LEGAL INFORMATION NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest.

We would welcome any comment you might have.

OVERVIEW OF THE MAIN DOMESTIC STATUTORY REGULATIONS ON TRANSFER OF BUSINESSES (*PART II)*

Act No. 244/07
Act No. 633/72
Act No. 917/86
EU Directive No. 435/90
EU Directive No. 434/90
EU Directive No. 434/03

INTRODUCTION – Several amendments to domestic statutory regulation have been enforced during the recent years, following the general goal of simplifying procedures.

In relation to merger, consolidation and split up, statutory law provides that specific rules are set for drawing up the first balance sheet subsequent to merger and split up operations.

The first balance sheet subsequent to a merger or consolidation involving exchange of stock shares must report the exchange ratio and values agreed upon for such share exchange, and not their market value. [1]

Vice-versa, when a deficit emerges from a consolidation without share-exchange, the business activities of the acquired company are adjusted, even if such adjustment is not consistent with the values adopted by the acquiring company for its own activities, and maintained after the consolidation process.

[1] Act No. 366/01.

We analyzed the rules governing the merger and acquisition process in our previous informative newsletter nr. 2 of March 2009.

Through the present newsletter we wish to address the topic of split-up of a company, as well as that of transfer of the business assets of a company.

SPLIT-UP OF COMPANIES – There are several express references to the statutory regulation of mergers, which apply.

The Civil code provides that with a split up a company transfers:

[A] All of its assets and liability to more than one company, pre-existing or newly established, or

[B] Part of its assets and liabilities, in such case also to a single company, and the relevant shares or quotas to its stockholders.[2]

An adjustment in cash is permitted provided that it is not higher than 10% of the par value of the shares or the quotas allocated. It is also permitted, with unanimous consent, that shares of the split company are given to certain members, rather than shares of one of the companies benefiting from the split.

The split company may, with the split, either terminate its activities without liquidation or may continue its activities. Companies in liquidation, which have started distribution of their assets are not allowed to split.

Splitting up is however permitted to those companies undergoing insolvency proceedings.

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[2] Civil code, Article 2506.

PROCEDURAL STEPS – With reference to the split-up plan, provisions of the Civil code[3] set out that:

[A] The management body of the participant companies shall draw up a plan, which must include all the information that law provides for[4], as well an accurate description of the asset and liability items to be transferred to each of the beneficiary companies along with a description of the cash adjustment, if any.

[B] Upon transfer of all of the assets and liabilities of the split-up company, if the destination of an asset item cannot be inferred from the plan, the same item is apportioned among the beneficiary companies in proportion to the share of the net assets transferred to each of them, as evaluated for purposes of determination of the share exchange ratio.

[C] If the transfer of the net assets of the company is only partial; the item remains attributed to the transferor company.

[D] For the liability items whose destination cannot be inferred from the plan, there is joint and several liability (1) among beneficiary companies in case of transfer of all of the assets and liabilities to more than one company, (2) among the transferor company and the beneficiary companies in case of partial transfer of assets and liabilities of a company.

The joint and several liability is limited to the actual value of the net assets attributed to each of the beneficiary companies.

[E] The split-up plan must provide for criteria of distribution of the shares or quotas of the beneficiary companies.

If the plan provide for an allocation of the holdings to members of the split up company, which is not proportionate to their original percentage of holdings, the plan itself must set forth appraisal rights for those members who did not approve the split, at a price determined in accordance with the criteria provided for the withdrawal.
The split up plan shall be filed for registration with the Companies' Registry.

[3] Civil code, Article 2506bis.
[4] Civil code, Article 2501ter.

The management bodies of the participant companies must draw up the balance sheet and the their report in accordance with rules that the provisions of the Civil code set forth in case of merger of companies.[5]

The balance sheet shall be at a date not earlier than 120 days prior to the date on which the split-up plan is deposited at the company's legal address.

The management report shall justify, from a legal and economic perspective, the split-up plan and the share (or quotas) exchange ratio, as well as criteria and any eventual difficulty for its assessment.

In addition, the management report must also provide information about the criteria of distribution of the shares or quotas and shall indicate the actual value of the net assets transferred to the beneficiary company and of those, if any, which are retained by the split-up company.

The appraisal report is governed by the rules set forth in case of merger.

Such report is not required when the split-up occurs through the formation of one or more new companies and no criteria for the assignment of the shares or quotas are provided other than a proportional criterion.

With the unanimous consent of the members and of the eventual holders of other financial instruments, the company may be exempted from drawing-up the above mentioned reports.

The split-up takes effect as from the date of the last registration of the filings to be made with the Companies' Register where the beneficiary companies are registered.

A subsequent date may be established, except in case of split-up into newly established companies.

Each company remains jointly and severally liable to the extent and limitation of the actual value of the net assets transferred to it or retained, for the debts of the split-up company that are not satisfied by the companies to which they are charged.

[5] Civil code, Article 2501quater and 2501quinques.

Any beneficiary company may carry out the mandatory requirements of publicity relating to the split-up company.

The first balance sheet subsequent to the split-up shall report assets and liabilities at their actual value on the date that the split-up took effect.

In case of companies with outstanding shares held by public investors, information on the values attributed to assets and liabilities of the participant companies as well as the appraisal reports must be attached to the integrative report by the Board of Directors.

TRANSFER OF THE BUSINESS ASSETS OF A COMPANY – In order to structure a sale of the assets of a company in compliance with Italian statutory regulations, the drawing up of a written master agreement is customary.

The selling company has to draft an updated balance sheet relating to the assets that the company intends to convey.

The deed of sale must be notarized and registered with the Companies' Registry within thirty days from the date it was executed by the parties.

A written deed of sale is necessary for the:

[A] Assignment and granting of administrative licenses, whenever feasible

[B] Continuation of a rental contract or the entering of a new one

[C] Registration with the Companies' Registry.
Also, a written deed of sale is required to the fiscal purposes.

The following matters must be taken into consideration, in a transaction for the transfer of the business assets of a company.

[A] **Succession to contracts –** According to provision of Civil Code 2558 unless otherwise agreed, those who acquire a business succeed to contracts entered for the carrying out of the business unless they are of personal nature.

If there is just cause, the third contracting party can withdraw from the contract (Article 1373) within three months from the date of notice of the assignment.

Such withdrawal does not affect the eventual liability of the seller. This provision is usually referred to the ongoing contracts.

Save for those of personal nature, the contracts of the business as a whole are deemed to be assigned to the buyer, if there is not an express provision by the parties to the contrary.

[B] **Claims (credits) of transferred business –** Civil code, article 2559 sets forth that the assignment of claims pertaining to a transferred business is effective against third persons, even without notice or acceptance by the debtor (1264, 1265), from the time of registration of the assignment in the Companies' Registry.

However, debtor is released if, in good faith, he pays the transferor instead of the assignee.

It is advisable to list the claims assigned in the deed of sale.

In the absence of specific provision about it any claim pertaining to the transferred business is automatically assigned to the purchaser.

[C] **Debts of a transferred business –** The seller is not released from debts incurred in the operation of a transferred business prior to the transfer, unless creditors consent to such release.[6]

Note that in the case of a sale of a commercial business the buyer is also liable for such debts, provided that they appear on the mandatory accounting books.[7]

Also, the acceptance by the creditor releases the original debtor only if there is an express provision to this effect or if the creditor expressly releases him.

If debtor is not released, he remains jointly and severally liable with the assignee.[8]

It is advisable to list the debts assigned in the deed of sale. As above mentioned, the agreement of the creditor is necessary in order to assign the debts pertaining to the business sold.

[6] Civil code, Article 2560.
[7] Civil code, Articles 2212-2214.
[8] Civil code, Article 1273.

Although tax liabilities remain primarily liabilities of the selling company the buyer remains jointly liable for the dues relating to the income taxes on the purchased assets, regardless of the fact that such debts are not recorded in the books of account or that the buyer was unaware about their existence.

Liability of the buyer for taxes of the purchased concern is however limited to the sale price and to tax due pertaining to the year of purchase and the two preceding years.[9]

In addition, tax authorities can advance claims against the seller only after those claims have been made against the seller and remained unsatisfied.

The above liability does not apply to the buyer for those taxes relating to the eventual gain realized by the seller, whenever they are treated to separate taxation [10].

Generally, in contractual practice, a bank guarantee for the benefit of the buyer may be established in order to limit its own liability up to a certain amount.

The Law also provides that Certificates of the tax Authority may be requested to disclaim buyer's liability in connection with tax returns already filed

[D] **Employment relationships –** Accordingly to provisions of statutory law[11], the employment relationships remain with the buyer in case of sale of assets where the employees transferred preserve any of their rights and claims.

Seller and buyer are jointly and severally liable for the overall credits that the employees transferred had at the time of the sale of assets.

The buyer has to apply the economic and regulatory treatment that the Collective Bargain Agreements (CCNL) and the actual corporate agreements set forth at the time the sale took place and up to their expiration.

Note that if a company has more than 15, employees the seller and the buyer must serve written notice of the prospective sale to the representatives of the trade unions and of the respective labour associations within at least 25 days before the date scheduled for the sale, with particulars of the juridical and economical reasons underlying the sale of the business.[12]

The transfer does not itself constitute reason for the termination of the employment relationship.

However, the business seller may obtain a discharge with the need of reducing the workforce due to a decrease in the business activity and due to the impossibility of useful employment.

Whenever the transfer concerns companies or manufacturing units on which the Authorities have acknowledge a status of economical crisis or enterprises declared insolvent by the Tribunal, the above provision concerning continuity of the employment relationships would not apply to those employees whose relationships continue with the buyer company, save where the agreement sets forth more favourable conditions.[13]

Trade unions may request both the transferor and the transferee to provide them with an assessment about the possible outcome of the business transfer as regardsthe employees.

Non-compliance of the above request constitutes an "unfair unions practice" and may cause workers' representatives to take legal action before the Labour Court.

The Court can impel the transferor and/or the transferee to comply with the consultation requirement.

In case of the sale of the corporate goodwill including the workforce, it is therefore advisable to enter a written agreement (so called: *verbale di conciliazione*) with the employees before the sale goesthrough.

[E] **Tax treatment –** 3% registration tax is charged on transferred assets, plus goodwill, minus transferred liabilities.

The tax Authority generally applies the following scheme for assessing the value of

[9] Act 472/97, Article 14.
[10] Resolution Ministry of Finance, 9.2.82, nr. 15/283.
[11] Civil code, Articles 2558 and 2112; Act No. 428/90.
[12] Act No. 300/70.
[13] Act No. 675/77.

the goodwill transferred on which the tax shall be levied:

Stated Corporate Gross Income
2005
1.000.000,00 A)
2004
2.000.000,00
2003
3.000.000,00

____

6.000.000,00
Average 2003-2005
2.000.000,00 B)

Corporate Taxable Earnings
Year 2005
400.000,00 C)

Profitability Ratio
Year 2005 0,40
D=C)/A)

Goodwill 2005
2.400.000,00 C)*D)*3

The buyer may ordinarily depreciate goodwill and fixed assets out of the purchase price and thus achieve a tax advantage, provided that the buyer is a profitable business (up to 10% deductible per year).

[F] **Subsequent insolvency of the selling company –** Pursuant to Article 67 of the Italian Bankruptcy Law the "*suspect period*" (i.e. the run-up to bankruptcy) within which the liquidator may void or set-aside pre-bankruptcy transactions, is one or two years prior to the declaration of bankruptcy, depending on the circumstances.

Pursuant to the provisions of the Insolvency Act[14], all transactions for no consideration or at an undervalue are ineffective as against creditors if entered into by the bankrupt in the 2 year period prior to the declaration of bankruptcy.

Also, payments of receivables falling due on the day of the declaration of bankruptcy or thereafter are ineffective as against creditors, if made by the bankrupt during the 2 year period prior to bankruptcy.[15]

[14] Act No. 267/42, Article 64.
[15] Act No. 267/42, Article 65.

The following transactions may be set aside by the bankruptcy receiver, unless the other contracting party proves that it did not know that the debtor was insolvent:[16]

[1] Transactions at an undervalue (if performances rendered or obligations undertaken by the bankrupt were remarkably disproportionate to the consideration provided by the other contracting party)

[2] Payment of receivables owing and payable, which has been effected by any means other than cash, if made in the 2 year period prior to declaration of bankruptcy

[3] Pledges and mortgages granted in the 2 year period prior to bankruptcy to secure past debts not yet owing and payable

[4] Pledges and mortgages granted in the 1 year period prior to bankruptcy to secure debts already owing and payable.

If entered into in the 1 year period prior to bankruptcy, the following transactions may also be set aside, if the bankruptcy receiver proves that the other party knew or ought to have known of the debtor's insolvency:

[i] Payments of debts fallen due

[ii] Transactions for valuable consideration,

[iii] Transactions whereby security was granted to secure debts created at the same time.

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[16] Act No. 267/42, Article 67.