



Italy: Court decision on the withholding tax exemption for outbound interest payments

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Offices

Milan

Via Vittor Pisani 31, 20124
T: +39 02 676441

Ancona

Via I° Maggio 150/a, 60131
T: +39 071 2916378

Bologna

Via Innocenzo Malvasia 6, 40131
T: +39 051 4392711

Florence

Viale Niccolò Machiavelli 29, 50125
T: +39 055 261961

Genoa

P.zza della Vittoria 15/12, 16121
T: +39 010 5702225

Naples

Via F. Caracciolo 17, 80122
T: +39 081 662617

Padua

Piazza Salvemini 2, 35131
T: +39 049 8239611

Perugia

Via Campo di Marte 19, 06124
T: +39 075 5734518

Pescara

P.zza Duca D'Aosta 31, 65121
T: +39 085 4210479

Rome

Via Curtatone 3, 00185
T: +39 06 809631

Turin

C.so Vittorio Emanuele II 48, 10123
T: +39 011 883166

Verona

Via Leone Pancaldo 68, 37138
T: +39 045 8114111

Testing beneficial ownership requirements on a look-through basis for the application of the Italian withholding tax exemption on cross-border interest payments

Regional Tax Court of Lombardy Decision no. 295 of 3 February 2022

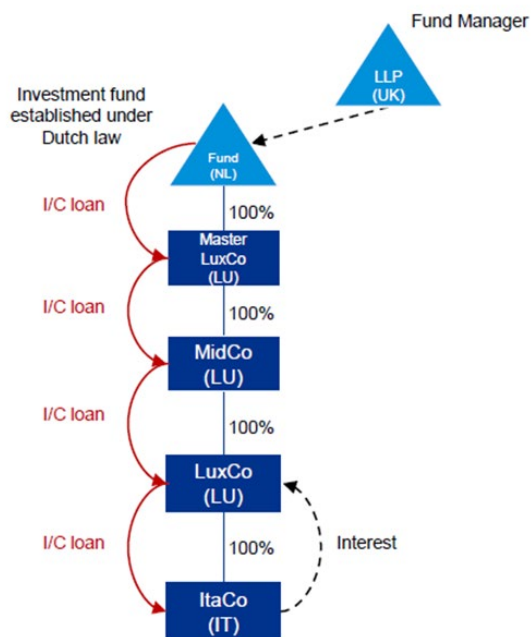
On 3 February 2022 the Regional Tax Court of Lombardy (the second-tier court), deciding on a case concerning outbound interest payments from an Italian company ('ItaCo') to its Luxembourg parent company ('LuxCo'), stated that a look-through approach is applicable to both:

- the withholding tax ('WHT') exemption under the Interest and Royalties Directive 2003/49/EU ('IRD WHT Exemption') and
- the WHT exemption under article 26(5-*bis*) of Presidential Decree no. 600/1973 ('Direct Lending WHT Exemption').

Therefore, it continued, the IRD WHT Exemption can be applied even if the beneficial owner, eligible under the IRD, is not the direct recipient of the interest and the Direct Lending WHT Exemption can be applied even if a foreign qualifying investment fund, set up in a country listed as a cooperative jurisdiction, is not the direct recipient of the payments but the ultimate beneficial owner.

Background

The Regional Tax Court of Lombardy decided on a tax claim related to the structure portrayed below, already rejected by the Provincial Tax Court.



ItaCo paid interest on an intra-group loan to LuxCo and, based on the IRD, no WHT was applied on the interest payment.

LuxCo is wholly owned by MidCo (Luxembourg tax resident), which, in turn, is wholly owned by Master LuxCo (Luxembourg tax resident). Master LuxCo, in turn, is wholly owned by a Dutch investment fund, whose fund manager is a UK LLP, FCA registered.

The Italian tax authority ('ITA') argued that LuxCo, not being the beneficial owner of the interest payments, was ineligible for the IRD WHT Exemption and, therefore, imposed 26% domestic WHT, plus penalties.

The Provincial Tax Court decided in favor of the ITA. However, the Regional Tax Court, in the appeal decision, reversed the decision of the Provincial Tax Court.

The decision

The Regional Tax Court stated that the IRD WHT Exemption applies even if the beneficial owner, which would qualify for the exemption per se, is not the direct recipient of the interest.

The fact that the immediate recipient of the interest in an EU state does not qualify as its 'beneficial owner' does not jeopardize the application of the IRD WHT Exemption where the beneficial owner (the indirect recipient) is eligible for it and satisfies the necessary requirements.

This position seems grounded on point no. 94 of the so-called ECJ Danish Cases (joined Cases C-115/16, C-118/16, C-119/16 and C-299/16).

In the case at hand, however, ItaCo was unable to prove that Master LuxCo qualified as the beneficial owner of the interest payment (which was the taxpayer's line of defense).

The judges also stated that the Direct Lending WHT Exemption is applicable to interest paid on medium to long-term loans (i.e. maturity longer than 18 months and one day) granted by non-Italian qualifying investment funds (whether subject to tax or not) set up in a country listed as a cooperative jurisdiction in the Ministerial Decree of 4 September 1996 and subject to regulatory supervision in their home country, to the extent the provisions of Legislative Decree no. 385/1993 (the 'Italian Banking Law') are respected.

Lastly, the judges confirmed that the look-through approach described above should not only be applicable to the IRD WHT Exemption, but also to the Direct Lending WHT Exemption, as the aim of eliminating double taxation is the common rationale behind both these exemptions.

KPMG commentary

Regional Tax Court of Lombardy Decision no. 295 of 3 February 2022 is quite innovative and contrasts with a different view taken by the ITA in several tax audits and in Resolution no. 76 of 12 August 2019.

This decision upholds a precedent decision of the Provincial Tax Court of Milan on a similar case (Decision no. 4708 of 11 November 2019).

It remains to be seen what position the Supreme Court will take in the appeal that is likely to be filed against Decision no. 295/2022.

Should the decision in the case be favorable to the taxpayer and consolidate into a trend, this could have a favorable impact on Italian inbound investments.

Contacts

KPMG in Italy, Tax & Legal

Stefano Cervo

Country Leader

Deal Advisory, M&A Tax

E: scervo@kpmg.it

T: +39 02 67644811

kpmg.com/it

kpmg.com/it/socialmedia



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