# Real Estate Tax Services News

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# Proposed abolition of Italian taxation on dividends and capital gains earned by EU/EEA investment funds

## In brief

The first draft of the 2021 Italian Budget legislation provides for the abolition of domestic taxation on Italian dividends and capital gains earned by UCITSs and investment funds managed by regulated AIFMs in compliance with the Alternative Investment Fund Managers Directive (AIFMD) based in Countries of the European Union (EU) and of the European Economic Area (EEA). If this provision is enacted, the tax exemption will apply to dividends distributed and capital gains realised on or after 1 January 2021.

## The provisions in the draft 2021 Italian Budget legislation

### Background

Under the current Italian tax regime, Italian UCITSs and Alternative Investment Funds (AIFs) are exempt from Italian income taxation, provided they, or their Managers, are regulated. Consequently, they are not subject to any levy on Italian dividends and capital gains earned.

Conversely, similar foreign funds which collect Italian source dividends (in the case of a direct investment into Italian limited companies distributing such dividends) are subject to final Italian withholding tax (WHT) at source (currently with the rate of 26%, with possibility of partial refund only).

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In respect of capital gains, the same foreign entities which own a “qualified” interest in an Italian company (ie, exceeding, in terms of voting rights and equity ownership, 2% and 5% or 20% and 25% respectively, if the company is listed or not-listed) are liable to Italian taxation, currently at 26%. For capital gains on “non-qualified” shareholdings, a capital gain tax exemption is already available in domestic law. However, the tax exemption on Italian capital gains may only be claimed under double tax treaties (DTTs), if there is any, and provided there is no clause which allocates the right to tax to the source state.

The new Budget legislation, as currently drafted, intends to prevent this possible discrimination going forward, at least with respect to investment funds based in Countries of the EU and of the EEA which allow the exchange of tax information with Italy (ie, included in the Italian “White List”).

### The draft provisions

In particular, the draft Budget legislation states the following:

- The Italian WHT applying to dividends distributed by Italian limited companies does not apply to foreign undertakings established for the collective investment of savings (Italian acronym: OICR) which are compliant with the EU Directive 2009/65/CE dated 13 July 2009 (ie, harmonised UCITS IV) and to those undertakings not compliant with this Directive (thus not harmonised) whose managers are regulated in their home countries pursuant to EU Directive 2011/61/UE dated 8 June 2011, provided they are set up in EU Member States and/or EEA countries which allow an adequate exchange of tax information with Italy. This exemption is appliable to dividends distributed on or after the enforcement of this provision (ie, 1 January 2021).
- Capital gains and losses derived from “qualified” shareholdings are not subject to Italian income taxation (currently applicable by way of a ‘substitute’ (alternative) tax) when earned by the foreign investment funds mentioned above. This exemption will apply to capital gains and losses earned on or after the enactment of these provisions (ie, 1 January 2021).

For completeness, it should be noted that the draft new provisions do not consider the WHT applicable to dividends distributed by SIIQs (ie, the Italian REIT) from tax exempt profits, whose application is regulated by a different piece of legislation from that subject to amendment by the 2021 Budget legislation, but which provides for a similar difference between Italian and foreign regulated investment funds.

## Our view

The tax exemptions under discussion, if enacted, will impact on how EU and EEA based regulated investment funds are able to structure their investments in Italian assets, because direct investment in Italian asset companies will be incentivised.

In addition, indirect investments through foreign corporate structures may benefit from this potential new Italian tax regime. Indeed, if the intermediate corporate structure is not significantly tax motivated, it may be expected that the tax exemptions applied (pursuant to the EU Parent-Subsidiary Directive and, for example, under a DTT, having regard to, respectively, dividends collected and capital gains earned by the foreign EU corporate direct shareholders with respect to their Italian subsidiaries) should no longer be challenged (for dividends accrued and capital gains as of the law change) on the basis of benefiting from more favourable tax regimes.

The Budget legislation will need to be approved before the end of the year. We recommend following the progress of the legislation through the Parliament to monitor any potential amendments to the provisions.

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