



Leveraged Buyouts Circular letter

Tax Alert
6 April 2016



Offices

Milan

Via Vittor Pisani 27, 20124
T: +39 02 676441 - F: +39 02 67644758

Ancona

Via I° Maggio 150/a, 60131
T: +39 071 2916378 - F: +39 071 2916221

Bologna

Via Andrea Costa 160, 40134
T: +39 051 4392711 - F: +39 051 4392799

Florence

Viale Niccolò Machiavelli 29, 50125
T: +39 055 261961 - F: +39 055 2619666

Genoa

P.zza della Vittoria 15/12, 16121
T: +39 010 5702225 - F: +39 010 584670

Naples

Via F. Caracciolo 17, 80122
T: +39 081 662617 - F: +39 081 2488373

Padua

Piazza Salvemini 2, 35131
T: +39 049 8239611 - F: +39 049 8239666

Perugia

Via Campo di Marte 19, 06124
T: +39 075 5734518 - F: +39 075 5723783

Pescara

P.zza Duca D'Aosta 34, 65121
T: +39 085 4210479 - F: +39 085 4220295

Rome

Piazza delle Muse 8, 00197
T: +39 06 809631 - F: +39 06 8077459

Turin

C.so Vittorio Emanuele II 48, 10123
T: +39 011 883166 - F: +39 011 8395865

Verona

Via Leone Pancaldo 68, 37138
T: +39 045 8114111 - F: +39 045 8114390

On March 30th, the Italian Tax Authority ('ITA') has provided some clarifications on the tax treatment of leveraged buyouts ('LBOs') via a Circular Letter ('the Circular').

Key messages from the ITA are:

- (i) the LBO is not generally a tax abusive transaction; therefore, the related interest expenses are deductible, under the ordinary earning stripping rules
- (ii) emphasis on the substance and activity of foreign inbound investment platforms or holdings, which is essential to a tax efficient exit
- (iii) look through approach on withholding tax on interest and dividends.

1. Background

The Italian Civil Law explicitly regulates the LBO, but no special tax rules are applicable to this topic. Over the last decade, ITA has frequently challenged this kind of transactions, supporting its claims mainly via the following arguments:

- Abuse of law;
- Lack of business purpose for the interest incurred by the BidCo; and
- Application of transfer pricing rules between BidCo and its non-Italian Parent.

2. Interest deductibility

According to the Circular, interest expenses incurred by an Italian BidCo on loans obtained to fund the LBO should be considered, in principle, as having business purpose and therefore tax deductible. Abusive transactions are still subject to tax authority reviews.

3. Other fees deductibility

Management fees and other similar expenses paid by the BidCo / Target to private equity sponsors are deductible only to the extent they have a business purpose.

4. IBLOR loans treatment

According to the Circular, in order to understand the correct withholding tax ('WHT') treatment on interest on IBLOR (Italian Bank Lender of Record, lending structures where an Italian bank grants loans backed up by foreign credit support providers) loans, a look-through approach should be used.

The Circular also confirms that, following the 2016 Direct Investment Decree, no WHT is due on interest paid to certain qualified foreign investors.

5. Shareholder loans

Shareholder loans granted in the context of a LBO can be recast as equity based on a substance over form approach. Typical subordination, maturity and rating terms should be considered in that respect.

6. Artificial structures

The Circular emphasizes that 'substance' is essential to obtain Treaty Benefits and/or access to EU Directives on exit. A foreign resident holding company can be respected as such only to the extent it is a 'genuine set up' and not 'artificial structures'.

A structure would be artificial in case:

- It does not have sufficient 'substance'. Substance indicators are the availability of directors and/or staff with adequate skills, not provided by third party advisory organizations and the real involvement of the Holding company in decision making process related to its investments;
- It is a conduit structure.

An artificial structure would be denied Treaty Benefits and would be subject to the general anti abuse rules provided by EU Parent Subsidiary Directive.

The Circular indicates that in case a Foreign Holding company is disregarded for Treaty purposes, it should be possible to apply to its shareholders the same Double Tax Treaty Regime that would be applicable had they invested directly.

7. Effects of the Circular

The Circular addresses important issues and confirms the deductibility of interest costs on acquisition financing.

At the same time, it focuses on the tax treatment of the exit from Italian investment placing emphasis on foreign investors' substance. It can therefore be anticipated an increased focus of the Tax Authorities on scrutinizing the tax treatment of the exit from Italian investments.

Contatti

Studio Associato - Consulenza legale e tributaria

Stefano Cervo
KPMG, Tax & Legal
T: +39 02 676441
E: scervo@kpmg.it

Giuseppe Moretti
KPMG, Tax & Legal
T: +39 02 676441
E: giuseppemoretti@kpmg.it

Tax Alert / KPMG in Italy / 6 April 2016

© 2016 Studio Associato - Consulenza legale e tributaria, an Italian professional partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ('KPMG International'), a Swiss entity. All rights reserved.

The KPMG name, logo are registered trademarks or trademarks of KPMG International Cooperative ('KPMG International').

Studio Associato - Consulenza legale e tributaria is a leading Italian law firm and a member firm of KPMG International for tax and legal services.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.