Focus Team Capital Markets

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Contatti del FT Capital Markets

Bancario e finanziario
Massimiliano Danusso
massimiliano.danusso@belex.com

Emanuela Da Rin
emanuela.darin@belex.com

Regolamentazione Bancaria e Assicurativa
Federico Vezzani
federico.vezzani@belex.com

Societario
Mauro Cusmai
mauro.cusmai@belex.com

Vittoria Giustiniani
vittoria.giustiniani@belex.com

Carlo Montagna
carlo.montagna@belex.com

Barbara Napolitano
barbara.napolitano@belex.com

Alessandra Piersimoni
alessandra.piersimoni@belex.com

Silvia Romanelli
silvia.romanelli@belex.com

Alberto Saravalle
alberto.saravalle@belex.com

Gianfranco Veneziano
gianfranco.veneziano@belex.com

Elisabetta Bellini
elisabetta.bellini@belex.com

Federica Munno
federica.munno@belex.com

Stefania Aristei
stefania.aristei@belex.com

Sara Cerrone
sara.cerrone@belex.com

Giampaolo Garofalo
giampaolo.garofalo@belex.com

Francesca Marchetti
francesca.marchetti@belex.com

Riccardo Salerno
riccardo.salerno@belex.com

LONG TERM INDIVIDUAL SAVINGS PLANS

The law no. 232 of 11 December 2016 (the **Budget Law 2017**) has introduced the possibility to establish long-term individual savings plans in Italy (*Piani Individuali di Risparmio*, **PIR**), with the aim of enhancing individual investments and encouraging the growth of Italian businesses.

The new individual savings plans, which are the Italian equivalent of the French *plans d'épargne* and the UK Individual Saving Account, carry a full exemption from 26% income tax if, *inter alia*, savers stay invested for at least 5 years.

As at today, various PIR compliant funds have been established in Italy, including four open-end funds and two ETF listed on the Italian stock exchange

I. Main Feature of the PIR

PIR are long term investment plans aimed at individual investors only, resident in Italy, who can invest a maximum of Euro 30,000 per year and up to Euro 150,000 overall.

A PIR can be qualified as an "investments container", created for tax purposes, which may take the form, *inter alia*, of funds, asset management contracts, insurance contracts or securities deposits.

In light of the above, a PIR may also be created by simply subscribing units of an existing UCITS established in Italy or in an EU member State or a State of the European Economic Area that complies with the investment constraints envisaged by the Budget Law 2017 for the creation of a PIR.

PIR can be offered and managed by authorised intermediaries, such as banks or asset management companies and insurance companies, either incorporated in Italy or incorporated in a foreign country but authorised to act in Italy on a cross-border basis or through an Italian branch. In the latter hypothesis, the entity is required to appoint a tax representative.

I.A *Investment portfolio limits*

The main characteristic of the new savings plan is their focus on the Italian small and medium enterprises market. The regulatory regime established by the Budget Law 2017 is aimed at enhancing the investment in the Italian market with particular regard to the growth of Italian businesses.

Accordingly, Article 1, paragraphs 101 to 105, of the Budget Law 2017 set out certain investment restrictions aimed at channelling the investments in the Italian small and medium enterprises market. Specifically, for at least two-thirds of each year:

(i) at least 70% of the investment portfolio must comprise securities issued by Italian companies, or EU companies with an Italian branch, or other financial instruments entered into which such entities, or shares in UCITS compliant with such requirements; and

(ii) at least 30% of the quota mentioned under point (i) above, shall be invested in securities issued by, or entered into with, entities which are not listed on the FTSE MIB of the Italian stock exchange or on an equivalent index of another country (*i.e.* in small and medium enterprises).

Additionally, companies which engage in the real estate market shall be excluded from the basket of relevant companies in which the funds collected under a PIR can be invested. In this regard, we note that, according to paragraph 102 of Article 1 of the Budget Law 2017, in such category it shall be included all the companies whose assets are mainly real estate assets, other than (i) the hypothesis in which the assets' production or exchange is the object of the activity carried out by the company; and (ii) those required for the exercise of the business activity (such as industrial plants and other buildings in which the activity is carried out).

Finally, the Budget Law 2017 imposes a concentration risk limitation, requiring that no more than 10% of the portfolio can be invested in financial instruments issued by, or entered into with, the same company or other members of the group of such company, or in deposits and bank accounts.

I.B *Time limits*

In a nut shell, the investment shall be for a minimum of 5 years.

More precisely, the Budget Law 2017 does not expressly prevent the disposal of the investment prior to the end of the 5-year term and the investor has in any case the possibility of disposing of the relevant financial instruments included in the PIR.

However the fiscal benefits are entirely conditioned upon the fact that the investor does not disinvest prior to the end of the 5 years (see par. **Error! Reference source not found.** below)

II Benefits: The Tax Exemption

The main benefit of the PIR is the tax exemption on the proceeds from investments compliant with the PIR requirements.

In particular, investments made under a PIR not in connection with the performance of a business activity are exempt from the 26% substitute tax ordinarily applicable on financial income and capital gains (the **PIR Tax Exemption**). However, the PIR Tax Exemption does not apply to financial income and capital gains deriving from "qualifying participations", *i.e.* participations attributing to the holder a percentage of voting rights in the ordinary shareholders' meeting higher than 2% - or 20% for non-listed companies - or representing a percentage of the share capital higher than 5% - or 25% for non-listed companies, including also rights and shares held by relatives and through controlled companies.

The PIR Tax Exemption is also subject to a minimum 5-year holding period requirement (see par. I.B above). Therefore, in case of transfer of the relevant financial instruments before the minimum 5-year term, capital gains realised upon transfer and financial income already received by the investor will become taxable according to the ordinary rules (including interests). In case of reimbursement of financial instruments included in the PIR before the 5-year term (not depending from a transfer by the investor), the PIR Tax Exemption should not be revoked provided that the amounts obtained thereof are reinvested within 90 days in new financial products compliant with the PIR requirements described under paragraph I.A above.

Capital losses generated by the disposal or reimbursement of financial instruments within the PIR may be deducted from capital gains not eligible for the PIR Tax Exemption subsequently realized within the same PIR, within 5 fiscal years.

In addition, financial instruments included in the PIR are exempt from inheritance tax in case of related transfer *mortis causa*.

III Possible Issues and Preferred Forms of PIR

PIRs are clearly aimed at incentivising the investments of retail clients, by providing a strong financial advantage connected to the PIR Tax Exemption, as well as the investments in companies operating in Italy, with the aim of both encouraging individual investments and the growth of Italian business.

However, certain topics must be born in mind.

The fiscal benefits are entirely conditioned upon the fact that the investor does not disinvest prior to the end of the 5 years (see par. **Error! Reference source not found.** above). Additionally, investments covered by the PIRs can only be small and medium-sized companies. Small and medium-sized companies are generally low-paying and very volatile medium-sized businesses. Investments in financial instruments issued by small and medium enterprises might encounter difficulties in their disposal if an active market for their exchange does not exist.

Furthermore, investments covered by the PIRs can only be companies based in Italy, bearing an intrinsic risk connected with the country economy considered in its entirety.

In the light of the above, PIR could be a medium-high risk illiquid investment and:

(i) the relevant individual retail investor in PIRs seems to be likely to evaluate the economic convenience and adequacy of the investment, mainly, if not solely, on the basis of the related fiscal advantages, partially disregarding the relevant flotation of the market;

(ii) financial intermediaries wishing to offer PIRs should consider whether the type of investment is adequate for the relevant individual retail investor in PIRs. In order to offer PIRs to retail clients in compliance with the current regulatory framework, financial intermediaries shall implement a series of measures to counterbalance the issues highlighted above. Specifically, considering the possible classification of PIRs as medium-high risk investments, financial intermediaries shall carefully asses the adequacy and appropriateness of the investment for the client, having particular regard to the investment timeline chosen by the client. Indeed, considering the possible illiquidity risk connected to the investment in a PIR, such investments would be clearly inadequate for investors who have given a preference for short-term investments[1];

On the other hand, it should be considered that the Budget Law 2017 imposes a ban on concentration (see par. I.A above) which partially corrects the abovementioned concentration risks.

Furthermore, the illiquidity risk appears to be only theoretical in the hypothesis in which a PIR is created by underwriting the quotas of an open-end UCITS, in particular if listed on a regulated market. Indeed, in such hypothesis the instruments *per se* is not illiquid.

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[1] According to the Consob regulation no. DIN/9019104 of 2 March 2009 on illiquid products distribution (the **Illiquid Products Regulation**), in evaluating the adequacy of an illiquid investment for a client, the financial intermediary shall consider as inadequate all the investments in financial instruments that have a maturity which exceeds the timeline elected by the client for its investments.

In any case, in accordance with the Illiquid Products Regulation, intermediaries offering PIRs shall ensure that adequate information are given to the client in order to compensate the lack of information that may derive from the absence of a liquid market for the underlying instrument. Specifically, clients shall be clearly informed with regard to the modalities to dismiss the investment.

In light of the above, in general terms, financial intermediaries which offer PIRs to retail clients shall implement enhanced transparency measures and carefully evaluate the adequacy and the appropriateness of the investment for their clients. In particular, easily exchangeable products such as listed UCITS or ETF shall be preferred, with a balanced portfolio invested in both obligations and shares. Furthermore, if the PIR is offered through funds or insurance products intermediaries shall have regard to the definition of complex instruments under the Consob regulation no. 0097996 of 22 December 2014. Accordingly, PIR compliant funds and insurance products shall have adequate features in order not to be qualified as complex products. Additionally, individuals shall be advised against concentrating their investments in PIRs, considering that these shall only form part of their investment portfolio in order to counterbalance the risks existing thereunder with other investments in different sectors and financial instruments.

In conclusion, the introduction of PIRs in the Italian market, along the line of their French and English predecessors, shall be positively assessed. Indeed, the instrument designed by the Budget Law 2017 is potentially promising for both investors and Italian businesses, in particular if customised in order minimise its weaknesses and be appropriately offered to retail clients in compliance with the existing financial regulations.

IV Comparison with the English and the French Individual Savings Plans

As a final remark, we note that saving plans similar to PIR already exist in France and in the UK.

Specifically, the French "*Plan d'épargne en actions (Pea)*" were introduced in 1992 and allow a tax free investment in, *inter alia*, shares and mutual funds and ETF that invest in shares issued by entities incorporated in France or in a European member State. However, similarly to the Italian PIR, an eight years-time requirement is imposed in order to fully benefit of the tax exemption, while prior disinvestments determine the imposition of a full or reduced taxation and, in the hypothesis of disinvestment prior to 5 years, impose the closure of the savings plan.

On the other and, the British ancestors of the PIR, the so called "Individual Saving Accounts (ISA)" were introduced in 1999 and offer different typologies of tax free investments, with no minimum holding period, among which: (i) cash ISA, which is substantially a tax free cash deposit account; (ii) stocks and shares ISA, under which money are invested in cash, government or corporate bonds, property, shares or quotas of funds; and (ii) innovative finance ISA under which individuals may lend money through an approved peer-to-peer lending platform.