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THE TAX EXEMPTION REGIME PROVIDED FOR QUALIFIED LONG-TERM INVESTMENTS MADE BY PENSION FUNDS – BY LUCA A. PANGRAZZI AND ANGELO R. BONISSONI (CBA STUDIO LEGALE E TRIBUTARIO)

1. Introduction

The recent Italian Law n. 232 dated December 11, 2016 (hereinafter also called "***2017 Budget Law***") has introduced a tax exemption regime that could potentially push the fundraising of the investments funds and the subsequent financial investments in Italian companies as well as in the Italian economy in general.

In particular, paragraphs 88-99 of article 1 of the above mentioned 2017 Budget Law, introduced – starting from January 1, 2017 – a tax exemption regime for financial incomes gained (i) by social security funds (*i.e.* "*casse di previdenza*") ruled by Legislative Decree n. 509 dated June 30, 1994 and Legislative Decree n. 103 dated February 10, 1996 and (ii) by supplementary pension funds (*i.e.* "*forme pensionistiche complementari*") ruled by Legislative Decree December 5 2005 n. 252 (hereinafter also called "***Pension Funds***"), in relation to some specific and qualified long-term investments (see *infra*).

The new mentioned rule should be read also keeping into consideration the relevant amount of Pension Funds' financial assets and the will of the Italian Government to push financial investments in Italian companies. As a matter of fact, based on the information reported in the 2015 report of the public board of supervisors of the Italian pension funds, their financial assets invested were equal to about euro 190 billion, of which less than half were invested in domestic financial assets.

As stated above, the new rule could have, on the one hand, a significant influence on the investment strategy of institutional investors eligible for tax exemption, and, on the other hand, it could represent a great opportunity for companies and investment funds to raise new capital.

From a tax perspective, the above mentioned 2017 tax incentive represents an innovation for the Italian tax system, as it provides a full tax exemption of financial incomes and capital gains arising from a few qualified investments held by Pension Funds.

2. The tax exemption regime and conditions to be-met according to 2017 Budget Law

The above mentioned 2017 Budget Law provides a full tax exemption regime for financial incomes (dividends and capital gains[1] included) gained by Pension Funds in relation to long-term financial investments, represented by (i) shares or quotas issued by Italian companies or EU/ EEA entities with a permanent establishment in Italy and/or (ii) quotas or shares of Italian or EU/EEA investment funds which mainly invest in financial instruments as described in the previous point (i) (hereinafter also called "***Qualified Investments***" – *i.e.* **first condition**).

In addition, the Qualified Investments should not exceed the ceiling represented by 5% of total assets of the Pension Fund, resulting from its last financial statement (*i.e.* **second condition**). Please note that the 5% threshold should only represents the tax limit of the Qualified Investments eligible for the tax exemption and should not affect or limit the investments strategy of the institutional investors.

In order to get the above mentioned tax advantage (*i.e.* tax exemption regime), the Qualified Investments must also be held by the Pension Fund for at least 5 years (*i.e.* **third condition**). In case of an early disposal of the Qualified Investment, a full tax recapture is foreseen (*i.e.* payment of taxes and interests related to the financial incomes received during the holding period until the disposal date), without penalties.

The tax exemption provided by the above mentioned tax rule has effects immediately for all financial incomes arising from the Qualified Investments. As a matter of fact, the 5 years holding period requirement is necessary only in order to definitively set the tax exemption regime applied on previous gained incomes. After the above mentioned holding period, all financial incomes gained and related to Qualified Investment will be still exempt from taxation.

A special rule is applicable in case the Qualified Investment is reimbursed or expired during the 5 years holding period. In this case, the tax exemption regime will remain in force if, within 90 days from the date of the reimbursement/expiration, the amounts cashed by the Pension Fund are re-invested in other Qualified Investments.

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[1] The above mentioned tax incentive regime is not applicable in relation to financial investments *ex* article 67 paragraph 1 letter c) of Presidential Decree 917/1986, which are still taxed applying ordinary rules. In other words, the new tax exemption regime is not applicable to financial incomes arising from stakes, which represent over the 20% of the voting rights or the 25% of the share capital (the mentioned thresholds are reduced respectively to 2% and 5% in relation to shares listed in regulated markets).

3. Differences compared to the previous tax incentive regime applicable until December 31, 2016

The article 1 paragraphs 91-94 of the Law n. 190 dated December 23, 2014 (hereinafter also called "***2015 Budget Law***") and the following Decree dated June 19, 2015, had introduced a tax credit regime for financial incomes gained by Pension Funds in relation to some specific and long-term investments.

Also the mentioned tax regime (currently no longer in force) was aimed at pushing financial investments of Pension Funds in Italian companies operating in a few specific business sectors, but with some relevant differences. The main two adjustments in respect of the tax exemption regime introduced by the Budget Law 2017 are: (i) the financial investments in the scope of the tax incentive regime and (ii) the technical procedures in order to benefit of the tax incentive.

With reference to the first difference, please note that the previous mentioned tax incentive allowed access to tax credit for the following investments: (i) shares or quotas issued by Italian or EU/EEA companies operating mainly in the development or implementation of projects related to tourism infrastructure sectors, culture, environmental, water, road, rail, ports, airports, health-care, public non-residential real estate, telecommunications, including digital ones, and production and transportation of energy; (ii) bonds or other debt securities issued by entities identified in previous point (i); (iii) quotas or shares of investment funds with a duration of not less than 5 years which mainly invest in the financial instruments described in the previous points (i) and (ii) and in long-term credits granted to the same entities; (iv) quotas or shares of investment funds with a duration of not less than 5 years and which mainly invest in financial instruments issued by companies (other than banks and insurances) not listed in regulated markets and in long-term credits granted to the same entities.

By comparing the two tax regimes just described, it is clear that the previous tax incentive regime allowed the access to tax credit for a greater portfolio of financial instruments while the tax exemption regime provided by the 2017 Budget law is limited to shares or quotas of companies and investments funds which mainly invest in the same companies.

The second difference is related to the effective application of the tax incentive: in the previous regime the law provided for a tax credit to offset with other tax liabilities while the current tax regime provides for the full tax exemption of financial incomes received. From this perspective the current regime should be more attractive for Pension Funds, as financial incomes received in relation to qualified investments are immediately exempt from taxation.

In consideration of the low attractiveness and accessibility, the previous tax credit regime was not particularly successful and was repealed by the aforementioned regime introduced by the 2017 Budget Law.

4. Conclusions

Based on the information provided above, the aforementioned new tax exemption regime should represent a great opportunity both for institutional investors (*i.e.* Pension Funds) and for investment funds, which could potentially use the mentioned tax exemption regime in their marketing fundraising activities. In fact, the application of the current tax exemption regime seems more simple, immediate and attractive for Pension Funds in respect of the previous tax credit regime.

However, we believe that, in order to push financial investments in the Italian real economy, the aforementioned new tax exemption regime should also have been extended by the Italian Government to other financial instruments (currently not included), as foreseen by the previous tax credit regime introduced by the above mentioned Law 190/2014, which had included in the concept of "qualified investments", for example, also bonds and other debt securities and not only equity instruments.