

## Italian tax treatment of inbound and outbound interest

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## 1. Foreword

Italian tax rules on the cross-border taxation of interest consist of different sets of provisions that must be combined and also read in conjunction with international rules and principles.

The following paragraphs will summarize the main tax regimes and treatment of both outbound and inbound interest. The taxation of the relevant interest payment may vary depending on several features (including the legal arrangement the interest derives from, the nature of the payor etc.); accordingly, only some of the main tax regimes applicable to interest payments will be described below. For instance, the regime applicable to interest derived from debt securities issued from States or from project bonds (both subject to a 12.5% taxation where certain conditions are met) will not be described below.

## 2. Outbound interest

According to Art. 23 of Presidential Decree no. 917/86 (“**TUIR**”) interest is considered to be sourced from Italy to the extent that they are paid by Italian resident persons or by permanent establishments of non-resident entities that are located in Italy.

Interest that is considered to be sourced in Italy may be subject to tax therein pursuant to one of the following regimes.

### 2.1 Exemption under the “Interest&Royalty” Directive

The “**Interest&Royalty**” Directive (Council Directive 2003/49/EC of 3 June 2003) has been implemented in Italy through Art. 26-*quater* of the Presidential Decree no. 600/1973.

Art. 26-*quater* provides for an exemption from Italian withholdings on interest to the extent that the following requirements are met:

- the payer and the payor are both resident in an EU Country (without been considered to be resident in a third Country pursuant to a tax treaty) and subject therein to one of the corporate income taxes listed in Annex B to the Directive without benefiting from an exemption;
- the payer and the payor are both set-up in specific legal forms listed in Annex A to the Directive;
- the relevant interest is subject to tax in the payor jurisdiction;
- the payor qualifies as the beneficial owner of the interest;
- the payor holds a participation equal to at least 25% of the voting rights in the payer or the payer holds such a participation in the payor or both are participated by a common shareholder holding at least 25% of the voting rights in both the companies;
- the relevant participations listed in the point above have been maintained for an uninterrupted period of at least one year;

The benefits of Art. 26-*quater* may alternatively be granted:

- directly by the Italian withholding agent (under its own responsibility) by not applying any withholding;
- through a refund request.

In both cases, it is necessary to collect the documentation proving that the requirements provided for by Art. 26-*quater* are met before the relevant payments occur. The **Italian Tax Authorities** have issued a specific form to that extent (**Form F**, issued by **Ordinance** no. 84404 approved and published on 10 July 2013).

With respect to that, the Italian Tax Authorities repeatedly stated that the Italian withholding agent may directly apply the exemption from withholding only to the extent that the holding period is met at the date of the distribution (see, among the others, ruling no. 695 of 11 October 2021).

When the holding period is met after the relevant interest distribution, the non-resident recipient entity will only be entitled to claim for a refund of the withholding suffered.

### **Interest paid to Swiss companies**

A similar set of rules is also provided for by outbound interest payments having Swiss companies as recipients. Indeed, the EU and Switzerland have entered into an agreement related to cross-



border interest that contains provisions that are similar to those contained in the Interest&Royalty Directive.

The main difference between the EU-Switzerland agreement and the provisions of Art. 26-*quarter* lies in the holding period (in the EU-Switzerland agreement it is equal to 2 years).

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*Interest&Royalty Directive (European companies as recipients)*

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Requirements (Art. 26- <i>quarter</i> P.D. 600/1973)	
Residence for tax purposes	In an EU country or in Switzerland
Legal form	The recipient must be incorporated under one of the legal forms listed in Annex A to the Directive
Subject-to-tax requirement	The recipient must be subject to one the taxes listed in Annex B to the Directive and the interest must be subject to such tax
Minimum participation requirement	At least 25%
Minimum holding period	At least one year (two years, for the Swiss companies)

## 2.2 Exemption for Medium/Long Term Loans

An exemption from Italian withholding is provided for by art. 26 (5-*bis*) of the Presidential Decree no. 600/73 where the following conditions are met:

- Italian sourced interest is paid under a medium/long term loan (namely, with a maturity of at least 18 months);
- the Italian payor qualifies as an Italian enterprise;
- the foreign lender is either;
  - an EU bank;
  - an EU insurance company;
  - an entity listed in Art. 2(5) no. 4) to 23 of the EU Directive 2013/36/EU;
  - a **foreign institutional investor** mentioned in Art. 6 of the Legislative Decree no. 239/96, subject to supervision in its own Country of establishment (e.g. foreign collective investment vehicle subject to supervision).

## 2.3 Exemption for Interest Paid Under Certain Kinds of Bonds

A specific exemption provided for by Legislative Decree no. 239/96 may apply with respect to interest paid under bonds and similar securities (and promissory notes) issued by some specific entities (e.g. Italian, EU and EEA listed companies).

Where certain specific conditions are met, interest paid under the securities mentioned above may benefit from an exemption from Italian withholding. The foreign entities that may benefit from such exemption are:

- white-listed resident entities;
- international bodies set-up pursuant to international agreements ratified in Italy;
- white-listed foreign institutional investors, even if not liable to tax;
- central banks and other bodies managing State's reserves.

## 2.4 Exemption for Interest Paid on Deposits and Current Accounts

A specific exemption is provided for by Art. 26-*bis* of the Presidential Decree 600/73 for certain specific kinds of interest.

Indeed, interest paid on deposits and current accounts (other than the ones deriving from arrangement entered into with banks and the Italian *poste*) may benefit from an exemption from any Italian



taxation where derived by the persons listed in Art. 6 of the Legislative Decree no. 239/96. This means that the persons that may benefit from such exemption are the same listed under 2.3 above. Where certain specific conditions are met, interest paid under the securities mentioned above may benefit from an exemption from Italian withholding. The foreign entities that may benefit from such exemption are:

## 2.5 Tax Treaty Reduction

The tax treaties Italy has entered into with several countries usually provides for a reduction of the domestic withholding with respect to outbound interest (usually, to 10%).

In order for a treaty reduction to apply, it is necessary that all the requirements set forth therein are met. Usually, the most important and common requirements provided for by the relevant treaties are that the recipient must qualify as a person resident in the other Contracting State and as the **beneficial owner** of the relevant income.

Usually, these kinds of reductions are claimed where the requirements for the (more beneficial) regimes described under 2.1 to 2.4 above are not met.

The Italian Tax Authorities have issued a specific form to that extent (**Form B**, issued by Ordinance no. 84404 approved and published on 10 July 2013).

Where an Italian withholding is applied under a specific tax treaty, the residence State of the recipient is usually bound to provide a relief for the potential juridical double taxation that may arise (either as a foreign tax credit or an exemption).

## 2.6 Domestic Withholding Tax

Where none of the regimes described above may apply, Art. 26 of the Presidential Decree no. 600/73 provides for the application of a final 26% withholding rate on outbound interest payments.

### *Outbound interest*

Recipient	Tax treatment	Forms (to claim exemption/reduced rates/refund)
EU companies (and Swiss companies)	Exemption under Interest&Royalty (and EU-Switzerland Agreement)	Form F (to the withholding agent, or to the competent <b>Italian Office for non-residents</b> in Pescara to claim for refunds) containing a residence certification issued by the foreign Tax Authority
Non-EU companies and individuals (Tax Treaty Reduction)	Withholding tax provided in the Tax Treaty (usually, 10%)	Form B (to the withholding agent, or to the competent Italian Office for non-residents in Pescara to claim for refunds) containing a residence certification issued by the foreign Tax Authority
Non-EU companies and individuals (Domestic Withholding Tax)	Withholding tax provided in the domestic legislation (26%)	None
Interest on deposits and current account	Exemption where some objective and subjective requirements are met	Self-declaration (form released with the decree of the Ministry of Finance on 12 December 2001)
Bonds and similar securities	Exemption where some objective and subjective requirements are met	Self-declaration (form released with the decree of the Ministry of Finance on 12 December 2001)



### 3. Inbound interest

The tax treatment of inbound interest varies depending on the nature of the recipient.

#### 3.1 Individuals

The taxation varies depending on the following features:

- if an individual is engaged in an entrepreneurial activity and the relevant agreement from which the interest derive is connected to such activity, the Italian intermediary intervening in the collection of the relevant amount applies a provisional withholding of 26%. The interest will be taxed in full by applying the ordinary individual income tax progressive system;
- if an individual is not engaged in an entrepreneurial activity, interest received through an Italian intermediary are subject to tax at a 26% rate final withholding (no foreign tax credit is granted in this case). However, the taxpayer may elect for the interest to be subject to the ordinary individual income tax progressive system and having recognized a credit for taxes paid abroad on such income.

#### 3.2 Companies

Interest received by Italian resident companies from foreign entities is ordinarily subject to **corporate income tax** (and also to the regional tax on productive activities – **IRAP** – if the recipient carries out some specific kind of activities, e.g. banks).

#### *Inbound interest - individuals*

Recipient	Tax treatment	Foreign tax credit
Entrepreneurs	Provisional withholding tax (26%). The interest will concur to the overall taxable base.	Yes
Individuals not engaged in entrepreneurial activities	<ul style="list-style-type: none"> <li>• 26% final withholding tax, if received through an Italian intermediary;</li> <li>• <b>substitute tax</b> (26%), if not received through an Italian intermediary (to be reported through the annual tax return and autonomously paid).</li> </ul>	No
	Upon election of the taxpayer, the interest will not be subject to the 26% tax (withholding or substitute tax) but will be fully taxed by applying the progressive individual income tax rates.	Yes



## 4. Glossary

### **Beneficial owner**

Recipient of the income having the right to use and to enjoy it, unconstrained by contractual or legal obligations to pass on the payment to another person.

### **Corporate Tax rates**

Italian Corporate Tax (IRES) is a 24% flat rate, reduced to 12% for some no-profit organisations and increased to 27.5% for banks and other financial institutions.

### **Foreign institutional investor**

Particular kind of investor located abroad and meeting some specific requirements, e.g. whose activities is professionally managing funds for the benefit of the investors, managed by a body/entity which is independent from such investors and subject to the supervision of the local regulatory authority.

### **Form B**

Form needed to claim for the application of reduced rates or refund on interest derived by non-residents recipients pursuant to a Double Tax Convention.

### **Form F**

Form needed to claim for the exemption or refund on interest/royalties derived by non-residents recipients pursuant to the Interest&Royalty Directive.

### **Income Tax rates**

Italian Income Tax (IRPEF) has the following rates and brackets:

- 23% (0 to 15.000 EUR);
- 25% (15.001 to 28.000 EUR);
- 35% (28.001 to 50.000 EUR);
- 43% (over 50.000 EUR).

### **IRAP**

Regional tax on productive activities levied on companies with a 3.9% rate.

### **Italian Office for non-residents (“Centro Operativo di Pescara”)**

Competent Italian Office for claims for a refund of taxes paid by non-residents on Italian-sourced income.

### **Italian Tax Authorities (“Agenzia delle Entrate”)**

Agency, under control of the Ministry of Finance, which performs all the functions and tasks assigned by the law in the field of tax revenue and tax duties.

### **Ordinance**

Official document issued by the Italian Tax Authorities containing rules aiming at implementing and supplementing provisions of tax law (tax returns, etc.).

### **Interest&Royalty Directive**

Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

### **Substitute Tax on interest**

Tax assessed in the annual tax return (RM form, section V) with a 26% rate, if the foreign-sourced interest is not collected through an Italian intermediary.

### **TUIR (“Testo Unico delle imposte sui redditi”)**

Italian Income Tax Code, enacted through Presidential Decree no. 917/86.

