

Newsalert

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Italian Tax Authorities deny the 11% reduced withholding tax rate on dividends paid to foreign tax transparent vehicles held by EU/EEA pension funds

On 28 May 2020, the Italian Tax Authorities (“ITA”) issued Ruling No. 156 (the “**Ruling**”), providing guidelines on the tax treatment of dividends paid by Italian companies to a UK Authorized Contractual Scheme (“**ACS**”), entirely held by UK pension funds.

The ACS is a contractual scheme aimed at managing a pool of resources for investment purposes. From a regulatory perspective, the ACS is managed by a manager who is subject to either the UCITS Directive or to the AIFMD regimes, and is regulated by the Financial Conduct Authority of the United Kingdom. From a tax perspective, the ACS is fiscally transparent under UK tax laws.

I. Legal background

According to Article 27, paragraph 3, of Presidential Decree No. 600 of 29 September 1973, dividends distributed by Italian companies to their foreign shareholders are taxable upon distribution by way of a withholding tax (“**WHT**”) at the 26% statutory rate.

The WHT rate can be reduced under Double Tax Treaties, to the extent that the recipients are entitled to the relevant benefits. Further, the WHT rate can be reduced to 11%, if dividends are distributed to pension funds established in EU Member States and in States belonging to the European Economic Area (“**EEA**”) (“**EU/EEA pension funds**”).

II. The Ruling

The ruling request sought clarifications on whether:

- (i) until Brexit (*i.e.*, 31 December 2020), the ACS could benefit from the 11% WHT rate, despite the UK pension funds who participate in the ACS are not direct shareholders of the Italian distributing companies; and
- (ii) after Brexit (*i.e.*, 1 January 2021), a UK pension fund participating in the ACS could benefit from the 15% WHT rate under the Double Tax Treaty between the UK and Italy (the “DTT”).

In the Ruling, ITA maintained that the benefit of the 11% WHT rate on dividends is not available to the ACS, insofar as the ACS does not qualify as a pension fund and the plain wording of the law (*i.e.*, “*dividends paid to*”) would exclude that the 11% reduced WHT rate can be applied on a look-through basis to the beneficial owner of the dividends. Indeed, according to ITA, the 11% WHT rate can only be enjoyed by EU/EEA pension funds who are direct shareholders of the Italian company paying dividends.

With respect to the application of the DTT to a pension fund participating in the ACS, although the ACS is not itself a resident person under the DTT, ITA clarified that the DTT may apply to such UK pension fund on a tax transparency basis, insofar as ACS’s income is directly allocated to its participants irrespective of the financial distribution and that the UK pension fund incorporates ACS’s income in its own tax return.

Finally, ITA confirmed that the entitlement to the DTT occurs to the extent that the UK pension fund is liable to tax, even if only potentially and thus not actually subject to tax.

III. Remarks on the Ruling

The position taken by ITA with respect to entitlement to the DTT on a tax transparency basis is correct and constitutes a welcome confirmation.

On the other hand, the position denying the 11% WHT rate in case an EU/EEA pension fund is the beneficial owner of the dividends, but not the direct recipient, could be questioned.

Indeed, beneficial ownership clause has been normally applied by the same ITA with broader scope and the plain wording of the applicable provisions – “*dividends paid to*” – is not incompatible with the application of the 11% WHT rate to the beneficial owner of the dividends on a look-through basis.

Further, the position held by ITA, which is consistent with previous unpublished rulings, is now even more debatable. Indeed, pursuant to new provisions effective as of 1 January 2020, Italian-source dividends received by Italian simple partnerships (*società semplici*) are taxable in the hands of resident and non-resident partners according to their individual regime, thereby completely disregarding the simple partnership: in the light of this new legislative framework, the position of the Ruling may raise issues of compatibility with EU law, given that dividends flowing through an Italian simple partnership should be now taxable at 11% WHT rate, if received by EU/EEA pension funds.

As a final note, we highlight that dividends paid to Undertakings for Collective Investment (“**UCIs**”) established in Italy are exempt from any taxation, while UCIs established abroad are taxable by way of WHT: this tax treatment, which amounts to a discrimination of foreign UCIs, raises serious doubts of compatibility with EU law.

Since the ACS qualifies as a UCI fully compliant with a harmonized regulatory framework, any WHT levied on dividends paid to an ACS might be questioned also under this perspective.

For further information, please reach out to tax@chiomenti.net