



**Romano Prodi**  
**Presidente del Consiglio dei Ministri**  
**Palazzo Chigi**  
**Piazza Colonna 370**  
**IT 00186 ROMA**

July 17, 2006

**Dear Presidente,**  
**Dear Romano,**

**Italian Law Decree No. 223, published on 4 July 2006 in the Official Gazette No. 153**  
**About removal of income tax exemption for stock options under Article 36, (25) and**  
**(26)**

This letter is written on behalf of members of EFES - the European Federation for Employee Share Ownership – Federazione Europea dell'Azionariato dei Dipendenti. EFES acts as the umbrella organization of employee owners, companies, employee representatives and institutions looking to promote employee ownership and participation in Europe. EFES is recognized by the European Commission (DG Enterprises and Industry) as European Business Representative Organization in this field. One of EFES's foremost aims is to make employee owners' voices heard in the social and political dialogue at the European level.

The purpose of this letter is to draw the attention of the Italian Government to certain adverse implications that article 36, (25) and (26) in Law Decree No. 223 have for companies, particularly UK, French and US companies, operating broad-based employee share plans in Italy, as well as their employees.

For reasons given below, we would point out that these provisions are prejudicial to all-employee share option plans implemented by foreign and local companies in Italy. Those adversely affected by this change are the wider workforce (not just senior executives, which we understand is the primary concern). We are keen to highlight that UK, French and US companies granting options under the option plan regime which Law Decree No. 223 is seeking to change use these on a very wide basis, and not just for senior executives.

***To reduce the impact of these provisions, we therefore request that the Italian Government amends this law, at least to remove the retrospective effect of these provisions. This amendment would mean that the provisions apply to share options granted (not exercised) on or after 4 July 2006.***

#### **The change introduced by Law Decree No. 223**

Until 3 July 2006, companies setting up employee share plans in Italy have been able to structure their share option plans to enable their employees to benefit from favourable tax treatment. Income from options exercised by an employee under a share option plan has been exempt from income tax and social security contributions, provided that the exercise price of the share options was equal to market value (defined by law) at the date of offer.

Law Decree No. 223, published on 4 July 2006 in the Official Gazette No. 153, repeals this favourable tax treatment by removing the income tax and social security exemption on the exercise of share options granted at market value. This repeal is effective for all options **exercised** on or after 4 July 2006.

## **Initiatives to promote employee share ownership in Europe**

The favourable tax regime available for employee share option plans (meeting the relevant conditions) until 3 July 2006 has been widely used by multinational and Italian companies to incentivise their Italian workforce and to promote employee share ownership.

This has been consistent with the favourable tax regimes offered by other EU countries, in particular France and the UK. While employee share plans were traditionally used to remunerate higher management in these countries, the introduction of tax incentives has led to widespread use of broad-based (all-employee) plans.

There have also been a number of EU-level initiatives to promote employee financial and equity participation. These include the "Final Report of the High Level Group of Experts of the European Commission on cross-border obstacles to financial participation of employees for companies having a transnational dimension" of December 18, 2003 and the "PEPPER" Reports published in 1990 and 1996.

The benefits of employee share ownership are well-recognised, in particular giving employees an interest in increase their company's value as represented by the stock price, and retaining employees (as those who leave employment may lose their rights to exercise options or receive shares).

## **Specific concerns about change introduced by Law Decree No. 223**

### ***All-employee share option plans extended in Italy***

It is common practice for UK multinationals to implement a particular form of UK Inland Revenue - approved discounted employee share option plan (i.e. a plan providing for the grant of options at a discount to market value) for all employees in order to benefit from associated tax advantages for the UK workforce, and to replicate that plan on a global basis in order to ensure that its international workforce hold the same form of award.

EFES member and international law firm, Allen & Overy LLP, has provided some examples of clients who operate discounted employee share option plans across their international operations, but have structured their Italian employee share option plans differently so as to benefit from the favourable tax regime (that has been available until 3 July 2006). For confidentiality reasons, the names of these companies cannot be disclosed.

- A global multimedia company which changed their usual all-employee share reward policy, under which options can be granted at a discount to market value, specifically so as to grant Italian employees share options at market value. The grants were made to employees only days before the change was announced.
- A global publishing company which amended their global plan, so as to grant Italian employees share options at market value.
- A multinational pharmaceuticals company which made option grants at market value to over 400 employees in Italy in 2006, and to the entire Italian workforce in 1999.

Allen & Overy LLP comments that, had there been some notice of this change, these companies would have had an opportunity to structure their plans differently so as to utilise other Italian fiscal incentives. If these companies had used discounted share option arrangements, employees could have benefited from the economic advantage of the "discount", as well as an annual income tax exemption of EUR 2,065.83. As a result of the change introduced by Law Decree No. 223, employees will lose the tax benefits which they are expecting (as have been notified to them in communications), and the benefits which they could have obtained had the Italian plan been structured originally as a discounted option plan.

In some cases, the change may make withholding the amount of tax due on exercise difficult for companies who may not have provided for this when the options were granted. Unless

an express right has been included within the share option plan permitting the company to withhold an amount of shares equal to the tax due, the company has no right to withhold tax, nor any provision against which to make withholding on option exercise (since the employee gets shares on option exercise, rather than a cash entitlement).

### ***Retrospective effect***

By providing that the change introduced by Law Decree No. 223 applies to options **exercised** on or after 4 July 2006, this change has retrospective effect as it applies to share options granted up to 3 July 2006 (but exercised after that date).

Multinational and Italian companies with plans already in place, and their employees, therefore lose tax benefits with immediate effect, not only for future option grants, but also for options granted previously that are exercised from 4 July 2006.

We would urge the Italian Government to amend this Decree to remove the retrospective effect of these provisions, by applying them to share options **granted** (rather than **exercised**) on or after 4 July 2006.

### ***Damage to business confidence***

As a result of the change introduced by Law Decree No. 223, companies will need to re-consider the structure of their employee share plans immediately, even in cases where plans in Italy have been recently reviewed. This puts an administrative and financial burden on companies who must re-consider, and possibly amend, their plans.

We would also point out the potentially damaging consequences that this change may have on business confidence in Italy. Companies which have invested time and money in complying with the Italian legislation are likely to be concerned that tax breaks previously available have been retrospectively withdrawn to the detriment of their employees.

### ***EU process***

We consider that this measure is inconsistent with EU policy on the promotion of employee share ownership.

Please also note the following extract from the "Final Report of the High Level Group of Experts of the European Commission on cross-border obstacles to financial participation of employees for companies having a transnational dimension" of December 18, 2003, which suggests that there should be some co-ordination among EU member states in relation to proposed changes affecting the tax treatment of share options:

"General recommendation:... Introducing an EU convention on the taxation of share options.

The Member States should consider the introduction of an EU-wide Convention that would agree on consistent rules on taxation and social security contributions that are clear and easy to apply for employees who change residence. This approach could equally apply to all types of financial participation, but as the concept of a share option is simple and options are frequently used, it justifies the signing of a fiscal convention between Member States on share options..."

We thank you in advance for your attention to this letter, and would ask that this be drawn to the attention of the relevant Government Ministers.

Yours faithfully

***Marc Mathieu***  
***Secretary General***