



Dividends to non-EU shareholders: The Italian Supreme Tax Court rules on potential discriminatory tax treatment

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In brief

The Italian Supreme Tax Court has taken the position that the higher withholding tax treatment of dividends paid by Italian resident companies to foreign investment funds vs the tax treatment applied to dividends to Italian investment funds was unreasonably discriminatory, hence causing an unjustifiable restriction to the movement of capital and therefore breaching European Law (Treaty of the Functioning of the European Union [TFEU]).

The Italian Supreme Tax Court (2022 Decisions no. 25691, 25692 and 25693) reached the same conclusion regarding Italian source dividends paid to non-EU pension funds, which were subject to worse tax treatment compared to Italian pension funds.

In both cases, the different tax treatment was found to constitute an obstacle to investments in Europe, following that the above funds were entitled to the refund of taxes paid or suffered in excess of the taxes that an Italian fund would have paid or suffered upon the same distribution.

Although referring specifically to investment funds and to pension funds, the above Italian Tax Court's Decisions make clear that valid argument should be available to support the view that dividend payments to non-EU companies should not be subject to higher taxation than the taxation that would have applied if an Italian or an EU company had received that dividend, which is 1.2% of the gross dividend amount.

Accordingly, Japanese resident corporations (as well as non-EU sub-holding companies, such as UK corporations) should be entitled to claim the refund of taxes withheld by their Italian resident subsidiaries at the time of payment of dividends.

Action item: Japanese headquarters should consider the potential for conducting the refund procedure for taxes withheld by their (controlled) Italian subsidiaries at the time of payment of dividends to their Japanese parent or their non-EU (sub-holding) direct parent over the last four years.

In detail

Article 63 of the TFEU states that 'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited'. The freedom of movement of capital guaranteed by Article 63 is the only TFEU fundamental freedom which also applies to non-EU States.

The need to preserve the free movement of capital is not unconditional, as restrictions may still apply, provided the restriction is 'justified' in consideration of objective circumstances that make it clear that a given case is not comparable to the base case. It follows that the given case and the base case may well be subject to a different treatment, even if such different treatment entails a restriction (to the freedom of movement of capital).

In July 2022, the Italian Supreme Court was asked to rule on the tax treatment applied to Italian source dividends paid to US investment funds and answer the question of whether the different (worse) tax treatment to which those investment funds were subject on the basis of the applicable tax laws, including the applicable Treaty against double taxation (15%), breached the TFEU (Article 63). The base case for the comparison was the case of an Italian investment fund receiving a dividend and the taxation arising thereof (12.5% substitute tax).

According to the Supreme Court (2022 Decisions, no. 21454, 21475, 21480, 21481 e 21482) the different tax treatment applied to these foreign investment funds was deemed to breach the TFEU, as it had the possibility to disincentivise investments in the EU, therefore entailing a restriction to the freedom of movement of capital, without any motivated rationale behind it. On such basis, the Court stated the entitlement of the investment funds to a refund of the withholding tax suffered at payment, for the portion exceeding the amount to which an Italian investment fund would have been subjected if receiving the same dividend.

It is worth noting that the Italian Supreme Court (Decisions no. 25691, 25692 and 25693 2022) ruled substantially in the same way in connection with dividends paid to non-EU pension funds that were subject to a worse tax treatment than Italian pension funds.

The above Tax Court Decisions should entitle Japanese headquarters holding control over an Italy resident company, directly or through a non-European resident sub-holding company (such as a UK company) to obtain the refund of taxes withheld by their Italian resident subsidiaries at the time of payment of dividends.

For illustrative purposes, the withholding tax rate applied on dividends paid to Japanese shareholders should not exceed 1.2% of the gross dividend, resulting in the potential for a refund claim ranging from 8.8% or from 13.8% depending (if Japan is the country of residence of the recipient) on the withholding tax rate applied at payment (10% or 15% based on Article 10, paragraph 2 of the Italy-Japan Tax Treaty).

The ability to claim the refund of taxes withheld is not adversely affected by the fact that the Italian subsidiary applied the withholding tax rate as set-forth by the Treaty and the (non-EU) jurisdiction of residence of the recipient.

Observation: Japanese headquarters interested in this opportunity should be aware that the Italian tax authorities will likely deny the refund at first by way of a silent rejection. The refund applicant will then need to appeal this rejection before the tax Court after 90 days.

Let's talk

For a deeper discussion on this opportunity, please contact:

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