

## 26. TAX PAYABLES

The tax payables mainly relate to national and regional income taxes and total euro 83,809 thousand (of which euro 3,537 thousand recognised in non-current liabilities), compared to euro 81,781 thousand at December 31, 2012 (of which euro 4,172 thousand recognised in non-current liabilities).

## 27. DERIVATIVE FINANCIAL INSTRUMENTS

This item includes the fair value of derivative instruments outstanding at December 31, 2013. The following table shows the breakdown

(in thousands of euro)

	12.31.2013		12.31.2012	
	Current Assets	Current Liabilities	Current Assets	Current Liabilities
<b>Hedge accounting not adopted</b>				
Foreign currency derivatives - commercial transactions	17,255	(13,544)	28,847	(25,588)
Foreign currency derivatives - included in net financial position	4,438	(3,175)	13,065	(19,168)
Other derivatives - included in net financial position	575	-	296	0
<b>Hedge accounting adopted</b>				
● <b>cash flow hedge:</b>				
Foreign currency derivatives - commercial transactions	384	(1,482)	603	(927)
Interest rate derivatives	513	(38,824)		(50,665)
Other derivatives		(14)	117	
● <b>fair value hedge</b>				
Interest rate derivatives - included in net financial position	1,653		4,775	
	<b>24,818</b>	<b>(57,039)</b>	<b>47,703</b>	<b>(96,348)</b>
Total derivatives included in net financial position	6,666	(3,175)	18,136	(19,168)

### ***Derivative financial instruments without adoption of hedge accounting***

The value of **foreign currency derivatives** corresponds to the fair value of forward currency purchases/sales outstanding at the closing date of the period. These involve hedges of Group commercial and financial transactions for which hedge accounting was not adopted. The fair value is determined by using the forward exchange rate at the reporting date.

### ***Derivative financial instruments with adoption of hedge accounting***

#### **CASH FLOW HEDGE**

The value of **interest rate derivatives**, recognised under current liabilities for euro 38,824 thousand (euro 50,665 thousand at December 31, 2012), consists mainly of:

- euro 20,302 thousand (euro 39,566 thousand at December 31, 2012) for the fair value of 12 "plain vanilla" interest rate swaps on a total notional amount of euro 575 million maturing in February 2015, which envisage the payment of an average fixed interest rate and collection of a variable interest rate. These derivatives were made to hedge against the risk of change in interest rates associated with the variable rate revolving syndicated credit facility granted to Pirelli & C. S.p.A., Pirelli Tyre S.p.A. and Pirelli International Limited for a total amount of euro 1,200,000 thousand and of which euro 575,000 thousand was used at December 31, 2013.

The amount recognised in equity during the period for the effective part was euro 15,068 thousand, broken down as follows:

- euro 10,669 thousand for profits recognised in equity during the period;
- euro 4,399 thousand for reclassification to the Income Statement of losses previously accumulated in equity (refer to note 36 "financial expenses");
- euro 17,423 thousand (euro 8,420 thousand at December 31, 2012) for the fair value of four cross currency interest rate swaps negotiated in November 2012 to hedge exposure to currency risk and limit exposure to the interest rate risk associated with the private placement by Pirelli International Ltd on the American market for an aggregate nominal amount of USD 150 million, having a duration of between 5 and 12 years (refer to note 23 "Borrowings from banks and other financial institutions"). The aim is to hedge against changes in the cash flows of the payable denominated in foreign currency (both principal and interest) tied to changes in foreign exchange rates. A negative amount for euro 4,437 thousand was recognised in equity for the year.

#### **FAIR VALUE HEDGE**

The value of **interest rate derivatives** recognised as current assets for euro 1,653 thousand (euro 4,775 thousand at December 31, 2012) includes the fair value of five interest rate swaps on a notional amount of euro 125 million, made to hedge the risk of changes in the fair value of a portion of the fixed rate bond issued by Pirelli & C. S.p.A. in February 2011 for euro 500 million (refer to note 23 "Borrowings from banks and other financial institutions"). Fair value hedge accounting was adopted for these derivative financial instruments, according to which the negative change in fair value of the derivative instrument (euro 3,122 thousand at December 31, 2013) is recognised in the Income Statement and is offset by a gain on the bond attributable to the risk hedged for the same amount, recognised in the Income Statement as financial income and that adjusted the carrying amount of the bond ("basis adjustment").

## **28. COMMITMENTS AND CONTINGENCIES**

### ***Commitments to purchase property, plant and equipment***

The commitments to purchase property, plant and equipment amount to euro 109,535 thousand (euro 120,735 thousand at December 31, 2012), and mostly relates to companies in Russia, Romania, Brazil, Germany, Italy, Mexico and Turkey.

### ***Commitments to purchase of equity interests/fund units***

These refer to commitments to subscribe units of the company Equinox Two S.c.a., a private equity company specialised in investments in listed and unlisted companies with high growth potential, for a maximum countervalue of euro 2,801 thousand.

### ***Guarantees given on the sale of Olimpia***

On the sale of the interest in Olimpia S.p.A., the sellers (Pirelli and Sintonia) remained contractually liable for all the contingent tax liabilities regarding the years up to the date of sale. The settled or outstanding tax litigation can be summarised as follows.

At the end of 2006, the Italian Internal Revenue Agency ("Agenzia delle Entrate") served Olimpia S.p.A. with an assessment notice for **2001**, concerning IRAP (regional tax on productive activity).

More precisely, on the basis of an absolutely unfounded assumption both legally and economically, the Agenzia delle Entrate had found that non-existent financial income had been realised on the Bell Bond Loan redeemable with Olivetti shares, with a consequent IRAP tax of euro 26.5 million (with euro 21.2 million being the portion attributable to the owners of Pirelli & C. S.p.A.), plus penalties for the same amount. The Company appealed against this tax assessment, claiming that the ascertained taxable income was manifestly non-existent. At the trial level, the Trial Tax Court accepted the Company's appeal, cancelling the entire tax assessment. The Agenzia delle Entrate subsequently appealed this decision. The appeal by the Agenzia delle

Entrate was also rejected by the Regional Tax Court. Notwithstanding the unexceptionable double judgements against it, the Agenzia delle Entrate filed an appeal before the Court of Cassation, against which the Company has filed a cross-appeal. It is awaiting scheduling of the hearing before the Court of Cassation. As mentioned above, there are grounds to believe that the final judgement will be favourable.

In the assessment for the **2002** tax year, served at the end of 2007, Olimpia was classified as a "shell company," on the basis of perfectly arbitrary reclassification of items on its financial statements and arbitrary statutory interpretations. The tax challenge was extinguished when the Appeal Court decision became final and the Agenzia delle Entrate did not file appeal in the Court of Cassation against the Appeal Court decision.

At the end of 2008, a second notice of assessment was served for the **2003** tax year, in which Olimpia was once again classified as a "shell company." The IRPEG (corporate income tax) claim amounted to euro 28.5 million (with euro 22.8 million being the portion attributable to the owners of Pirelli & C. S.p.A.), plus penalties for the same amount.

The Company appealed to the Tax Court of first instance against this tax assessment, which was, like the other ones, absolutely unfounded. The Tax Court ruled in favour of the Company. The Agenzia delle Entrate lodged an appeal against the Trial Tax Court decision. The Company then submitted its own counter-arguments against that appeal.

Following extinguishment of the similar tax claim previously made for the 2002 tax year and the subsequent one concerning the 2004 tax year, the Agenzia delle Entrate requested at the hearing held on October 23, 2012 that discussion of the claims be postponed until February 26, 2013. After that postponement, the case was postponed a second time, until September 24, 2013. Both postponements were aimed at preparing a similar abandonment of the claims, after first obtaining the necessary authorisation to do so from the Lombardy DRE (Regional Revenue Agency Head Office).

In its own written submission, the Agenzia delle Entrate formally stated its wish to abandon continuation of its claim regarding the asserted classification of Ol-

impia as a shell company.

The Regional Tax Court accepted this abandonment of claim, thereby finalising the previous favourable decision.

Instead, the Agenzia delle Entrate has appealed to the Court of Cassation against the decision by the Regional Tax Court to apply the merely formal penalty on the shareholder loss not reported in the previously submitted income tax return.

The Company in turn, purely in defence of a principle, is preparing its own counterarguments. In fact, the dispute does not determine the accrual of liabilities.

Finally, at the end of 2009, a third notice of assessment was served for the **2004** tax year, in which Olimpia was yet again classified as a "shell company." The IRES (corporate income tax) claim amounts to euro 29.6 million (with euro 23.7 million being the portion attributable to the owners of Pirelli & C. S.p.A.), plus penalties for the same amount.

This assessment, just like the ones that preceded it, is absolutely unfounded. Therefore, the Company lodged an appeal against it too before the Tax Court of first instance, which ruled in favour of the Company just as it had done before.

The Agenzia delle Entrate lodged an appeal against the Trial Tax Court decision. The Company then submitted its own counter-arguments against that appeal.

At the next hearing the appeal court ruled in favour of the Company, upholding the trial court decision.

Once again, the Agenzia delle Entrate did not appeal this third tax claim against the "shell companies", just as in the case of the 2002 tax year and subsequent 2003 tax year claim. Therefore, this third tax claim has also been extinguished for failure to appeal to the Court of Cassation against the Regional Tax Court decision becoming final.

### **Other contingencies**

As part of the investigation by the European Commission on the underground and submarine electric cable market, Pirelli received notice on July 5, 2011 of charges against it in regard and limited to its status as controlling shareholder of Prysmian Cavi e Sistemi Energia S.r.l. until July 2005. The Commission has not made

any charge of direct participation by Pirelli in the alleged cartel.

Pirelli has submitted its own defence arguments in regard to its involvement as parent company and has continued to maintain its own line of defence during the subsequent phases of the proceeding before the European Commission. It is expected that the European Commission will issue its decision in 2Q 2014.

## 29. REVENUE FROM SALES AND SERVICES

The breakdown of revenue from sales and services is as follows

(in thousands of euro)

	2013	2012
Revenue from sales of goods	6,036,768	5,969,183
Revenue from services	109,392	102,352
	<b>6,146,160</b>	<b>6,071,535</b>

## 30. OTHER INCOME

The breakdown of this account is as follows

(in thousands of euro)

	2013	2012
Gains on disposal of property, plant and equipment	37,862	22,485
Rent income	9,831	9,035
Insurance indemnities	8,485	12,676
Recoveries and reimbursements	63,000	59,519
Government grants	6,483	9,157
Other income	126,648	128,758
	<b>252,309</b>	<b>241,630</b>

**Gains from disposal of property, plant and equipment** include euro 31,142 thousand from the sale of several properties not used for the industrial activity in Brazil and euro 2,767 thousand for the disposal of land in Great Britain.

**Recoveries and reimbursements** mainly consist of taxes and duties refunds totalling euro 26,563 thousand, and other tax refunds totalling euro 12,606 thousand resulting from tax incentives applied in the Brazilian State of Bahia, for merchandise manufactured locally and then exported.

The item **other income** mainly includes income from sports activities for euro 36,270 thousand, income from the sale of receivables under litigation for euro 13,202 thousand, reversal of provision accrued for the superseded three-year 2012-2014 incentive plan euro 12,371 thousand, and income from reversal of provisions for liabilities and charges (euro 22,674 thousand) and provisions for bad debts (euro 7,926 thousand).

The gains resulting from disposal of properties not used for the industrial activity in Brazil (euro 31,142 thousand) and the income resulting from sale of receivables under litigation (euro 13,202 thousand) are classified as **non-re-**

**curring events** (17.6% of the total). In 2012 non-recurring events included the gains on disposal of properties in Brazil and the income resulting from elimination of the earn-out associated with the acquisition in Russia, for a total of euro 29,646 thousand (12.3% of the total).

## 31. PERSONNEL EXPENSE

The breakdown of this account is as follows

(in thousands of euro)

	<b>2013</b>	<b>2012</b>
Wages and salaries	937,560	898,059
Social security and welfare contributions	168,049	193,306
Expenses for employees' leaving indemnity and similar costs (*)	29,498	31,396
Expenses for defined contribution pension funds	20,577	19,798
Expenses for defined benefit pension funds	923	811
Expenses for jubilee awards	888	2,594
Expenses for defined contribution healthcare plans	36,140	39,032
Other costs	18,126	8,931
	<b>1,211,761</b>	<b>1,193,927</b>

\* Includes Italian and foreign companies

Personnel expense includes **non-recurring events** for a total amount of euro 45,445 thousand (3.8% of the total), which include euro 25,447 thousand for restructuring costs (euro 28,827 thousand in 2012, or 2.4% of the total) and euro 19,998 thousand for charges related to the settlement of a lawsuit in Brazil.

## 32. AMORTISATION, DEPRECIATION AND IMPAIRMENT

The breakdown of this account is as follows

(in thousands of euro)

	<b>2013</b>	<b>2012</b>
Amortisation	19,016	11,342
Depreciation	269,917	260,065
Impairment of property, plant and equipment	7,559	10,839
	<b>296,492</b>	<b>282,246</b>

**Impairment** is essentially related to reduction of the anti-particulate filter activities (in China and Romania), also as consequence of the focus on the Tyre Business.