CBA

Renewed tax scrutiny of MLBOs

Alleged abuse of law in transactions involving seller reinvestment

Management and Leveraged Buy-Out (MLBO) transactions, common practice in the private equity sector, are once again drawing the attention of the Italian Tax Authorities. Despite previous ministerial clarifications that appeared to legitimize such deals once and for all, the tax authorities have recently launched a new wave of audits, this time invoking the principle of "abuse of law", raising concerns among industry operators.

The current challenges seem to focus on transactions widely adopted in the market which, although backed by sound business rationale, involve the reinvestment by the sellers as a means of aligning their interests with those of the acquiring entity. In particular, the tax authorities are targeting cases in which individual sellers (i) first revalue their shareholdings under Article 5 of Law No. 448/2001, a regime set to become permanent as of 2025, then (ii) sell 100% of the shares in their company to an acquirer (typically a private equity fund acting through a dedicated investment vehicle), and (iii) reinvest part of the sale proceeds (e.g., 20%) into the SPV that acquires the target through a debt-financed structure pursuant to Article 2501-bis of the Italian Civil Code, with the intention of later merging with it.

According to the tax authorities, the portion of the equity corresponding to the actually divested interest (80%, i.e., the 100% sold, net of the 20% reinvested) should not be viewed as a straightforward sale followed by a partial reinvestment. Instead, they argue that the transaction constitutes a partial withdrawal in the form of a statutory redemption, which under Article 47(7) of the Italian Income Tax Code (TUIR) qualifies as investment income. On this basis, the SPV is accused of failing to apply the 26% withholding tax due on capital income, pursuant to Article 27(1) of Presidential Decree No. 600/1973. Simultaneously, the sellers face claims of unreported taxable income, without being entitled to benefit from the step-up in value previously recognized through the payment of substitute tax.

Under this interpretation, the private equity transaction in question would amount to an abuse of law under Article 10-bis of Law No. 212/2000, as it allegedly results in an undue tax advantage for the sellers, namely, the differential between (i) the 26% tax rate on capital income and (ii) the substitute tax rate on the revaluation (currently set at 18%).

This new enforcement approach raises significant concerns, especially in cases where there is demonstrable economic substance. For one, withdrawal, as a tax-relevant event, can only occur where the statutory or legislative conditions for such an option are met, which is not the case in the transactions under scrutiny.

Moreover, the tax authorities themselves have recently acknowledged that leveraged buyouts, even those involving partial reinvestment by the selling shareholder, do not constitute an abuse of law, provided there is a genuine change of control (see Ruling No. 251/2024).

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