Incentives for Innovative Start-Ups

October 5, 2012

I. Overview

On October 4, 2012, the Italian Government approved a Law Decree (the “Decree”), aimed at promoting the establishment and growth of innovative start-ups in Italy.

Many of the new rules are based on the proposals developed by the so-called Start-Up Task Force, established by the Ministry of Economic Development.

The new rules apply to innovative start-ups and include:

- amendments to (or exemptions from) the existing rules applicable to Italian companies, aimed at facilitating the setting up of start-up companies, in particular by eliminating bureaucratic and legislative barriers; and

- economic incentives, including tax benefits and support for access to credit.

The Decree must be converted into law by the Italian Parliament within 60 days of the date of its publication on the Official Gazette, expected to occur in the coming days.

II. What is an Innovative Start-Up?

Definition

Innovative start-ups (the “Innovative Start-Ups”) set forth by the Decree include all types of not-listed companies (società di capitali), including cooperatives or European Companies, that meet certain requirements, intended to select new enterprises the business

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1 See the “Restart, Italia!” report published by the above mentioned Start-Up Task Force on September 13, 2012 (http://www.palazzochigi.it/governoinforma/dossier/restart_italia/Restart-italia_versione_completa_ITA.pdf).

2 Law Decrees enter into force, unless otherwise specified, on the day following their publication on the Official Gazette and must be converted into Law by Parliament within 60 days of this publication. Otherwise they cease to be effective retroactively. This memorandum has been drafted on the basis of the draft circulated on the press. Although no amendments are expected, the final text that will be published on the Official Gazette may differ from the one made available.
of which focuses on research, development and innovation, and the workforce of which consists largely of qualified and likely younger workers.³

In order to benefit from the special regime introduced by the Decree, an Innovative Start-Up must be enrolled in a special section of the Companies’ Register. Such an enrollment only requires the submission of an electronic form.

**End of the favorable regime**

The favorable regime for Innovative Start-Ups set out in the Decree ceases:

- if the above-mentioned requirements are no longer met by the relevant company; and
- in any case, after four years from the date the company was established.⁴

³ For the sake of completeness, the requirements set forth by the Decree are the following:

(a) the majority of the company’s share capital and of the voting capital is held by individuals;

(b) as from the second year of activity, the company’s total production value (valore della produzione) resulting from the most recent financial statements does not exceed Euro 5 million; and

(c) the company: (i) has been in business for less than 48 months; (ii) has its main administrative office in Italy; (iii) does not, and has not distributed in the past, any of its profits; (iv) has its corporate purpose limited to the development and distribution of innovative products and services with high technological value; (v) was not established as a result of a merger, de-merger, sale of business or sale of a line of business (cessione di ramo d’azienda), and (vi) meets at least one of the following requirements:

1. its research and development expenses, excluding costs incurred for the purchase of real estate, are equal to or higher than 30% of the greater of: (A) the company’s total production expenses (costo della produzione); or (B) the company’s total production value (valore della produzione). Research and development expenses must result from the most recent financial statements and be described in the note to the accounts; otherwise, they can be certified by the company’s legal representative;

2. at least one third of its workforce comprises persons who have completed or are currently completing a Ph.D. at any Italian or foreign university or who have carried out at least three years of post-graduated research activities at a public or private research institute;

3. is the owner or licensee of at least one IP right regarding an industrial or biotechnological invention, a topography of a semiconductor product or a new vegetable variety directly related to its corporate purpose or activity.

⁴ With respect to Innovative Start-Ups established as limited liability companies (società a responsabilità limitata), the provisions set forth in the article of association (see Paragraph III, below) continue to be effective in relation to quotas already subscribed to and profit-participating instruments already issued.
Application of the favorable regime to existing companies

Existing companies can also qualify as Innovative Start-Ups and benefit from the applicable regime. In order to do so, existing companies must file with the Companies’ Register a self-certification form attesting that they meet the above-mentioned requirements, within 60 days from the date on which the Decree is converted into law. In this case, the favorable regime applies for a period that varies depending on the date on which the relevant company was initially established.

III. The start-up phase

Reduction of establishment-related costs

In order to reduce the costs associated with establishing a new company, under the Decree, Innovative Start-Ups are exempted from the payment of stamp duties (imposta di bollo) and administrative fees (diritti di segreteria) due in connection with the enrollment with the Companies' Register, as well as from the payment of the annual fee (diritto annuale) in favor of the Chamber of Commerce.

Certified incubators

Business incubators are entities designed to advise and assist start-up companies during the start-up phase and the subsequent steps. Under the rules introduced by the Decree, incubators specialized in Innovative Start-Ups which meet specific standards may enjoy certain measures applicable to Innovative Start-Ups, including, for example:

- the possibility of issuing profit-participating financial instruments;
- incentives related to work-for-equity and incentive plans; and
- support to gain access to credit.

New investment opportunities and work-for-equity

The opportunities available for venture capitalists and investors have been generally broadened by extending certain provisions, previously applicable only to joint-stock companies (società per azioni), to Innovative Start-Ups established as limited liability companies (società a responsabilità limitata). In particular, Start-Ups established as limited liability companies (società a responsabilità limitata) are now allowed to:

- create categories of quotas that do not incorporate any voting rights or the voting rights of which are not proportional to the related interest in the company’s capital; and
• issue profit-participating instruments.

The enhanced flexibility granted to Innovative Start-Ups in issuing different kinds of equity instruments expands the options available for Innovative Start-Ups to remunerate third-party service providers (including advisors) with various forms of equity participation. The Decree also introduces a beneficial treatment of these remuneration schemes from a tax perspective, as it provides that the grant of shares, quotas and profit-participating financial instruments issued in exchange for services provided by third-party suppliers to Innovative Start-Ups should not be taken into account in determining the suppliers’ taxable income. Any capital gain deriving from the subsequent sale of such financial instruments will be treated as a taxable gain for income tax purposes, according to ordinary rules.

Incentives to investment in Innovative Start-Ups

The Decree introduces specific tax incentives for investing in Innovative Start-Ups, even if only for the 2013, 2014 and 2015 tax years. In particular,

• Italian personal income tax taxpayers may benefit from a tax credit equal to 19% of the amount invested in the Innovative Start-Ups, up to a maximum of Euro 500,000; and

• Italian corporate income tax taxpayers may benefit from a tax allowance equal to 20% of the amount invested in the Innovative Start-Up’s share capital, up to a maximum of Euro 1,800,000.

These tax benefits are subject to investors maintaining, for at least two years, an investment in the Innovative Start-Up at least amounting to the allowed tax credit or deduction, as the case may be.

Tax exemption for equity and equity-like awards

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5 These tax benefits apply to any investment made by the relevant parties directly or through certain investment funds or companies specialized in investments in Innovative Start-Ups.

6 Any amount in excess of the available tax credit may be carried forward to obtain a tax credit in any of the three subsequent tax years.

7 These tax benefits, however, would not apply to investments made by Innovative Start-Ups, certain investment funds and by companies specialized in investments in Innovative Start-Ups. With respect to: (i) investments in the so-called “social” Innovative Start-Ups (i.e., Innovative Start-Ups mainly involved in social sectors, such as social or medical assistance, education, research, environmental protection or the promotion of cultural heritage); and (ii) Innovative Start-Ups active in the development and sale of high-tech products or services in the energy sector, the tax credit will threshold equals 25% of any investment amount while the tax deduction threshold equals a maximum of 27% of any investment amount, respectively.
In order to promote the executives retention and ensure that their interests are aligned with those of the shareholders, the Decree provides that any income derived by directors, executives and certain consultants from the grant of equity-settled awards by the Innovative Start-Ups would be fully exempted from tax and social security charges. Such an exemption applies as long as the relevant awards are not purchased back by the Innovative Start-Up or by any entity of its group.

For this purpose, exempted equity-settled awards would include any incentive plan providing the grant of shares, financial instruments and any similar rights, either directly (such as stock or restricted stock grants) or indirectly (e.g., through options or restricted stock units providing the grant of financial instruments). However, incentives providing cash payments on the basis of the value of such shares and financial instruments are not included in the exemption provision.

This exemption will apply only with respect to awards issued, as of the date on which the Decree is converted into law, by Innovative Start-Ups or by a company directly controlled by an Innovative Start-Up.

Under Italian company law, limited liability companies (società a responsabilità limitata) cannot carry out transactions on their treasury quotas. The Decree introduces an exemption to this rule, when the relevant transaction is made pursuant to incentive plans that consist in the assignment of quotas to employees, contractors, members of the management body or third-party service providers.

Employment agreements for Innovative Start-Ups

In order to provide Innovative Start-Ups with the possibility to hire an adequate number of workers while maintaining, at the same time, a certain degree of flexibility, Innovative Start-Ups are allowed, under the Decree, to enter into ad-hoc 6 to 36-month fixed-term employment agreements with their personnel.\(^8\) Such agreements can be entered into: (i) by newly-established Innovative Start-Ups, during the first four years from the date of their establishment; and (ii) by Innovative Start-Ups that are already established as of the date of the Decree, for a period of 2 to 4 years depending on the date of their establishment.

Moreover, the Decree provides that these fixed-term agreements must include a compensation structure including a fixed component (which should not be lower than the minimum set forth under applicable laws or collective bargaining agreements) and a variable component, linked to the performance of the company, of the employee or the employee’s

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\(^8\) In addition, the Decree provides that the new 1.4% additional social security charge to be levied, as of 2013, on any employment arrangements other than permanent full-time employments, would not apply with respect to the fixed-term agreements entered into by the Innovative Start-Ups pursuant to the Decree.
team (also in the form of an equity-based incentive plan, as to which please see the previous paragraph).

IV. Development of Innovative Start-Ups

Raising capital: crowdfunding

For the first time in Italy, the Decree introduces the possibility to set up and manage crowdfunding portals. Through these portals, Innovative Start-Ups can promote their projects and directly raise capital from potential investors, who can contribute even limited amounts. These new rules are intended to reduce compliance burdens for Innovative Start-Ups and funding portal managers, without jeopardizing investor protection.

Management of crowdfunding portals. Crowdfunding portals can be managed by Italian investment firms and banks, or simply by joint-stock companies with registered offices or branches in Italy, provided that such companies are enrolled in a special registry kept by Consob (the Italian securities and exchange commission)\(^9\). In order for the company to be enrolled, the company’s controlling shareholders and the individuals performing management, direction and controlling functions must meet certain honorability and/or professional standards. The supervision over the managers of crowdfunding portals is delegated to Consob. Consob must also specify the rules of conduct applicable to the managers of crowdfunding portals.

Offer to the public through crowdfunding portals. Public offerings carried out by any Innovative Start-Up exclusively through the crowdfunding portals must be eligible for the “total consideration exemption” set out in Article 100, paragraph 1, letter c) of the Italian Consolidated Financial Law.\(^10\) Consob is delegated to determine what rules will be applicable to such public offerings, taking into account the following guidelines:

- if the offering is not reserved exclusively to professional clients, then at least part of the securities offered must be subscribed by professional clients or specialized investors; and

- non-professional investors must be safeguarded in case of a change of control of the Innovative Start-Up subsequent to the offering.

Moreover, the Decree provides that, by departing from general rules under Italian company law, also quotas of Innovative Start-Ups established as limited liability companies

\(^9\) Such companies must convey any subscription or purchase order exclusively to banks or investment companies.

\(^10\) Article 100, paragraph 1, letter c) of the Italian Consolidated Financial Law, as implemented by Article 34-ter, paragraph 1, letter c) of Consob’s Issuers Regulation, provides that the rules on public offerings of financial products do not apply to those public offerings the total consideration of which, within the European Union, is less than Euro 5 million.
(società a responsabilità limitata) may be offered to the public (including through the crowdfunding portals mentioned above).

Consob must issue the regulations implementing the above provisions within 90 days from the date on which the Decree is converted into law.

Access to credit

To facilitate access by Innovative Start-Ups to credit, the Decree provides that Innovative Start-Ups may benefit from the services of the Central Fund of Guarantee for Small and Medium-Sized Enterprises (Fondo centrale di garanzia per le piccole e medie imprese) free of charge and on the basis of simplified terms and conditions which will be determined by the Ministry of Finance and the Ministry of Economic Development within 60 days from the date on which the Decree is converted into law.

Exemption from rules on non-operative companies and companies with recurrent tax losses

For purposes of reducing the tax burden on Innovative Start-Ups, the Decree provides that the tax rules on non-operative companies and companies with recurrent tax losses (generally providing the imputation to such companies of a minimum taxable income, determined on a presumptive basis, regardless of the income or losses effectively reported by the company) will not apply to Innovative Start-Ups.11

Postponement of re-capitalization obligations

The new rules help Innovative Start-Ups to complete the start-up phase and absorb losses accrued during their initial stages of activity, specifically by:

- extending, by twelve months, the so-called loss carry-forward period (rinvio a nuovo delle perdite) (from the end of the subsequent financial year to the end of the second following financial year); and

- allowing the postponement of the recapitalization obligations, in the event losses erode the share capital below the statutory minimum, until the end of the following financial year (while, under the ordinary regime, recapitalization is required immediately).

11 An Italian company is deemed to be non-operative in any relevant tax year if: (i) it reports tax losses on a recurrent basis (e.g., in case it reports tax losses for three consecutive tax years); or (ii) it doesn’t meet the so-called operating test, i.e., if its total average turnover (increased by certain other income items) does not exceed an “operating threshold”, which is calculated on a notional basis in relation to the company’s assets. Should a company be treated as non-operating, among other things, it would be subject to tax in the relevant tax year on a notional income, calculated on the basis of the company's assets, regardless of company's actual income or losses. The tax rate applicable to such presumptive income is increased, as of 2012, by 10.5 points, i.e, currently up to 38%.
Exemption from bankruptcy procedures

The Decree provides a simplified procedure for Innovative Start-Ups vis-à-vis the one set forth by current bankruptcy law. Innovative Start-Ups are shielded from any bankruptcy procedure and are solely subject to the so-called “over-indebtedness procedure”. Such measure is intended to shorten judicial liquidation and reduce possible reputational consequences deriving from the bankruptcy procedure.

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If you have any questions concerning this memorandum, please feel free to contact Roberto Bonsignore or Pietro Fioruzzi in our Milan office (+39 02 72 60 81) or Vania Petrella (+39 06 69 52 21) in our Rome office, or any of our other Italy-based partners and counsel listed under M&A, Corporate Governance, Capital Markets or Tax Practice Areas under the “Practices” section of our website at www.clearygottlieb.com, or any of your regular contacts at the firm.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

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12 This is a special procedure recently introduced for individuals that are not subject to winding-up procedures in case of consistent imbalances between outstanding obligations and liquid assets and a clear incapability to meet obligations when due. See Law of January 27, 2012 No. 3, Section II.
Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE
Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG
Cleary Gottlieb Steen & Hamilton (Hong Kong)
Bank of China Tower, 39th Floor
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES
CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI
Al Odaid Tower
Office 1105, 11th Floor
Airport Road; PO Box 128161
Abu Dhabi, United Arab Emirates
T: +971 2 414 6628
F: +971 2 414 6600

www.clearygottlieb.com