 2025, given the increased scrutiny on sus-

1 Bloomberg, " ESG Assets Rising to $50 Trillion Will Reshape $140.5 Trillion of Global AUM by 2025, Finds Bloomberg Intelligence" (July 2021). Available at: https://www.bloomberg.com/company/press/esg-assets-rising-to-50-trillion-will-reshape-140-5-trillion-of-global-aum-by-2025-finds-bloomberg-intelligence/. Accessed on February 3, 2025

2 Grantham Research Institute on Climate Change, "Global trends in climate change litigation: 2024 snapshot" (June 2024). Available at: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2024/06/Global-trends-in-climate-change-litigation-2024-snapshot.pdf. Accessed on February 3, 2025

tainability statements that companies are required to submit. Following this, 73% of respondents affirm they are considering changing, or have already changed, their environmental or sustainability statements to mitigate exposure to allegations of *greenwashing*, for example. This strategy was particularly adopted by companies involved in the energy sector, in fact almost half of them (46%) affirm they have actively revised such statements (following the suggestions of their lawyers).[3]

Some recent examples of ESG litigation will be given below in order to give the reader an insight into the various contexts from which it may arise.

Environmental (Climate) Litigation: claims for damages in France for breach of duty to supervise corporate activities

The genesis of climate change litigation can be traced back to legal actions initiated by environmental activists and non-governmental organisations against governments and corporations. These legal challenges arose from the dissonance between the (admittedly ambitious) global commitments to curb temperature increases and the inadequacy of their policies to actually reduce carbon emission to meet those targets.

For example, between 2019 and 2023, three court cases were initiated in France against large companies in relation to their obligation (imposed on them by the French Vigilance Obligation Law) to adopt and monitor a vigilance plan that assesses the impact of their activities on human rights and the environment:

1. The first case was brought by several non-governmental organisations and local authorities against a well-known French oil company and was aimed at obtaining an injunction obliging the company to implement a supervisory plan adapted to climate change issues;[4]
2. The second case was brought by several French and Mexican non-governmental organisations against an electricity company and was aimed at obtaining both the approval of a new supervisory plan and compensation for damages caused as a result of the implementation of a wind farm project on Mexican indigenous land;

3 Norton Rose Fulbright, "2025 Annual Litigation Trends Survey" (June 2025). Available at: https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/knowledge-pdfs/norton-rose-fulbright---2025-annual-litigation-trends-survey.pdf. Accessed on February 3, 2025

4 See the litigation brought against a well-known French oil company: Sabin Center for Climate Change Law, "Notre Affaire à Tous and Others v. Total". Available at: https://climatecasechart.com/non-us-case/notre-affaire-a-tous-and-others-v-total/. Accessed on February 3, 2025

3. The third case was brought by several French and Chilean non-governmental organisations against a large French water company and was aimed at obtaining approval of a new surveillance plan following alleged water pollution in Chile.

Well, the Paris Court of Appeal (hearing the matter following the rejection of the claims in the first instance) examined the three cases in a single hearing on 5 March 2024 (given the existence of the same procedural admissibility issues) and issued a decision on 18 June 2024, thus clarifying the procedural requirements of the French Vigilance Obligation Law. In order to avoid unnecessary repetition, we will examine below the decision issued in connection with the first proceeding, as it provides the most significant conclusions on the matter.

Firstly, the Court reiterated that a formal notice to the company is mandatory before bringing legal action as to the adequacy of the supervisory plan adopted, although there need not be equal motivation between the notice and the document filed to bring legal actions. In fact, it is sufficient that they are adequately related and, even more importantly, do not necessarily have to refer to the same supervisory obligations but must refer to the same substantive obligations that the company must comply with under the French Vigilance Obligation Law.

Secondly, the Court criticised and reformed the first instance judge's interpretation that the plaintiffs in the proceedings must be the authors of the formal notice. It recognised the right of any interested party to initiate proceedings after the issuance of a formal notice, regardless of whether they were the authors of such notice or not.

Thirdly, the Court found that the local authorities of Paris have a legitimate interest in taking legal action in this context, as they are particularly exposed to the negative impacts on climate change caused by that company's activity.

Fourth, the Court, unlike at first instance, admitted the claim based on the prevention of ecological damage.

Generally speaking, what can be deduced from such a decision is that the Court has shown a much less restrictive tendency than previous courts have done in the past, as if to reduce any procedural obstacles to have justice for individuals adversely affected by the anti-ESG activity carried out by companies such as the one involved. Such a decision therefore, in addition to better defining the scope of application of the French Vigilance Obligation Law, could provide a solid basis for future proceedings.

Social Litigation: the jurisprudential protection of human rights in India and South Africa

On 21 March 2024, the Indian Supreme Court in Ranjitsinh v. Union of India issued a decision that could be described as revolutionary, as it recognised a right of individuals to be "*free from the adverse effects of climate change*" under Articles 14 and 21 of the Indian Constitution. This decision in fact recognised a much broader scope of protection than most other jurisdictions, which have limited themselves to recognising a constitutional right to a clean and healthy environment. There is in fact a substantial difference between recognising a general constitutional right to a healthy environment and recognising a specific right of the individual to be protected from the negative impacts of climate change; the latter recognition in fact requires the state to take positive action to ensure and render such protection effective.

In fact, the decision states that although there have been *(i)* a plethora of decisions on the right to a clean environment and on the recognition of climate change as a serious threat, and *(ii)* national policies that seek to combat climate change, it has not yet been affirmed that people have a right to be protected from the negative effects of climate change. This is probably because, from a logical point of view, the right to protection from the adverse effects of climate change and the right to a clean environment are two sides of the same coin. However, the Indian court continued, as the damage caused by climate change increases year by year, it becomes necessary to identify the former as a distinct right, recognised to the individual by Articles 14 and 21 of the Indian Constitution.

The Indian Supreme Court further acknowledges that states have both a duty of care towards their citizens to prevent harm and ensure the general welfare and an obligation to take effective measures to mitigate the negative effects of climate change and ensure that all individuals have the opportunity to adapt to the climate crisis.[5]

Moving geographically, it is equally important to note that in June 2024, the South African Human Rights Commission conducted an enquiry into the impact of mining activities on the (allegedly damaged) human rights of the inhabitants of the Limpopo province in South Africa. The issues raised include blast damage, air and water pollution, and food security damage

5 Sabin Center for Climate Change Law, " MK Ranjitsinh et al. v. Union of India et al.". Available at: https://climatecasechart.com/non-us-case/mk-ranjitsinh-ors-v-union-of-india-ors/. Accessed on February 4, 2025

(due to difficulties in cultivating fields because of mining activities). The South African Human Rights Commission has not yet released the results of such an investigation but has indicated that the outcome should facilitate the formulation of conclusions and recommendations for compensation for human rights violations. The Limpopo authorities went on to state that they are committed to holding the bodies that oversee mining activities accountable if a violation of these rights is found.[6]

It is therefore evident that the protection of human rights is increasingly emerging as a fundamental pillar within ESG practices. The protection of these rights implies, for example, the adoption of strict policies in order to avoid the violation of workers' rights, while ensuring safe and decent working conditions. In confirmation of this, companies are increasingly called upon (and required) to respect local communities and promote transparency and fairness in their global operations.

Governance Litigation: the involvement of the European Court of Human Rights in the case of Verein KlimaSeniorinnen Schweiz and others v. Switzerland

On 9 April 2024, the European Court of Human Rights issued a highly significant decision in the case of Verein Klimaseniorinnen v. Switzerland (on the same day, the Court also issued a decision in two other cases, respectively *Carême v. France* and *Duarte Agostinho et al. v. Portugal and 32 other states,* which were declared inadmissible).

In the case of Verein Klimaseniorinnen v. Switzerland, the plaintiffs (i.e. a Swiss association comprising more than two thousand women and four women over the age of 80) argued that the measures taken so far by the Swiss authorities were insufficient to mitigate the impact of climate change on individuals and that it could therefore affect their health and living conditions. In a ruling of over 250 pages, the Court recognised for the first time that protection against the adverse effects of climate change falls within the scope of the European Convention on Human Rights (ECHR) and found that Switzerland's climate laws violated Articles 6 (right to a fair trial) and 8 (right to respect for private and family life) of the ECHR. Indeed, the Court ruled that Article 8 of the ECHR includes the right to effective protection by state authorities against the serious adverse effects of climate change on quality of

6 The Citizen, " Human Rights Commission probes mining activities in Limpopo". Available at: https://www.citizen.co.za/news/south-africa/human-rights-commission-probes-mining-activities-in-limpopo/. Accessed on February 4, 2025

life, health and well-being. In fact, the Court identified a number of issues in the implementation process of the national regulatory framework, including the Swiss authorities' failure to quantify national greenhouse gas emission limits, as well as Switzerland's failure to meet its previously set greenhouse gas emission reduction targets. While recognising that States enjoy a wide margin of appreciation in choosing the means by which to pursue their climate objectives, they have a reduced margin of appreciation with regard to their commitment to combat climate change (arising from the nature and severity of that phenomenon). More specifically, the Court considers that Article 8 of the ECHR requires states to adopt and effectively implement measures to reduce greenhouse gas emissions with the aim of achieving their temperature reduction targets, in principle, within the next three decades. On the contrary, the Court noted the absence of concrete and appropriate measures in the Swiss national framework to achieve these goals, resulting in a violation of Article 8 ECHR.[7]

No less important is the decision issued on 30 January 2025 by the European Court of Human Rights in the case *Cannavacciuolo and Others v. Italy*: the European Court of Human Rights in fact unanimously ruled that Italy had violated Article 2 of the ECHR for failing to adequately protect the right to life of the inhabitants of the so-called "Land of Flames" (*Terra dei Fuochi*) in relation to the widespread practice of dumping, burying and illegal burning of waste by criminal organisations (in the same area, an increase in certain types of cancer and other diseases was also recorded). The Court acknowledged the existence of a '*sufficiently serious, real and ascertainable*' as well as '*imminent*' risk to life, also highlighting the tardiness of the national intervention and the lack of diligence in the management of this issue (also with regard to prevention and risk communication to the local inhabitants).

The Court therefore indicated to Italy, in accordance with Article 46 ECHR, the actions to be taken to address this situation, requiring in particular: **(i)** the implementation of a comprehensive strategy that considers all existing and future measures, at all levels of the state apparatus, to combat the phenomenon of pollution (§§ 464-497); **(ii)** the creation of an independent mechanism to monitor the implementation and effectiveness of the measures adopted (§ 499); **(iii)** the establishment of a platform to provide

7 Judgement of the European Court of Human Rights, "Verein KlimaSeniorinnen Schweiz and Others v. Switzerland [GC] - 53600/20, Judgment 9.4.2024". Available at: https://hudoc.echr.coe.int/eng/#{%22itemid%22:[%22002-14304%22]}. Accessed on February 4, 2025

all relevant information regarding the problem of the "Land of Flames" and the measures adopted or planned to address it, to be updated periodically (§ 500). However, it should be noted that this is not a final judgement, all parties involved have three months to appeal to the Grand Chamber (such deadline is still pending at the time of writing).[8]

Both of these rulings reinforce the obligation of states to set the necessary targets to combat climate change and thus introduce and implement effective measures to reduce global temperatures.

Legal Framework and Sanctions

From the perspective of litigation concerns, it is useful to examine the liability profiles underpinning the relevant legal framework and the related sanctions. As previously highlighted, three initiatives stand as fundamental cornerstones for global sustainability: the United Nations Global Compact (2000), the 2030 Agenda (2015), and the Paris Agreement (2015). The main challenge associated with the United Nations Global Compact and the 2030 Agenda lies in their non-binding nature. While they call upon nations, financial institutions, and entire economies to advocate for global sustainability, the absence of legal obligations is a formidable hurdle. This makes the identification of legal liability profiles exceptionally difficult, if not outright impossible.

On the contrary, the Paris Agreement is a legally binding international treaty for states that have signed and it addresses climate change. However, it is noteworthy that while the agreement provides a legal framework, it lacks strong enforcement mechanisms. At the heart of the agreement is the requirement for all members to submit action pledges every five years aimed at reducing their greenhouse gas emissions. These commitments are referred to as their "*Nationally Determined Contributions*" (NDCs). However, although countries are obliged to submit these pledges, they retain autonomy over their content and have the discretion to determine the specifics of what they commit to in their NDCs. Formal accountability is also limited: each country is obliged to submit periodic reports detailing their actions, which include national emissions inventories and

8 Judgement of the European Court of Human Rights, " CASE OF CANNAVACCIUOLO AND OTHERS v. ITALY". Available at: https://hudoc.echr.coe.int/#{%22documentcollectionid2%22:[%22GRANDCHAMBER%22,%22CHAMBER%22],%22itemid%22:[%22001-241395%22]}. Accessed on February 4, 2025

progress towards meeting their NDCs, and the main repercussion for a member falling to meet its targets is a meeting with a global committee.

In the EU context, under Directives 2014/95 (known as the *Non Financial Reporting Directive*, NFRD)[9] and 2017/828[10], a potential liability profile can be identified within national regulations. Regarding the NFRD, it introduces a *comply-or-explain* mechanism, which does not lead to sanctions in case of justified failure to disclose. Even if an institution fails to release the required information, the directive delegates the task of identifying appropriate sanctions to the individual Member States. In Italy, the Legislative Decree No. 254 of December 30, 2016, implementing the directive in question, provides in Article 8 that the directors of a public-interest entity, who fail to submit the individual or consolidated non-financial statement to the companies register within the required deadline or submit a statement that differs from what is required, will be subject to an administrative fine of between twenty thousand and one hundred thousand euros (with an optional one-third reduction if the submission is made within thirty days of the deadline). The aforementioned penalty also extends to the person in charge of the statutory audit of the financial statements. This individual is in fact required to further certify, through a specific report, the compliance of the information provided with the provisions of the aforementioned legislative decree and adherence to the specified principles. With specific reference to the supervisory body, the same sanction applies to member of the that body who, in breach of their supervisory and reporting duties, fail to report to the shareholders' meeting that the individual or consolidated non-financial statement has not been prepared in accordance with the prescribed requirements. The same sanction, reduced by one half, also applies to directors and members of the supervisory body who have certified the compliance of the a declaration not drawn up in accordance with the legal requirements. Finally, the directors and members of the supervisory body of the public interest entity are ultimately subject to an administrative fine ranging from fifty thousand to one hundred and

9 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance

10 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (Text with EEA relevance)

fifty thousand euros when the declaration contains untrue facts or omits relevant information.[11]

With regard to Directive 2017/828, Article 14b of Chapter II expressly states that Member States are responsible for laying down the rules regarding measures and penalties applicable in the event of infringements of the national provisions adopted in accordance with this Directive. The directive has been transposed into Italian law by Legislative Decree No. 49 of May 10, 2019. Article 4 of this decree outlines a series of financial penalties, ranging from five thousand to one hundred and fifty thousand euros, for non-compliance with the implementing provisions.[12]

Similarly, Regulation 2019/2088[13] (known as the *Sustainable Finance Disclosure Regulation*, SFDR), while directly applicable as such, does not provide for direct sanctions for non-compliance. Instead, the responsibility for supervising the compliance of financial market participants and financial advisors with the requirements of the regulation lies with the individual member states. This oversight includes both supervisory and investigative powers, as set out in Article 14.

Under Regulation 2019/2089[14], Member States retain the authority to determine the relevant sanctions. However, the Regulation is more explicit in outlining the types of infringements that require specific administrative and disqualifying sanctions, as set out in Article 42. These include, *inter alia*, violations of: Chapter 1, Title I (governance and control by directors), Chapter 2, Title I (input data, methodology, and reporting of violations), Chapter 3, Title I (Code of Conduct), Title IV (transparency and consumer protection), and other specific sections. Pursuant to Article 9 of European Delegation Law No. 163 of October 25, 2017 (implementing European Regulation

11 Official Gazette, Legislative Decree No. 254 of Dec. 30, 2016, Implementation of Directive 2014/95/EU of the European Parliament and of the Council of Oct. 22, 2014, amending Directive 2013/34/EU as regards the disclosure of non-financial and diversity information by certain undertakings and large groups

12 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

13 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

14 Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks

2016/1011, which already referred to the sanctioning regime), CONSOB was designated as the authority empowered to identify the corresponding sanctions. Through an amendment to the Consolidated Law on Financial Intermediation (TUF) (Legislative Decree No. 58 of February 24, 1998), Article 190 bis was consequently introduced, which outlines the administrative sanctions for violations of the provisions of Regulation (EU) 2016/1011. In particular, pursuant to the first paragraph of Article 190 bis, in the event of a breach of the provisions set put in Chapter 1, 2 and 3 of Title I by legal entities, an administrative sanction of between ten thousand euros and one million euros, or up to ten per cent of the total annual turnover if greater than one million euros, shall apply. For individuals, an administrative sanction ranging from five thousand euros to five hundred thousand euros shall apply. The sanction referred to in paragraph 1, concerning individuals, also applies to those performing administrative, management or supervisory functions, as well as to companies' personnel.[15]

On the other hand, Regulation 2020/852[16] (otherwise known as the *Taxonomy Regulation*) also stipulates that Member States will be responsible for defining measures and penalties for violations of Articles 5, 6, and 7. These articles deal with the transparency of environmentally sustainable investments, financial products promoting environmental characteristics, and other financial products. The measures and sanctions prescribed must meet the criteria of effectiveness, proportionality and dissuasiveness, as set out in Article 22.

Directive 2022/2464 (also known as the *Corporate Sustainability Reporting Directive*, CSRD)[17] amended several directives (namely Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU), all of which provide for a system of sanctions. Specifically:

1. The transposition of Directive 2004/109 in Italy took place through Legislative Decree No. 1 of 6 November 2007;

15 Legislative Decree No. 58 of February 24, 1998: Consolidated text of provisions on financial intermediation, pursuant to Articles 8 and 21 of Law No. 520 of February 6, 1996

16 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

17 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting

2. Directive 2006/43 was transposed in Italy by Legislative Decree No. 39 of 27 January 2010;
3. Directive 2006/43 was instead transposed in Italy by Legislative Decree No. 39 of 27 January 2010;
4. The CSRD was then implemented in Italy by Legislative Decree No. 125 of 6 September 2024 and has been in force since 25 September 2024.

The directives referred to in points 1, 2 and 3 above, in Articles 28, 30 and 51 respectively, empower Member States to determine the penalties to be applied in the event of infringement of the relevant legislation.

Legislative Decree No. 195 of 6 November 2007[18] introduced amendment to the TUF and extended the application of Article 193. The latter article provides for fines, with a wide range from five thousand to ten million euros, and other sanctions. In particular, the obligation to issue a public statement indicating the natural or legal person responsible for the violation and its nature, when it is characterised by low offensiveness or dangerousness, has been introduced. An order to eliminate the alleged infringement may also be issued. Such an order may include indications of the measures to be taken and the time limit for compliance, and it may also be requested to refrain from repeating such violations when they are of minor offensiveness or dangerousness.

Legislative Decree of 27 January 2010, No. 39[19] Article 24, as last amended by Legislative Decree of 6 September 2024, No. 125 (which transposed the CSRD) provides that: "*When the Ministry of Economy and Finance ascertains irregularities in the performance of the activity of statutory audit or attestation of sustainability reporting compliance, it may apply the following sanctions:*

a. *a warning, requiring the natural or legal person responsible for the breach to cease the conduct and to refrain from repeating it;*
b. *a statement that the audit report or attestation report does not meet the requirements of Articles 14 and 14-bis, respectively;*
c. *censure, consisting of a public statement of reprimand, indicating the person responsible and the nature of the violation;*

18 Legislative Decree No. 195 of November 6, 2007, "Implementation of Directive 2004/109/EC on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC"

19 Legislative Decree No. 39 of January 27, 2010, "Implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, amending Directives 78/660/EEC and 83/349/EEC and repealing Directive 84/253/EEC"

d. *a fine ranging from one thousand to one hundred and fifty thousand euros;*
e. *the suspension from the Register, for a period not exceeding three years, of the person to whom the irregularities related to the statutory audit engagement are attributable;*
f. *suspension of the activity of certifying the compliance of the sustainability report, for a period not exceeding three years, of the entity to which the irregularities are attributable;*
g. *revocation of one or more statutory audit or sustainability reporting compliance engagements;*
h. *the prohibition of the statutory auditor or the statutory auditing firm from accepting new statutory audit or sustainability assurance engagements for a period not exceeding three years;*
i. *the removal from the Register of the person to whom the irregularities related to the statutory audit engagement are attributable.*

Moreover, this Legislative Decree (as last amended by Legislative Decree No. 125 of 6 September 2024) provided for an additional system of sanctions that CONSOB may apply if it finds that certain provisions of the Decree have been breached. Specifically: *1. CONSOB may apply the following sanction*s:

a. *a pecuniary administrative sanction ranging from ten thousand to five hundred thousand euros against the sustainability auditor, the statutory auditing firm and the sustainability manager. For any breach of the prohibitions set forth in Article 17, paragraphs 3-bis, 3-ter, 3-quater and 5-bis, a pecuniary administrative sanction ranging from one hundred thousand to five hundred thousand euros shall apply;*
b. *revocation of one or more sustainability reporting compliance attestation assignments related to public interest entities or entities subject to an intermediate regime;*
c. *the prohibition of the sustainability auditor or the statutory auditing firm from accepting new sustainability reporting compliance attestation engagements related to public interest entities or entities subject to an interim regime for a period not exceeding three years;*
d. *the suspension of the sustainability auditor, statutory auditor or sustainability manager to whom the irregularities are attributable, for a period not exceeding three years.*

2. *Consob shall notify the Ministry of Economy and Finance of the measures referred to in paragraph 1 lit. d) for the purpose of their entry in the Register.*
3. *When the breaches referred to in paragraph 1 are characterised by low offensiveness or dangerousness, Consob may, as an alternative to the sanctions re-*

ferred to in the same paragraph: a) publish a statement indicating the person responsible for the breach and the nature thereof; b) order the elimination of the breaches objected to, with possible indication of the measures to be taken and the deadline for compliance, and to refrain from repeating them.

4. *For failure to comply within the prescribed time limit with the order referred to in paragraph 3 lit. b), Consob shall apply the administrative pecuniary sanction provided for the original infringement increased by up to one third.*
5. *Where the irregularities ascertained have resulted in the issuance of an attestation report that does not meet the requirements laid down in Article 14-bis, Consob shall, by the order imposing the sanction provided for in paragraph 1, declare that the audit report does not meet the requirements laid down in Article 14-bis.*
6. *Where Consob ascertains a breach of Article 9-bis, paragraph 8-quater, it may impose the sanctions set forth in paragraphs 1(a), 3 and 4 on the sustainability auditor or the statutory auditing firm.*
7. *Without prejudice to the application of the sanctions envisaged in paragraph 1, Consob, for failure to comply with the provisions of Articles 10-ter, paragraph 11-bis, and 17, paragraphs 3-bis, 3-ter, 3-quater and 5-bis of this Decree, and the relevant implementing provisions applies a pecuniary administrative sanction ranging from ten thousand euros to five hundred thousand euros to members of the administrative and management bodies of the statutory auditing companies when the non-compliance is the consequence of the breach of duties by the members of their own bodies or of the body to which they belong, and one or both of the following conditions are met a) the conduct has materially affected the overall organisation or the risk profiles for the independence and quality of the audit firm's sustainability reporting activities; b) the conduct has contributed to the company's non-compliance with the provisions of Articles 10-ter, paragraph 11-bis, and 17 paragraphs 3-bis, 3-ter, 3-quater and 5-bis of this Decree, and the relevant implementing rules.*
8. *Where Consob ascertains a breach of Article 10 (13-bis and 13-ter) and Article 17 (3-bis, 3-ter, 3-quater and 5-bis) of this decree, and of the relevant implementing provisions, by persons other than those referred to in paragraphs 1 and 7, it shall apply a pecuniary administrative sanction varying from ten thousand to five hundred thousand euros.*
9. *With the measure applying the sanction, in view of the seriousness of the violation ascertained, Consob may apply the ancillary administrative sanc-*

tion of temporary disqualification, for a period not exceeding three years, from exercising functions in statutory audit firms.

10. *When Consob ascertains that the administrative bodies of a public interest entity or of an entity subject to an intermediate regime have failed to comply with the obligations set out in Article 14-bis, paragraph 5, it shall apply a pecuniary administrative sanction ranging from ten thousand to five hundred thousand euros to the members of such bodies responsible for the breaches. Where the breaches are particularly serious, Consob may temporarily prohibit, for a period not exceeding three years, the members of the administrative and management bodies responsible for the breaches from exercising functions at public interest entities or entities subject to an intermediate regime.*
11. *Where the breach of the provisions of Articles 10, paragraphs 13-bis and 13-ter and 17, paragraphs 3-bis, 3-ter, 3-quater and 5-bis of this Decree, and of the related implementing rules is attributable to shareholders, members of the board of directors or employees of the auditing firm registered in the Register, Consob may adopt against such persons the measures provided for in paragraph 1, letter d).*
12. *Article 195 of the Consolidated Law on Finance shall apply to the sanction proceedings referred to in this Article.*
13. *Articles 194-bis and 195-bis of the Consolidated Law on Finance shall apply to the measures referred to in this Article.*

The remainder of Chapter VIII of the same Legislative Decree, which deals specifically with administrative and criminal sanctions, addresses more peculiar cases such as false reports or communications by auditors, bribery of auditors, obstruction of control, illegal remuneration and unlawful financial dealings with the audited company.

Article 44 of Legislative Decree No. 136 of 18 August 2015[20] then establishes that intermediaries subject to IFRS (international financial reporting standards) will be subject to administrative pecuniary sanctions of between

20 Legislative Decree August 18, 2015, No. 136 : Implementation of Directive 2013/34/EU on the annual accounts, consolidated accounts and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Directives 78/660/EEC and 83/349/EEC, for the part relating to the annual accounts and consolidated accounts of banks and other financial institutions, as well as on the disclosure of accounting documents of branches, established in a member state, of credit institutions and financial institutions with registered offices outside that member state, and repealing and replacing Legislative Decree No. 87.

six thousand and one hundred and fifty thousand euros in the event of a breach of the provisions adopted in the exercise of the powers referred to in Article 43. With regard to non-compliance with such provisions, those who perform administrative, management and control roles for IFRS intermediaries, as well as the manager responsible for the preparation of corporate accounting documents, will be subject to administrative pecuniary sanctions in the range of between four thousand and one hundred and twenty thousand euros in the event of a breach of their duties or the duties of the body to which they belong.

Finally, Article 10 of Legislative Decree No. 125 of 6 September 2024[21] (which, as mentioned, transposed the CSRD) then introduced a special system to identify hypotheses of liability and the respective sanctions, providing that:

a. The responsibility for ensuring that the information required under the decree is provided lies with the directors of the companies required to comply with the decree, who act in a diligent and professional manner. Alongside the directors, the supervisory bodies also monitor compliance with these provisions and report on them in their annual report to the shareholders' meeting;
b. for the two years following the entry into force of the aforementioned decree, persons performing administrative, management or control functions, as well as personnel, who have failed to comply with the provisions relating to the submission of the annual financial report (with related sustainability reporting), may be subject to an administrative fine in the range of between five thousand euros and one hundred and fifty thousand euros;
c. for the two years following the entry into force of the aforementioned decree, members of the board of statutory auditors, the supervisory board and the management control committee, if they have failed to comply with the provisions relating to the submission of the annual financial report (with related sustainability reporting), may be subject to an administrative fine in the range of between five thousand euros and one hundred and fifty thousand euros;

21 Legislative Decree No 125 of 6 September 2024: Implementation of Directive 2022/2464/EU of the European Parliament and of the Council of 14 December 2022 amending Regulation 537/2014/EU, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU as regards corporate sustainability reporting. (24G00145)

d. for the two years following the entry into force of the aforementioned decree, companies, entities or associations that have not complied with the provisions concerning the submission of the annual financial report (with related sustainability reporting) may be subject to an administrative pecuniary sanction in the range of between five thousand euros and two million five hundred thousand euros;
e. furthermore, for the two years following the entry into force of the aforementioned decree, in the case of violations committed by auditing companies and auditors, the administrative pecuniary sanctions may not exceed one hundred and twenty-five thousand euros and fifty thousand euros, respectively;
f. if the infringements themselves are characterised by low offensiveness or dangerousness, the following administrative sanctions may be applied: a public statement indicating the natural or legal person responsible for the infringement and the nature of the infringement; an order to eliminate the contested infringements, possibly with an indication of the measures to be taken and the time limit for compliance, and to refrain from repeating them;
g. lastly, for the purpose of identifying the sanction to be applied, CONSOB takes into account at least one of the following circumstances: a) the procedures adopted by the company's administrative body for the preparation of the sustainability report, also in the light of any guidelines or indications provided by national and European authorities in relation to sustainability reporting; b) the breach of obligations if related to the omission or disclosure of information by companies included in the value chain that are not subject to control by the company itself.

23.1. Greenwashing and Socialwashing

In the financial context, *greenwashing* occurs when people or entities express of perform actions that do not transparently and accurately reflect the sustainability profile of an entity. This entity may be the creator or distributor of financial products, such as banks, investment companies or insurance companies. This may concern specific financial products such as shares, bonds, loans or insurance, as well as financial services such as consultancy. This practice can be misleading for consumers, investors and other market participants.

Actors who may engage in *greenwashing* practices include: the entity being claimed or responsible for the product; entities providing advice or information on the product, and third parties such as certified sustainability agencies.

According to the preliminary report of the *European Banking Authority*, suspicious situations of *greenwashing* emerge in relation to the sustainability of banks. These cases include: (a) statements claiming to contribute to the reduction of global carbon dioxide emissions, but at the same time granting financing to companies involved in the construction of coal-fired power plants; (b) public commitments to reduce carbon dioxide emissions related to investment and financing activities, supported by less credible plans; (c) banks' failure to comply with their own environmental and social policies, with the conscious financing of projects that cause significantly negative impacts on the environment and society.

From the point of view of products or services, *greenwashing* can manifest itself by way of example through: (a) situations in which inaccurate information is provided to clients regarding the characteristics, objectives, composition and 'green' effects of investment products; (b) the introduction of a sustainable investment label that allows investment in fossil fuel companies without making real improvements to their sustainable investment policies.

Social washing (or *woke washing*), similar to the more widespread phenomenon of greenwashing, occurs when there is a gap between the apparent commitment to social issues and the actions actually taken. It refers to an artificial approach taken by companies to enhance their reputation through social responsibility initiatives that, in reality, prove to be ineffective. In more serious situations, these actions may be perceived as superficial, aiming primarily at gaining an economic advantage rather than generating significant social impacts. This practice may manifest itself through '*brand activism*' or through corporate statements on a wide range of social issues (such as diversity, labour equity and standards, justice or human rights). Concrete examples of *social washing* practices include:

a. a well-known grocery chain in the United Kingdom, which introduced an 'LGBT sandwich' in the UK during Pride Month celebrations, but avoided marketing it in markets where same-sex relationships are considered illegal;
b. a well-known car manufacturer, which launched a campaign during the Super Bowl to promote gender equality, despite the limited presence of women in leadership positions and, at the time, the absence of female board members.[22]

22 The Guardian, "Woke-washing: how brands are cashing in on the culture wars" (2019). Available at: https://www.theguardian.com/media/2019/may/23/woke-washing-brands-cashing-

An example of *social washing* can also be found in the case, known to the general public as '*pandorogate*' associated, *inter alia*, with a well-known Italian influencer, whose company was sanctioned by the Italian Competition Authority, which found that the social message associated with the promotion of the sale of the Christmas cake was misleading.

The phenomena of *greenwashing* and *social washing*, together with the associated possible controversies, bring with them a number of risks, both financial and non-financial[23]. These include:

1. Reputational risks: these may arise from media campaigns and consumer association initiatives, as well as from public reporting of *greenwashing* complaints by customers. In addition, legal disputes may arise due to alleged *greenwashing* practices. Reputational risk arising from *greenwashing* or its perception may also increase other risks, such as business, operational, market and liquidity risks, leading, for example, to difficulties in attracting and retaining customers, employees, business partners and investors;
2. Operational risks (including losses related to litigation and liability risks), as a result of, for example:
   a. losses arising from claims related to the mis-selling of products that are presented as environmentally friendly, but do not meet the standards for such products or do not meet the stated level of green credentials;
   b. lawsuits filed against institutions on the grounds that publicised support for initiatives related to environmental protection initiatives could constitute *greenwashing*;
   c. lawsuits filed against institutions due to a discrepancy between their internal environmental or social policies and some of their actual activities.
3. Strategic and business risks that may arise from:
   a. Declines in profits or loss of confidence on the part of investors or participants in the interbank market;
   b. loss of earnings as a result of non-compliant behaviour and fines.

in-on-culture-wars-owen-jones. Accessed 23 January 2024

23 European Banking Authority, "EBA Progress Report on Greenwashing Monitoring and Supervision" (2023). Available at: https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2023/1055934/EBA%20progress%20report%20on%20greewnwashing.pdf. Accessed 23 January 2024

4. Liquidity and financing risks, evident in circumstances such as:
   a. limited access to market financing or less favourable access conditions, motivated by reputational damage that may lead to the withdrawal of financial support provided to the institution by investors (whether institutional, corporate, governmental or retail)
   b. reduced ability to issue green bonds due to a lack of confidence resulting from reputational damage.
5. Credit risks, with impairment of the ability to meet commitments and weakened creditworthiness.
6. Market risks, which may arise as a result of: losses due to a decrease in the market value of financial instruments identified as "green", if they lose their positive environmental consideration or due to an increase in the variability of the market price of such instruments.

Greenwashing could pose a risk to the overall financial integrity of the market. A "*Minsky*" situation could occur, in which green financial instruments, either as a whole or in a substantial part, are no longer perceived as such, adversely affecting the credibility of sustainable financial markets and causing widespread revaluation and a decrease in liquidity. This could then lead to a risk for the entire financial system, such as through the massive liquidation of green bonds.

Furthermore, it could be argued that, due to the overly positive assessment of transition timeframes, metrices and stated targets by entities, *greenwashing* has detrimental impacts due to the inability to accurately assess the risks of a product. This could underestimate transition risk, increasing the danger of a disorderly climate transition and ultimately undermining the resilience of financial institutions.

23.2. Liability Profiles

The ultimate outcome is that, due to ESG factors and instances of *greenwashing*, various claims may arise. Therefore, this section will delve into the legal foundation upon which such claims can be brought before a court.

Pre-contractual Liability and the resolutions of Italian Regulatory Authorities

The origin of pre-contractual liability, also known as *culpa in contrahendo*, can be found in two articles of the Italian Civil Code, namely Article 1337 and Article 1338. Part of jurisprudence interprets liability for *culpa in contrahendo* as a form of extra-contractual liability, linked to the violation of rules of conduct during the contract formation phase (Cass. S.U. 9645/2001; Cass.

9157/1995). Other case law, however, interprets this form of liability within the context of contractual liability. In particular, it mentions the liability arising from the so-called 'qualified social contact', understood as an event capable of generating obligations (Article 1173 of the Civil Code), from which reciprocal duties of good faith, protection and information derive, pursuant to Articles 1175 and 1375 of the Civil Code (Cass. 25644/2017; Cass. 14188/2016; Cass. 27648/2011). According to the most recent interpretation of jurisprudence, "*liability for the damage caused by one party to the other, insofar as it arises from the breach of specific duties (good faith, protection, information) prior to those that might arise from the contract, should it be concluded, and not from the generic principle of neminem laedere, must necessarily be qualified as contractual liability*" (Cass. 14188/2016). Although this divergent interpretation may lead to significant impacts, such as on the legal requirements front, the main focus in this context is on the specific situations from which such a liability may originate in relation to ESG factors. In this context, the possible breach of duties of good faith during negotiations and the contract formation phase, as well as related disclosure and information obligations, seems to assume greater relevance. A concrete example could be a situation in which insufficient information is provided regarding the ESG financial instrument in which one intends to invest, especially if this instrument falls within the definitions laid down in the Taxonomy Regulation. Furthermore, according to Article 94 of Legislative Decree 58/1998, investors have the possibility to claim damages from the issuer of a financial product in the event that the prospectus contains untrue or misleading information in relation to the product itself. This regulatory provision could thus be invoked in the context of *greenwashing* practices to claim damages in the presence of prejudice caused by misleading statements on the 'green' or ecological characteristics of an *impact financing* product.

This is the context for the information that must necessarily be provided to investors who decide to invest in an ESG investment fund under the very recent European Securities and Markets Authority (**ESMA**) Guidelines on the use of environmental, social and governance or sustainability-related terms in fund names. In fact, ESMA has clarified that in order to be able to use ESG terminology in fund designations - or terminology in any case related to sustainability - a minimum threshold of 80% of the fund's investments should be used to meet environmental or social characteristics or achieve sustainable investment objectives.[24] Well, both CONSOB (by notice of 29 October 2024[25]) and the Bank of Italy (by note No. 43 of 30 October 2024[26]) have informed ESMA, for the profiles of their respective competences, that they intend to comply with the aforementioned Guidelines. In particular, these Guidelines will have to be considered in force as of 21 November 2024 for funds established as of that date and as of 21 May 2025 for funds already in existence as of 21 November 2024 (which funds were in fact granted a six-month transitional period to comply with them). What is relevant in this case is that all operators involved in the sector are obliged (though not formally obliged, as they may choose alternative ways if adequately motivated and equally valid) both to be more cautious in using ESG terminology in the name of a fund and to provide information to investors that actually reflects the 'green' characteristics of a fund. Indeed, if unclear or misleading information is provided, this could give rise to claims for damages by investors for not being adequately protected against the negative impacts of the allegedly 'green' products purchased.

Contractual Liability: the use of the "climate neutral" definition in the real estate sector

The key provision for this type of liability is Article 1218 of the Italian Civil Code, which states that "*a debtor who fails to perform exactly as he should shall be liable for damages unless he proves that the non-performance or delay was caused by an impossibility of performance resulting from a cause beyond his control*". Such liability may for instance be invoked if a statement or representation included in a contract is proven to be false or untrue. In this context, the investor would have the burden of proving the existence of the contract (containing the untrue statements) and any damages suffered. A similar situation could arise especially in the real estate sector, considering

24 ESMA34-1592494965-657

25 Consob Notice of 29 October 2024: Notice on the Guidelines issued by ESMA on the use of environmental, social and governance or sustainability-related terms in fund names. Available at: https://www.consob.it/web/area-pubblica/-/avviso-consob-del-29-ottobre-2024. Accessed on February 5, 2025

26 Note No. 43 of 30 October 2024: European Securities and Markets Authority (ESMA) guidelines on the use of environmental, social and governance or sustainability-related terms in fund designations (ESMA34-1592494965- 657). Available at: https://www.bancaditalia.it/compiti/vigilanza/normativa/orientamenti-vigilanza/elenco-esa/note/Nota-43-del-30-ottobre-2024.pdf. Accessed on February 5, 2025

the recent increase in green renovations of existing buildings. In this scenario, financing or loan contracts related to ESG-certified real estate could be entered into, but at the same time carry contractual liability risks in case the 'green' promises related to such investments are not fulfilled. This could result in non-performance of the contractual obligation due to failure to achieve the desired investment objective.

This is the background to the recent decision by the German Federal Court of Justice concerning the legality of claims about environmental benefits generically used for investment products. In the present case, the defendant had advertised the production of gummy sweets by describing them as 'climate neutral' to the general public. However, this turned out not to be exactly true, as the production mechanism was not in itself entirely 'climate-neutral', but stipulated that, in order to offset CO^2 emissions, the company would support projects to protect against the negative impacts of climate change through an external company (which was not clearly indicated on the product, but could only be found out by framing a QR code on the product itself). Regardless of the circumstances of the case, the German Federal Court of Justice made it clear for the first time that strict and specific requirements must be placed on the explanatory information of a product.[27]

Clearly, judgements of this kind emphasise the importance of clear, transparent and informed statements and set a precedent on the quality of the information to be provided. Transferring this to the real estate sphere, the increase in so-called 'zero-emission' buildings (or buildings that are in any case constructed in such a way as to be climate-neutral) calls for a higher level of attention in the drafting of contracts, to ensure that they describe all relevant energy characteristics in a clear and comprehensible manner and, above all, do not set more ambitious energy efficiency targets than actually achievable. This is also particularly relevant in light of the recent approval of the directive on the energy performance of buildings (Directive 2024/1275[28]), which set new targets for improving the energy performance of buildings and reducing greenhouse gas emissions from buildings within the European Union.

27 Bundesgerichtshof, Bundesgerichtshof entscheidet zur Zulässigkeit von Werbung mit dem Begriff „klimaneutral". Available at: https://www.bundesgerichtshof.de/SharedDocs/Pressemitteilungen/DE/2024/2024138.html;jsessionid=4C9B0DD971C D7C90BE963C10CE264915.internet012?nn=10690868. Accessed on February 5, 2025

28 Directive (EU) 2024/1275 of the European Parliament and of the Council of 24 April 2024 on the energy performance of buildings (recast) (Text with EEA relevance)

Consider again, in the context of the 'S' factor (*Social*), employment contracts concluded with companies that, in addition to declaring a special attention to gender issues, use disadvantageous practices in the workplace. By way of example, the Court of Bologna, on 31 December 2020, had ruled on the matter following an appeal filed against a well-known food delivery company. In that circumstance, there was a situation in which individual rights, in particular the right to strike, were not respected by the algorithm used by the employer to distribute work among *riders*. Such a situation could also occur in the case of non-respect of human rights, thus falling within the 'S' scope of these factors.

Environmental reporting in companies' financial statements and financial documents can also generate potential legal risks. A concrete example is the possibility that a company's shareholders may decide to take legal action to claim damages arising from any irregularities or omissions in the information provided in the 'Non-financial statement', which plays the role of a 'Sustainability Report'. This document reflects the company's environmental and social performance and is mandatory for certain large companies in accordance with Legislative Decree 254/16, which implements EU Directive 2014/95 on the disclosure of non-financial information.

Extracontractual Liability: the new civil liability regime introduced by the CS-DDD

Extra-contractual liability arises as a result of wrongful conduct occurring within relationships between two or more entities that are not previously bound by a contractual agreement. The pivotal rule is Article 2043 of the Italian Civil Code, according to which "*Any intentional or negligent act, which causes unjust damage to others, obliges the person who committed the act to compensate for the damage*." This type of liability is particularly relevant for two different (but interrelated) aspects: the attribution of negative externalities and the management of natural resources.

Externalities are the consequences of activities that affect third parties without being reflected in market prices. Externalities can be categorised as: negative (where total costs exceed the costs of private parties) and positive (where total costs are lower than the costs of private parties). Negative externalities occur when the party causing harmful impacts does not internalise the cost of the damage inflicted on the injured party, i.e. does not economically compensate for the damage suffered (think of the inhabitants of a given area who, for whatever reason, suffer some type of air pollution). In this case, therefore, it is clear that the issuing body is not bearing all the costs, which will inevitably be borne by individuals. Undoubtedly, the analysis and integration of ESG criteria into a portfolio allows for the anticipation of negative impacts in order to mitigate risk in advance and absorb costs that would then be assessed in due course. However, not all companies adopt a long-term strategy to absorb the externalities produced. Even today, there are situations where negative externalities, related to environmental, social or governance factors, are borne by individuals. In these circumstances, in the absence of a contractual relationship and with the presence of the subjective elements required by law and the damage suffered, it is possible to invoke Article 2043 to bring an action for damages. A traditional example of a negative environmental externality is a factory polluting a river, thus worsening the quality of water used by people downstream causing damage to the ecosystem.

Some examples in this context include: the penalty of one hundred and forty thousand pounds fine imposed on a company in the United Kingdom, which was issued following proceedings initiated by the British government's Environment Agency[29]; the lawsuit filed by the state of New York against the manufacturer of a well-known soft drink for polluting a river[30]; or the settlement reached between Texas residents (as plaintiffs) and a chemical manufacturer, which agreed to pay $50 million to settle a lawsuit in which a judge ruled that the company had illegally dumped billions of plastic granules and other pollutants into Lavaca Bay and other waterways.[31]

The issue of resource depletion focuses on the possibility that the integration of ESG factors provides in preserving these resources, allowing companies to conduct their business with a reduced climate impact. On the other hand, companies that neglect the consideration of ESG factors or do so inadequately with respect to their actual emissions run a high risk of facing non-contractual liability charges for their long-term actions. In essence, attention to or neglect of ESG factors could become a crucial element in as-

29 The Guardian, "Court fines Weetabix £140,000 for polluting river near factory" (2019). Available at: https://www.theguardian.com/environment/2019/nov/22/court-fines-weetabix-polluting-river-ise-close-factory-northamptonshire. Accessed 24 January 2024

30 Food Manufacturing, "PepsiCo Sued Over River Pollution" (2023). Available a: https://www.foodmanufacturing.com/packaging/news/22879513/pepsico-sued-over-river-pollution. Accessed 24 January 2024

31 The Texas Tribune, "Plastic company set to pay $50 million settlement in water pollution suit brought on by Texas residents" (2019). Available at: https://www.texastribune.org/2019/10/15/formosa-plastics-pay-50-million-texas-clean-water-act-lawsuit/. Accessed 24 January 2024

sessing corporate behavior and its implications for environmental resources (for all the assumptions mentioned above).

As evidence of the above, it is worth noting that the European Directive 2024/1760 - concerning companies' duty of due diligence for sustainability purposes (so called CSDDD[32]) - introduced in Article 29 a general regime of "*Civil liability of companies and the right to full compensation*", whereby companies can be held liable for damages caused by failure to comply with the due diligence obligations imposed by the directive itself and, should a breach be found, any natural or legal person would be entitled to full compensation for the damage in accordance with the relevant national provisions. However, it is equally true that the conditions necessary for such a liability to be incorporated appear rather restrictive, due to elements such as **(i)** the reference to damage directly affecting individuals (as if to exclude strictly environmental damage) **(ii)** the necessity that there must have been a negligent or intentional breach of the obligation to prevent or stop any negative impact; **(iii)** the presence of the causal link between the specific breach and the damage suffered by the individual (this link is however normatively excluded if the damage was caused exclusively by business partners). The burden of proof rests entirely on the plaintiff, who would thus be faced with a not insignificant challenge in actually arguing his claims for compensation.

This does not detract from the fact that the provision of such a liability mechanism emphasises even more the role played by companies in auditing the supply chain, and the need for them to take due account of the negative impacts of their activities in order to prevent, or mitigate the risk of, future claims.

Litigation instances for Greenwashing and Socialwashing phenomena

In the course of 2021, the Court of Gorizia issued a precautionary measure (although later revoked on appeal, albeit for reasons unrelated to the merits of the dispute) against a textile company in the North East of Italy obliging it to stop marketing certain microfiber products, which had been misleadingly presented as being 100% recyclable and having and 80% reduced impact on CO_2 emissions. In the present case, the Court held that: "*the legal basis of consumer protection can be traced back to the time of the Treaty establishing the EEC ..... the Union contributes*

32 Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859 (Text with EEA relevance)

to protecting the health, safety and economic interests of consumers and to promoting their right to information, education and to organise themselves in order to safeguard their interests'. Mention should also be made of Article 12 TFEU, according to which the Union, when defining and implementing other policies or activities, must always take consumer protection requirements into account; and Article 38 of the Charter of Fundamental Rights of the European Union, which reaffirms the consumer protection granted by the EU, stating that the highest level of protection for individuals must always be ensured in European policies. In 2007, in implementation of Article 14 of the above-mentioned Directive 2005/29/EC, amending Directive 84/450/EC on misleading advertising, Legislative Decree. 145/07, which, while leaving the substance of the definition of misleading advertising unchanged, introduced significant innovations, such as the possibility for the Competition and Market Authority to act ex officio against unlawful misleading and comparative advertising; the possibility for the offending company to undertake to resolve the infringement by ceasing to disseminate the misleading advertising or by modifying it; as well as the application of higher fines". It goes on to say that "*it is not consistent with a requirement of effective protection of the environment for environmental boasts to become phrases in common use, devoid of concrete meaning for the purposes of product characterisation and differentiation. More generally, self-disciplinary jurisprudence (decisions of the Jury and final injunctions of the Control Committee) has pointed out that environmental advertising may refer, implicitly or explicitly: to the relationship between product and environment; to the promotion of an eco-friendly lifestyle; to the presentation of a corporate image characterised by environmental commitment. And this, through the use of "green" environmental declarations that must be clear, truthful, accurate and not misleading, based on scientific data presented in a comprehensible manner'*. It goes on to state that *"In the present case, the advertising messages complained of by the plaintiff are certainly very generic in some cases - natural choice, environmentally friendly, the first and only microfiber that guarantees eco-sustainability throughout the production cycle, ecological microfiber - and certainly create a green image of the company in the consumer's mind without, however, actually giving an account of which company policies allow greater respect for the environment and effectively reduce the impact that the production and marketing of a fabric derived from petroleum may have in a positive sense on the environment and its respect*".[33]

Furthermore, the dissemination of misleading or inaccurate information may give rise to liability under the Consumer Code (Legislative Decree 206/03), which implements EC Directive 2005/29. This legislation regulates unfair and deceptive commercial practices towards consumers in the advertising and marketing of products. Such misleading statements are also

33 Precautionary order from 25 November 2021, Tribunal of Gorizia

subject to the legal provisions prohibiting unfair competition (Art. 2598, Section III of the Civil Code).

During 2024, several proceedings were initiated for greenwashing practices, the most relevant of which are listed below:

a. On 30 April 2024, the European Commission and the European Consumer Protection Network announced coordinated action against the greenwashing practices of 20 European airlines, which allegedly engaged in misleading commercial practices.[34] To stay on topic, already on 20 March 2024, the District Court of Amsterdam declared that 15 of the green statements made by a Danish airline were misleading and therefore ordered the airline to avoid such statements in the future, to make corrective statements, and to publish warnings on its website and on airline tickets already purchased;[35]
b. in South Africa, in June 2024, the association Fossil Free South Africa filed its first greenwashing complaint against a well-known French oil company, contesting an advertising campaign that the company ran in collaboration with the national parks protection organisation (SANParks) in which it offered prizes to those who sponsored the parks with reference to the oil company itself. The complaint challenged this advertising in its entirety, in which it was claimed that through such a collaboration the South African people had the opportunity to appreciate their country's natural heritage;[36]
c. on 24 July 2024, the environmental organisation Stand.earth took legal action before the French Antitrust Authority against the official supplier of the Canadian team to the 2024 Summer Olympics. According to the plaintiff, the marketing campaign launched by that supplier (depicting images of rivers, forests and pristine nature) conveyed a vague message

34 European Commission, "Commission and national consumer protection authorities starts action against 20 airlines for misleading greenwashing practices". Available at: https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_24_2322/IP_24_2322_EN.pdf. Accessed on February 6, 2025

35 Federal Court of Amsterdam, decision of 20 March 2024 available at: https://uitspraken.rechtspraak.nl/details?id=ECLI:NL:RBAMS:2024:1512. Accessed on February 6, 2025

36 It should be noted that at the time of writing, a favourable decision has already been rendered for the plaintiffs, which the other party has already declared its intention to challenge. Financial Times, 'TotalEnergies to appeal landmark greenwashing ruling in South Africa'. Available at: https://www.ft.com/content/16a8fcc0-5e75-4493-b775-9bc4876b72b9. Accessed on February 6, 2025

that the company would contribute to a healthy planet. This, however, would not be reflected in the company's real operations;[37]

d. on 2 August 2024, following the filing of the relevant appeal, the Australian Federal Court ordered a well-known Australian pension fund to pay a fine of approximately $11.3 million for violating Australian law due to misleading statements made in relation to allegedly 'green' investments made (which instead involved fossil fuels, gambling activities and alcohol);[38]
e. on 17 October 2024, the well-known NGO ClientEarth filed a lawsuit with the French Financial Supervisory Authority against a well-known US asset manager, contesting the 'green' properties of eighteen investment funds that were marketed as 'sustainable' in the UK and EU and would instead continue to invest in fossil fuels;[39]
f. on 24 October 2024, a group of non-governmental organisations - including Rainforest Action Network, Third World Network, the Forests & Finance, Indigenous Environmental Network, WECAN, Bank Track, Global Forest Coalition, Friends of the Earth International and others - took legal action against the United Nations Environment Programme (UNEP) over its support for the controversial Taskforce on Nature-related Financial Disclosures, claiming that in doing so, UNEP violated its own internal regulations on environmental advocacy, the promotion of gender equality and access to information, and thus sought to disguise the involvement of the said Taskforce in anti-ESG initiatives.[40]

37 Forbes, "Canada Launches Greenwashing Investigation Into Lululemon". Available at: https://www.forbes.com/sites/jonmcgowan/2024/05/13/canada-launches-greenwashing-investigation-into-lululemon/. Accessed on February 6, 2025

38 Federal Court of Australia, Australian Securities and Investments Commission v Mercer Superannuation (Australia) Limited 2024 [FCA] 850. Available at: https://download.asic.gov.au/media/bq0nxstc/24-173mr-asic-v-mercer-superannuation-australia-limited-judgment-2-aug-2024.pdf. Accessed on February 6, 2025

39 ClientEarth, 'Greenwashing of BlackRock investment funds'. Available at: https://www.clientearth.org/media/0tuj2bit/clientearth-complaint-to-the-amf-english.pdf. Accessed on February 6, 2025

40 Friends of the Earth, " Global NGOs File Complaint with UN Program Over Support for "Corporate Greenwashing" Initiative". Available at: https://foe.org/news/cop16-complaint-unep/. Accessed on February 6, 2025

Class Actions

The scope of class actions has expanded considerably thanks to the recent reform introduced by Law No. 31 of 12 April 2019. Now, anyone wishing to assert 'homogeneous individual rights' can bring a class action, thus overcoming the previous restrictions that the limited protection to 'consumer' or 'user' rights under the provisions of the Italian Consumer Code. Moreover, a class action may be initiated for any type of 'homogeneous individual right', with no constraints related to the title of the action, with clearly greater risks for financial institutions that find themselves in the eye of the storm for alleged *greenwashing* practices. This affects not only professional investors, but also smaller investors operating in a non-professional investment context. The recent reform has broadened the scope of class actions, making them suitable to deal with disputes both between companies (B2B) and between collective investors. Thus, smaller or medium-sized individual investors could be incentivised to initiate legal proceedings against a bank in relation to claims about the 'green' sustainability of financial products offered by the credit institution. A salient aspect of the class action, following the reform, is the possibility of joining after the order admitting the class action has been issued. By means of such an order, the court establishes a period of 60-150 days during which other potential injured parties, not previously involved in the class action, can file claims for compensation (thus preventing the resisting parties from calculating the costs to be borne in advance).

On a global level (and by way of example), the following proceedings are noted:

a. a class action against an energy company was filed in Massachusetts state court on 31 May 2024, invoking consumer protection laws against deceptive advertising practices. The plaintiffs allege that the company's advertisements for natural gas do not give due consideration to the emission of chemicals that are harmful to health;[41]
b. in July 2024, a class action was filed in the US District Court for the Southern District of Florida against a global apparel retailer, accusing the company's marketing campaigns of being unfair and deceptive to consumers due to simultaneous greenhouse gas emissions from its production system and the release of microplastics into the environment;[42]

41 Commonwealth of Massachusetts, Class Action complaint and demand for trial by jury. Available at: https://climatecasechart.com/wp-content/uploads/case-documents/2024/20240531_docket-24-1455H_complaint.pdf. Accessed on February 6, 2025

42 Sabin Center for Climate Change Law, "Gyani v. Lululemon Athletica Inc.". Accessed at:

c. also in July 2024, a class action was initiated by a number of South African residents and non-governmental organisations for harmful gas emissions following a warehouse fire in July 2021. The class action provides for different classes of plaintiffs, including both those who suffered economic damages as a result of the event (i.e. those who were prevented from fishing or farming) and those who suffered physical injuries as a result of the fire.[43]

23.3. Directors' liability

Today, the company director takes on the role of a 'guarantor', as a person with a central role in protecting the company's assets in situations of corporate crisis or insolvency. Already Directive 2019/1023 (or Insolvency Directive), transposed in Italy by Legislative Decree No. 83 of 17 June 2022, had given the director the task, in situations of financial difficulty of the company, of putting in place all appropriate measures to reduce losses and avoid insolvency. This approach wan then recovered in the Italian current Corporate Crisis and Insolvency Code, since the director is vested with the power to manage the company, therefore it is his task, on the one hand, to establish appropriate organisational, administrative and accounting structures that allow the '*prompt identification of the state of crisis and the taking of appropriate initiatives*', and, on the other hand, to identify and implement the most appropriate method for resolving the crisis situation encountered (an obligation already provided for in the case of joint-stock companies and limited partnerships, and which is now also provided for in the case of partnerships and limited liability companies following the introduction of Articles 375 and 377 of Legislative Decree No. 14/2019).

The relevant legislation in this respect therefore includes the following provisions:

1. Article 2392 Civil Code (et seq.), according to which a director's duties are to be performed with diligence, prudence and competence, taking

https://climatecasechart.com/case/gyani-v-lululemon-athletica-inc/. Accessed on 6 February 2025

43 Sabin Center for Climate Change Law, " South Durban Community Environmental Alliance v. Minister of Environment and Others". Available at: https://climatecasechart.com/non-us-case/south-durban-community-environmental-alliance-v-minister-of-environment-et-al/. Accessed on February 6, 2025

into account the nature of the task and the management decisions taken, the directors having to ensure that the information provided is accurate, complete and in accordance with applicable standards;

1. Article 2428 of the Civil Code, pursuant to which a faithful, balanced and comprehensive analysis of the company's situation is requires;
2. Article 2381 para. 6 of the Civil Code, according to which the directors must act in an informed manner, evaluating all factual and methodological elements of the case;
3. Article 2086 of the Civil Code and Article 3 of the Code of Corporate Crisis and Insolvency, which provide for the definition of adequate organisational, administrative and accounting structures that allow for the prompt detection of a state of crisis (referring to the so-called *best practices* and therefore assessing the adequacy of the adopted structural model, approved business and operational plans as well as internal control and risk management systems;
4. Articles 3 and 120 bis of the Code of Corporate Crisis and Insolvency, which require the use of the most appropriate means provided by national law to overcome the state of crisis and restore business continuity;
5. Article 2486 paragraph 3 of the Civil Code, which states that: "*Upon the occurrence of a cause for dissolution and until the delivery referred to in Article 2487 bis, the directors retain the power to manage the company, solely for the purpose of preserving the integrity and value of the company's assets*".

There are also specific provisions on the criminal liability of company directors, which could occur as a result of the presentation of false or misleading information (see, for example, Articles 2621 and 2622 of the Civil Code concerning false accounting).

However, it should be remembered that the actual attribution of liability to the director due to negligent management that is detrimental to the company and the other stakeholders concerned is limited by the application of the so-called '*business judgment rule*'. In this situation, management decisions made by the director cannot be judged *ex post* on the basis of the results obtained. The balancing act between these two opposing poles is particularly relevant in the ESG sphere, since a potential *mala gestio* (with consequent damages) could be closely linked to these factors and thus have considerable implications in possible bankruptcy proceedings. In concrete terms, the '*business judgment rule*' prevents courts from thoroughly scrutinising management choices that fall within the competence of directors. However, it is crucial to clarify that this rule does not apply when negligent conduct in the decision-making process on the part of the director is found (i.e. if the director is found to have acted in violation of applicable regulations or made decisions without an adequate basis of information, as set forth in Article 2381 of the Civil Code).

In the context of ESG, two perspectives should be examined. Firstly, one has to assess whether the director has adequately assessed the impact of ESG risks within the organisational structures created, in particular in relation to the *risk assessments* carried out and internal management. This is the context of the European interventions to introduce **(i)** Non-Financial Statements[44] (which deal with an analysis of company's management, dynamics and results, with the aim of highlighting aspects related to the environment, the social dimension, personnel, respect for human rights and the commitment to fight corruption), **(ii)** Diligence Duties and **(iii)** Duties to Shareholders. In the event that the director has not taken these risks into account or has not managed them adequately, it is necessary to quantify the damages specifically related to the harmful administrative conduct.

However, it should be noted that it is difficult to argue that sustainability has an immediate impact on directors' liability. At present, there is no effective provision in the current legal framework that grants stakeholders the possibility to exercise any form of liability towards the management body. Given this scenario, it is important to emphasise the role played by national case law and EU initiatives.

Among the most recent regulatory initiatives driven by European directives, it is first worth mentioning Legislative Decree No. 49/2019, which transposed the Revision of the Shareholders' Rights Directive (2017/828/EU, known as SRD II). This decree introduced changes to national regulations on remuneration policies, requiring listed companies to explain how the directors' remuneration policy contributes to the pursuit of the company's long-term interests and sustainability. This provision further promoted the alignment of directors' interests with the company's strategic objectives, including environmental and social objectives.

Secondly, Directive No. 2022/2464/EU - *Corporate Sustainability Reporting Directive* (CSRD) was recently transposed in Italy with Legislative Decree No. 125/2024, which came into force on 25 September 2024. This directive,

44 Directive 2014/95 UE, adopted with Legislative Decree 254/2016. See also Corporate Sustainability Reporting Directive, 2022/2464 UE

as is known, introduces significant corporate sustainability reporting obligations, thus opening the way for potential liability situations for directors. In fact, Article 10 paragraph 1 of Legislative Decree No. 125 of 2024 directly places the burden on directors to ensure that the ESG reporting process complies with all legal requirements. It is also true, however, that this decree does not lay down any specific rules for the purpose of identifying hypotheses of liability, thus referring to the general national legislation mentioned above.

In any case, the Legislative Decree requires that sustainability reporting be included in the annual financial reporting required under the Consolidated Law on Financial Intermediation, with the consequent power of CONSOB to apply the relevant administrative sanctions (for more information, see the previous section on the regulatory framework and sanctions).

Also under this Decree, directors, in order to reduce the risks associated with sustainability reporting, are required to: **(i)** train regularly; **(ii)** map risks; **(iii)** develop appropriate sustainability policies; **(iv)** establish internal control policies; **(v)** engage experts specialised in sustainability; and **(vi)** maintain an open dialogue with investors and customers.

Again, the recent *Corporate Sustainability Due Diligence Directive* (CSDDD) aims to incorporate respect for human rights and the environment into corporate management. Following the adoption of this directive, companies are obliged to identify and, if necessary, prevent, end or reduce the negative impacts of their activities on human rights and the environment. Furthermore, they are required to monitor and evaluate the effects of their operations. To this end, they are required to implement a 'green transition plan' that may involve variable financial incentives for directors.

It is undeniable that, in the context of the Italian legal system, a growing interest is emerging in broader aspects than those exclusively related to shareholders (a trend that is also reflected in specific regulatory provisions and case law guidelines).

Final remarks

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Tax regimes compared

The choice of the instruments to be adopted for a real estate investment transaction depends on a number of key elements, determined by commercial, technical, financial reasons, among others. The instruments we have described in detail in the pages above also meet different purposes and objectives, as evidenced, among other things, by the particular statutory and regulatory requirements provided for real estate funds and for SIIQ). However, some general considerations are possible and, indeed, desirable.

First of all, it must be said that the choice of the legal instrument best suited for a given property investment transaction should be made on the basis of specific factual and economic circumstances, thus the conclusions can easily vary on a case by case basis.

Having said that, the analysis of the different tax systems applicable to the different real estate investment instruments considered in this work (real property companies, real estate funds, real estate SICAFs, SIIQs and SIINQs and, lastly, "real estate securitization" vehicles) leads to detect a significant difference in the tax treatment of such instruments in the three main stages of a real estate investment: (i) acquisition, (ii) management and (iii) sale (exit).

At acquisition stage, typically implemented through operations consisting in the transfer/contribution or purchase of assets for a consideration, the legislator has reserved a favourable treatment for real estate funds, SICAFs and SIIQs, both for the purposes of direct taxation (substitute tax of 20%) and of indirect taxation (e.g. transfer/contribution of mainly leased fixed assets; mortgage and registration taxes are reduced by a half for transfers of commercial buildings used in business with a real estate fund as one of the parties, etc.). By contrast, the transfer of properties to a real estate company is normally taxed at ordinary rates and is liable to indirect taxation on a proportional basis. With regard to real estate companies, in lieu of a direct transfer of the property to third parties, the shares in the real estate company that owns the property can be sold (the transaction is known as *share deal*), with the result that direct and indirect taxes will impact to a lesser extent.

At the *management stage*, the tax laws appear, in principle, to favour real estate funds, SICAFs (not liable to income tax) and SIIQs (tax exempt with regard to the income from core business), whereas real estate companies are subjected to tax on rents and capital gains deriving from the sale of assets. It should also be pointed out that the tax transparency regime for real estate funds (where applicable) essentially results in a further financial burden for those investors who hold units in connection with a business (as it determines an anticipation of taxation) compared to the system of taxation at the time of distribution; moreover, a comparison with real estate companies shows that the determination of the fund's income to be imputed for transparency purposes would not be subject to the provisions regarding the business income set out in the Income Tax Code. On the other hand, it could also be noted that, in substance, real estate companies can deduct interest expenses (entirely or up to 30% of the gross operating result, as applicable), and depreciation charges (with resulting decrease in the carrying value recognized for tax purposes), in certain cases reaching a significant abatement of the taxable base.

Finally, at *disposal stage*, it can be observed that the real estate fund benefits from total exemption (except for the comments on transparency above) and the same can be said also for SIIQs, as a consequence of the new rules applicable, while real estate companies are subject to taxation. In assessing the overall tax burden, the taxation of shareholders/participants is also to be taken into consideration. Corporate entities are liable, on the one hand, to ordinary taxation of the proceeds from real estate funds and SIIQs, with the result that such investments determine the deferment of the tax liability (for a SIIQ, that is however true to a limited extent, given the annual distribution requirement), while on the other, they benefit from the exemption of 95% on dividends. For individuals acting in their personal capacity and not for business purposes, direct tax on investments in funds and SIIQs amounts to 26% (or the ordinary rate, where the tax transparency regime of real estate funds is applicable), while taxation on distributed dividends is equal to 26% in light of the provisions on the equivalence between qualified and non-qualified investments.

In a nutshell, the tax regime of real estate funds and SIIQs presents favourable elements compared to the tax treatment of real estate companies (except for qualifying holdings and for the possibility of an exempt *share deal)*. In addition to tax savings in absolute terms, the financial effect arising from the postponement of taxation until the distribution of the proceeds of the fund should also be taken into consideration. Peculiar lines of reasoning, and consequent opportunities, may arise from the possible use, as an investment tool, of "real estate securitisations" vehicles, recently introduced into our legal system by the 2019 Budget Law, also in light of the clarifications provided by the Revenue Agency.

For financing instruments, the choice is normally dependent on the offer provided by debt and capital markets. Besides, the possibility of adopting a specific form of financing is in turn connected to the type of investment instrument chosen as well as to the applicable tax legislation. As previously pointed out elsewhere in this publication, so far in our country the real estate sector has exclusively been financed through mortgage loans and finance granted by the banking sector, mainly for two reasons:

- In the past, the tax regime for medium to long-term banking loans was generally more favourable than other types of debt, including bond issues.
- The type of investment instruments chosen by investors (normallysingle investment S.r.l.s or S.p.A.s or real estate funds) was hardly compatible with financing options other than banking loans. However, the 2008 financial crisis triggered a series of changes.

On the one hand, banking institutions have shifted to a more stringent management of their capital, increasing the diversification of their assets and favouring sourcing and distribution activities that generate commissions, over traditional lending that generates interest. This situation has encouraged banks to propose to their clients, more and more often, where viable, to issue bond-type financial instruments instead of raising mortgage loans and financing. On the other hand, the Italian State, with a view to encouraging this diversification and the risk limitation process adopted by the banking system and ensuring a flow of finance in line with the needs of the domestic economy, has implemented a series of improvement amendments to tax regulations in the last few years, extending to less traditional financing options (bonds, loans granted by funds and insurance companies etc.) certain conditions that used to apply only to the medium to long-term loans offered by the banks.

Thus, even though this transition process from bank loans to other forms of finance is still at an initial stage and further regulatory and legislative actions are desirable, the progressive elimination of obstacles of a fiscal nature is unlocking the market of medium to long-term real estate lending and opening it to new players such as insurance companies, debt funds and other institutional investors, thus significantly broadening the offer of funds for the financing of the real estate sector.

Certainly, the emergence of new corporate forms such as SIIQs has also paved the way for a more frequent use of the bond instrument as a replacement for traditional bank financing. That has been possible, above all, due to its status as listed company, which involves stringent obligations in terms of transparency and disclosure, and accordingly better meets the typical information needs of the subscribers of debt securities. The need for these companies to compete at European and global level led the largest of them to acquire a public credit rating, gradually reshaping their debt structure to accommodate debenture debt in the same or even higher proportion than banking debt.

Finally, the issues related to sustainability in a broad sense, summarized by the acronym ESG (Environment, Social, Governance), are becoming increasingly important also in the financial field. Financing linked to sustainability is now a consolidated practice commonly adopted by foreign banking institutions and is also spreading in our country. These loans normally provide for adjustment mechanisms of the economic conditions upon the achievement of certain sustainability objectives agreed between the lender and the borrower and consistent with the latter's sustainability plan and policies. Several companies, especially in the listed segment, are implementing and making public their sustainable financing plans, formalizing in a structured way the policies for the use of the resources obtained through sustainable financing, as well as the reporting and control mechanisms aimed at guaranteeing the effective use of the same in qualified properties.

In this evolving context, it is evident that the choice of an adequate financing instrument for a real estate investment is, even in our country, increasingly complex and strictly connected to tax and regulatory variables that need to be examined in detail with reference to the specific factual circumstances of each investment.

Points of comparison with other tax systems on an international scale

As we have seen, the offer of real estate investment and financing instruments has considerably expanded in recent years and the more sophisticated investors have now various options on offer when entering the Italian real estate investment market. Italy is gradually reaching the same level as other foreign real estate markets that have already implemented and integrated new investment tools in their corpus of regulations.

Since these new tools have been introduced only recently, they do not have the track record and consolidated practice that generally helps limit many of the uncertainties related to tax law or tax administration interpretations and that could reassure investors about what they can expect in the future. In other words, consolidated practice simplifies scenario planning, making it possible to minimise the estimates of investment and profitability, in a situation where grey areas and interpretations are considerable.

To overcome these drawbacks, as highlighted several times in the course of this publication, the legislator could try to reduce these grey areas even simply by analysing what have now become consolidated practices in other countries and through an open and constructive dialogue with the stakeholders in the sector.

Such dialogue, as also evidenced by the recent legislative changes, may be the harbinger of important and necessary stimuli for the growth and maturation of the Italian real estate sector. Considering, for instance, the legislation on real estate funds and SIIQs, it is clear how important a mindful legislative action can be.

Italy was one of the first countries in Europe to introduce and regulate real estate funds. They contributed significantly to the considerable growth of the Italian real estate sector in terms of volumes, professional standards and attraction of foreign capital. Subsequent penalizing legislation along with the introduction of similar (more competitive) instruments in other countries, in conjunction with the scarce economic growth led to a slowdown of the influence of this instrument on the economic growth of the country.

In the case of SIIQs, we warmly welcomed the reform introduced in Budget Law 2022, which now makes it possible for parties other than SIIQs to invest efficiently in the capital of SIIINQs, provided that the SIIQs retain legal control of the investee; indeed, this amendment opens the way for domestic and foreign investors to participate in individual initiatives promoted by one or more SIIQs.

However, the change in the taxation of permanent establishments of foreign REITs that have opted for the SIIQ regime still remains to be introduced. Such change would considerably boost investment in Italy by the large pan-European REITs, significantly increasing the scale of the institutional real estate sector in our country and, ultimately, the liquidity of the overall market.

A further issue of great importance for the sector is the tax treatment of residential properties. Despite the growing interest in the commercial exploitation of residential properties in a professional form, which is common to the main European countries, the current tax regime represents a serious penalty that considerably limits the development of the related activities, compressing their economic potential. The heaviest penalty is undoubtedly represented by the substantial non-deductibility of VAT by persons, funds or companies other than those that have built or renovated the properties. Unable to access the option for the taxability of active operations – leases and sales – they are deeply affected by the proportional non-deductibility of VAT in application of the pro-rata mechanism. This situation, combined with the substantial non-deductibility of management costs, depending on the lack of recognition of the status of such investments as instrumental to the business activity, prevents the development of professional investment in residential properties which, in other countries, is instead a widespread and important economic driving force. A modification of the VAT treatment of residential properties, at least in relation to the professional operators who own and lease them, appears therefore absolutely necessary if we really want to develop an institutional and professional market for housing leases in Italy, also with a view to restarting the building and real estate industry and improving the housing offer for citizens.

Final considerations

As described in the opening part of this eleventh edition, there are many topics that are expected to have an impact on the real estate sector globally during 2025 and consequently the challenges, but also the opportunities, that will arise for the operators. With specific reference to our country, a larger-scale involvement of savings and of private investors, that is essential to activate the actions required by the significant and rapid changes taking place, will only be possible through the availability of investment and financing instruments truly adequate and comparable with those already in place in other European countries. Several steps forward have been taken in recent years to promote the development of the Italian real estate sector through the adoption of standards and regulations comparable to those in use in the most advanced European countries but, as we have seen, much remains to be done. The effort of all the stakeholders in the Italian real estate sector must, therefore, converge on stimulating the growth of the industry through a proactive contribution – be it in the field of transparency or innovation and regulatory simplification – that may help to establish clear, simple and fair rules.

With this book, we hope we have contributed to clarify and provide indications on the main issues impacting on the sector, to all those who intend to operate actively, in various capacities, on the Italian real estate market, by highlighting some of the key issues that we consider essential in terms of encouraging the future development of the market.

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With “Investing in Italian Real Estate - Eleventh Edition”, Confindustria Assoimmobiliare offers a comprehensive analysis of the most critical and complex issues shaping the real estate industry: regulation, taxation, and financing. By providing guidance on the primary topics and trends in the industry, the book serves as a reference point for anyone looking to operate in the Italian real estate market - whether investors, lenders, tenants, intermediaries, consultants, or regulators.

Established in 1997, Confindustria Assoimmobiliare is the association representing all real estate industry operators in Italy. Its membership base includes institutional investors (asset management companies and real estate funds, listed and unlisted real estate companies, banks, and insurance firms), state-owned companies managing large real estate portfolios, leading Italian and international developers, proptech firms, engineering and planning companies, as well as companies providing property management, brokerage, legal, valuation, and consultancy services. www.assoimmobiliare.it

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