

METHODS OF OPERATION IN ITALY

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INTRODUCTION

Italian law and custom are traditionally liberal in permitting foreign entities and individuals to operate in Italy, subjecting them to rules or controls no more restrictive than those applicable to national enterprises.

It is consequently fair to say that foreigners, persons and corporations both, can do business in Italy secure in the knowledge that they will not be discriminated against, either in principle or in fact. The conclusion does not follow, however, that any method of operations will be suitable for Italian use because it has proven successful in the United States or elsewhere. It is still desirable, when in Rome, to do as the Romans do.

The scope of this article will therefore be limited to an analysis of those methods of operating in Italy which have proven most successful through the years.¹

DISTRIBUTORSHIP AGREEMENTS

Selling in Italy through an unrelated Italian distributor involves the least degree of commitment. Among the obvious advantages is the fact that an American manufacturer thereby avoids any direct financial investment,² avoids being subject to the jurisdiction of the Italian courts,³ and, so long as the tests of Article II of the Tax Treaty between the United States and Italy of March 30, 1955 are met,⁴ avoids the maintenance of a permanent establishment in Italy and the consequent taxation of its sales.

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¹ Licensing arrangements are omitted from the following discussion because of space considerations, and because they do not, properly speaking, represent a method of operating in Italy.

² The extension of credit in the normal course of business may make this an advantage in theory only.

³ However, Article 4 of the Italian Code of Civil Procedure, *Código di Procedura Civile* art. 4 (Giuffrè ed. 1961), provides in pertinent part: "A foreigner is subject to Italian jurisdiction if . . . (3) the complaint relates to property situated in the Republic, or estates of Italian nationals, or decedents who died in the Republic, or obligations which arose or are performed in the Republic." It is consequently difficult to avoid the jurisdiction of the Italian courts with regard to arrangements which contemplate the sale or distribution of goods in Italy.

⁴ [1956] 3 U.S.T. & O.I.A. 2999, 3001-02, T.I.A.S. No. 3679, hereafter referred to as the Tax Treaty, provides:

(c) The term "permanent establishment" means a branch, office, factory, warehouse or other fixed place of business, but does not include the casual and temporary use of merely storage facilities, nor does it include an agency unless

The primary disadvantage of distributorship arrangements, over and beyond the obvious ones of limited control over sales, sales policy and the market, is that the I.G.E., or turnover tax, must be paid an additional time. Since the Italian turnover tax is of the so-called cascading type, and applies to every sale, it must be paid both on the sale to and on the sale by the distributor. The normal rate of the tax is 4%,⁵ and this added burden may represent an insurmountable competitive obstacle.⁶

Distribution agreements covering Italy must be carefully examined in relation to the registration requirements of Council Regulation 17, dated February 6, 1962, implementing Articles 85 and 86 of the Rome Treaty, particularly with a view to determining whether they contravene the antitrust provisions of such articles.⁷

AGENCY AGREEMENTS

Agency agreements, while avoiding the double I.G.E. burden of distributorship agreements, carry the danger that the principal will be deemed to maintain a permanent establishment in Italy and consequently will be liable for Italian income and corporation taxes.⁸ The position which may be taken by the Italian tax authorities in this regard is not entirely predictable and may in certain instances be somewhat at variance with the terms of the Tax Treaty.

An additional disadvantage of agency arrangements is that under

the agent has and exercises a general authority to negotiate and conclude contracts on behalf of an enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other State merely because it carries on business dealings in such other State through a bona fide commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the contracting States maintains in the other State a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one contracting State has a subsidiary corporation which is a corporation of the other State or which is engaged in trade or business in the other State shall not of itself constitute the subsidiary corporation a permanent establishment of its parent corporation

⁵ For many years the basic rate was 3%. It was increased to 3.3% in 1963, and to 4% effective January 1, 1965.

⁶ Under the aegis of the Common Market, studies are afoot to harmonize EEC turnover taxes; progress has been slow to date, however, primarily because of the enormous revenue these levies produce and their consequent importance within the fiscal framework of several of the EEC countries.

⁷ Grundig-Consten, *Décision de la Commission*, Sept. 23, 1964, 161 *Journal Officiel des Communautés Européennes* 2545 (1964), CCH Common Market Rep. ¶ 7026 (1962), holding that the exclusive distributorship agreement between Grundig and Consten, covering France, was an infringement of the cartel provisions of the Treaty.

It hardly requires mention that distributorship agreements between a U.S. manufacturer and a European distributor may also run afoul of the U.S. antitrust laws.

⁸ *Supra* note 4.

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Italian law they are treated, to a limited extent, as employment agreements, principally as regards termination compensation, social security benefits, and the applicability of collective bargaining agreements.

In general, therefore, agency agreements covering sales have proven less suitable for Italian operations than distributorship arrangements.

BRANCH OFFICES

Italian law in no way prevents the maintenance by an American corporation of one or more branch offices in Italy. Certain formal requirements, however, must be met: the articles of incorporation and by-laws of the parent corporation must be filed with the record office of the local court, as must the names and signatures of the person or persons authorized to operate the branch. Failure to observe this requirement will subject the managers to personal liability. The corporation's annual balance sheet must be published by filing a copy with the Registry of Companies,⁹ a requirement which similarly applies to Italian corporations.

The maintenance of branch offices in Italy carries with it submission to the jurisdiction of the Italian courts, no limitation of liability on the capital invested in the venture, and, far more serious, an amorphous and potentially dangerous tax position. In theory, for purposes of the income tax the liability of the parent corporation is limited to Italian profits, and for purposes of the corporation tax, to that portion of the corporation's capital which is utilized in Italy in order to produce the same. In practice, however, it may prove extremely difficult to persuade the Italian tax authorities to accept a proper apportionment of costs and profits between Italian and other operations.

The advantages of branch operations, which primarily allow simplified procedures and the retention of a more direct control over operations, are insufficient to outweigh the disadvantages listed above. The conclusion follows that this method is not to be recommended for operating in Italy except in unusual circumstances.¹⁰

ASSOCIATIONS

Considerations of a purely mercantile nature may dictate a greater degree of commitment and require the making of a direct investment in Italy. Two benefits automatically flow from such a decision. First,

⁹ Codice Civile [hereinafter cited as C.C.] art. 2506 (Italy-Padova ed. 1964).

¹⁰ Traditionally, shipping companies operate through branch offices in Italy; if the parent corporation does little or no business other than selling in Italy, the branch method may also be considered.

even though, as previously indicated, Italian law and custom do not discriminate against foreigners, there are certain obvious psychological advantages attaching to the adoption of local protective coloring, that is, by conducting Italian operations through the medium of an Italian vehicle. In addition, it is frequently possible to qualify such vehicles for one or more of the very substantial inducements which Italy offers to foreign investments.¹¹

Five distinct types of business associations are available for this purpose, three being fundamentally partnership forms, and two being corporate forms.

It may be useful to recall, before going into particulars, that partnership forms are generally best suited for relatively small operations requiring limited capital, where the investors plan to personally participate in management and where the problems which might arise in the event of the death or disability of a partner, or the transfer of a partner's interest, are not primary considerations. Partnership forms have consequently not been used by American investors with any degree of frequency.

1. PARTNERSHIP (*Societa' in nome collettivo*):¹² Partners are jointly and severally liable for partnership obligations; a copy of the partnership agreement must be filed with the Registry of Companies. The partnership's affairs may be managed by all or any of the partners.

2. LIMITED PARTNERSHIP (*Societa' in Accomandita Semplice*):¹³ There are both limited and general partners in limited partnerships. The liability of limited partners is limited to their respective capital contributions, but they may not participate in the management of the business, or have their names included in the partnership name.

3. LIMITED PARTNERSHIP WITH SHARES (*Societa' in Accomandita per Azioni*):¹⁴ This type of association is similar to a limited partnership, except that the interest of the limited partners is represented by shares and several of the provisions regulating companies apply to it. This hybrid legal institution has not been frequently used by foreign investors.

4. LIMITED LIABILITY COMPANY. (*Societa' a Responsabilita'*

¹¹ The principal benefits are: fiscal incentives, credit facilities, direct subsidies, and freight reductions (Law of Feb. 7, 1956, No. 43, [1956] *Gazzetta Ufficiale* 703, and subsequent legislation). While all of these benefits are available to ventures which locate themselves in Southern Italy, the majority can also be obtained for those which locate in areas which are determined to be "depressed" or "mountainous." A thorough preliminary investigation of this question may prove to be extremely rewarding.

Law No. 43 also guarantees the repatriation of capital and profits in qualified investments, and thus protects against the risk of convertibility of Lira into dollars.

¹² C.C. arts. 2291-2312.

¹³ C.C. arts. 2313-24.

¹⁴ C.C. arts. 2462-71.

Limitata, or *S.r.l.*):¹⁵ An *S.r.l.* is a true corporation, that is, it is a separate legal entity, and the liability of the investors is limited to the unpaid portion, if any, of their respective capital subscriptions. The investors' participations are represented by parts, rather than by negotiable stock certificates. The management of *S.r.l.*'s may be conducted along somewhat simpler lines than those of an *S.p.A.*, or true corporation, the salient simplification being that if the capital of an *S.r.l.* is less than Lire 1,000,000, its management need not include a board of auditors.¹⁶

An *S.r.l.* is a suitable vehicle for small ventures or for closely held enterprises, but the limitations on the transferability of the parts and certain rights of the partholders,¹⁷ *inter alia*, make it inappropriate for large or even medium sized enterprises.¹⁸

5. CORPORATION (*Societa' per Azioni*, or *S.p.A.*):¹⁹ The minimum capital requirement is Lire 1,000,000, which is represented by negotiable stock certificates, in registered form.²⁰ An *S.p.A.*, unlike an *S.r.l.*, can issue different classes of stock, including preferred shares. It can issue bonds in either registered or bearer form, in an amount which cannot exceed its paid in capital, unless the bonds are secured by mortgages on real estate, in which event an issue up to two-thirds of the value of the real estate is permissible.

Prior to the incorporation, the entire capital of the *S.p.A.* must be subscribed²¹ and 30% thereof deposited with the Bank of Italy. It may be withdrawn by the corporation after organization is completed.

The minimum number of shareholders for incorporation is two. While it is possible to transfer all the stock to a single stockholder after incorporation, this is not recommended procedure, since, under Article 2362 of the Civil Code, such stockholder would then be personally liable for all of the obligations of the corporation incurred during the time he was the sole stockholder.

The articles of incorporation and by-laws must be drafted by a notary, and submitted for approval to the court having jurisdiction over the *S.p.A.*'s registered office. Within twenty days thereafter, the corporation must be registered in the Registry Office, and the Registry Tax paid. In addition, the articles of incorporation and by-laws, to-

¹⁵ C.C. arts. 2472-97.

¹⁶ C.C. art. 2488.

¹⁷ C.C. art. 2489.

¹⁸ However, an *S.r.l.* may be converted into an *S.p.A.*, as its business grows and its needs change.

¹⁹ C.C. arts. 2325-2461.

²⁰ Note, however, that legislation is presently under study which would substantially increase the minimum capitalization requirements of *S.r.l.*'s and *S.p.A.*'s.

²¹ C.C. art. 2329; it is possible, however, to authorize that only a part of an *S.p.A.*'s capital be subscribed immediately, and the balance issued on resolution of the board of directors at any time within one year of incorporation.

gether with a copy of the Bank of Italy's receipt for the deposit of 30% of the subscribed capital, must be filed within thirty days of incorporation in the Commercial Registry which is maintained at the court. Finally, a filing must be effected with the local Chamber of Commerce.

Management of the S.p.A. is vested in the board of directors,²² which may consist of one or more members. There are no officers, as the expression is understood in United States law, though a director may be designated president of the S.p.A. Directors need be neither shareholders, Italian citizens nor residents, but they must each post a bond equal to 2% of the corporation's capital.²³ Meetings may be held abroad, but directors cannot be represented by proxies. Directors can only be removed for cause.

In addition, S.p.A.'s must have a board of auditors, whose task is the supervision of the corporation's financial affairs. The board of auditors is composed of three members, one of whom must be selected from a special professional panel, plus two alternates.²⁴ Auditors need not be shareholders. Auditors are elected for three-year terms, and may not be removed by either the directors or stockholders.

The stockholders appoint the board of directors and the board of auditors. Stockholder meetings must be held in Italy and may be attended by proxies. Notice of all meetings, annual and special,²⁵ must be given in the Italian Official Gazette.²⁶ An annual stockholders meeting is legally required. Twenty percent of the stockholders may compel a special meeting at any time.

The Civil Code specifies the matters which can be dealt with at regular and special meetings.²⁷ A quorum is present if more than 50% of the corporate capital is present at either regular or special meetings, but while regular meetings may pass resolutions on the favorable vote of the majority of the capital present (unless a greater majority is

²² Numerous S.p.A.'s have a single director, which is legally permissible under C.C. art. 2380.

²³ However, the articles of incorporation may limit such bond to a sum not exceeding Lire 200,000 (about \$300).

²⁴ C.C. art. 2397.

²⁵ C.C. arts. 2364 and 2365 re different notices.

²⁶ C.C. art. 2366(2).

²⁷ C.C. art. 2364 provides: Ordinary Meetings. An Ordinary Meeting: (1) approves the balance sheet, (2) elects directors, auditors and the president of the board of auditors, (3) establishes the compensation the directors and the auditors are to receive, unless already provided in the articles of incorporation, (4) deliberates on such other matters relating to the management of the corporation as are within its competence as provided in the articles of incorporation, or subjected to its review by the directors, as well as on the responsibility of the directors and the auditors. . . .

C.C. art. 2365 states: "Special Meetings. A special meeting deliberates on amendments to the articles of incorporation and on the issue of bonds. It also deliberates on the appointment and the powers of liquidators pursuant to articles 2450 and 2452."

required by the articles of incorporation), special meetings require the favorable vote of the majority of the entire corporate capital.

JOINT VENTURES

In recent years, American operations in Italy have been conducted more and more through the medium of joint ventures. While, under Italian law, joint ventures can take any of the forms of association listed above,²⁸ the corporate form has predominated.

Ideally, a joint venture can combine the best features of a distributorship or licensing arrangement and those of direct participation through the medium of a branch or subsidiary. The advantages are apparent: less capital is required, since the local partner also contributes a share; personnel problems, always present in foreign operations, are resolved or alleviated; better relations with the local government are assured; better public relations result; and, last but not least, complementary skills can frequently be so combined as to produce a whole which is greater than the sum of its parts.

The disadvantages of joint ventures are of a less obvious nature, and frequently result from conflicts of interest which emerge at a subsequent date, and from differences in mentalities and approaches which impede the development or maintenance of mutually satisfactory corporate policies.

Questions of corporate control are accordingly of prime importance in joint ventures. Special problems are presented by Italian corporate law since stockholders' agreements are relatively unknown in Italian practice, and of doubtful legal validity, primarily because, to the extent they may be said to obligate or commit voting rights, they are illegal.²⁹ It is of course possible to protect minority interests in a negative sense, and to a limited extent, through the careful draftsmanship of the articles of incorporation and by-laws.³⁰

Nevertheless, the record of American joint ventures in Italy has been very good, and has frequently resulted in the successful exploitation of complementing assets and attributes.

²⁸ Plus one, *Associazione in Partecipazione*, or unincorporated joint venture, which permits the foreign investor to avoid doing business in Italy, to escape the jurisdiction of the Italian courts, and which offers certain tax advantages. This type of joint venture has been used very seldom by American investors.

²⁹ Stockholders' agreements, therefore, largely partake of the character of gentlemen's agreements, and may be enforceable only through arbitration "*ex aequo et bono*."

³⁰ Generally, by ensuring representation on the board of directors, and compelling a deadlock in case of disagreement within the board itself.