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The Italian Investment Management Exemption: A New Dawn for Asset Management in Italy?

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Context

Italy is well known for its cultural heritage, amazing landscapes, vibrant SMEs, brands, skilled work force and many other features, including its food…. It is also known in the international tax world for the advances of its tax administration towards more efficient and innovative practices, such as electronic invoicing, pre-filled tax returns, and the use of machine learning techniques. This image is sometimes affected by a quite aggressive (and unique) approach in claiming the existence of a permanent establishment (PE) of non-resident operators. This applies both when the non-resident group has no Italian presence whatsoever and when it has a subsidiary in Italy.

While one would expect that the tax administration would (correctly) assert the existence of PEs in the case of relevant activities carried out by non-resident operators, what happens in many cases is that tax auditors maintain the existence of a (hidden) PE when the operator has already a "taxable" presence through the establishment of a subsidiary. As the existence of a PE triggers the obligation to file a tax return, the lack of submission of the latter (by the "PE") triggers a specific criminal liability whenever certain (very low) thresholds in terms of undeclared taxes are exceeded. Hence, a notice of crime is sent to the public prosecutor, who usually starts an investigation. In most if not all cases, the asserted PE existence is converted into a transfer pricing discussion in the context of a settlement with the revenue agency and criminal charges are eventually dropped once the tax bill is fully paid. There is a widespread perception that the potential criminal liability (that is personal under Italian law), particularly in the case of foreign groups, is a leverage in the negotiation of the settlement.

The cases that resemble this path are numerous and the ultimate effect is short-term (revenue) gains with long-term (economic) pain. In fact this generates a country-risk that is substantially higher compared to other developed economies. This is chiefly because in other countries issues related to the interpretation of tax law (such as the interpretation of the notion of "permanent establishment") generally do not trigger a criminal tax liability as such. In addition, in relation specifically to the activities of fund managers, other countries address the issue either via legislation (the UK, Australia and Singapore for example) or administrative guidance (apparently, France and Switzerland).

This context may be one of the reasons why several asset managers willing to relocate to Italy (not

least because of its tax incentives to attract human capital) have not done so yet. The risk that a criminal charge could arise because of the activities carried out in Italy has kept many of these highly-skilled individuals out of the country. The issue was partly addressed in certain rulings according to which a foreign fund cannot carry out commercial activities and hence by definition cannot have a PE in Italy. The issue however remained if the fund used corporate vehicles for its acquisitions and disposals. This has now changed with the 2023 Budget Law.

The Italian investment management exemption

The 2023 Budget contains the so-called investment management exemption, a provision according to which the activities of the managers do not give rise to a PE provided certain conditions are met. The amendments to the definition of PE for domestic law purposes are aimed at excluding the existence of an Italian PE in the hands of non-Italian tax resident investment vehicles as a consequence of the presence in Italy of Italian or non-Italian tax resident asset or investment managers.

In particular, the new Article 162(7-ter) states that no agency PE can be deemed to arise if independent asset/investment managers (either Italian or non-Italian tax residents, including those operating in Italy through a PE), habitually, and even exercising discretionary powers, (a) enter into contracts for purchasing, selling or negotiating financial instruments, derivative and receivables on behalf of foreign investment vehicles (and their direct or indirect controlled companies), or (b) actively contribute, including with preliminary and ancillary activities, to the executions of the transactions under (a) above, in the name and/or behalf of the foreign investment vehicle.

By presumption of law, an asset/investment manager is regarded as independent from the foreign investment vehicle and its controlled entities, if the following conditions are met:

1. the foreign investment vehicle and its non-Italian tax resident controlled companies are resident (or established) in States that allow for an adequate exchange of information with the Italian authorities (and hence included in a specific list);
2. the foreign investment vehicle meets the independence requirements that will be established by a Decree of the Minister of Economy and Finance;
3. the asset/investment manager who performs activities within the Italian territory, (a) must not hold any directorship or managing office in the corporate bodies of the foreign investment vehicle and its controlled companies, and (b) must not be entitled to more than 25% of the profits of the foreign investment vehicle (also considering profit entitlements held by other entities of the group). The Ministerial Decree will determine the profit entitlements that shall be taken into account for verifying compliance with the threshold under (b) above;
4. the Italian tax resident asset/investment manager, or the PE of the non-Italian tax resident entity, has received a remuneration that is supported by adequate transfer pricing documentation. In this respect, the Italian tax authorities will issue the relevant implementing guidelines.

Furthermore, the 2023 Budget Law introduced Article 162(9-bis) providing for the exclusion of the configuration of an Italian fixed place of business PE in the hands of the foreign investment vehicle and its controlled companies. In particular, provided that the requirements set forth by Article 162(7-quater) are met, the premises of an Italian enterprise do not constitute *per se* an Italian fixed place of business PE of the foreign investment vehicle due to the mere circumstance that the activity rendered by the Italian enterprise is beneficial for the foreign investment vehicle.

Key issues

The key issues that arise from the new provision include:

- **Role as safe harbour:** Given the existing perception, it will be important to underline what is already stated in the Explanatory report accompanying the introduction of the provision, i.*e.* that the mere circumstance that any of the conditions included therein is not fulfilled does not imply that a PE exists. Its existence shall in fact be based on the existence of the conditions provided for in Article 162 to consider a PE to exist.
- **Definition of investment vehicle:** The provision does not provide an ad hoc definition of "investment vehicle" nor of "asset/investment manager". In this respect, according to the Explanatory report , the definition of "investment vehicle" should include the concept of "institutional investors" as defined by Article 6(1)(b) of Legislative Decree No. 239/1996. According to the guidance provided for by the Italian tax authorities for the purposes of Legislative Decree No. 239/1996, an "institutional investor" is an entity, whether or not subject to tax, carrying out investment activities on its own behalf or on behalf of other persons and established in White-List States (*g.*, investment funds, pensions funds, insurance companies that are subject to regulatory supervision in their States of establishment). Should these investors not be subject to regulatory supervision, any foreign entity with specific experience and competence in financial instruments can anyhow fall within the definition of "institutional investor" if it has not been organized or incorporated to manage investments on behalf of a restricted number of participants resident in Italy or of a State not included in the White List.
- **The notion of independence:** This seems to be related to two connected – but separate – issues. In fact, the provision states that a Ministerial Decree will indicate the criteria pursuant to which the independence of the foreign investment vehicle should be evaluated. At the same time, the provision itself requires that the fund managers must not hold any directorship or managing office in the corporate bodies of the foreign investment vehicle and of its controlled companies, and must not be entitled to more than 25% of the profits of the foreign investment vehicle. While the condition about the profit entitlement is common to other jurisdictions, the one regarding the participation in corporate bodies is pretty unique and triggers questions, especially in light of the market practice in the private equity industry. It seems that the independence of the managers vis-à-vis the investors in the fund is being mixed with the independence of the manager from the fund and its controlled entities. Similar provisions in other countries tend to focus only on the former and not on the latter.
- **Relationship with transfer pricing rules:** The provision makes reference to the fact that the remuneration is supported by adequate transfer pricing documentation. We read into the provision the requirement that the remuneration of the fund manager is at arm's length, i.e. it approximates what a third party would have received in independent circumstances. This is a core element of the provision: in fact, under most scenarios, even if a PE would be deemed to exist, the profits attributable to it would be equal to what an independent party would make, i.e., the arm's length fee paid to the manager. At the same time, the managers' remuneration would be a deductible cost at the level of the PE, and hence by definition the profits of the PE would be equal to zero. If the remuneration of the manager is not at arm's length, this should be adjusted under a pricing solution, but that does not mean that automatically a PE is deemed to exist. In any case, where needed, a request aimed at confirming that the remuneration of the asset/investment manager is compliant with the arm's length principle can be submitted to the Italian tax authorities in order to obtain a ruling in that respect.

Outlook

Italy was lagging behind in terms of certainty and predictability for foreign investors. A number of steps in the right direction have been taken and the hope is that the stigma can disappear. For example, criminal liabilities which arose in the past also following assessments based on the abuse of law doctrine are now expressly excluded. Similarly, criminal liabilities which arose in the past in the case of transfer pricing assessments are now excluded where appropriate documentation exists. As regards the existence of a PE for multinational groups, there is the possibility in certain cases to request an advance ruling and this provides a shield also against any potential criminal liability.

Going back to the specific investment management exemption, the Ministerial Decree in the making, as well as the forthcoming Revenue Agency guidance, and ultimately their practical application, will play an important role in the success (or failure) of the overall policy underlying the introduction of the provision.

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