CLIFFORD
CHANCE

**Client briefing**
April 2011

# New Definition of “Investment Fund”

## Consultation process opens

The Italian Government is opening a consultation process on proposed amendments to the secondary legislation governing investment funds. The consultation period closes on Friday **23 April 2011**.The proposed amendments to the secondary legislation are meant to implement the new definition of "investment fund" as introduced by Article 32 of Decree Law No. 78 of 31 May 2010.

Under the new definition, an investment fund is a:

"*pool of investments collected, through one or more issuance of units, amongst a plurality of investors with the aim of investing the same on the basis of a predefined investment policy; divided into units attributable to a plurality of participants; managed collectively in the interest of the participants but independently from the same*" (emphasis added).

The new definition is to be supplemented by secondary legislation that defines the notion of "plurality of investors" and the criteria to assess the independence of the management company from the participants.

The objective of the change in law is to counteract the use of collective investment vehicles, especially real estate funds, in the case of Italian vehicles:

- having only one or very few investors; and/or
- having the powers of the relevant management company significantly reduced through the attribution of powers to the investors.

The main features of the secondary legislation that has been submitted for consultation (the “**Proposed Amendments**”) can be summarised as follows.

## The notion of "plurality" of investors

In the Proposed Amendments, a fund will be deemed as having a "plurality" of investors (the "**Plurality Test**") if:

(a) the three largest participants hold no more than two thirds of the units of the fund; if the participation in the Italian fund is held directly, or through a wholly owned special purpose vehicle, by an Italian or foreign collective investment undertaking whose management body is subject to regulatory supervision, for the purposes of the test, the participation to the (Italian) fund must be attributed to the ultimate beneficial owners, i.e. the participants to the top collective investment undertaking; or

(b) at least 50% of the units of the fund is held by one or more of the following persons:

  i. the Italian State or a State-controlled entity;

  ii. an Italian local authority;

  iii. a foreign state or an international body was constitutional government has been ratified by Italy or a central bank or an entity managing the official reserves of a foreign state;

**Key Issues**

**Fight against closely held funds**

**Notion of plurality of investors**

**Independence of the management company**

If you would like to know more about the subjects covered in this publication or our services, please contact:

**Carlo Galli,** Tax Partner

**Marco Palanca,** Tax Advisor

**Domenico Dell'Orletta,** Tax Advisor

**Sara Mancinelli,** Tax Advisor

Clifford Chance Studio Legale Associato,
Piazzetta M.Bossi, 3, 20121 Milan, Italy
+39 02 80634 1
www.cliffordchance.com

iv. an Italian or foreign social security body providing mandatory social security coverage;

v. an Italian or foreign insurance company subject to regulatory control, in relation to the investments made to cover their technical reserves;

vi. a foreign collective investment undertaking whose management is subject to regulatory supervision, having no less than 100 participants;

vii. a special purpose investment entity wholly owned by one of the persons listed from (i) to (vi) above.

For the purposes of the Plurality Test, "related participants" are considered to be a single participant; "related participants" means participants, either individuals or legal entities, who:

(a) are directly or indirectly linked through a "control" relationship;

(a) are controlled by the same person;

(b) are members of the management or supervisory board of one of the persons listed at (a) and (b) above;

(c) are in a position to exercise a relevant influence on another participant; a "relevant influence" shall be deemed to exist in the presence of a direct or indirect holding in at least 20% of the capital or voting rights of the other person, or in at least 10% in the case of listed entities;

(d) are relatives, within the fourth degree, or the spouse of another participant;

(e) are connected through an employment or a quasi-employment relationship, or another relationship, including family ties, capable of influencing their decision-making process in relation to their participation to the fund.

The Plurality Test is to be satisfied on a continuous basis . In the case of close-ended funds, the test must be first carried out at the later of (i) the closing of the subscription period or, (ii) at the end of the public offer of the units of the fund, which must start no later than six months after the closing of the subscription period and must end within the following six months. The management company will be responsible for carrying out the test, based on the declarations that the participants will have to make (as provided in the regulations of the fund). If the Plurality Test is not met, the Italian management company will have six months to restore the plurality. Failure to do so will mandate the liquidation of the fund.

The main pointers of the Proposed Amendments appear to be the following:

i. the plurality would be assessed based on a substance over form approach, i.e. funds directly or indirectly held by other funds will be deemed to have the same number of participants as the participating fund. However, this approach will be limited to funds whose management company is subject to regulatory supervision. Under a literal interpretation of the Proposed Amendments, funds formally managed by unregulated entities that are advised by regulated entities should not qualify for this look-through approach;

ii. the Proposed Amendments speak rather generally of "forms of regulatory supervision" without further specifications (whereas in other circumstances Italian law makes reference to regulatory supervision "similar" to the one applicable in Italy). Hence, the conclusion should be that any form of supervision by a regulatory body may be sufficient;

iii. contrary to other drafts that had been circulated several months ago, there is no distinction on the basis of whether the foreign fund is established in a white-listed jurisdiction;

iv. it is not clear whether the look-through approach will apply also in the case of foreign funds that have a holding in an Italian investment fund through more than one special purpose vehicle. In fact, the Proposed Amendments always make reference to "a special purpose vehicle" in the singular. This particular point should be cleared through the consultation procedure.

### The Independence Test

Another key point that was addressed by the changes in law, and is being implemented in the Proposed Amendments, is the issue of the independence of the management company from the interference of the participants. In the perception of the lawmakers, investment funds were being abused through the downgrade of the role of the management company to a merely formal role, with all important decisions (such as investment and divestments) being under the control of the participants (possibly through the participants' meeting, that, in the case of closely held funds, was a formal rather than actual assembly).

The Proposed Amendments aim to define the notion of "independence" (the "**Independence Test**") by providing that:

i. the management company must operate autonomously and independently in the interest of the participants, due regard being had to the rights of the creditors of the fund;

ii. the participants may not interfere in any way with the operational management of the fund; in particular, the participants may not be given the power to authorise single management decisions (with certain exceptions, see below at (iv)); similarly, the participants cannot be given veto powers on the decision by the management company to liquidate the fund if the continuation of its activity may deplete the assets to the detriment of the rights of the creditors of the fund;

iii. without prejudice to the exclusive liability of the management company, in order to ensure the consistency of the management of the fund with its purpose, object and investment policy, the participants may have powers to request information and may be given the power to authorise the adoption or amendment of the strategic plans of the fund, such as the multiple year investment and divestment plan;

iv. without prejudice to the liability of the management company and its management and supervision body, the participants may be given the power to authorise transactions which give rise to a conflict of interests;

v. the fund's regulations must expressly regulate the powers of the participants; the powers of the participants are to be proportionate to their respective holdings and any change of the fund's regulations on the powers of the participants must unanimously approved by the participants.

Although it is not expressly stated in the Proposed Amendments, it seems fairly clear that participants, through the participants' meeting, may be given only very limited powers of interference. In particular, such powers may affect specific transactions only in the presence of a conflict of interests. Conversely, it appears that also the most important (specific) investment or divestment decisions may not be subject to the authorisation of the participants, who may only approve the long term investment and divestment plan. It remains to be seen whether the Proposed Amendments will also affect the ability of the participants to appoint special bodies (e.g. an advisory board) active within the management company and having more extensive powers. It is reasonable to expect that such powers would have to be as limited as those attributable to the participants themselves. Moreover, it appears that the Proposed Amendments will prevent the possibility to contemplate a formal authorisation by the participants, whereas it might be argued that some form of involvement in the form of non-binding advice might still be admissible.

### The entry into force and the consequences of non-compliance

Once the secondary legislation will be formally enacted, the management companies of funds that do not comply with the new requirements (namely the Plurality Test and the Independence Test) will have to approve the amendments to the fund within 30 days from the date of enactment of the secondary legislation. Failure to approve the relevant amendments implies the obligation to liquidate the fund within five years. A substitute tax levied at a rate of 7% will be consequently payable on the net asset value of the fund as resulting on 31 December 2009. Moreover, starting from 1 January 2010 and during the liquidation period the 7% substitute tax applies on a yearly basis on the net asset value of the fund as resulting at year-end. The management companies must pay the 7% substitute tax on the 16th day of February in the year after the reference fiscal year.

Special tax rules shall apply during liquidation, in particular:

- VAT on the disposal of (commercial) property shall be complied with through the reverse charge mechanism (subject to EU approval);
- the contribution of several properties shall be deemed to constitute a contribution of business for indirect taxation purposes; as a consequence, it shall not be subject to VAT, whereas registration, mortgage and cadastral taxes will each be applicable in the lump sum of EUR168;
- transfers of shares shall not be deemed to constitute the main activity for VAT purposes, thus not adversely affecting the taxable person's ability to deduct input VAT.