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Subject: State Aid SA.48570 (2018/N) – Italy – Fiscal incentives for investments in innovative start-ups and innovative SMEs

Sir,

1. PROCEDURE

(1) By letter dated 23 October 2018, and registered by the Commission on the same day, the Italian authorities notified their intention to amend the scheme SA.47184 (2016/N) – Italy – Fiscal incentives for investments in innovative start-ups.

(2) The scheme was originally approved on 5 December 2013[1] on the basis of the Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises (hereafter "RCGs")[2]. The Commission approved subsequent amendments on 14 December 2015[3] and on 19 June 2017[4] on the basis of the Guidelines on State aid to promote risk finance investments (hereafter "RFGs")[5].

2. DESCRIPTION OF THE SCHEME

2.1. Objective of the amended Scheme

(3) The amended Scheme aims at incentivizing private risk capital for innovative start-ups and innovative Small and Medium Enterprises ("SMEs") in Italy.

[1] State aid case SA.36866 (2013/N) (OJ C 17, 21.1.2014, p. 10).
[2] OJ C 194, 18.08.2006 p. 2-22.
[3] State aid case SA.43005 (2015/N) (OJ C 379, 19.10.2018, p. 2).
[4] State aid case SA.47184 (2016/N) (OJ C 422, 8.12.2017, p. 13).
[5] OJ C 19, 22.1.2014, p. 4–34.

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(4) An independent expert – Professor Samuele Murtinu – carried out a study (the ex-ante assessment) which pointed at an equity gap in the Italian risk capital market for innovative start-ups, innovative SMEs, and also for other SMEs in the age group of 7 to 10 years counting from the date of their first commercial sale. This ex-ante assessment formed part of the notification.

2.2. Brief description of the existing Scheme

2.2.1. Eligible investors

(5) The existing scheme contains tax advantages for both natural person investors and corporate investors for their equity investments in target undertakings.

The investment can be either indirect - through Collective Investment Bodies or other companies that then primarily invest in target undertakings - or direct.

2.2.2. Target undertakings

(6) The target undertakings are innovative start-ups. They have to be unlisted SMEs that are not older than 5 years (i.e. 60 months) counting from the date of their first commercial sale. They also have to respect a series of criteria to qualify as "innovative".

(7) The target undertakings can benefit in total from risk finance investments up to EUR 15 million.

(8) The target undertakings are not required to have their headquarters or their principal establishment in Italy but they must carry out an economic activity in Italy through a permanent establishment.

2.2.3. Form of aid

(9) Physical persons investing in innovative start-ups can deduct from their due income tax 30% of their investment (up to EUR 1 million per year). In other words, for physical persons the measure takes the form of a tax deduction.

(10) Companies investing in innovative start-ups can deduct from their tax base 30% of their investment (up to EUR 1.8 million per year). In other words, for corporate investors, the measure takes the form of a tax base deduction.

2.2.4. Granting authority

(11) The granting authorities are the Italian Ministry of Economic Development and the Ministry of Economy and Finance.

2.2.5. Legal Basis

(12) The existing scheme finds its legal basis in the Italian Law no. 221/2012, converting into law Decree Law no. 179/2012, and the Italian Law no. 33/2015, converting into law Decree Law no. 3/2015.

2.2.6. Duration

(13) The existing measure will be in effect for applications introduced until 31 December 2025.

(14) The proposed duration of the scheme goes beyond the period of application of the RFGs which only extends until 31 December 2020. The Italian authorities have, however, committed to undertake any necessary appropriate measures to bring - after the expiry of the RFGs - the scheme in line with any new applicable rules.

2.2.7. Budget

(15) The overall budget of the existing scheme was EUR 166.5 million for the period 2017-2025 which is equivalent to an average annual budget of EUR 18.5 million.

2.3. Notified amendments to the Scheme

(16) The Scheme will now be amended so as to include in the target undertakings - next to "innovative start-ups" - also "innovative SMEs". The budget has been revised accordingly and will now amount to EUR 303 million (which is equivalent to EUR 33 million on average per year). The notification explains that the measure will target 501 to 1000 companies.

(17) The Italian authorities confirmed that other conditions of the existing scheme remain unchanged.

2.3.1. New scope of target undertakings

(18) The Amended Scheme will not only target innovative start-ups but also innovative SMEs. Innovative SMEs are unlisted SMEs that are recorded in an *ad hoc* register[6]. On top of that, eligible innovative SMEs

(a) respect at least two of the following three criteria:

– Research & Development (R&D) expenditure is at least 3% of the greater value of the cost and the value of production;

– 1/5 of their employees:

(i) pursue or hold a Ph.D. or;

(ii) hold a bachelor degree and are involved in certified research activities or 1/3 of their employees hold a 5yr equivalent ("Laurea Magistrale") univerity degree;

– own at least one industrial patent related to an invention associated with the company's business activity;

and

(b) fall in one of the following three categories:

[6] Registro delle Imprese – Startup e PMI Innovative

- The company has operated in the market for less than 7 years counting from the date of its first commercial sale;

- The company has operated in the market for less than 10 years counting from the date of its first commercial sale, and has not yet sufficiently proven its potential to generate returns;

- The company makes a risk finance investment - based on a business plan prepared in view of entering a new product or a new geographical market - that is higher than 50% of the average annual turnover in the preceding 5 years (irrespectively of their age). This provision is in line with Article 21 of the General Block Exemption Regulation (hereafter "GBER")[7].

(19) The Italian authorities provided an ex ante assessment of Professor Samuele Murtinu. This assessment showed that also innovative SMEs still struggle to have sufficient access to risk capital on the Italian market. The assessment provides evidence of the existence of an equity gap, by analysing both the supply and the demand side of risk finance to innovative SMEs. In doing so, the study performs extensive comparisons with other EU Member States. It concludes that the equity gap persists over the 7 year limit for innovative companies.

(20) On the supply side, the assessment shows that venture capital and business angels in Italy, provide significantly less capital than in other comparable EU countries; as for private equity, the available capital for traditional companies is broadly in line with that in other countries, while capital for innovative companies is not sufficient.[8]

(21) On the demand side, the assessment shows that the average quality of the investment opportunity in innovative SMEs in Italy is comparable to the one in other EU Member States.

2.3.2. Legal Basis of the Amendments

(22) Implementing Decree "Modalitá di attuazione dell'articolo 29 del decreto-legge 18 ottobre 2012, n. 179, convertito, con modificazioni, dalla legge 17 dicembre 2012, e dall'articolo 4 del decreto-legge 24 gennaio 2015, n.3, convertito, con modificazioni, dalla legge 24 marzo 2015, n. 33, recante incentivi fiscali all'investimento in start-up innovative e in PMI innovative". The draft implementing-decree formed part of the notification.

3. ASSESSMENT OF THE AMENDED SCHEME

3.1. Existence of State aid

(23) The Commission established in its previous decisions that the fiscal incentives under the scheme constitute State aid in the sense of Art. 107(1) of the TFEU. As established in recitals (44) to (57) of the SA.36866 (2013/N) Decision, the aid

[7] OJ L 187 26.6.2014, p.1.

[8] In the ex-ante assessment by S. Murtinu, business angels and venture capitals are considered to normally provide risk finance to companies in their early stages, while private equity are considered to normally provide risk finane to companies that are beyond 5 years or even well established.

beneficiaries of the scheme are the investors (insofar as they perform economic activities) and the target undertakings.

(24) The proposed amendments do not change the Commission's existence of aid assessment of the aforementioned Commission's decisions.

3.2. Lawfulness of the aid

(25) The Commission notes that the amendments of the scheme do not fall in the remit of Article 21 of the GBER as that Article does not allow granting risk finance aid in the form of fiscal incentives to investors that are involved in economic activities. Moreover, that GBER article also does not cover risk finance aid incentivising investments in SMEs that have operated for more than 7 years counting from the date of their first commercial sale.

(26) By notifying the measure before putting it into effect, the Italian authorities have respected their obligations under Article 108(3) of the Treaty.

(27) Article 107(3)(c) of the Treaty provides that aid to facilitate the development of certain economic activities may be considered compatible with the internal market where such aid does not adversely affect trading conditions to an extent contrary to the common interest.

(28) The RFGs outline how the Commission applies Article 107(3)(c) of the Treaty with regard to risk finance aid.

(29) The notified measure incentivizes private investors to invest more private capital in risk finance. The notified measure thus constitutes a risk finance measure, and has to be assessed on the basis of the RFGs.

(30) Under the RFGs, a series of standard conditions laid down in section 2 has to be verified, and in addition the Commission has to ascertain that the aid is in line with the Common Assessment Principles for risk finance measures, as laid down in section 3.

3.3. Assessment of the requirements in Section 2 of the RFGs

Exclusion of risk finance to companies listed on the official list of a stock exchange or a regulated market:

(31) Point 22 of the RFGs states that companies listed on the official list of a stock exchange or a regulated market cannot be supported through risk finance aid.

(32) This requirement is met (see recital (18) above).

Minimum involvement of private investors:

(33) Point 23 of the RFGs prohibits any risk finance aid measures that do not involve private investors.

(34) Point 24 of the RFGs excludes risk finance aid where no appreciable risk is undertaken by the private investors, and/or where the benefits flow entirely to the private investors.

(35) In the case at hand, investor receive a tax advantage at the time of investment but they still have to make a meaningful investment themselves and remain fully exposed to the future performance of their (direct or indirect) investments. Therefore, The notified scheme meets those requirement, since private investors have to finance the investment from their own resources.

Exclusion of buy-outs, of companies in difficulty and of companies that have received unrecovered illegal State aid, and of export related activities:

(36) Point 25 of the RFGs states that risk finance aid may not be used to support buy outs (except in case of risk finance aid in the form of replacement capital).

(37) Point 26 of the RFGs excludes risk finance aid to enterprises in difficulty, and to undertakings that have received illegal State aid which has not been fully recovered.

(38) Point 27 of the RFGs excludes risk finance aid to export-related activities towards third countries or Member States.

(39) The Italian authorities committed to respect those requirements (see recital (17) above).

3.4. Assessment under Section 3 of the RFGs

(40) To assess whether a notified aid measure can be considered compatible with the internal market, the Commission generally analyses whether the design of the aid measure ensures that the positive impact of the aid towards an objective of common interest outweighs its potential negative effects on trade between Member States and competition.

(41) The Commission will consider an aid measure compatible with the Treaty only if it satisfies all of the following criteria:

(a) contribution to a well-defined objective of common interest;
(b) need for State intervention;
(c) appropriateness of the aid measure;
(d) incentive effect;
(e) proportionality of the aid (aid limited to the minimum);
(f) avoidance of undue negative effects on competition and trade between Member States;
(g) transparency of aid.

3.4.1. Contribution to a common objective (Section 3.2 RFGs)

(42) The RFGs state that *"[f]or risk finance aid, the general policy objective is to improve the provision of finance to viable SMEs from their early-development up to their growth stages, […], so as to develop in the longer run a competitive business finance market in the Union, which should contribute to overall economic growth". Furthermore, they require that "[t]he measure must define specific policy objectives in view of these general policy objectives" and that "[t]o that end, the Member State must carry out an ex ante assessment in order to identify the policy targets and define the relevant performance indicators. The size and duration of the measure should be adequate for the policy targets*."

(43) The objectives of the existing scheme – which are still relevant also after the amendments - are the following:

(a) To support sustainable economic and technological development, and employment particularly among young people,

(b) To develop a new entrepreneurship culture, thus favouring innovation, social mobility and human and financial capital formation.

(44) The existing scheme, while stimulating the overall number of deals and the total amount invested in innovative start-ups, was yet unable to give a decisive boost to the Italian venture capital and related industries, whose size is still negligible compared to similar economies such as France, Germany, UK and Spain. One of the objectives of the measure is to further promote risk finance in Italy. At the same time, the scheme had a positive impact on employment and capital formation, but that impact is still considered to be too limited.

(45) The extension of the target undertakings to innovative SMEs is instrumental to better achieve these objectives. SMEs are the backbone of the Italian entrepreneurial fabric, by accounting for 99.9% of the total amount of companies, 78.6% of the overall labour force and 66.6 % of the gross value added. The notification explains that Italy targets 501-1000 companies with this measure.

(46) In conclusion, the Commission finds that the above general and specific objectives of the scheme, as amended, are in line with the RFGs, and that the amendment to the scheme, by also favouring better access to finance for innovative SMEs should help to reach these objectives.

3.4.2. Need for state intervention to address a market failure (Section 3.3 RFGs) and avoidance of undue negative effects on competition and trade between Member States (Section 3.7 RFGs)

(47) Point 63 of the RFGs recalls that "*State aid can only be justified if it is targeted at specific market failures affecting the delivery of the common objective.*" As for the "access to finance" market failure, point 64 of the RFGs points out that there is no general market failure as regards to access to finance for SMEs but at the same time it notes that there are "*SMEs in their early stages which, despite their growth prospects, are unable to demonstrate their credit-worthiness or the soundness of their business plans to investors".*

(48) From a theoretical perspective, the Commission observes that the scheme targets a subcategory of corporates, i.e. innovative start-ups and innovative SMEs. The process of companies convincing investors to invest in their companies or projects is typically characterised by asymmetry of information. This asymmetry of information problem is typically more pronounced for innovative companies, which have still untested business models, have not yet built up a credit history and cannot yet offer sufficient collateral. Also small companies tend to be more prone to this asymmetry of information problem. Indeed, investors have to make an effort to overcome the asymmetry of information problem and for smaller

investments, the search and monitoring costs associated with this process might outweigh the potential benefits of the investment[9].

(49) From an empirical perspective, by looking at both the supply and demand side of risk capital, the Commission concludes that there is still an equity gap in the Italian risk capital market, also as compared to EU peers. The Commission takes in particular note of the following:

(a) On the supply side, as explained in recital (20) the assessment shows that venture capital and business angels in Italy provide significantly less risk capital than in other comparable EU countries (adjusted for the GDP). For example, in the case of venture capital the amount invested in Italy in 2016 is below 13% of the average in Germany, France, United Kingdom and Spain. In the case of business angels the amount invested in Italy in 2013-15 represents less than 30% of the average of the investment in the same countries. Moreover, the assessment shows that, private equity investments are skewed in Italy towards traditional sectors. The ratio between the private equity investments in the ICT sector and their total investments in 2016 stood at 20% in Italy, 30% in Germany and French, 40% in the UK and Spain.

(b) On the demand side, as explained in recital (21), the assessment notes that number of Italian innovative SMEs, as recorded by Eurostat, is below the number of German companies, but in line with the number of UK companies, and even above the number of French and Spanish companies. Hence, the demand of capital by Italian SMEs is unlikely to be lower than in other EU comparable countries. In addition, by looking at the available human capital (measured by percentage of Ph.D. graduates between 25-34 year olds) and at the innovative SMEs' profile (in particular at the R&D expenditures and at the educational level of the employees), the assessment concludes that the quality of the Italian innovative SMEs cannot be considered ex-ante lower than the one of the innovative SMEs in the other comparable EU countries.

(50) As regards the fact that the scope of target undertakings now also includes companies whose commercial activities started more than 7 years ago but less than 10 years ago, point 73 of the RFGs acknowledges that "*certain types of undertakings may be regarded as still being in their expansion/early growth stages if, even after this seven-year period, they have not yet sufficiently proven their potential to generate returns and/or do not have a sufficiently robust track record and collaterals. This may be the case in high-risk sectors, such as the biotech, cultural and creative industries, and more in general for innovative SMEs*[10]."

(51) The Commission takes note of the fact that the Italian ex-ante assessment shows that the lack of equity investment applies in Italy to a broader age sample of

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9 The Commission observes that risk finance schemes covering as similar scope of target undertakings have been also approved in France (SA.41265, OJ C 46, 5.2.2016, p. 8), UK (SA.49923, OJ C 360, 5.10.2018, p. 5) and Germany (SA.46308, OJ C68, 3.3.2017, p. 14).

10 The innovative character of an SME is to be appraised in the light of the definition set out in GBER.

innovative SMEs, and is not limited to the early stage SMEs. Also, the equity gap in Italy is not limited to business angels and venture capital, which tend to support companies in their early expansion, but also to private equity, which normally provides capital only at a later stage. Finally, the Italian authorities provide information that the extension of the 7 year age limit by 3 additional years would relate to an additional 20.5% of innovative SMEs. The proportion of innovative SMEs - as recorded in the specific Italian registry - younger than 10 years represents around 66.5% of total innovative SMEs.

(52) The Commission accepts that the way that target undertakings are defined is aligned with the definition of innovative SMEs as set out in Art 2(80) GBER. In this regard, the Commission notes positively that innovative SMEs have to demonstrate, through an independent audit, that they have not yet sufficiently proven their potential to generate returns, in order to be able to access the aid beyond the 7 year period.

(53) As regards the need to also grant a corporate tax advantage – which is already one of the characteristics of the measure since the beginning, point 87 of the RFGs acknowledges that "*Member States may find it appropriate to put in place measures applying […] incentives to corporate investors. […] The measure must […] be subject to specific restrictions in order to ensure that aid at the level of the corporate investors remains proportionate and has a real incentive effect*".

(54) The Commission takes note of the Italian argument that, due to the lack of a well-developed and established entrepreneurship culture, the effectiveness of the measure would significantly increase by also allowing professional investors and corporates to benefit from the scheme.

(55) The Commission notes that the form of aid for this category of eligible investors is capped and that the advantage is more limited than the aid available to natural persons. In fact, for natural persons the measure takes the form of a 30% tax deduction, while for corporates the measure takes the form of a 30% tax base deduction. Concretely, this implies that the tax advantage is less prominent for corporates, which – in light of their professional skills – should anyhow be better able to screen investment opportunities in particular in innovative start-ups and innovative SMEs. Moreover, the different treatment between individual person investors and corporates is consistent with the requirements of proportionality, appropriateness and incentive effects, as further discussed in Sections 3.4.3 and 3.4.4.

(56) The Commission concludes that the existence of the market failure which the amended aims to address is sufficiently demonstrated.

3.4.3. Appropriateness of the aid measure (Section 3.4 RFGs)

(57) According to point 89 of the RFGs, "*In order to address the identified market failures and to contribute to the achievement of the policy objectives pursued by the measure, the proposed risk finance aid must be an appropriate instrument, while at the same time being the least distortive for competition.*"

(58) In recitals (63) to (78) of the SA.36866 Decision, the Commission already concluded that using a fiscal incentive for private investors incentivizing them to invest more in risk capital was an appropriate measure. In particular, the

Commission concluded that points 120 and 126 of the "RFGs" were respected. The extension of this aid to investors in SMEs does not change this conclusion.

(59) The Commission takes positive note of the fact that the ex-ante assessment refers to both the theoretical and empirical literature to show that fiscal State aid to investors is the most effective tool to achieve the objectives mentioned in paragraph (4).

(60) The Commission also observes that – as compared to similar initiatives in other Member States – the measure does not seem to be excessively large. In particular, the independent expert's study finds that – in accordance with Invest Europe data – public contribution in the Italian venture capital market amounted in 2016 to EUR 80 millions, well below the levels in France (around EUR 290 millions), Germany (around EUR 200 million), Spain (around EUR 193 million) and UK (around EUR 240 million). In other words, the public interventions in other similar EU countries are around 2.5-3.5 times the amount invested in Italy in the venture capital market. The ratios are similar in the private equity markets. Keeping this in mind, it can be accepted that the amended measure in the form of a fiscal benefit for investors, would have a limited distortive effect on competition and on trade between Member States.

(61) Based on the above, the Commission concludes that it is sufficiently demonstrated that the notified tax incentives are an appropriate policy tool to stimulate the Italian risk capital market and access to finance to innovative start-ups and innovative SMEs, while also being the least distortive for competition.

3.4.4. Incentive effect of the aid (Section 3.5 RFGs)

(62) Point 130 of the RFGs specifies that "*State aid can only be found compatible with the internal market if it has an incentive effect that induces the aid beneficiary to change its behaviour by undertaking activities which it would not carry out without the aid or would carry out in a more restrictive manner due to the existence of a market failure.*" In addition, point 132 of the RFGs specifies that *"once the market failure has been properly identified and the measure has an appropriate design, it can be assumed that an incentive effect is present*".

(63) As the measure, as amended, is needed and appropriately designed, the Commission concludes that its incentive effect is respected. The Commission notes that the measures encourages investors to make risk finance investments which they would not have made without the incentives, while at the same time still exposing them to the future performance of their investments.

3.4.5. Proportionality of the aid (Section 3.6 RFGs)

(64) According to point 133 of the RFGs, *"State aid must be proportionate in relation to the market failure being addressed in order to achieve the relevant policy objectives. It must be designed in a cost-efficient manner, in line with the principles of sound financial management. For an aid measure to be considered proportionate, aid must be limited to the strict minimum necessary to attract funding from the market to close the identified funding gap, without generating undue advantages".*

(65) In recitals (15) to (29) of the SA.47184 Decision, the Commission already concluded that the aid was proportionate. The Commission has come to the

conclusion that the extension of the beneficiary undertakings to innovative SMEs does not alter such conclusion and also took into account the following observations.

(66) First, the Commission notes that investments made under the scheme, including to innovative SMEs, are made by private investors without any direct participation of public investors. This ensures that all investment decisions are commercially driven by the individual decision of private investors. The Commission also notes that the increase in the budget is limited as described in recital (16).

(67) Secondly, as regards the proportionality requirements of the RFGs for fiscal instrument, the Commission notes that point 149 of the RFGs requires that the "*Total investment for each beneficiary undertaking may not exceed the maximum amount fixed by the risk finance provision of the GBER*", i.e. EUR 15 million. The measure, as amended, continues to respect this condition and the underlying legal framework contains an explicit reference to this limit.

(68) Point 150 of the RFGs requires that "*Irrespective of the type of tax relief, eligible shares must be full-risk, ordinary shares, newly issued by an eligible undertaking as defined in the ex ante assessment, and they must be held for at least 3 years. The relief cannot be available to investors who are not independent from the company invested in*". The measure, as amended, continues to respect this condition and expressly requires the independence of private investors.

(69) Point 151 of the RFGs requires that "*In the case of income tax relief, investors providing finance to eligible undertakings may receive relief of up to a reasonable percentage of the amount invested in eligible undertakings, provided the maximum income tax liability of the investor, as established prior to the fiscal measure, is not exceeded. In the Commission's experience, capping the tax relief at 30 % of the invested amount is considered reasonable. Losses arising upon disposal of the shares may be set against income tax*". The measure, as amended, continues to respect this quantitative 30% limit.

(70) In view of the above, the Commission considers that the measure is proportionate.

3.4.6. Avoidance of undue negative effects on competition and trade between Member States (Section 3.7 RFGs)

(71) Point 115 of the RFGs requires that "*The State aid measure must be designed in such a way that it limits distortions of competition within the internal market. The negative effects have to be balanced against the overall positive effect of the measure.*"

(72) Frist, as regards competition distortions as the level of the investors, the Commission takes comfort from the fact that the measure is targeting a well-defined market failure, which substantially reduces the risk of crowding out. Private investors are still incentivised to focus on the performance of their investments, the risk investment amounts per company are not excessive and the measure targets a specific category of SMEs (as opposed to larger companies).

(73) Second as regards competition distortions at the level of the target undertakings, the Commission observes that the measure explicitly excludes companies in difficulty and focuses on innovative start-up and innovative SMEs.

(74) Taking into account the above, the Commission concludes that the measure is designed in such a way as to limit the distortion to competition and minimize undue advantages and that its positive effects outweigh any potential negative effects on competition in the internal market.

3.4.6. Transparency

(75) The transparency requirement, specified in Section 3.8 of the RFGs, is fulfilled (see recital (11) above).

3.4.7. Cumulation

(76) The requirement on cumulation, specified in Section 3.9 of the RFGs, is fulfilled (see recital (12) above).

4. CONCLUSION

The Commission has decided to consider the notified aid to be compatible with the internal market pursuant to Article 107(3)(c) of the Treaty. Accordingly, it decides not to raise objections to the measure.

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Your request should be sent electronically to the following address:

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Yours faithfully
For the Commission

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