The Italian Revenue Agency Circular Letter on the Italian Investment Management Exemption

Overview

On 19 November 2024, the Italian Revenue Agency released Circular letter no. 23/E ("**Circular Letter**") on the application of the so-called *Investment Management Exemption* ("**IME**").

The Circular Letter addresses a number of relevant issues such as: the effectiveness of the IME and its scope, the independence requirements for non-EU collective investment undertakings ("**CIUs**") and for non-EU entities other than CIUs, the application of the IME to Master/Feeder structures and to cases of delegation or sub-delegation of the asset management activities, as well as the transfer pricing ("**TP**") aspects of relevant intra-group transactions and the related documentation requirements.

I The Investment Management Exemption regime

The 2023 Italian Budget Law[1] ("**Budget Law**") amended the domestic definition of permanent establishment ("**PE**") as set out in Article 162 of the Income Tax Code ("**ITC**"), introducing the so-called *Investment Management Exemption* ("**IME**") regime.

In accordance with the new provisions, the Italian Vice Minister of Economy and Finance and the Italian Revenue Agency ("**IRA**") issued, respectively, the Ministerial Decree setting out the conditions for the applicability of the IME ("**Implementing Decree**") and the TP guidelines ("**IME TP Guidelines**") to determine the arm's length nature of the remuneration received by the asset manager operating in Italy.

The IME provides for an irrebuttable presumption under which the activities carried out in Italy by the asset or investment managers of foreign investment vehicles ("**Foreign Vehicles**") do not give rise to a PE provided certain conditions are met.

[1] Law No. 197 of 29 December 2022.

A. The Legislation

Under Article 162(7-*ter*) of the ITC, an asset/investment manager (either Italian or non-Italian tax resident, even operating in Italy through a PE, "**Asset Manager**") who habitually, and possibly with discretionary powers, in the name and/or on behalf of a Foreign Vehicle or of its controlled entities:

(i) enters into contracts for purchasing, selling or negotiating financial instruments, including derivatives and equity/capital participations, and receivables; or
(ii) contributes, including preliminary and ancillary activities, to the conclusion of the above transactions,

is considered to be independent *vis-à-vis* the Foreign Vehicle, and therefore no PE of the latter and/or its foreign-controlled entities is deemed to exist.

To this end, the conditions set forth by Article 162(7-*quater*) ITC shall be met, namely:

(i) the Foreign Vehicle and its foreign controlled entities shall be established in a "White-list" jurisdiction (*i.e.*, a jurisdiction that allows for an adequate exchange of tax information with Italy);
(ii) the Foreign Vehicles hall meet the independence requirements established in the Implementing Decree;
(iii) the investment manager shall not hold directorship or supervising offices and shall not be entitled to more than 25% of the profits of the Foreign Vehicle and its foreign-controlled entities;
(iv) the investment manager shall receive a remuneration that is supported by adequate transfer pricing documentation.

B. The Implementing Decree

The Implementing Decree sets out the independence requirements applicable to the Foreign Vehicle *vis-à-vis* its investors, as well as the criteria to assess the independence of the Asset Manager *vis-à-vis* the Foreign Vehicle and its controlled entities. According to Article 1(2) of the Decree, the following categories of Foreign Vehicles shall be considered as independent:

a. CIUs established in an EU Member State or in an EEA State allowing for an adequate exchange of information with Italy which complies with EU Directive 2009/65 ("**UCITS Directive**"), or whose Asset Manager is subject to forms of supervision in its State of establishment under Directive 2011/61/EU ("**AIFM Directive**");
b. CIUs established in a White-list Country if: (i) the assets are gathered from a plurality of investors, managed collectively in the interest of investors and independently from the latter, according to a predetermined investment policy; and (ii) the CIUs or their Asset Managers are subject to prudential supervision and regulations substantially equivalent to those of either the UCITS or the AIFM Directives;
c. entities established in a White-list Country and subject to prudential supervision, which exclusively or mainly invest capital raised from third parties based on a predetermined investment policy, subject to the following conditions: 1) no party holds a participation in the capital or in the net assets of more than 20%. Participations held by parties which are "closely linked" are also included in this computation, while participations without administrative rights are not relevant; 2)

the capital raised by such entities is collectively managed in the interest of their investors and independently from them.

According to the Implementing Decree, the above categories of Foreign Vehicles are relevant for the purposes of determining the conditions under which the Asset Manager shall be considered as independent from the Foreign Vehicle itself. In the case of Foreign Vehicles under Article 1(2)(a) and (b) of the Decree, the Asset Manager is regarded as independent without the need to meet further requirements. In other words, the features of CIUs under Article 1(2)(a) and (b) of the Decree ensure by themselves that the Asset Manager is independent from the investors and hence from the Foreign Vehicle. On the other hand, in the case of Foreign Vehicles under Article 1(2)(c), the Asset Manager may be regarded as independent from the Foreign Vehicle only if the Asset Manager and its employees or directors:

(i) do not hold any managing or supervisory offices with general operational responsibilities in the corporate bodies of the Foreign Vehicle or of its non-resident (directly or indirectly) controlled companies. To this end, the attribution of executive powers via specific mandates approved by the management body and granted to an individual for specific actions has no relevance; and

(ii) do not hold a participation in the economic results of the Foreign Vehicle higher than 25% including also: (i) participations held by parties belonging to the same group of the Asset Manager or that are linked by a control relationship with the Asset Manager; (ii) the leverage (if any) produced by the ownership chain; and (iii) the pro-rata return derived from any investment in the Foreign Vehicle and its controlled subsidiaries, as well as the return which exceeds the pro-rata return from investment (e.g. carried interest entitlements).

For further details on the Implementing Decree, see our newsletter *"Implementation of the Investment Management Exemption in Italy"*.

C. The IME TP Guidelines

For the IME safe harbour to apply, the Asset Manager providing services to other non-resident group entities shall receive a remuneration for these services that is supported by appropriate TP documentation (in line with OECD standards). Article 162(7-quater) (d) ITC delegated the IRA to issue guidelines to properly determine the application of Italian transfer pricing provisions (laid down by Article 110(7) ITC) to such remuneration; on 28 February 2024 the IRA issued the IME TP Guidelines.

The IME TP Guidelines clarify which TP method is considered to be the most appropriate to determine the arm's length remuneration attributable to the Italian Asset Manager. In this respect, the IME TP Guidelines identify two types of services: investment management services and services which are related and instrumental to investment management services.

As regards investment management services, the IME TP Guidelines clarify that the Comparable Uncontrolled Price ("**CUP**") method is the most appropriate method to be applied. Where the CUP method cannot be reliably applied and provided that: (i) both parties involved in the transaction bear the same economically significant risks; (ii) the parties separately assume economically significant and closely related risks, then the Profit Split Method shall be considered as the most appropriate method to be applied. If it can be properly demonstrated that neither the CUP nor the Profit Split methods can be reliably applied, one of the other TP methods described in the OECD TP Guidelines and the relevant ministerial

decree should be used, except for those that use a financial indicator based on costs. Notwithstanding the above, if, as a result of the accurate delineation of the transaction, it is appropriately demonstrated that, based on all the relevant facts and circumstances, the provision of the services at hand does not involve the assumption of economically significant risks, the arm's length remuneration of the transaction at hand may be assessed by selecting any TP method described in the OECD TP Guidelines and the relevant Italian ministerial decree , including those that use a financial indicator based on costs.

As regards the services which are related and instrumental to investment management services, the IME TP Guidelines clarify that the arm's length remuneration of the transaction may be assessed by selecting one of the methods described in the OECD TP Guidelines and the relevant ministerial decree, including methods that use a financial indicator based on costs. In the opposite scenario, where the accurate delineation of the transaction leads to the conclusion is that the provision of the services does indeed involve the assumption of economically significant risks, the arm's length remuneration of the transaction shall be assessed according to the clarifications provided by the IME TP Guidelines in relation to the investment management services.

For further details on the IME TP Guidelines, see our newsletter *"Implementation of the Investment Management Exemption Transfer Pricing Guidelines issued by the Italian Tax Authorities"*.

II Key Aspects of the Circular Letter

The Circular Letter addresses a number of relevant issues such as: the effectiveness of the IME and its scope, the independence requirements for non-EU collective investment undertakings ("**CIUs**") and for non-EU entities other than CIUs, the application of the IME to Master/Feeder structures and to cases of delegation or sub-delegation of the asset management activities, as well as the transfer pricing ("**TP**") aspects of relevant intra-group transactions and the related documentation requirements.

A. Entry into force of the IME

The Circular Letter clarifies that the possibility of relying on the safe harbour provided by the IME applies as from fiscal year 2024 as the Implementing Decree, providing for the enacting provisions of the IME, was issued by the Italian Vice Minister of Economy and Finance in that fiscal year. This notwithstanding the fact that the IME provisions were approved and in force as from the 2023 fiscal year.

B. Coverage of non-resident asset managers

The Circular Letter clarifies that the safe harbour provided under the IME shall not be regarded as applicable in relation to non-resident management companies, but only in relation to Foreign Vehicles and their controlled entities.

C. Independence requirement for non-EU CIUs

According to Article 1, para. b) of the Implementing Decree, the IME applies to non-EU CIUs to the extent that: (i) the latter are established in a White-list Country; (ii) their assets are gathered from a plurality of investors, managed collectively in the interest of investors and independently from the latter, according to a predetermined investment policy; and (ii) the

CIUs or their asset managers are subject to prudential supervision and regulations substantially equivalent to those of either the UCITS or the AIFM Directives.

In this respect, the Circular Letter clarifies that:

(i) in line with past clarifications provided by the IRA in relation to other tax provisions, the CIUs (or their manager) shall be regarded as being subject to "prudential supervision" to the extent that:
   (a) the commencement of the activity is subject to prior authorisation by the competent regulatory authority; and
   (b) the carrying out of its activity (or of that of its investment manager) is subject to periodic and mandatory controls by such authority, according to the applicable regulatory framework.

(ii) the "substantial equivalence" of the regulations to those of either the UCITS or the AIFM Directives is met when the regulations are based on general principles and specific objectives similar to those which inspire the above EU Directives. In particular, according to the Circular Letter this condition would be met when the regulatory framework under analysis requires that:
   (a) the CIUs have a plurality of investors, are managed collectively in the interest of the investors, and independently from them, based on a predetermined investment policy;
   (b) there are regulations aimed at ensuring compliance with the requirements under let. a) above.

D. Application of the IME to Master/Feeder structures

According to Article 1, para. c) of the Implementing Decree, the IME applies to Foreign Vehicles established in a White-list State, if, amongst others, no party holds a stake in their capital of more than 20%, including in this computation also stakes held by parties which are "closely related". The Circular Letter clarifies that, in case of master-feeder structures, the abovementioned 20% threshold must be verified based on a look-through approach.

E. Temporary suspension for the computation of the 20% threshold

As mentioned, a Foreign Vehicle may benefit from the IME under Article 1, para. c) of the Implementing Decree, to the extent that no party holds a stake in their capital of more than 20%, including in this computation also stakes held by parties which are "closely related".

In this respect, the Circular Letter – in line with the clarifications provided under the Implementing Decree – points out that for the purposes of calculating such 20% threshold, participations without administrative rights shall be excluded. Moreover, the application of the 20% threshold is temporarily suspended when the Foreign Vehicle raises additional capital or reduces existing capital, provided that the suspension does not exceed 12 months. From the moment the Foreign Vehicle commences liquidation activities in order to redeem the units or shares to investors, the 20% threshold is also suspended.

The Circular Letter further clarifies that the application of the 20% threshold is also suspended in the initial phase of set-up of the Foreign Vehicle.

F. Independence requirements of the asset manager and the calculation of the 25% participation to the economic results of the Foreign Vehicle

According to the Implementing Decree, the Asset Manager of the entities falling within Article 1, para. c) of the Implementing Decree may be considered as independent from the latter – thereby allowing the possibility of relying on the IME – only to the extent that, among others, the Asset Manager, its employees and directors, do not hold a participation to the economic results of the Foreign Vehicle higher than 25%.

In line with the clarifications provided in the Implementing Decree, the Circular Letter confirms that such 25% threshold shall include, on top of the *pro-rata* return derived from any investment in the Foreign Vehicle and its controlled subsidiaries, also the return exceeding the *pro-rata* return from investment, *e.g.*, any carried interest entitlements.

In this respect, the Circular Letter sets forth that, for the purposes of determining whether the threshold at hand is met, the carried interest should not be considered in its entirety in the tax period in which it is distributed. Instead, it must be allocated on a *pro-rata* basis over the duration of the specific investment, having reference to the maximum participation percentage provided for in the relevant corporate documentation. Under this calculation mechanism, the taxpayer will adjust, in the tax period in which the distribution occurs, the difference between the amount of carried interest actually distributed and the maximum threshold of carried interest previously accounted for.

Moreover, the Circular Letter further provides that the 25% threshold shall be computed taking into account the participation to the economic results of the Foreign Vehicle held by the Asset Manager and by parties belonging to the same group of the Asset Manager (*i.e.*, parties which are linked by a control relationship with the asset manager are considered part of the same group), as well as the employees and directors of those.

G. Application of the IME in case of delegation (or sub-delegation) of the management activities

The UCITS Directive and the AIFM Directive allow asset managers to delegate to third parties, the performance of certain functions related to the management of the CIUs established and managed by the delegating manager, provided that certain conditions are met. It is worth noting that this delegation is possible irrespective of whether the delegated entity belongs to the same group, and is possible also in cases where the delegated person is located in States other than that in which the asset manager has been authorised.

In this respect, the Circular Letter notes that in case the sub-delegation concerning CIUs included in Article 1, para. a) and b) of the Implementing Decree, no further analysis regarding the independence requirement is needed, provided that:

(i) the delegated or sub-delegated entities are resident in "White-list" jurisdiction (*i.e.*, a jurisdiction that allows for an adequate exchange of tax information with Italy) for tax purposes; and
(ii) in case of non-EU CIUs included in Article 1, para. b) of the Implementing Decree, the County in which the non-EU CIUs is established, provides for a legal framework of management delegations inspired by the principles set out in the UCITS and AIFM Directive principles.

Differently, in the case of Foreign Vehicles included in Article 1, para. c) of the Implementing Decree, the analysis of the existence of the independence of the delegated or sub-delegated entities must be carried out in respect of the entity that materially carries out the management activity of the entity, since in this case "*the guarantees provided by the aforementioned directives or by substantially equivalent regulations would lack*".

H. Arm's length nature of the fees paid by the Foreign Vehicle to its asset manager

The Circular Letter acknowledges that the fee paid by the Foreign Vehicles to their management companies is *per se* at arm's length. This conclusion is based on the contractual nature of the fee arrangement, which is concluded between independent parties. Indeed, the management fee (or equivalent fee) is determined through agreements between the management company - which sets up the fund and its regulations - and the investors who accept these conditions upon subscribing to the fund's shares/units. This contractual set-up reflects that the fees are *per se* compliant with the arm's length principle as they are determined according to market conditions.

I. Transfer pricing aspects of relevant intra-group transactions

The Circular Letter emphasizes the importance of selecting the most appropriate TP method to ensure that the remuneration for the relevant intra-group services is consistent with the arm's length principle. In this respect, the Circular Letter confirms that the most appropriate method is the CUP. However, in cases where the CUP method is not applicable with equal reliability, the Circular Letter confirms the need to use the PSM under a contribution analysis.[2]

Application of the CUP method

The Circular Letter provided the following examples of the key factors to be taken into account:

i. Type of Foreign Vehicles.
ii. Asset Classes.
iii. Geographical Differences and market information.
iv. Market Capitalization.
v. Investment Objectives.

Application of the PSM method

The Circular Letter highlights that the PSM – under the contribution analysis – is considered the most appropriate method, particularly when the parties involved share economically significant risks or assume separate but closely related risks. In the case of Foreign Vehicles that qualify as multi-compartment funds, the Circular Letter clarifies that if there are reliable and objective data, the combined profit shall be determined for each compartment for which the management activities carried out in Italy refers to.

Furthermore, with respect to the allocation keys to be used to apportion the overall profit, the Circular Letter recommends following a multi-factor approach as provided by the sections related to the Global Trading of the Report on the attribution of profits to permanent establishments issued by the OECD in 2010.

J. TP documentation requirements under the IME

[2] According to the OECD (2022), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, the Contribution Analysis is "*an analysis used in the profit split method under which the relevant profits from controlled transactions are divided between the associated enterprises based upon the relative value of the contributions made by each of the associated enterprises participating in those transactions, supplemented where possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances*".

The Circular Letter specifies that to benefit from the IME, the ordinary Italian TP documentation rules to benefit from the penalty protection regime applies.[3]

In addition, the documentation should include information required by the IME TP Guidelines. In this respect, the following table summarizes the relationship between the IME TP Guidelines and the Italian TP documentation rules.

Relationship between IME TP Guidelines and Italian TP documentation rules		
Compliance with Italian TP documentation rules	**Compliance with IME TP Guidelines**	**Outcome**
YES	YES	Compliance with both penalty protection under Italian TP documentation rules and IME TP Guidelines
YES	NO	Compliance with penalty protection under Italian TP documentation. No benefit from IME
NO	NO	No penalty protection under Italian TP documentation rules and no IME benefit

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For more information, please contact Chiomenti's tax law department.

tax@chiomenti.net

[3] Article 8 of the Ministerial Decree of 14 May 2018 and Provision no. 0360494 of 23 November 2020.