

**JULY 6, 2006**  
**2006-120****SHARE OPTION RULES  
CHANGED WITH NEW ITALIAN  
DECREE LAW**

by Antonella Cavallaro and David  
Roberts, K Studio Associato  
Consulenza Tributaria e Legale,  
Milan (K Studio Associato  
Consulenza Tributaria e Legale in  
Italy is a KPMG International  
member firm)

The Italian government has issued a Decree Law ("Decreto Legge") that entered into force on July 4, 2006.<sup>1</sup> (The Decreto Legge will be converted into law by Parliament. Should the provisions go unamended, they are to apply from July 4, 2006.) The Decreto Legge introduces important tax legislation amendments for the current fiscal year (2006) and modifies, in particular, the tax treatment on share option plans.

**Background**

According to the current article 51, paragraph g-bis of the Italian "Consolidated Text on Direct Taxation," the difference between the value of the shares at the time of grant and the amount paid by the employee (date of exercise), is not taxed as employment income, provided the amount paid by the employee is at least equal to the fair market value of the same shares on the offer date (as calculated according to the Italian fair market value rules, i.e., the average closing price from the 30 days preceding the offer date) and the shares represent a non-qualified percentage of voting rights. This provision allows for such options to be taxed at a rate of 12.5 percent upon the employee's disposal of the shares, with no taxation on exercise.

**New Decreto Legge**

Article 36 (25) of the Decreto Legge abrogates the current Article 51 g-bis, with the effect that the aforementioned tax relief no longer applies. According to the Decreto Legge, the new provision under Article 36 (25) applies to shares assigned to employees *following* the date of entry into force of the Decreto Legge, in other words, **after July 3, 2006**.

The article adopts similar wording as used in the existing legislation in referring to the assignment of shares. Thus, the abrogated rules exclude from taxation as employment income "the difference between the value of the shares at the date of assignment (exercise) and the amount paid (for those shares) by the employee, on condition that the aforesaid amount is at least equal to the value of the shares at the date of offer (grant)."

The legislation prior to the Decreto Legge did not directly mention share options, but the meaning was clear that the employee payment on the date of assignment of the shares should equal the fair market value at the offer date. Therefore, the legislation has always differentiated between the award date (i.e., date of offer or grant) and assignment date (i.e., date of exercise). Other ministerial circulars have referred to the date of assignment of the shares as being synonymous with the exercise (see Circolare 30/E of February 25, 2000 – for prior coverage, see [Flash International Executive Alert 2000-18](#), February 16, 2000.)

Since the new provision refers to shares assigned to the employee after the date of entry into force, using the same language as the old rules, it clearly applies to options already awarded as at July 4, 2006, but not yet exercised.

The technical notice related to the Decreto Legge does not make matters considerably clearer, but it does contain sample calculations noting the replacement of the 12.5-percent capital gains tax on the estimated total amount of options exercisable (based on published accounts and the extra tax receipts) – these are, instead, taxed as ordinary employment income (on the same amount), consequently, making no distinction as to *when* options were granted.

The technical notice seems to suggest that EUR 152.5 million a year could be raised as a result of the new rules.

#### **KPMG Comments**

Following publication of the initial draft of the Decreto Legge, some quarters of the Italian press (as of July 2, 2006) were remarkably bullish that the change would not apply to already granted but unexercised options; however by July 4, commentators were already concluding that taken in context, the new legislation and the technical notice issued by the Ministry of Finance, together, appeared to indicate that the change applies also to already granted but not exercised options.

Commentators continue to express views about the perceived unfairness of the new rules for employees who were granted options in expectation of one fiscal regime, but now find themselves confronting a wholly different fiscal regime.

Previous changes to Italy's share option rules have included transitional measures, but no such provision for transitional relief has been made in this Decreto Legge.

Therefore, assuming that there are no further changes to the Decreto Legge before it is converted into law, any share option exercises from July 4, 2006, will be taxed as ordinary employment income on the difference between the fair market value of the shares received on exercise and the amount paid by the employee.

#### *Footnote:*

1 *Disposizioni urgenti per il rilancio economico e sociale, per il contenimento e la razionalizzazione della spesa pubblica, nonche' interventi in materia di entrate e di contrasto all'evasione fiscale.* (Gazzetta Ufficiale n. 153 del 4-7-2006.)

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