

1. INTRODUCTION

This brief article is intended to provide the basic information concerning the setting up and functioning of an Italy subsidiary or holding company, as well as the most relevant tax aspects.

2. METHODS OF MARKET ENTRY IN ITALY

2.1 DISTRIBUTION AND AGENCY

The Italian legal system makes a distinction between (i) intermediaries acting in their own name, but on behalf of the principal (commission agents), (ii) intermediaries who merely promote the conclusion of sales (agents), and (iii) intermediaries who are fully impartial as a broker who place the parties in contact. Aside from the types of intermediaries regulated by the Civil Code, other types, such as distributorships, have become common in business practice which have increasing importance although they are not regulated by specific provisions of law.

2.2 BRANCH

The registration of a permanent branch office by a foreign company allows that company to operate in Italy subject to Italian law without forming a separate legal entity for this purpose. The branch must be registered with the Registrar of Companies of the competent Chamber of Commerce.

2.3 PARTNERSHIPS

The authorized types of partnership are as follows:

- informal partnership;
- unlimited partnership; and
- limited partnership.

Partnerships operate under the following principles (albeit with some exceptions):

- the partners have joint and unlimited liability for the company's obligations, to the full extent of their assets;
- the power to manage the company is directly connected to the position of partner;
- the position of partner cannot be transferred without the prior consent of the other shareholders; and
- the by-laws can be amended only with the consent of all partners.

The informal partnership cannot be used to perform commercial activities.

2.4 ITALIAN LIMITED LIABILITY COMPANIES

Foreign subjects, either individuals or companies, are entitled to incorporate and, therefore, own shares or quotas of an Italian limited liability company. There are two main types: joint stock corporation (*Società per Azioni*) and limited liability company (*Società a Responsabilità Limitata*). For both companies, liability of the share (quota) holder(s) is limited to the amount of issued and paid-up capital.

3. FORMATION OF A LIMITED LIABILITY COMPANY

3.1 LIMITED LIABILITY COMPANY

The incorporation in Italy of a limited liability company ("*società a responsabilità limitata*") is effected through notarial deed with the assistance of a public notary. The Articles of Association ("*Atto costitutivo*") must contain the information required by Article 2328 of the Civil Code and provide the By-Laws ("*Statuto*") of the new company.

At the date of execution of the Articles of Association, at least 3/10 of the subscribed share capital must be paid up (this requirement is generally carried on by crediting a bank account of the Notary Public). The minimum amount of share capital is € 10.000 for a limited liability company.

The Articles of Association shall also appoint the sole director of the company or the directors in case of creation of a Board of Directors ("*Consiglio di Amministrazione*"). The quotaholders may appear before the Notary Public personally or may be represented by a proxyholder. In case of legal persons, the legal representative of the company may appear personally or he may grant a power of attorney to a third person. The said power of attorney must be notarized or may be notarized by the local Italian Consulate.

Following the execution of the notarial deed, the Notary Public shall request at the Companies Registrar of the Chamber of Commerce of the legal seat of company the registration of the new company. **Only when this formality is completed will the new company acquire the status of legal person.**

For operations carried on in the name of the company **before the registration**, the persons who acted are liable without limitation and jointly towards third parties. Subsequently, a number of other formalities of technical and administrative nature shall have to be fulfilled with the Chamber of Commerce, the fiscal, labour and social security authorities in order to have the company fully in position to carry on its business in Italy.

3.2 JOINT STOCK CORPORATIONS

Joint stock corporations may be incorporated either by contract or through unilateral act. Upon incorporation, the authorized capital which cannot be lower than € 120.000,00 must be fully paid up and 25% of this sum deposited in a bank account in Italy (100% must be deposited in the case of incorporation through unilateral act or where the contributions are made in kind). Any authorizations needed in order to conduct the intended commercial activities must also be obtained prior to incorporation.

Contributions may be made in kind only if this is expressly provided for in the articles of incorporation, and in no event may have as their object the performance of activities or services. Special rules apply to contributions in kind, including receivables, as well as to the corporation's acquisition of assets from its shareholders within two years of incorporation, which aim to verify the value of such assets.

The articles of incorporation must be drawn up as a declaration before a notary public. Having verified that the articles of incorporation comply with the law, the notary public will file them with the local office of the Companies Register and request registration of the company. Through registration, the corporation obtains legal personality. Anyone who acts in the name of the corporation before the date of registration shares joint and unlimited liability with the shareholders who authorized such activity.

Among other things, the articles of incorporation must indicate:

- the name and commercial purpose of the company;
- the corporate governance system chosen;
- the criteria for the distribution of profits; and
- the duration of the corporation, or alternatively the withdrawal term.

The by-laws specify ongoing rules for the corporation's management and, even where set out in a separate document, are considered to be an integral part of the articles of incorporation. In case of inconsistencies, the bylaws will prevail.

4. MANAGEMENT OF A LIMITED LIABILITY COMPANY

In January 2003, the Italian Parliament passed a wide-ranging reform of the corporate law provisions of the Civil Code (the "Reform"), which became effective on January 1, 2004. By the Reform the legislator has clearly manifested its intention, *inter alia*, to regulate smaller enterprises and those which do not have access to equity capital markets in a totally different manner than the others, by stressing the importance of the personal contribution provided to the company by shareholders/quotaholders. To a certain extent, this type of company has been equalled to a limited liability partnership but it is still characterised by its capital being divided into intangible shares, which are not represented by certificates.

4.1 CORPORATE GOVERNANCE IN "SOCIETA PER AZIONI"

A joint stock corporation ("*società per azioni*") may choose to establish (i) a traditional Italian governance system with a Board of Directors and a Board of Statutory Auditors ("*collegio sindacale*"); (ii) a two-tier governance system with a management board and a supervisory board; or (iii) a one-tier governance system with a single board which includes an audit committee. If a company does not explicitly choose to adopt one of these options, the traditional Italian governance system (under (i) above) will apply by default.

Traditional System

Under the traditional system, a company shall have a Board of Directors and a board of Statutory Auditors.

Responsibilities

The Board of Directors are responsible for the day-to-day management of the company and may delegate some of its duties to one of its members or an executive committee, even though the board may always exercise its authority on the matters delegated to said entities. The Board of Statutory Auditors is responsible for carrying out control activities. The board generally will no longer be responsible for the audit of the annual accounts, which will be performed by an external auditor. In some cases, companies may assign such responsibility to the Board of Statutory Auditors in order to reduce administrative costs.

Election and Composition

The members of the Board of Directors and of the Board of Statutory Auditors must be elected at the shareholders' meeting. The Board of Statutory Auditors shall consist of three professional auditors each of whom is independent (a professional auditor is defined as a person enrolled in the registry of auditors held by the Ministry of Justice).

Two Tier System

Under the two-tier (German style) system, a company is governed by an administrative body (the management board) and a controlling body (the supervisory board).

Responsibilities

The management board has the same type of responsibilities as those which are attributed to the Board of Directors in the traditional system. Its members are appointed and revoked/dismissed by the supervisory board. The responsibilities of the supervisory board are similar to those of the Board of Statutory Auditors under the traditional governance system, but also include additional responsibilities, such as appointing and removing members of the management board, approving the financial statements, bringing derivative suits against the members of the management board and determining the compensation of the members of the management board (unless the company's by-laws provide that such compensation be set at the shareholders' meeting). The supervisory board cannot be charged with the duty to audit the company's accounts, which is a mandatory responsibility of the external auditor.

Election

Members of the supervisory board are elected at the company's shareholders' meeting. The shareholders have the right to recall supervisory directors by a resolution approved by shareholders representing at least one-fifth of the outstanding capital stock. However, any shareholder who is a member of the management board may not vote upon a resolution to appoint or recall any supervisory director.

Composition

The supervisory board shall have at least three members, of whom at least one must be a professional auditor.

One Tier System

Under the one-tier, U.K./U.S. style governance system, a company must have a single board of directors and an audit committee that meets certain requirements.

Independence of the Board

At least one-third of the directors must be independent.

Appointment – Composition - Independence of the Audit Committee

Unless the company's by-laws provide that the members of an audit committee shall be appointed by the shareholders at a shareholders' meeting, the board is required to appoint the committee from its own members.

Responsibilities of the Audit Committee

The committee is responsible for carrying out control activities similar to those performed by the statutory auditors in the traditional Italian system. As in the two-tier model, the audit of the company's accounts is a mandatory responsibility of the external auditors.

4.2 CORPORATE GOVERNANCE IN "SOCIETÀ A RESPONSABILITÀ LIMITATA" ("S.R.L.")

In the view of the legislator an S.R.L should be the swiftest and most flexible tool in the hands of quotaholders. A much greater degree of discretion has thus been recognised to quotaholders by the Reform, particularly in laying down the rules for the administration of their company. Articles of Associations will be set forth by quotaholders in accordance with their needs. Therefore, they will be less formal and quite probably be drawn up in the form of contracts. In line with this very flexible structure, the managing body of an S.R.L. may be freely shaped by quotaholders by way of recourse to some alternative solutions:

- a sole Director;
- a traditional Board of Directors, collectively acting as a committee, which will appoint a Chairman and a Managing Director;
- a Board of Directors not acting as a committee, formed by a plurality of members having the same powers. Depending on the shareholders' choices, such directors may operate:
 - severally: this alternative, however, carries with it the power of each director to veto resolutions proposed by the other directors;
 - severally on certain issues (for instance in matters concerning the day-to-day business);
 - jointly; and
 - jointly on certain matters (for instance as regards the so called "extraordinary administration").

A "non collective" Board of Directors will not act as a body. In fact, the Articles of Association may provide that a formal board meeting is not necessary to resolve on issues concerning the management of a company. **In this case, decisions may be adopted by "written consultation" on the basis of a written proposal circulated among directors at the initiative of one of them, or by "written consent" to a proposal not solicited by other directors.**

Supervision of management and accounts shall be entrusted to a Board of Statutory Auditors or a sole auditor, where the company's capital is in excess of € 120.000,00 or when the turnover or the size of an S.R.L are beyond a certain threshold determined by law.

5. OFFICERS' LIABILITY IN A LIMITED LIABILITY COMPANY

Directors must fulfil the duties imposed upon them by law and the company by-laws with the diligence requested by their office and in accordance with their skills. If directors do not fulfil their duties with the requisite diligence, the company may, in certain circumstances, sue them for damages. Should the powers be delegated to a managing director or an executive committee, the other members of the board may be jointly liable to the company for failing to supervise the conduct of corporate affairs. In any case, the managing director and the executive committee are bound to provide appropriate information to the board of directors regarding the management of the company.

Directors may also be liable to the company's creditors for non-observance of their duties regarding the preservation of the company's assets. Likewise, any shareholder or third party which has been directly injured as a result of a director's malice, fraud or negligence is entitled to request compensation for damages.

The provisions on directors' liability also apply to chief executive officers appointed by the shareholders meeting or indicated in the bylaws with reference to the functions entrusted to them, without prejudice to the actions which may be exercised on the basis of the employment agreement between the chief executive officer and the company.

With regards to the duty of care and the liability of directors of a S.R.L similar rules to those provided for the joint stock corporation apply. An important difference between the two sets of rules concerns the right to take legal action against the directors: in the case of the limited liability company (S.R.L), this right may be exercised by a single quota holder, irrespective of the value of its holding.

Specific rules apply in case of group of companies. The directors of controlled or affiliated companies will be in breach of their duties towards their company if they confine themselves to approving and enforcing the directives of the board of the holding company, which are in conflict with the interests of the company they manage.

The directors of the holding company will be liable:

- (i) contractually, for breach of rules on correct management and coordination of the company; and
- (ii) in tort for damages they have caused to controlled or affiliated companies by imposing directives on their boards which are in the exclusive or predominant interests of the holding company or by inducing said boards to adopt them, in breach of the directors' duty of care and loyalty.

6. TAXATION OF PROFITS

Italy has a very complex tax system, generally updated each year by the annual Finance Act (*Legge Finanziaria*). Resident companies and individuals are subject to Italian tax on worldwide income. Non-resident companies and individuals are subject to tax on Italian-source income only. A flat rate is applied to the total taxable income of a corporation. Progressive rates apply for individuals.

The tax payable by resident companies covers all earnings generated in Italy and abroad, except where bilateral conventions on double taxation exist between Italy and other countries. Companies are "resident" if they have their legal address, administrative headquarters or their principal operational base in Italy.

IRPEG - corporate income tax. Companies are directly subject to IRES tax (33%). Partners are liable only in the event of dividend distribution. A 95% exemption is granted for dividends paid to resident companies by other companies, whether resident or non-resident. However, the dividend-paying company must not be resident in a tax haven.

The dividend exemption regime is quite favourable, as neither a minimum holding period nor a minimum shareholding in the dividend-paying company is required.

6.1 GROUP TAXATION

Companies subject to group taxation may be structured as a domestic group or an international group.

Domestic group

The taxable income of a domestic group comprises the combined taxable income of the companies in the group, which in principle must be resident in Italy.

The group must adopt the group taxation model for at least three financial years and may do so only if it satisfies certain criteria, the most important of which is that the parent company holds (directly or indirectly) over 50% of the equity interest and over 50% of the profit share in the subsidiary.

All companies under the parent's control need not be included in the group taxation.

International group

In certain circumstances it is also possible to opt for international group taxation, which differs from domestic group taxation as follows:

- all non-resident subsidiaries must be included in the group;
- the taxable income of foreign subsidiaries is not considered in its entirety, but rather with reference to the profits percentage held by the parent company; and
- the taxation model must be adopted for at least five financial years (with subsequent renewals for three-year periods).

6.2 TRANSPARENCY REGIME

Where the shareholders of a resident company own an equity interest of between 10% and 50% of the voting rights and profit share, and additional conditions are satisfied, the company can elect the application of a fiscal transparency regime similar to that which applies to resident partnerships.

Under this regime, the company's income is attributed to and taxed in the hands of its shareholders. The shareholders must be limited liability companies and need not be resident in Italy. However, in the latter instance the transparency regime may only be availed of where dividends distributed by the Italian company to the foreign shareholders would not be subject to Italian withholding tax. In practice, this will be the case where an EU parent company owns at least 25% of the share capital of the Italian company for an uninterrupted period of at least one year.

Authors

Andrea Lo Gaglio

Studio legale Biamonti, Rome, Italy
E-mail andrea.logaglio@studiobiamonti.it
Tel. +39 06 326 96 51

Antonia Marsaglia

Studio Legale Marsaglia, Milan, Italy
E-mail amarsaglia@marsaglialex.it
Tel. + 39 02 55 18 75 69

To contact PLG

Julienne Laveaux
PLG Secretariat
PANNONE LAW GROUP E.E.I.G.
avenue de Sumatra 41
1180 Brussels
Belgium

Tel. +32 2 374 88 46
Fax: +32 2 374 90 61
E-mail plg@plg.be
www.plg.eu.com

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