Executive Summary

On 16 October 2017, Italian Tax Authorities released official guidelines on the new tax regime applicable to carried interest under Article 60 of Law Decree 24 April 2017, No. 50 (the Decree), converted into Law 21 June 2017, No. 96. The guidelines provide important clarifications on the scope of, and on the requirements envisaged under, the new tax regime.

Detailed discussion

Background – carried interest

Article 60 of the Decree introduced a non-rebuttable presumption whereby remuneration derived from certain carried interest schemes qualified as income from capital, or capital gain, generally subject only to a 26% tax. Therefore, if the conditions envisaged under the new tax law are met, carried interest cannot be taxed as income from employment which is subject to: (i) individual income tax (Irppef) at progressive rates, up to approximately 45%; and (ii) social security contributions (ranging from 36% to 45% of which 10% is borne by the employee).
Under the new tax regime income from direct or indirect participation in companies, entities or undertakings for collective investment (UCI) derived by their employees or directors or by employees or directors of other entities controlling, controlled by, or in charge of the management of the latter (the Beneficiaries) arising from shares or other similar financial instruments granting enhanced economic rights (so called carried interest) is deemed as income from capital or capital gain rather than employment income when the following conditions are met:

- The overall investment commitment of all the aforementioned employees and directors entails an actual cash outlay of, at least, 1% of: (i) the overall investment carried out by the UIC; or of (ii) the net equity in case of companies or other entities.
- The above income accrues only after that all shareholders (or unit holders in the case of a UIC) have received an amount equal to the equity invested plus the minimum yield provided by the by-law, even in the case of change of control.
- The fund managers maintain their investment for at least five years, or for a shorter period in the case of change of control or change of management.

Eligible instruments are issued by UCIs, companies or entities that are tax resident or established in Italy or in a State that allows an adequate exchange of information with Italy.

The described tax regime is applicable to income from eligible instruments that is received and/or realized by the Beneficiaries starting from the date of entry into force of Law Decree 24 April 2017, No. 50 (i.e., from 24 April 2017).

Clarifications on carried interest

In its official interpretation - Circular No. 25/E of 16 October 2017 - Italian Tax Authorities clarified, among other points, that:

- In addition to the directors/employees of UCIs, managing companies (SGRs) and target companies, the employees/directors of their advisory companies also may benefit from the new tax regime (Eligible Entities).
- Only employees and directors of Eligible Entities may benefit from the new tax regime while professionals are explicitly excluded.
- Eligible instruments may also be issued by industrial and trading companies not operating in the financial sector.
- The 1% investment threshold includes shares/units directly or indirectly held in Eligible Entities by the Beneficiaries (also through trusts and foundations).
- With reference to Eligible Instruments issued by UCIs, the 1% investment threshold is determined on the overall investment carried out by the UCI (including management fees). Thus, reference should be made to the amount of the whole commitment without considering any indebtedness undertaken by the UCIs for making its investments. Should the draw-downs be lower than the commitment, the 1% threshold is computed on such a lower amount.
- As for eligible instruments issued by companies, the 1% investment threshold should be determined on the actual value of the net equity to be determined through an expert appraisal.
- The Beneficiaries should actually run a real risk in making the investment in the eligible instruments; thus, the new tax regime would be disregarded if for subscribing the eligible instruments Beneficiaries receive financing from their employer, whose repayment is waived.
- Carried interest qualifies for the new tax regime only after that all the equity invested plus the minimum yield (hurdle rate) is paid to the investors/shareholders. However, before then, Beneficiaries may receive - like other investors/shareholders - ordinary financial proceeds payable under the eligible instruments which do not qualify as carried interest.
- Achievement of the 1% investment threshold should be met at the time the eligible instruments are subscribed. Subsequent events reducing the threshold should not, in principle, jeopardize the entitlement to the regime.
- The five-year holding period starts from the date of each subscriptions/acquisition. If an incoming employee/director acquires eligible instruments from a leaving employee/director, the accrued holding period is not inherited by the former Beneficiary.
- If the carried interest is paid before the holding period is met, it is temporarily treated as financial income. However, if later on the eligible instruments are disposed of before the holding period is met, such income may be recharacterized into income from employment thus triggering Irpef, at progressive rates, and social security contributions.
If a carried interest scheme meets the three requirements described above, the presence of Good and Bad Leaver clauses (Leavership Clauses) does not jeopardize the entitlement to the new tax regime.

Implications

The new tax regime on carried interest represents an interesting opportunity to implement management investment plans not only within the private equity field. Income derived from carried interest schemes - lacking any of the previously mentioned requirements - does not automatically qualify as income from employment as a case-by-case analysis would be required in order to verify the nature of the income. Italian Tax Authorities confirmed that under these circumstances taxpayers may apply for an advance ruling on the income characterization of the carried interest.

Italian Tax Authorities also confirmed that the new tax provision applies to subscriptions made (even) before 24 April 2017 from which employees/directors derived income that has been subsequently paid. Furthermore, it was also confirmed that carried interest schemes approved before 24 April 2017 may be amended in order to benefit from the new regime.

Finally, the new tax regime has no retrospective effects, thus the income characterization of carried interest paid prior to 24 April 2017 would be subject to a case-by-case analysis to be performed also in the light of the guidelines provided by the Circular.

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