

## **Private Equity funds: Tax exemption on Italian dividends and capital gains earned by EU UCITS/AIF**

*Art. 1, Paragraphs 631-633 of Law No. 178 of 30<sup>th</sup> December 2020 (published on the Official Gazette of 30<sup>th</sup> December 2020) the “2021 Budget Law” equates the tax exempt treatment of dividends and capital gains currently applicable to Italian mutual funds to the tax regime applicable to Undertakings for Collective Investment in Transferable Securities (UCITS) and qualified AIF established in a EU Member State (or in States signing the Agreement on the European Economic Area (EEA) that grant an adequate exchange of information)*

### **Warning & Actions:**

**The law provisions are very significant for the private equity market. EU UCITS and qualified AIF are now tax exempt from Italian taxation on capital gains on Italian qualified equity investments and Italian source dividends like Italian mutual funds.**

**However, the new provisions apply only to dividends received and capital gains realised as from the date on which the Budget Law comes into force. This provision on non-retroactivity is legally arguable considering the case law of the ECJ that in similar occasions concluded that measures to mitigate discriminatory tax provisions cannot be applicable only for the future.**

**Therefore, it is advisable to assess whether the conditions to claim the tax refunds of Italian taxes applied so far on Italian source dividends and capital gains to EU qualified funds are met, in order to timely submit the related tax claims.**

### **1. The tax discriminatory provisions before 2021 Budget Law**



Dividends paid to UCITS and qualified AIF set up in Italy, other than real estate and Luxembourg UCITS, already authorised for subscriptions in Italy, pursuant to Art. 11-bis, Law Decree no. 512/1983, are exempt from income tax, provided that the asset management company is subject to regulatory supervision.

On the contrary, dividends paid by Italian companies to foreign UCITS and mutual funds were subject to a 26% final withholding.

Similarly, capital gains deriving from qualifying shareholdings in Italian companies (defined by Art. 67, paragraph 1, letter c) of the Italian Tax Code) realized by foreign mutual funds were subject to a 26% final substitute tax.

These provisions were discriminatory and contrary to the EU Treaty and negatively impacted private equity funds holding a controlling or a minority qualified stake in Italian companies,

## **2. The law amendment**

The 2021 Budget Law equates (from the date on which the law comes into force) the tax treatment of dividends and capital gains earned by UCITS and qualified AIFs established in EU Member States (or in States signing the Agreement on the European Economic Area (EEA) and which grant for an adequate exchange of information), with the tax treatment of dividends and capital gains earned by Italian mutual funds. The tax exemption, already applicable to Italian funds, is therefore also extended to EU UCITS and qualified AIF which, therefore, will no longer be subject to the Italian final 26% withholding tax.

In particular, 2021 Budget Law amends Art. 27 of the Presidential Decree No. 600/1973 in order to extend the tax exemption on Italian dividends paid to mutual funds (UCITS compliant with Directive No. 2009/65/EC or AIFs whose manager is subject to regulatory supervision in the Country of establishment pursuant to Directive No. 2011/61/EU) established in EU Member States and in States signing the Agreement on the EEA and granting an adequate exchange of information. Similar provisions have been introduced on taxation of capital gains on Italian equities.

## **3. Tax considerations on the provision that applies the tax exemption only to future dividends and capital gains**



The tax regime of Italian dividends, that taxed in a different way regulated Italian mutual funds compared to European ones, integrated an infringement of the principle of free movement of capital.

In particular, the ECJ in several occasions has deemed discriminatory the domestic taxation treating UCITS established in the relevant Country differently from those established in other EU member States, declaring the related domestic provisions non-compliant with the fundamental freedoms laid down in the EU Treaty and, in particular, with the free movement of capital, as per Art. 63 TFEU (Cases C-480/16, Fidelity Funds and C-156/17, Ka Deka).

Moreover, in this respect the EU Authorities already started an investigation against Italy (EU PILOT 8105/15TAXU) and the explanatory report to the 2021 Italian Budget Law recognizes that the law amendment aims at "overcoming such differences" of tax treatment and avoid an infringement procedure.

However, the law amendment provides that the tax exemption refers only to dividends paid and capital gains arising from the date on which the law becomes enforceable.

In this regard, there are grounded arguments on the illegitimacy of the timing effectiveness of this provision, which only exempts future dividends and capital gains earned by EU qualified mutual funds. We have other cases in which the Italian law has (illegitimately) provided only for the future in circumstances of clear non-compliance of Italian tax provisions with EU Treaty and regulations.

We may recall the 2008 Budget Law which reduced, with effect only for the future, the level of taxation of dividends paid to companies established in EU member States (and in States signing the Agreement on the EEA), at the same level applicable to dividends distributed to Italian companies. The law purpose was (as in this case) to remove a discriminatory tax treatment in compliance with the EU principles of non-discrimination, freedom of establishment and free movement of capital.

The ECJ concluded that the limitation to the "retroactivity" of the amending provision was contrary to European Law (case C-540/07 of November 19, 2009), thereby confirming that the tax claims of undue taxes paid before 2008 were legitimate. Indeed, the ECJ conclusions were also confirmed by the Italian Tax Authority in the Circular n. 32/E of 8th July, 2011, that clarified the conditions and the right to obtain the tax refunds for those EU companies which timely filed the tax claims.



We remain at your disposal for any request of clarification

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