KPMG

Italy: WHT on dividends distributed by Italian entities

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Withholding tax on dividends distributed by Italian entities

The Italian Tax Authority clarifies the case of dividends distributed to pension funds participating in an Authorized Contractual Scheme

On 28 May 2020 the Italian Tax Authority *(Agenzia delle Entrate)* issued Ruling no. 156 regarding the withholding tax (WHT) regime applicable to dividends distributed by Italian entities to an Authorized Contractual Scheme (ACS), whose investors are pension funds.

A taxpayer had asked the Italian Tax Authority if:

a) Article 27(3) of Presidential Decree no.600/1973, which provides for an 11 percent WHT rate (instead of 26 percent) on dividends paid by Italian entities to pension funds set up in EU or EEA countries, could be applied to the ACS until the United Kingdom’s exit from the EU;

b) Article 10(2) of the UK-Italy DTT, which provides for a 15 percent WHT rate (instead of 26 percent) could be applied to the participating pension funds even after the United Kingdom’s exit from the EU.

The Italian Tax Authority replied that:

a) On the basis of the withdrawal agreement between the UK and the EU, signed on 18 October 2019 and ratified on 30 January 2020, the UK will no longer be part of the customs and fiscal territory of the EU at the end of the transition period (31 December 2020); therefore, if the UK and the EU do not sign an agreement before this date, the UK will be considered a third State in its relationship with all the EU Member States;

b) In any case, the ACS cannot benefit from the 11 percent WHT or the 15 percent UK-Italy treaty rate; only the participating pension funds (and not the ACS) can benefit from this treaty rate.

An ACS is a form of collective investment fund (similar to a communion of properties), held and managed on behalf of a plurality of investors who are co-owners of the assets. Therefore an ACS does not qualify as a pension fund. It does not have a legal personality and, therefore, is not subject to tax and is fiscally transparent.

In this instance, the ACS is managed by an asset management company, regulated by the Financial Conduct Authority (FCA). Managing the pooled assets of nine Midlands-based local government pension funds, this management company is authorized to operate as an Alternative Investment Fund Manager (AIFM). Exclusively in this capacity, the company acts as the operator of the ACS collective investment vehicle.

Article 27(3) of Presidential Decree no. 600/1973 provides for an 11 percent WHT rate (instead of 26 percent) on dividends **paid** by Italian entities to **pension funds** set up in EU or EEA countries. Therefore, based on the literal wording of article 27(3), this provision does not refer to the ultimate beneficiaries of dividends (which, in the case at hand, are the pension funds participating in the ACS) but to the **first recipient of the payment** (the ACS). However, the ACS is not eligible for the 11 percent rate since it does not qualify as a pension fund. Therefore, Italian companies must apply the 26 percent WHT rate on dividends paid to the ACS.

Likewise, the ACS cannot directly benefit from the reduced rate of 15 percent established in the UK-Italy DTT since it cannot be considered a 'resident person'. However, the pension funds participating in the ACS may ask for the application of the reduced treaty rate if they fulfill all the requirements stipulated in the DTT. Accordingly, the Italian Tax Authority considers the participating pension funds to be eligible for the treaty conditions since they are partnership partners (as interpreted by the Commentary on article 1 of the OECD Model).

Therefore, pension funds may benefit from the treaty if:

a) the income arising from the collective investments is allocated to each participant in proportion to the shares it owns, as if it had received the income directly, regardless of distribution;

b) they are liable to income tax, even if exempt.

It is important to underline that this principle can be applied not only to pension funds (as in the case at hand) but also to all entities that qualify for treaty benefits (e.g. some kinds of investment funds).

In addition, the Italian Tax Authority has specified that WHT agents are not obliged to apply the treaty rate (generally 15 percent); this means that, in many cases, foreign entities have suffered (and will suffer in the future) the 26 percent WHT rate on dividends distributed by Italian companies instead of the reduced treaty rate, even if they have fulfilled the treaty requirements. In this circumstance, WHT agents are strongly recommended to file a refund claim for the difference between the 26 percent domestic rate levied and the treaty rate.

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