

Italian Supreme Court rules that withholding taxes levied on dividends distributed to German and US investment funds are incompatible with EU law

On 6-7 July 2022, the Tax Section of the Italian Supreme Court (“*Corte di Cassazione*”, the highest Court in Italy as regards tax matters) issued seven important judgments in which it ruled that Italian withholding taxes levied on dividends distributed to a German investment fund and six US investment funds are incompatible with EU law.

The fact of the cases

All the cases originate from different claims submitted to the Italian Tax Authorities by foreign investment funds (a German open-end investment fund and six US investment funds based in California) requesting the refund of the dividend withholding taxes suffered with respect to dividends received from Italian listed companies during the year 2003 (as regards the German investment fund) and the years 2007, 2008, 2009 and 2010 (as regards the US investment funds).

All the funds benefited from the reduced dividend withholding tax of 15% in accordance with the applicable double tax treaty into force between Italy and the respective foreign country concerned.

The requests for refund were based exclusively on EU law, in particular on the breach of Article 63 of the TFEU (free movement of capital) by the Italian legislator to the extent the legislation provided - during the years at issue - for the application of dividend withholding tax at the rate of 27% in the case of non-resident investment funds (or the reduced double tax treaty rate, in the cases at issue, equal to 15%) whilst Italian investment funds were not subject to withholding tax and were only subject to a taxation of 12,5% - which could be reduced to 5% or 0% under specific circumstances - on the net income accrued in each tax period calculated based on the difference between the value of the fund's net assets at the end of each calendar year and the value of the assets at the beginning of the same year, thus discriminating against foreign funds.

In the absence of replies from the Italian Tax Authorities, the investment funds filed several appeals before the Pescara Tax Court of First Instance which rejected all the appeals. The claimants appealed the negative judgments to the Pescara Tax Court of Appeal which also rejected all the appeals. Finally, the claimants appealed the cases to the Italian Supreme Court which instead upheld the claimant requests for refunds.

The Italian Supreme Court judgments

Judgment related to the German investment fund

The Italian Supreme Court Judges firstly acknowledged the absence of specific objections from the Italian Tax Authorities in the course of the litigation as regard the comparability from both a legal and regulatory standpoint between the German claimant – an open-end investment fund subject to the supervision of the German financial authority - and an Italian open-end investment fund.

Notably, the fact that the claimant was fully owned by a German insurance company did not affect the comparability of the German fund with an Italian open-end investment fund – which under Italian law requires multiple investors - due to the fact the sole investor, being an institutional investor, was in any case representing a plurality of separate interests, collectively managed.

The Italian Supreme Court Judges further highlighted that the application of the dividend withholding tax in the case of the non-resident German investment fund was solely due to the fact that the foreign investment fund was not resident in Italy but rather in Germany, highlighting that if the same type of investment was performed through the use of an Italian investment fund, such Italian investment fund vehicle would not have been subject to such taxation. Accordingly, the Supreme Court considered the difference of tax treatment as an unjustified infringement of Art. 63 of the TFEU ordering a full refund of the withholding tax suffered by the claimant.

Judgments related to the US investment funds

The Italian Supreme Court Judges, as a preliminary remark, highlighted that the Italian dividend taxation regime as regards foreign investment funds had already been scrutinised by the European Commission with specific reference to the discriminatory tax treatment of investment funds resident in the EU (EU PILOT 8105/15/TAXU) and this had eventually lead to the abolition of the dividend withholding tax for EU qualified investment funds (with effect only from 2021 onwards, see our previous newsalert [here](#)).

The Italian Supreme Court Judges further acknowledged that notwithstanding the fact that the claimants were investment funds governed by US law and therefore they were not resident in a Member State of the EU, the principle of equal treatment enshrined in Art. 63 TFEU applies also as regards taxpayers resident in third countries, like the US.

Accordingly, making reference to the relevant jurisprudence of the CJEU on the discriminatory tax treatment of dividend withholding tax for foreign investment funds resident outside the EU (see *Emerging Markets*, C-190/12), the Italian Supreme Court Judges upheld the claimants positions confirming that the difference of tax treatment between the claimants – subject to a final withholding tax of 15% - and a comparable Italian investment funds – only subject to taxation of 12,5% on the net income accrued – constituted an unjustified infringement of Art. 63 of the TFEU and, as requested by the claimants, ordered the refund of the withholding tax suffered equal to the difference between the rate of 15% and the rate of 12,5%.

Takeaway

These judgments from the Italian Supreme Court are of fundamental importance. The Italian Supreme Court is the highest Court in Italy with the specific role of ensuring the uniform interpretation of the law, including tax law provisions.

The principle expressed by the Italian Supreme Court with these judgments regarding the discriminatory tax treatment suffered by foreign EU and non-EU investment funds in Italy on dividends received, although it is based on the Italian tax regime applicable until July 2011, is still relevant today. In fact, starting from 1 July 2011, Italian investment funds are no longer subject to taxation at the rate of 12,5% on net income accrued (or the reduced rates if applicable) but exempt, thus putting Italian investment funds in an even better position – compared to foreign investment funds – than the one addressed in these cases. This was also recently acknowledged by the Pescara Tax Court of First instance (see our previous newsalert [here](#)).

The Italian Supreme Court, following the CJEU jurisprudence on the matter, also made clear that the principle of equal treatment as regard the taxation of cross-border dividends applies in favour of investment funds resident in third countries outside the EU granting adequate exchange of information.

Moreover, the Italian Supreme Court, as the Court of last instance with respect to litigation in Italy, is obliged to refer matters to the CJEU in any case where there is doubt concerning the interpretation of EU law. In the judgments under analysis the claimants asked the Italian Supreme Court - as an alternative request to the acceptance of the main application - to refer the matter to the CJEU. However, the Italian Supreme Court by upholding the claimants' main requests made clear that there was no need to refer the matter to the CJEU.

It is worth noting that the Italian lawmaker abolished the dividend withholding tax for qualified EU investment funds but only starting from 1 January 2021 and it did not extend the exemption to non-EU investment funds (see our previous newsalert [here](#)). The non exemption from the dividend withholding tax for qualified non-EU investment funds (and for EU funds prior to 1 January 2021) is still contrary to EU law, as confirmed by the Italian Supreme Court with the judgments at hand.

For this reason, both EU and non-EU investment funds should consider filing refund claims for the periods not yet statute barred (dividends paid from September 2018 onwards) in order to safeguard their rights to any refund.

Let's talk

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