

Italian Court of Cassation holds reduced dividend withholding tax is applicable on distributions to foreign pension funds

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Executive summary

By judgment No. 1967/2020,¹ recently made broadly available to the general public by local reporting, the Italian Court of Cassation (CC) affirmed that the reduced 1.65% dividend withholding tax (WHT) set forth under article 27, paragraph 3-ter, of Presidential Decree No. 600 of 29 September 1973 (the Decree), is applicable to a Spanish management company that in 2006 received dividend distributions from Italian resident entities on behalf of 11 Spanish pension funds.

The CC stated that the 1.65% WHT was applicable even if the Spanish pension funds were subject to corporate income tax at the rate of 0% in Spain and notwithstanding any exemption from corporate income tax due to particular objective exemptions linked to the nature of the corporate income, or taking into account the place where the business activity is carried out.

The CC also clarified that the provisions set forth under article 27, paragraph 3-ter of the Decree prevail over article 10 of the Treaty between Spain and Italy for the avoidance of double taxation (IT-ES DTT).

Detailed discussion

The case

The case examined by the CC concerns a refund claim filed with the Italian Tax Authorities (ITA) by a Spanish management company (Manco) that in 2006 received, on the behalf of 11 Spanish pension funds, dividend distributions from Italian resident entities. The paying entities had applied the 15% WHT, pursuant to article 10 of IT-ES DTT, while Manco held that the dividend should have benefited from the reduced 1.65% WHT provided by article 27, paragraph 3-ter of the Decree.²

Accordingly, Manco, on behalf of the pension funds, made a claim for a refund of the difference between the 15% WHT and the 1.65% rate by arguing that the dividend WHT withheld at the 15% rate was unlawful and in breach of the principles of non-discrimination, freedom of establishment and free movement of capital provided by the Treaty on the Functioning of the European Union (TFEU).³

Specifically, this is because the Italian resident entities would have taxed only 5% of dividend earned at 33% corporate income tax rate (i.e., $5\% * 33\% = 1.65\%$).

After a favorable outcome from the appellate tax court, the ITA appealed before the CC asking for the annulment of the appellate judgment challenging that the appellate judges:

- ▶ Had misinterpreted provisions under said article 27, paragraph 3⁴ of the Decree as in 2006 there was no more favorable dividend WHT applicable to foreign pension funds.
- ▶ Accordingly, they wrongly applied provisions under said article 27, paragraph 3-ter to the case at hand because the provisions under article 27, paragraph 3-ter should have applied to dividend distributions starting from 1 January 2008 and also because Italian source dividends paid to EU and EEA pension funds may have benefited from the 11% withholding tax but only starting from 29 July 2009.⁵
- ▶ Given that the provisions under article 27, paragraph 3-ter were not applicable, then only art. 10 of the IT-ES DTT (i.e., 15% WHT) would have applied to the case at hand.

The CC's judgment

Applicability of article 27, paragraph 3 of Presidential Decree No. 600 of 29 September 1973

The Italian CC stated that the Manco - on behalf of the Spanish pension funds - was eligible for the more favorable 1.65% WHT rate provided by article 27, paragraph 3-ter of the Decree.

This decision was grounded on the principles stated by the European Court of Justice (ECJ) in case C-540/07, published on 19 November 2009, following the infringement procedure started by the EU against Italy,⁶ for the violation of Article 56 (now 63) of the TFEU, because until 2008 Italy had applied a tax on dividends paid to EU corporate entities higher than the one applicable to Italian corporate entities.

In this regard, Italian resident corporate entities taxed only 5% of dividend earned at 33% corporate income tax rate for an effective tax rate of only 1.65% on dividend payouts from Italian resident entities while in contrast, Italian sourced dividend distributions to corporate entities settled in the EU and in the EEA was subject to the higher 27% internal dividend withholding tax provided by said article 27, paragraph 3.⁷

Applicability of the lower dividend WHT also to fiscal years prior than 2008

Furthermore, in order to grant full enforcement to judgment C-540/2007, in the instant case, the CC stated that the lower dividend withholding tax provided by Article 27, paragraph 3-ter, of the Decree should have also applied to the dividend paid before 1 January 2008, such as the 2006 dividend payout at stake.

The liable to tax requirement

With reference to subjective requirements, the CC clarified that the lower WHT is applicable for those foreign entities that are organized in the form of a corporation or other equivalent legal forms, resident in an EU Member State or within the EEA, liable to corporate income tax in their state of residence and that may not benefit from Parent-Subsidiary 0% dividend WHT.⁸

In this regard, the CC also stated that the reduced Italian WHT at stake should have been applied to those corporate entities resident within the EU and EEA which are liable to corporate income tax in their state of residence but that do not pay corporate income tax due to particular objective exemptions linked to the nature of their corporate income, or because of the place where the business activity is carried out.

Applicability of article 10 of the IT-ES DTT

Regarding the relationship between the domestic reduced WHT rates on dividends and the DTT provisions, the CC clarified that article 10 of the IT-ES DTT does not introduce specific WHT rules prevailing on the domestic taxation but establishes only a limit to the maximum rate that can be applied under the national legislation.

In the instant case, the 15% rate provided for the DTT however was not able to remedy the discrimination created by the Italian legislation in the taxation of outbound dividends in respect to dividend paid to Italian entities.

This discrimination can only be solved by applying the reduced 1.65% rate provided for by article 27, Para. 3-ter and consequently this article should have been applied in the case at stake instead of the IT-ES DTT rate.

The CC then concluded that the lower 1.65% WHT provided by article 27, paragraph 3-ter of the Decree must apply to Italian source dividends paid out to Manco acting on behalf of the pension funds that were liable to Spanish corporate income tax at 0% and that provisions carried by said article 27, paragraph 3-ter prevail over art. 10 of the IT-ES DTT.

Impact on business

Judgment No. 1967/2020 is precedential case law to be used in order to:

- ▶ Make a dividend WHT refund claim based upon non-discrimination principles where a higher internal dividend WHT has been applied.
- ▶ Manage pending dividend WHT refund claims by following up with the ITA to request the refund.
- ▶ Consider grounds for possible appeals against either the silent or explicit denial of the refund.
- ▶ Apply for additional refunds to be claimed where just DTT claims have been filed.⁹

Endnotes

1. This case was published on 29 January 2020.
2. Under the provision of article 27, paragraph 3-ter of Presidential Decree No. 600 of 29 September 1973, a dividend paid to a company which *does not* qualify for the exemption under the European Union (EU) Parent Subsidiary Directive, but:
 - i. Is organized in the form of a corporation or other equivalent legal form
 - ii. Is resident in an EU Member State or within the European Economic Area (EEA)
 - iii. Is subject to corporate income tax in its State of residence

Are subject to a reduced WHT of 1.20% (1.65% at the time of the facts, 1.375% starting from 2008 and 1.2% starting from 2017). The reduced WHT rate is aimed at equating the taxation of the outbound dividend to that of domestic intercompany dividend, whereby dividends are not subject to withholding and are partially exempt, under Italy's participation exemption regime, resulting in an effective tax rate of 1.20% in the hands of the corporate shareholder (in compliance with the non-discrimination principle and free movement of capital provision of the TFEU).
3. Respectively articles 18 (formerly 12), 49 (formerly 43) and 63 (formerly 56).
4. Which provided for a general 27% (now 26%) dividend withholding tax on dividend payouts to foreign recipients.
5. Law 88 of 7 July 2009, granting the reduced domestic withholding tax rate applicable to Italian dividend paid to EU and EEA pension funds, published in the Italian *Official Gazette* number 161 on 14 July 2009, was effective since 29 July 2009. Shareholders could apply to obtain the new 11% domestic withholding tax rate provided that the following conditions were both met:
 - i. The recipient of the dividend is an entity that is established as a pension fund.
 - ii. The pension fund is resident for tax purposes in an EU Member State or in an EEA country included in the new Italian White List.
6. Which led to the implementation of article 27, paragraph 3-ter of the Decree.
7. See ECJ judgment of 19 November 2009, Commission/Italy, C-540/07, paragraph 64. According to the ECJ, the less favorable tax treatment imposed by the Italian legislation on dividend distributed to companies established in other Member States had constitute a restriction on the free movement of capital incompatible with Article 56 (now 63) of the TFEU.
8. According to internal provision under article 27-bis, paragraph 1 of the Decree, the relevant participation threshold for benefiting from the Parent- Subsidiary 0% WHT has been reduced from 25% to 20% for dividend payouts occurred since 1 January 2005, then to 15% for dividend payouts occurred since 1 January 2007 and to 10% for dividend payouts occurred since 1 January 2009.
9. In this regard, please note that the relevant statute of limitations is 48 months since the dividend WHT has been levied i.e., all or part of 2016 may still be covered if filing during 2020.

For additional information with respect to this Alert, please contact the following:

Studio Legale Tributario, FSO Head of Tax, Milan

- ▶ Giuseppe Marco Ragusa marco.ragusa@it.ey.com

Studio Legale Tributario, FSO Global Compliance and Reporting - Wealth Asset Management, Milan

- ▶ Paolo Zucca paolo.zucca@it.ey.com
- ▶ Gabriella Cammarota gabriella.cammarota@it.ey.com

Studio Legale Tributario, FSO International Tax and Transaction Services, Milan

- ▶ Giancarlo Tardio giancarlo.tardio@it.ey.com

Studio Legale Tributario, FSO Tax Controversy, Milan

- ▶ Alberto Giorgi alberto.giorgi@it.ey.com
- ▶ Federico Pagani federico.pagani@it.ey.com

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