

# Tax Incentives for Investment in Innovative Start-Ups and SMEs

**This contribution describes the Italian legislation on tax incentives provided to individuals and companies investing in innovative small and medium-sized enterprises (SMEs) and start-ups.**

## 1. Introduction

In recent years, the Italian government has enacted legislation providing for tax incentives for the purpose of supporting start-ups and SMEs that promote and develop technological innovation and sustainable business.

Along this line, Law Decree No. 179 of 18 October 2012 (Decree No. 2012/179)<sup>1</sup> establishes the conditions that start-ups must comply with to be qualified as innovative (Innovative Start-Ups) and regulates specific tax incentives aimed at encouraging investment to support their business.

Subsequently, article 4 of Law Decree No. 3 of 24 January 2015 (Decree No. 2015/3)<sup>2</sup> extended the said incentives to SMEs engaged in technological innovation (Innovative SMEs). In 2018, Law No. 145 of 30 December 2018 (the Budget law for 2019 (2019 Budget Law)) increased the amount of the tax incentives, subject to the pending authorization of the European Commission.

This note describes the legislation, with a specific focus on the incentive mechanism and the subjective scope of application.

## 2. The Tax Incentives

Article 29 of Decree No. 2012/179, as amended by Law No. 232 of 11 December 2016, introduced tax incentives encouraging individuals and legal entities to invest in Innovative Start-Ups (subsequently extended to investments in SMEs, as mentioned).

Specifically, as of 2017, the legislation provides for:

- an allowance recognized for personal income tax purposes equal to 30% of the funds invested in each Innovative Start-Up/SME, up to a maximum amount of EUR 1 million per fiscal year; and
- a deduction from corporate taxable income equal to 30% of the investment, up to a maximum amount of EUR 1.8 million per fiscal year.

The above incentives were increased to 40% under the 2019 Budget Law.

In addition to the above, corporate entities are entitled to a deduction of 50% of the investment in the event (i) they acquire the entire share capital of the relevant Innovative Start-Up/SME and (ii) the participation is held for at least 3 years.

The provisions introduced for 2019 are subject to the approval of the European Commission, which should not be unreasonably withheld (such authorization is likely, given that the Commission authorized the pre-existing 30% incentives on 17 December 2018).

The Ministerial Decree of 7 May 2019, which incorporates the operative guidelines set out for implementation of the incentives (the “Implementing Decree”) clarifies that they apply to investments that qualify as subscriptions in cash of the share capital/share premium reserve of the relevant Innovative Start-Up/SME,<sup>3</sup> including the subscription of new shares as a consequence of the exercise of the right of conversion of bonds issued by the relevant Innovative Start-Up/SME. Also, the offsetting of accounts receivable against a subscription of share capital is considered a qualifying investment.

## 3. Eligible Investors

The incentives are granted to individuals and corporate entities subject to, respectively, Italian personal and corporate income tax. As a consequence, whilst not expressly addressed in the law, it is reasonable to argue that the incentives must also be available to non-resident investors making the investment via their Italian permanent establishments (PEs).

The legislation states that both individuals and corporations may make the investments directly or indirectly through Undertakings for Collective Investment that, in turn, primarily invest in Innovative Start-Ups/SMEs.

Indirect investments are also allowed using intermediate corporate entities (i.e. companies used by the investors to carry out the investment). This option seems to be restricted, under the law, to investors that are corporate entities. Neither the Implementing Decree nor the Circular Letter No. 16/E issued by the Tax Authorities on 11 June 2014 address, however, any distinction with regard to investors. As a consequence, it can be assumed that incen-

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1. Converted into IT: Law No. 221 of 17 Dec. 2012.

2. Converted into IT: Law No. 33 of 24 Mar. 2015.

3. Qualifying investments include cash subscriptions of the share capital/share premium of the company through which the investment is carried out; in this respect, see sec. 3.

tives are also granted to individuals investing in Innovative Start-Ups/SMEs through a company.

The noted Circular Letter states that, in the event of an indirect investment through a company, the incentive is recognized in proportion to the investment effectively made by the latter in the Innovative Start-Up/SME. Thus, with regard to a plurality of investors, the company must provide each investor with a certificate stating its pro-rata investment in the Innovative Start-Up/SME. This will be the amount taken into account in calculating the incentive.

## 4. Requirements for Innovative Start-Ups and SMEs to Qualify for the Incentive

### 4.1. Introductory remarks

In order to take advantage of the tax incentives described in the preceding paragraphs, Innovative Start-Ups and SMEs must comply with specific conditions and fulfil the requirements stated in the relevant legislation.

### 4.2. Innovative Start-Ups

In accordance with article 25 of Decree No. 2012/179, Innovative Start-Ups must be corporate entities, including corporate cooperatives, whose shares are not listed on a regulated market or on a multilateral negotiation system. They also must:

- be newly incorporated or have been operative for less than 5 years;
- be resident in Italy or in an EU Member State or EEA (European Economic Area) country. If they are resident in an EU/EEA country they must have at least a branch in Italy;
- have a yearly turnover lower than EUR 5 million;
- not have distributed profits;
- have as their exclusive or prevalent company purpose the production, development and commercialization of innovative products or services characterized as being of technological value; and
- not be the result of a merger, demerger or branch disposal.

In addition to the above, Innovative Start-Ups are identified by at least one of the following criteria:

- at least 15% of the company's expenses must be incurred for R&D activities;
- at least 1/3 of their employees must be PhD students, PhD holders or researchers, or alternatively, 2/3 must hold a Master's degree; or
- the Innovative Start-Up must be the holder, depositary or licensee of (at least) a registered industrial patent or the owner of a registered software.

### 4.3. Innovative SMEs

Decree No. 2015/3 provides for a specific definition of these enterprises, including SMEs of an innovative nature. In line with Recommendation 361/2003 of the European

Commission, they must meet at least two of the following thresholds: they must have less than 250 employees, an annual turnover not exceeding EUR 50 million and total assets in their financial statements not exceeding EUR 43 million.

Moreover, they need to fulfil the following requirements:

- they must be a corporate entity, including a cooperative, and must not be listed on a regulated market;
- they must be resident in Italy or in another EU/EEA country (in this scenario, they must have a branch in Italy);
- the last financial statement (or consolidated financial statement, if applicable) must be audited;
- they must not be registered in the section of the Register of Companies dedicated to Innovative Start-Ups and certified incubators; and
- they must fulfil at least two of the following criteria:
  - their R&D expenditures must be at least equal to 3% of the higher amount of annual turnover and annual costs; and/or
  - at least 1/5 of their human resources must be composed of PhD holders, PhD students or researchers, or at least 1/3 must hold a Master's degree; and/or
  - the company must be the owner or licensee of a registered patent or the owner of an original registered software.

A company that meets these requirements may certify its Innovative SME status by entering it into a special section of the Register of Companies.

The Implementing Decree integrates the above by requiring that Innovative SMEs fall into one of the following three categories:

- the company must have been active for less than 7 years (as of the date of its first commercial sale);
- the company must be active less than 10 years (as of the date of its first commercial sale and not yet have proven its full potential to generate returns); and
- without any time limit, the company must make investments: (i) based on a business plan prepared in view of an expansion into a new geographic market or the production of a new product; (ii) that exceed 50% of the average annual turnover of the preceding 5 years.

## 5. Conclusions

The legislation discussed herein provides an interesting tool to leverage investments in Innovative Start-Ups and SMEs, encouraging investors to sustain their growth at a stage when they are generally still financially and economically developing the business.

Specific attention must be paid to the requirements to qualify for the incentive, as they are somewhat rigid and should be carefully analysed in advance, having particular regard to the relevant conditions of the target Innovative Start-Up or SME.