July 2022

**TAX FLASH**

# The Italian tax regime of outbound dividends distributed to US investment funds breaches the principle of free movement of capital provided by Art. 63(1) TFEU

*Commentary on the Judgments of the Italian Supreme Court Nos. 21454, 21475, 21479, 21480, 21481 and 21482 of July 6, 2022*


## Summary

In Judgments Nos. 21454, 21475, 21479, 21480, 21481 and 21482 of July 6, 2022 ("**Judgments**"), the Italian Supreme Court has stated that dividends distributed – before FY 2011 – by resident companies to US open-end investment funds shall be subject to withholding tax at the same rate applicable from time to time to Italian resident funds[1].

The principle of law expressed by the Italian Supreme Court seems to provide answers to current issues, specifically regarding the persistent discrimination of non-EU investment funds in the domestic legislation, as briefly discussed below.


## The cases in dispute

The cases addressed by the Italian Supreme Court concern dividends paid in the FYs 2007 to 2010 by Italian resident companies to US resident investment funds, which were subject to the 15% withholding tax provided for by Art. 10 of the Double Taxation Convention between Italy and USA ("**ITA-USA DTC**").

The US investment funds claimed that the application of such conventional withholding tax would constitute a restriction in violation of the principle of free movement of capital under Art. 63(1) TFEU[2], by reason of the fact that in the same FYs the Italian funds were taxed at a lower rate of 12.5% under Art. 9(2) of Law No. 77/1983.

Endorsing the complaints of the plaintiff funds, the Supreme Court has stated that the taxpayer's residence in a non-EU State does not in principle preclude the applicability of EU principle of free movement of capital, which is unilaterally granted to third countries by the EU Member States, even outside the European framework, and could be limited

[1] Similar judgments, concerning the tax regime provided for EU (German) funds, were issued on July 7, 2022. See judgments Nos. 21581, 21587, 21598, 21599, 21610, 21641, 21642, 21643, 21645, 21647, of July 7, 2022.

[2] Pursuant to which «… *all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited*».

only on the basis of justified and proportionate restrictions[3]. Moreover, the full scope of the EU principle is not limited by the circumstance that the discrimination would result from the application of a conventional provision (namely, Art. 10 of ITA-USA DTC), as one should bear in mind that the EU principles find direct applicability in the interpretation of the domestic and conventional law of the EU Member States. Consequently, there is an obligation on the national courts and the public administration to interpret the (domestic or) conventional provisions in accordance with European law. In cases where such consistent interpretation should not be possible, all necessary actions must be taken to overcome the conflict between the provisions of the two legal systems, first by disapplying those (domestic or) conventional rules that conflict with the EU principles.

That said, the Supreme Court found that the different tax treatment applied to Italian outbound dividends distributed to foreign investment funds prior to FYs 2011, compared to that applicable to similar Italian investment funds, constitutes a discrimination in contrast with Art. 63(1) TFEU.

**Potential implications of the Judgments on the tax regime of non-EU funds**

The principle of law set out by the Supreme Court is consistent with a strand of case law of the European Court of Justice regarding discrimination against foreign funds. To this end, it is worth mentioning that on several occasions the European Court has found that Art. 63 TFEU must be interpreted as precluding legislation of a Member State which provides different (and penalizing) tax treatment for non-resident investment funds than that applicable to similar resident funds[4].

In fact, doubts about the consistency with EU law of the Italian tax regime applied to outbound dividends and capital gains of foreign investment funds established in EU/EEA Member States have been brought to the attention of the European Commission[5]. Therefore, the Italian Budget Law for 2021[6] has introduced significant changes to the rules concerning the taxation of domestic-source income received by non-resident investment funds, intending to remedy such discriminatory tax treatment that resulted from the previous regime. In particular, the amendment to Italian tax law – starting from 1 January 2021 – sought to equalize the treatment of domestic and comparable EU/EEA

[3] In that regard the Supreme Court recalls the EU settled case law, in particular *Emerging Markets*, Case C-190/12, in which the ECJ dealt with discrimination against US investment funds, and found that only the lack of effective exchange of information may justify a differential tax treatment of non-EU funds.
[4] See Case C-545/19, *AllianzGI-Fonds*; Case C-156/17, *Ka Deka*; and Case C-480/19. See also Case C-303/07, *Aberdeen*; and Cases C-338/11 to C-347/11, *Santander*.
[5] See EU PILOT 8105/15/TAXU. Under the tax regime in place before 2021, dividends paid to resident funds were exempt from withholding tax, while dividends paid to foreign funds were subject to source taxation at the ordinary rate or at the lower rate provided for by tax treaties. Symmetrically, the previous regime exempted capital gains from the disposal of domestic qualified shareholding realized by resident funds, taxing the same gains when realized by foreign funds.
[6] See Art. 1(631-633) of Italian Law No. 178 of 30 December 2020.

investment funds by extending the tax exemption granted to domestic funds under certain conditions.

At this point, the question arises as to whether the current national legislation complies with EU free movement of capital principle, insofar as it does not extend the tax exemption on outbound dividends and capital gains to comparable non-EU funds subject to regulatory supervision, established in third countries that exchange information with Italy.

In this regard, although the aforementioned Judgments transpose the principle of Art. 63 TFEU in Italy only with reference to the tax regime applicable to foreign funds prior to FY 2011, the principle of law set out by the Supreme Court seems to apply also in relation to the subsequent tax regimes in force from time to time until date. Indeed, the Supreme Court itself recalls in its judgments, in support of its reasoning, the legislative changes made on the matter by the Italian Budget Law for 2021.

These Judgments, therefore, for all the reasons stated above, support doubts about the lawfulness of the new tax framework with respect to non-EU investment funds, against which discrimination in violation of EU free-movement of capital persists. In that respect, legislative changes in 2021 should not be considered sufficient to overcome the non-consistency of Italian legislation with the EU law with respect to qualified non-EU funds.

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