Insight Views January 06, 2020 Posted By: Valentina Magri

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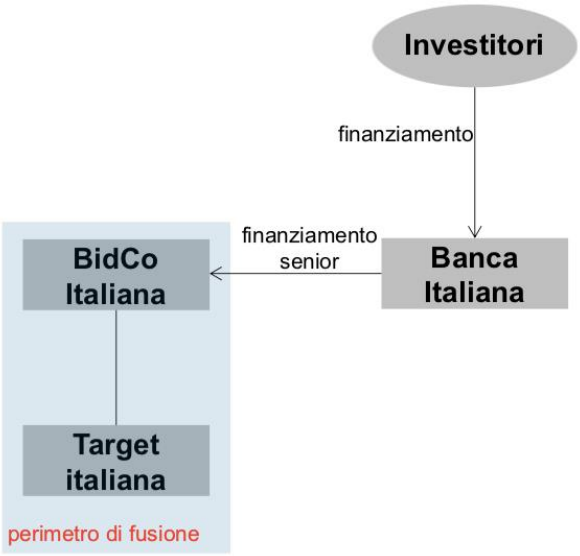
Fronted financing and tax transparency, here are the last news from Italian Revenues Agency and Italy's highest judicial authority



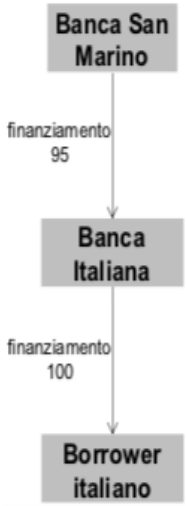
Two recent rulings by the **Italian Inland Revenue Agency (Agenzia delle Entrate)** and by the **Court of Cassation**, the Italian highest judicial authority, have touched on the issue of **fronted financing operations**, often used by **private equity firms**. The topic was explored on November 28th at the **Iside** conference "Contribution, financing and revaluation of investments", which was attended by **Francesco Guelfi** and **Stefano Sennhauser of Allen & Overy** (see the presentation here).

The fronted structures were created to **allow foreign investors to participate in the loan as lenders**, thereby expanding access to credit by Italian borrowers. These structures have often been used to finance the **senior tranche of a loan aimed at leveraged corporate acquisitions.**

In a typical fronted structure, **the Italian bank grants the loan and simultaneously enters into agreements with a number of investors** in order to receive a financial funding and to undertake to repay this funding and to pay the periodic interest in relation to it only within the limits of what the bank received from the borrower. The most commonly used contractual scheme was initially that of the **credit mandate** (in which investors give the Italian bank a mandate without representation to finance the borrower), then replaced by a **back-to-back and limited recourse loan agreement**. As a result, i**nvestors assume an exposure to risk both towards the funded entity and towards the fronted bank**. The latter in turn maintains a limited exposure to the borrower, of the order of 5-10%, and the remaining 90-95% to investors.

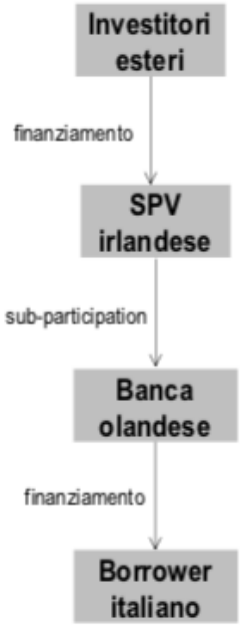
These structures were considered **fiscally transparent**, up to **sentence no. 12777 of 22 March 2019 of the Court of Cassation** on fronting operations conducted by a bank in **San Marino**.

The latter acted as an investor in a fronted financing scheme, acting as principal in a contractual mandate scheme without representation. The San Marino bank assumed the preponderant share of the risk of the loan (on average, 95%), while the Italian bank, agent according to the contractual scheme above, remained exposed for the remaining portion (on average, 5%). The operation was repeated several times, with different borrowers, who had contractual relations with the bank of San Marino.



However, the Cassation Court established that this structure constitutes an **abusive exercise of financial activity** by the bank of San Marino, which in fact provided loans in Italy.

Another important pronunciation was **answer no. 423 of the Revenue Agency of 24 October 2019.** The question to which the Agency replied came from a bank resident for tax purposes in the Netherlands (the instant), which had provided a pool loan in 2016 to an Italian borrower. The question came from a **bank that was fiscally resident in the Netherlands** (the instant), which had issued a pool loan in 2016 to an Italian borrower.



The bank had committed to pay a percentage of the loan granted by the Italian bank to the Italian borrower for an **Irish spv**. The latter is a securitization company, with a manager residing in UK and subject to regulatory supervision, whose activity consists in the purchase of shares of financing and is financed by investors residing in various countries on terms and conditions different from those provided by the sub-participation agreement (and, therefore, from those envisaged by the loan to the Italian borrower).

The Dutch bank asked the Revenue Agency if the Irish spv could be considered the actual beneficiary of the interest paid under the sub-participation agreement or if a look-through approach should be applied.

The bank also asked if the Irish spv could benefit from the withholding tax exemption pursuant to art. 26, paragraph 5-bis, of the Presidential Decree n. 600/73 as an institutional investor subject to regulatory supervision in a country included in the white list. The Revenue Agency has **confirmed the applicability of the exemption to the spv**, also because it is not possible to apply a look-through approach.