

## AN INDEMNITY RECEIVED PURSUANT TO AN SPA IS TAXABLE INCOME

The Italian Supreme Court, with ruling No. 17011/2020, stated that an indemnity paid by a seller pursuant to a share purchase agreement is taxable income. This decision is a milestone for taxation law and creates an important precedent for M&A contracts.

The High Court's decision relates to a litigation on an M&A deal for which, as customary, the seller had granted several representations and warranties undertaking to indemnify the purchaser for any loss suffered should any such representations prove to be false or incomplete. The Court affirms that any indemnity paid pursuant to such provision cannot be considered a price adjustment arguing that price adjustment clauses link the purchase price, or a portion thereof, to future events connected to the economic or financial progress of the target company. While this construction of price adjustment provisions made by the Court appears overly restrictive, the following interpretation of the customary indemnity provisions as an autonomous guarantee different from a price adjustment is correct.

An indemnification clause, pursuant to which the seller guarantees to the buyer that the target complies with certain representations and warranties, creates a new and autonomous obligation that is freely agreed by the parties and that does not affect the price of the asset being sold.

The distinction made by the Court has a very practical relevance since if the indemnity is to be considered a price adjustment it can be subject to the same participation exemption regime as the initial purchase price. On the contrary, if it is a sum due as a result of an indemnification obligation it is subject to ordinary taxation.

Therefore, contractual clauses that are found in an SPA that interpret the indemnification provisions as being a price adjustment clause are likely to be deemed irrelevant for tax purposes.

In light of this decision, the buyer should try to request a greater indemnity to take into account, at least partially, such tax burden.