Master in International Taxation
(University of Hamburg)
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2nd Joint Seminar

Tax Havens in the Age of Global Standards: a Comparative Analysis between Germany and Italy

(University of Hamburg, 4th March 2011)

Subtopic IV) – The single legal instruments

4. Dividends distributed to residents in Tax Havens

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The Italian Tax Legislation

- ✓ Presidential Decree n.600/1973: articles n. 27, paragraph 3, and 27 bis.

The Italian tax rule in brief

Dividends

paid to non resident entities without a permanent establishment (PE) in Italy are subject **to a withholding tax rate of 27%.**

The tax rate

is reduced to 12.5% for savings shares and to 11% for shares held by pension funds incorporated in an EU Member State or in an EEA Member State included in a so called "white list".

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What do "*dividends*" stand for?

<u>Dividends</u> refers to:

- ❖ profits raising from shares
- ❖ financial instruments assimilated to shares
- ❖ contracts of association (different from the joint venture for the lack of a new legal independent structure)

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Where else does the witholding tax apply?

The withholding tax rate of the 27% is also applied **on the part of earnings related to not deductible interests** deriving from the application of the *thin capitalization rule* (abolished by the Law n. 244/2007 and still operating for the fiscal year ending at the 31.12.2007).

But

The Circular 26/E of the 2004 of the Italian Tax Administration pointed out that as the calculation of the over financial exposure is made at the end of the fiscal period, the withholding tax to apply during the fiscal year is at the rate of 12,50% (**the rate provided for the payments of interests**). Anyway, in case of payment to a resident in tax havens this last mentioned rate is at 27%, as well. So no difference comes out.

Dividends distributed to residents in Tax Havens

Moreover…

<u>The witholding tax has to be </u>applied on the distribution of legal and some other available reserves, on the amounts due in case of liquidation, capital reduction, shareholders’ withdrawal, exclusion and ransom.

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Dividends distributed to residents in Tax Havens

In other circumstances *(1)…*

<u>Dividends paid to entities which are subject to a corporate tax in other EU or EEA Member States included in a so called "white list" are subject to a withholding tax or substitute tax at a rate of 1.375%,</u> starting from the distribution of dividends out of profits realized in fiscal year 2008,

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In other circumstances *(2)…*

Dividends paid to companies resident in other EU Member States, incorporated in a form provided for by the Directive, which are subject to a corporate tax in their home countries and which hold **at least 10% (from the 1st of January 2009) of the share capital of the Italian company, for at least one year,** The Parent-Subsidiary Directive applies.

What does it happen in case of a Convention?

Usually the conventions against double taxation concluded by Italy set a reduction of the taxes on dividends distributed to residents (beneficial owner) in the other State.

The range of the taxes applied is limited by the article 10 of the OECD model (**5%-15%**). Italy has expressed reservations in order to preserve the right of applying the minimum tax withholding rate (5%) only for dividends distributed to enterprises which hold more than 50% (instead of the 25%) of shares of the issuer.

What about the refund *(1)*?

<u>Ordinary refund</u>: under domestic Italian law, non resident shareholders subject to the 27% tax rate may recover from the Italian tax authorities up to the 4/9 (12%) of the withholding tax or substitute tax on dividends received by providing evidence of full payment of income tax on such dividends in their country of residence in an amount at least equal to the total refund claimed

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Dividends distributed to residents in Tax Havens

What about the refund *(2)*?

<u>Conventional refund (alternative to the ordinary refund)</u>: the rate is reduced under a tax treaty or exempted under the EC Parent Subsidiary Directive.

As the ordinary refund means that no resident recovers the 4/9 of the 27% (the 12% is refunded and the 15% is "lost"), he has interest in <u>requiring the application of the convention each time the conventional tax withholding rate is lower than 15%, otherwise he can ask the refund of the exceeding part (the 12%)</u>.

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Which kind of problems could raise?

❖ **Problem of identification of the true beneficial owner (who receives and has the avalaility of the amount earned;**

❖ identification of the true role of a not resident conduit company;

❖Risks of abuse of law.

↓

- Application of the tax avoidance rule contained in the article 37 bis of the Presidential Decree n. 600/73;
- application of the general anti avoidance principle contained in the article 53 of the Constitution.

Thanks for your attention!!!

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