ITALY

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PART II. THE AGREEMENT XXXII

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LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
Directive	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States
D.P.R. 600/73	Italian Tax Assessment Act , Presidential Decree of 29 September 1973, No 600
D.Lgs. n.143/2005	Legislative Decree of 30 May 2005, No 143, published in the Italian Official Gazette No 172 of 26 July 2005
D.P.R. 917/1986	Income Tax Act, Presidential Decree of 22 December 1986, No 917
Guideline No 47/E	Italian Tax Administration Circular (*Circolare del ministero dell`economia e delle finanze)* of 2 November 2005, No 47/E.
G.U.	*Gazzetta Ufficiale* (Italian Official Gazette)
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Savings Directive	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
T.U.I.R.	Income Tax Act*, Testo Unico Delle Imposte sui Redditi* (D.P.R. n. 917/1986)(Italian Tax Code)

LIST OF LEGAL REFERENCES

Laws

- Law of 30 December 1991, No 413.
- Presidential Decree of 29 September 1973, No 600.
- Presidential Decree of 22 December 1986, No 917.
- Legislative Decree of 30 May 2005, No 143, published in the Italian Official Gazette No 172 of 26 July 2005.
- Presidential Decree of 29 September 1973, No 602.

Administrative Guidelines and Recommendations

- Italian Tax Administration Circular (*Circolare del ministero dell`economia e delle finanze)* of 2 November 2005, No 47/E.
- Italian Tax Administration Final Report on Legislative Decree of 30 May 2005, No 143.

Articles

- E.Vial - N.Montuori, *Prime riflessioni sullo schema di decreto attuativo della Direttiva interessi e royalties n. 2003/49/CE*, in *Il Fisco* No 31/2005, p. 1-4845, Rome-Italy.
- M.Boidi – E. Fusa, *Il trattamento fiscale degli interessi e delle royalties all`interno dell`Unione Europea,* in *Il Fisco* No 32/2005, p. 12352, Rome-Italy.
- M. Greggi, La direttiva 2003/49/CE e il regime di tassazione degli interessi e delle royalties, in Rassegna Tributaria No 2/2004, p. 505, Rome-Italy.
- P. Troiano, *The EU Interest and Royalty Directive: The Italian Perspective*, in Intertax, Amsterdam, Volume 32, Issue 6/7, Kluwer Law international 2004.
- A. Piciariello, *Interessi e canoni comunitari infragruppo: la tassazione si sposta nello stato di destinazione. Recepita dall`Italia la Direttiva n. 2003/49/CE del 3 giugno 2003*, in *Il Fisco* No 39/2005, p. 1-6148.

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

Legislative Decree No 143 of 30 May 2005 implemented the Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States (the "Directive") in Italy and was published in the Italian Official Gazette No 172 of 26 July 2005 (Gazzetta Ufficiale, "G.U"). The provisions of the Decree ("D. Lgs. n. 143/2005") were codified in a new Art. 26-quater of the Italian Tax Assessment Act (Decreto del Presidente della Repubblica n. 600 del 29 settembre 1973, "D.P.R. 600/73") and modified Articles 25, 37-bis and 27 of the same Act.

The Italian Tax Administration on 2 November 2005 published the Guideline on the implementing legislation of the Directive (Circolare n. 47/E).

The enacted provisions concern the abolition of the withholding tax on Italian-source interest and royalty payments made by an Italian qualifying company to an associated company resident in another EU Member State. The provisions apply retroactively to interest and royalties accrued as of 1 January 2004.

The table below shows the relevant provisions of the Italian laws implementing the Directive.

Articles of the Directive	Relevant sections of national laws
Art.1 (1)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (1)
Art. 1(2)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (1)
Art. 1(3)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (1)
Art. 1(4)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (4)
Art. 1(5)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (4)
Art. 1(6)	-
Art. 1(7)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (2)
Art. 1(8)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (4)

Articles of the Directive	Relevant sections of national laws
Art. 1(9)	- - -
Art. 1 (10)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (2)(e)
Art. 1 (11)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (6)
Art. 1 (12)	- - -
Art. 1 (13)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (6)
Art. 1(14)	- - -
Art. 1(15)	D.Lgs n.143/2005, Art. 2 D.P.R. n. 602/1973, Art. 38
Art. 1(16)	D.Lgs n.143/2005, Art. 2 D.P.R. n. 602/1973, Art. 38
Art. 2(a)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (3)
Art. 2(b)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (3)
Art. 3(a)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art.26-quater (1)
Art. 3(b)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (2)
Art. 3(c)	- - -
Art. 4(1)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art.26-quater (3)
Art. 4(2)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (5)
Art. 5(1) and (2)	D.Lgs n.143/2005, Art. 1 D.P.R. 600/73, Art. 26-quater (8)

Articles of the Directive	Relevant sections of national laws
	D.P.R. 600/73, Art. 37-bis
Art. 7(1)	D.Lgs. n. 143/2005, Art. 6

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

a. Tax treatment at the level of the paying company

Deduction of interest and royalty payments

Interest paid is deductible in an amount corresponding to the ratio of gross taxable income to total gross income, the latter including taxable and exempt income. For the purposes of determining the ratio, foreign-source interest income is fully included in taxable income, even if it is fully or partially exempt from tax. A further limitation applies to interest paid to non-resident affiliated companies in that such interest is only deductible to the extent it is paid on an arm's length basis (see below).

Royalties paid for patents, trademarks, know-how and similar rights are deductible. Royalties paid to non-resident affiliated companies are deductible to the extent they are paid on an arm's length basis (see below).

As regards the interest deduction, it is subject to several limitations. First of all, the interest deduction is limited by thin capitalisation rules provided by Art. 98 of D.P.R. 917/1986. Moreover, interest on bonds issued by non-listed companies is not deductible for the part exceeding:
- 200% of the official discount rate, in the case of listed bonds or bonds offered to the public; and
- 166% of the official discount rate, in the case of other bonds.

The amount of interest which is deductible after the application of thin capitalization rules is subject to another limitation introduced in connection with the participation exemption: the holding of participations qualifying for the participation exemption triggers limitations to the deductibility of interest expenses. If, at the end of a financial year, the book value of the participations that qualify for the participation exemption exceeds the book value of net equity of the participating company, the portion of interest expenses that exceeds the interest income is not deductible for an amount corresponding to the ratio between the excess of the book value of the qualifying participations over the book value of the net equity of the company and the book value of total assets (reduced by the book value net equity and commercial debts).

The non-deductible portion of the interest expenses is furthermore reduced by the taxable portion of dividends received by the company in relation to the shareholdings that qualify for the participation exemption.

This limitation does not apply to shareholdings of companies included in tax consolidation or that have opted for the consortium relief, according to Art. 97 of the Income Tax Act (D.P.R. 917/1986).

Finally, interest deductible after the application of the above limitations is deductible for an amount corresponding to the ratio of gross taxable income to total gross income, with some

adjustments. In addition, payments of remuneration to an associated party under a silent partnership contract or another profit sharing contract are not deductible for the paying party.

Remuneration on securities and financial instruments which is related to the profits of the issuer or of a specific project or of a related party is not deductible, according to Art. 109(9)(b) of the Income Tax Act.

Thin capitalisation rules

Thin capitalization rules apply to companies whose turnover exceeds EUR 5,164,568.99 (and always to holding companies). If during the year, the average debt exceeds four times the adjusted equity with reference to a qualified shareholder or its related parties, the consideration on the excessive loans granted or guaranteed, directly or indirectly, by a qualified shareholder or its related parties is not deductible for tax purposes and, if received by a qualified shareholder, is re-characterized as a dividend. In determining the debt/equity ratio, loans granted or guaranteed by the shareholder's related parties have to be taken into account.

For thin capitalization purposes, a "qualified shareholder" is a shareholder that directly or indirectly controls the debtor according to the Civil Code or owns at least 25% of the share capital of the paying company. "Related parties" are defined as companies that are controlled according to the Civil Code or relatives as defined in the tax law.

The thin capitalization rules do not apply if the overall debt/equity ratio with reference to all qualified shareholders and their related parties does not exceed 4 to 1 (for 2005) or if the debtor proves that the excess debt is justified by its own credit capacity and so that also a third party would have granted the loan.

b. Tax treatment at the level of the beneficiary company

Interest and royalty payments by residents to an Italian beneficiary company

Interest is included in taxable income on an accrual basis (unless exempt; see below). If the rate of interest is not specified in writing, it is deemed to be equal to the statutory interest rate, which is 2.5% from 1 January 2004 (Art. 1284 of Italian Civil Code and Italian Ministerial Decree of 1 December 2003).

Interest received on current accounts is included in taxable income in its entirety, even if it is partially or totally offset by interest paid out on the same account. This is because the deductibility of the latter is subject to certain limitations (Art. 89(7) T.U.I.R.).

Interest on bank deposits, state bonds and shares in foreign mutual funds received by entities subject to corporate income tax and not exercising a commercial activity are subject to a final withholding tax (if paid by non resident, the intermediary applies the withholding or a substitute tax); such interest is, therefore, not included in taxable income.

Interest on "repo" contracts constitutes taxable income for the part accrued in the period between the purchase and resale of the security. The difference between the purchase and resale price, net of the interest accrued, is also included in taxable income to the extent it refers to the financial year (Art. 89(6) T.U.I.R.).

Interest paid by a resident company to a resident is subject to withholding tax at various rates, depending on the nature of the interest. All withholding taxes on payments to resident companies are advance payments and creditable against the recipient's income tax liability.
The withholding tax rates on interest are as follows:

- 0% for interest on bonds issued by the state of Italy, as well as by Italian banks and by companies listed on the Italian Stock Exchange with a maturity of at least 18 months;
-12.5% for interest on bonds issued by non-listed companies with a maturity of at least 18 months, provided that, at the date of issue, the interest rate was not higher than (a) 200% of the official discount rate, in the case of bonds listed on an EU-regulated market or (b) 166% of the official discount rate, in the case of other bonds and for interest on loans; and
-27% for interest on other bonds with a maturity of less than 18 months, as well as on bank or post office deposits and current accounts.

In general royalties paid by resident companies to other resident companies or to an Italian permanent establishment of a non resident company are not subject to any withholding tax, whereas they are subject to corporate income tax in the hands of the recipient.

Cross-border interest and royalty payments

Interest and royalties paid by Italian resident companies to non-resident companies without a permanent establishment in Italy are normally subject to a final withholding tax, subject to reduction under the relevant treaty provisions.

If interest and royalties are received through a permanent establishment in Italy, they are taxed as if received by an Italian resident company. In the absence of a treaty containing a provision similar to Art. 7 of the OECD MC, however, the force of attraction provided under domestic law may result in taxation in the hands of the permanent establishment even if the payment is not attributable to it (Art. 151(2) T.U.I.R.).

However, in practice, the application of the provisions of tax treaties concluded by Italy with other EU member States entails reduction of the withholding tax or its exemption in cases where the taxation of such income is reserved to the State of residence of beneficiary.

Tax treatment of inbound interest and royalties

Foreign interest and royalties are included in the taxable base for corporate income tax purposes. A foreign tax credit is granted. Interest on bonds issued by foreign states or by foreign local authorities before 10 September 1992 is exempt from corporate income tax (Art. 31 D.P.R. n. 601/1973).

Foreign interest derived through resident intermediaries, such as banks and other financial institutions, is subject to an advance withholding tax. Two different rates are provided for this withholding tax: 27% and 12.5%.

Tax treatment of outbound interest

In general, interest payments to non-resident companies without a permanent establishment are subject to a final withholding tax at the rates applicable to interest paid to residents.

However, no withholding tax is levied on interest paid to non-resident companies on deposit accounts and current accounts with banks and post offices.

Interest paid to non-residents on bonds issued by the state, banks or quoted companies, with a maturity of at least 18 months, is exempt if the beneficial owner is a resident of a country with which Italy has an adequate exchange-of-information system. In order to benefit from this exemption, the non-resident must deposit the bond with a resident bank or other approved intermediary.

Interest on certain bonds (other than the above) is subject to withholding tax. The rate is generally 27%. A 12.5% rate applies to interest on bonds with a maturity of at least 18 months, provided that, at the rate of issue, the interest rate was not higher than 200% of the

official discount rate, in the case of bonds listed on an EU-regulated market or 166% of the official discount rate, in the case of other bonds. Interest on public and private bonds issued before January 1997 may be subject to other rates.

Other types of interest paid to non-resident companies, including interest on loans, are subject to withholding tax at a 12.5% rate (but 27% if paid to a resident of a country or territory outside the European Union with a preferred tax regime).

Tax treatment of outbound royalties

Royalties paid by resident companies to non-resident companies without Italian establishment are subject to a 30% withholding tax in Italy. This withholding tax is applicable even when the income is paid by an Italian permanent establishment of a non-resident company. The withholding tax is generally applied to 75% of the gross amount of the payment, resulting in an effective rate of 22.5% (D.Lgs. 669/1996).

As from 2005, a 30% withholding is applied on 100% of the gross amount of payments received by non residents without a permanent establishment in Italy for the use of, or the right of use, industrial, commercial or scientific equipment that are situated in Italy. On the other hand, no withholding is applied on payments made to qualifying companies under the provision implementing the Directive.

Such withholding tax is not levied if the royalties are paid to an Italian permanent establishment of a non-resident company (both EU-resident or non-EU-resident companies).

Leasing fees received by non-residents are taxable in Italy only if the leased property is physically situated in Italy (Arts. 23(1)(f) and 67(1)(h) T.U.I.R.). A 30% withholding tax applies.

Royalties paid to non-resident affiliated companies are deductible to the extent they are paid on an arm's length basis.

c. Transfer pricing

Business income of a resident enterprise arising (i) from transactions with non-residents that, either directly or indirectly, exercise a dominant influence, (ii) from transactions where the resident enterprise (directly or indirectly) controls non-resident companies and (iii) from transactions between resident and non-resident companies that are under the common control of a third company, is assessed on the basis of the arm's length value of the goods transferred, services rendered or services received if an increase in taxable income derives therefrom. The provision also applies if a decrease in taxable income derives therefrom, but only if the mutual agreement procedure provided in double tax treaties is used. A circular of the Minister of Finance indicates the different methods of valuation (arm's length principle) to be used for each type of transaction.

d. Constructive distribution rules

In the situation where the payments made by an Italian company or an Italian permanent establishment of a foreign company to a related non-resident beneficiary are not at arm's length or fall under thin capitalization rules, the excess payments may be treated as a constructive distribution. In case of transfer of profits in any form between related companies, Italy generally considers that the amount paid must be reintegrated into the taxable base of the paying company and treated as a dividend distribution made to the beneficiary. Interest may be re-characterized as dividend distribution (a constructive distribution).

Interest

Interest, the deduction of which is disallowed under the thin capitalisation rules (see above) may be treated as a constructive distribution. The re-characterized interest will however benefit from the participation exemption regime available to dividends if the beneficiary is a resident parent company or the Italian permanent establishment of a foreign company covered by an appropriate non discrimination clause in the tax treaty and meeting the other relevant conditions.

Royalties

Where royalties are considered excessive the excess royalties are reintegrated into the tax base of the paying companies. The excess royalties are not treated as a profit distribution.

1.2.2. Treaties

Prior to the implementation of the Directive, the tax treatment of interest and royalty flows eligible to a withholding tax exemption under the Directive were covered by the tax treaty between Italy and the relevant Member State. Italy has double tax treaties with all other EU Member States (see Annex)

a. Interest

Most tax treaties concluded between Italy and EU Member States provide for a reduction of or an exemption from the above mentioned withholding taxes.

b. Royalties

The tax treaties between Italy and EU Member States provide, depending on the State of the beneficiary, either for exclusive taxation in the state of residence of the recipient or a reduced withholding tax ranging from 5 to 15%. Avoidance of double taxation is achieved by a credit amounting to the Italian withholding tax.

It should be noted that some tax treaties, following the OECD MC do not treat remuneration in consideration for the use or the right to use industrial, commercial or scientific equipment as royalty payments falling under Art. 12 OECD MC. Such payments fall under Art. 7 OECD MC.

c. Conclusion

Although the definition of interest and royalties under a tax treaty may differ from that in domestic law and in the Directive, some tax treaties concluded by Italy with some other Member States provide for the exclusive taxation of interest and royalty payments in the state of residence (i.e. exemption from withholding tax). The tax treaties providing for exclusive taxation of interest and royalty income in the state of residence are those concluded with:

- **Austria** (only in respect of royalties, paid by a company which is a resident of a Contracting State to a person who is a resident of the other Contracting State and which controls, directly or indirectly, more than 50% of the capital of the company paying the royalties, may be taxed in the first-mentioned State);
- **Czech Republic** (in respect of interests and royalties that are different from payments of any kind for the use of, or the right to use patents, trade-marks, designs or models, plans, secret formulae or processes and for the use of or the right to use industrial, commercial or scientific equipment which does not constitute immovable property as

meant in Article 6, and for information concerning experience of an industrial, commercial or scientific nature);
- **Ireland**, **Cyprus** (only in respect of royalties);
- **Finland** (only in respect of royalties that are not for the use of, or the right to use, cinematograph films, and films or tapes for television or radio broadcasting, or any patent, trade mark, design or model, plan, secret formula or process, or any industrial, commercial, or scientific equipment; or for information concerning industrial, commercial or scientific experience)
- **France** (only in respect of royalties for the use of, or the right to use, a copyright of literary, artistic or scientific work, excluding royalties for computer programmes, cinematograph films and other sound or visual recordings)
- **Germany** (only in respect of copyright royalties and other similar payments in respect of the production or reproduction of any literary, dramatic, musical or artistic work, including royalties in respect of cinematograph films and films or tapes for radio or television broadcasting)
- **Malta** (only in respect of royalties consist of payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, cinematographic films or tapes for television or broadcasting)
- **Netherlands** (only in respect of interests when: the debtor of such interest is the Government of that Contracting State or any of its local authorities; or the interest is paid to the Government of the other Contracting State, to any of its local authorities or to an institution or organization (including financial institutions) belonging wholly to that Contracting State or to any of its local authorities; or the interest is paid to other institutions or organizations (including financial institutions) in relation to loans made under agreements concluded between the Governments of the Contracting States).
- **United Kingdom** (only in respect of interest, when:
  - interests are paid in connection with the sale on credit of industrial, commercial or scientific equipment; or in connection with the sale on credit of goods delivered by one enterprise to another enterprise;
  - the payer of the interest is the first Contracting State referred to in paragraph 1 of this Article or one of its political or administrative subdivisions or local authorities (in the case of Italy) or one of its local authorities or agencies or instrumentalities of the Government or a local authority (in the case of the United Kingdom); or the interest is paid in consideration of a loan made, guaranteed or insured by the second Contracting State referred to in paragraph 1 of this Article ("the second Contracting State"), including the Export Credits Insurance Company (Società di Assicurazione ai Crediti per l'Esportazione), or one of its political or administrative subdivisions or local authorities (in the case of Italy) or one of its local authorities or by the United Kingdom Export Credits Guarantee Department (in the case of the United Kingdom) or a public establishment of the second Contracting State.)
- **Hungary** (for interest and royalties).

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

As regards the definition of "interest", Art. 26 quater of the D.P.R. 600/73 contains a definition of interest benefiting of the withholding tax exemption.

Interest is defined as income from debt-claims of every kind, whether or not secured by mortgage and, in particular, income derived from securities, bonds and loans, including other proceeds derived from securities and loans mentioned above.

It has to be pointed that Italian implementation regime of the Directive includes in the concept of interests the penalty charges for late payment, as mentioned in the Guideline No. 47/E of the Ministry of Finance of 2 of November 2005.

b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))

The Art. 26 quater implements the exclusions provided for in Art. 4 of the Directive.
The following payments or remunerations are not considered interest:

a) profits from Italian silent partnerships (AIP), contained in Art. 44(1)(f) of T.U.I.R;
b) the whole remuneration from participating instruments, such as securities or financial instruments related to the economic results of the issuing company, of other group companies or of the business in relation to which the participating instrument has been issued, contained in Art. 44(2)(a) of T.U.I.R.;
c) payments from particular kinds of convertible loans;
d) payments from debt-claims that contain no provision for repayment of the principal amount or where the repayment is due more than 50 years after the date of issue.

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

As regards the exclusion of payments as interest or royalties, Art. 26 quater (3) of the D.P.R. 600/73 excludes from the benefits of the Directive interest re-characterised as dividends pursuant to the thin capitalization rule contained in Art. 98 of the T.U.I.R. This interest will be treated as dividends and will be subject to the 27% withholding tax ordinary applicable to outbound dividends. However the rate of the withholding tax may be reduced under the relevant treaty. Furthermore, the legislative decree introduced a new paragraph to Art. 27 (dividends withholding) of the D.P.R. 600/73. Circular 26/E-2004 of the Ministry of Finance stated that the amount of interest that is re-characterised as dividends may be exempt in accordance with the Parent-Subsidiary Directive, as implemented by Art. 27 bis of the D.P.R. 600/73.

Art. 26 quater (8) of the D.P.R. 600/73 also provides that the dividend withholding tax will not apply to interest re-characterised as dividends pursuant to the thin capitalization rule, if paid by the permanent establishment of a non-resident company.

The exemption from interest withholding tax under discussion is not applicable to interest exceeding the arm's length value.

Art. 26 quater (5) of the D.P.R. 600/73 provides that if the paying company is controlled by the beneficial owner, or both are controlled by a third company, and the amount of interest exceeds the arm's length amount, the exemption from interest withholding tax will be applied only to the latter.

2.1.2. Concept of royalties

a. Definition

Royalties are defined as the remuneration of any kind received for the use of, or the right to use:

- copyright of literary, artistic or scientific works, including cinematograph films and software;
- patents, trade marks, designs or models, plans, secret formula or processes, or information concerning industrial, commercial or scientific experiences;
- industrial, commercial or scientific equipment.

b. Classification of revenue from leasing and software

As regards payments for the use of, or the right to use, industrial, commercial or scientific equipment, Art. 1 of Decree No 143 of 2005 modified Art. 25 of the D.P.R. 600/73.

The new Art. 25 of the D.P.R. 600/73 provides for a 30% withholding tax on payments made to non-residents for the use of, or the right to use, industrial, commercial or scientific equipment located in Italy. Such 30% withholding tax applies to payments made on or after 26 July 2005 if the exemption applicable under the provision implementing the Directive is not applicable.

Guideline No. 47/E of 2 of November 2005 of the Ministry of Finance stated that the concept of industrial, commercial or scientific equipment includes all goods that are used for a business activity that can be a commercial, industrial or services activity. The same Guideline mentioned some examples of these goods, listed below:

- industrial machinery;
- container;
- building machines;
- agricultural machines;
- goods and persons transport vehicles.

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

The withholding tax exemption under discussion is not applicable to royalties exceeding the arm's length value.

The Art. 26 quater (5) of the D.P.R. 600/73 provides that if the paying company is controlled by the beneficial owner of the royalties, or both are controlled by a third company, and the

amount of royalties exceeds the arm's length amount, the exemption will be applied only to the latter. The excess royalties are reintegrated into the tax base of the paying companies, and will not be treated as constructive dividend distributions.

2.2. COMPANIES

2.2.1 Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Other types of entities

The abolition of the Italian withholding tax applies to interest and royalties paid by an associated company which is resident in Italy and which takes one of the forms listed in Annex to the Directive.

The abolition of the Italian withholding tax also applies to interest and royalties distributed by an Italian permanent establishment of a non-resident associated company.

In that case the non-resident associated company (head office) must be resident in an EU Member State and have one of the legal forms listed in the Annex A, and may not be considered a resident outside the Europe Union according to a double taxation convention with a third State.

However, the interest and royalties paid by a permanent establishment only qualify if they are connected with and attributable to the permanent establishment.

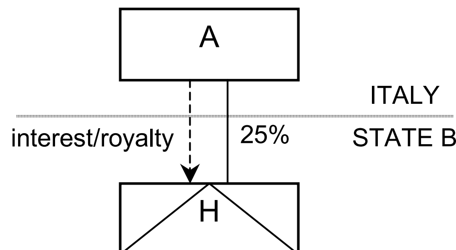
b. Hybrid entities

There is no specific guidance with respect to application of the exemption from withholding tax when interest or royalties are paid to or by hybrid entities. Conclusions on the tax treatment of such payments are tentatively drawn on the basis of general implementing provisions of the T.U.I.R. The issue of treatment of payments in situations involving hybrid entities is considered based in three hypothetical situations described below:

- Case 1: an Italian associated company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: an Italian hybrid entity H pays interest and royalties to an associated company in Member State A;
- Case 3: an Italian associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

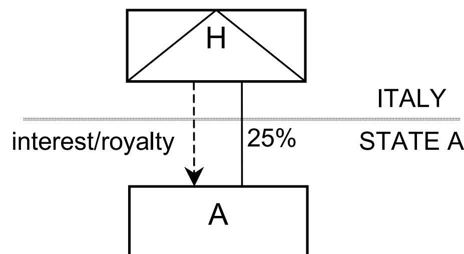
An Italian company A pays interest and royalties to an associated hybrid entity H situated in Member State B. Italy treats hybrid entity H as a transparent entity.



This case does not apply to Italy since, according to Art. 73 of the T.U.I.R Italy treats non-resident companies always as a non-transparent entity.

Case 2: Payment by a hybrid entity

A hybrid entity H in Italy pays interest or royalties to an associated company A in Member State A.



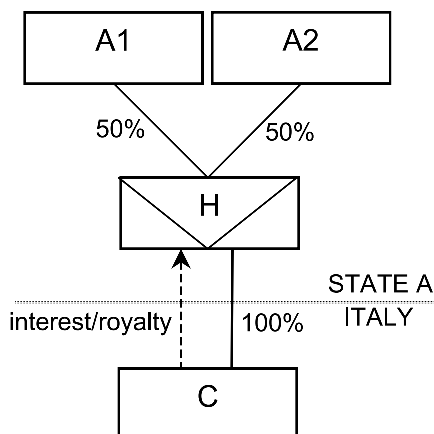
Situation a): Italy treats the hybrid entity as a transparent entity
Under certain conditions, Italian limited liability companies (*società a responsabilità limitata*), partnerships limited by shares (*società in accomandita per azioni*) and corporations *(società per azioni*) may opt to be treated as flow-through entities. If opted, the income of the Italian entity is attributed directly to its members.

Guidelines No 47/E do not clarify whether the Italian flow-through entity would be considered as entitled to the benefits of treaties and directives.

Situation b): Italy treats the hybrid entity as a non-transparent entity
In that case, the payment could be exempt provided all conditions are met.

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of the hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in Italy. Italy treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



This case does not apply to Italy since, according to Art. 73 of the T.U.I.R Italy treats non-resident companies always as a non-transparent entity (see Case 1).

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

Under Art. 26 quater (4) of the D.P.R. 600/73, the receiving company must meet all the following conditions:

- having one of the legal forms provided for in Annex A;
- being resident for tax purposes in an EU Member State and not considered resident outside the European Union according to a double taxation convention with a third State;
- being subject to one of the taxes listed in Annex B, without the being exempted, or to an identical or substantially similar tax applied in addition or instead of those listed taxes.

In Italy, resident companies are those which for the greater part of the tax year (i.e. more than 183 days) have had their legal seat, place of effective management or main business purpose in Italy. The place of incorporation is not relevant.

It is not clear whether a payment by an Italian company, having an eligible form under Annex A of the decree but having its effective management in another member State would benefit from the withholding tax exemption under Art. 26 quater of the D.P.R. 600/73. This issue will be discussed below.

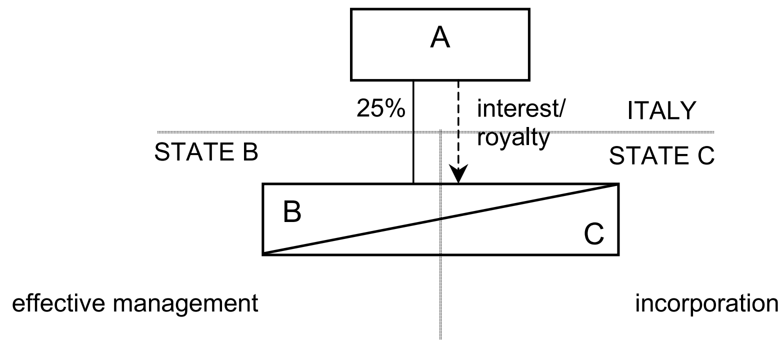
b. Application of the requirement in dual residence cases

There is no specific guidance with respect to application of exemption from tax when interest or royalties are paid to or by dual resident companies. The tentative conclusions on the tax treatment of such payments are drawn on the basis of general implementing provisions of the Decree No 143/2005. The issue of tax treatment of payments in situations involving dual residency is considered based on three situations described below:

- Case 1: an Italian company A makes an interest or royalty payment to an associated dual resident company BC incorporated in Member State C but with its effective management in Member State B;
- Case 2: a dual resident company BC incorporated in Member State C but with its effective management in Italy makes an interest or royalty payment to an associated company A resident in Member State A;
- Case 3: a dual resident company BC incorporated in Italy but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.
-

Case 1: Payment to a dual resident

An Italian company A makes an interest or royalty payment to an associated dual resident company BC incorporated in Member State C but with its effective management in Member State B.



Italian law requires the receiving EU associated company to meet, inter alia, the following conditions:

(i) being fiscally resident in an EU Member State and not considered resident outside the European Union according to a double taxation convention with a third State;
(ii) have one of the legal forms listed in the Annex to the Directive; and
(iii) be liable to corporate income tax, without being exempt.

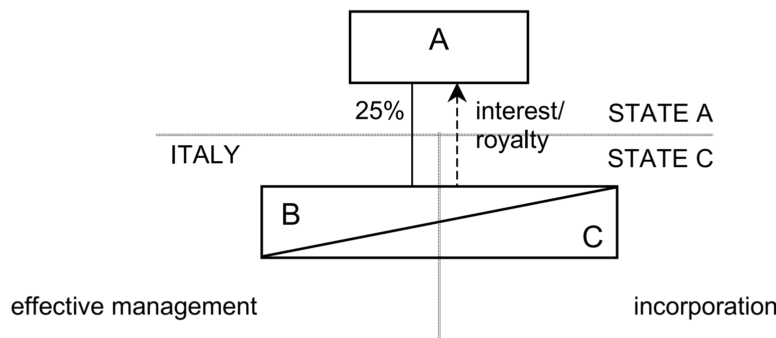
In the case at hand, the company BC meets requirements (i) and (ii) cited above: it is either fiscally resident in Member State B or in Member State C and it takes the legal form of a company of the Member State C listed in the Annex to the Directive.

In respect of (iii), generally, the company BC will be subject to B and C corporate income tax in Member State B and Member State C under the B and C domestic tax laws of Member State B and Member State C, respectively. The issue of dual residence of the recipient dual resident company will be solved under the provisions of the income tax treaty between Member States B and C.

Assuming that the tax treaty between B and C is identical to the OECD MC, company BC will be considered resident for treaty purposes in Member State B where its effective management is located (Art. 4 (3) of the OECD MC). In this situation it is most likely that Italy will grant the withholding tax exemption in respect of the payment made to the dual-resident company BC.

Case 2: Payment by a dual resident with the place of management in Italy

A dual resident company BC incorporated in Member State C but with its effective management in Italy makes an interest or royalty payment to an associated company A resident in Member State A.



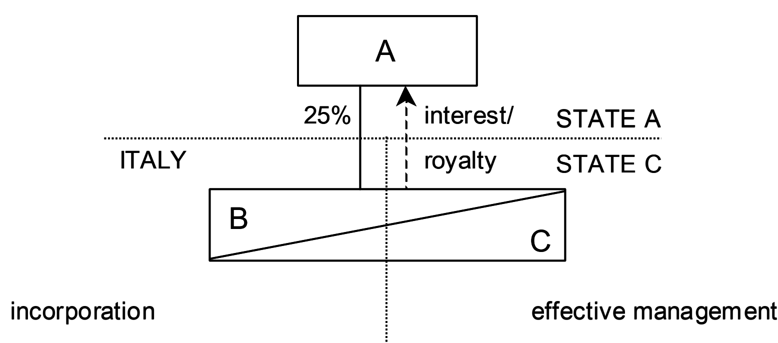
Under the Italian implementing provisions, Italy restricts the application of the Directive to payments made by companies listed in Annex A to the Directive and to Italian permanent establishments of EU listed associated companies. Italy should apply the Directive to any accompany having a legal form listed in Annex A to the Directive, provided that the company is subject to tax in Italy. However, the tax agency has not published any guidance in this respect. The issue of residence will have to be solved by the tax treaty between Italy and Member State C.

Treaty between Italy and State C
Assuming that the tax treaty between Italy and Member State C follows the OECD MC, the tie-breaker rule under Art. 4 (3) of the tax treaty between Italy and Member State C will designate Italy, where the effective management is located, as the country of residence for tax treaty purposes. The company will therefore be subject to tax in Italy.

Treaty between Italy and State A
If there is no permanent establishment in Member State C, Italy will be prevented from applying a withholding tax where the tax treaty between Italy and Member State A provides for an exclusive taxation of the interest or royalty payment in the state of residence (Member State A). In other cases, Italy may levy interest or royalty withholding tax albeit only at the reduced Italy-State A treaty rate.

Case 3: Payment by a dual resident with place of incorporation in Italy

A dual resident company BC incorporated in Italy but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



Under the Italian implementing provisions, Italy grants a withholding tax exemption for interest and royalties paid by a company listed in the Annex of the Decree No 143/2005 (see 2.2.1. *a. Other types of entities*), provided that the company is liable to Italian corporate tax without being exempt. To determine whether or not the Italian company is liable to Italian corporate income tax, it is necessary to determine the situation of company BC for Italy-State C tax treaty purposes in respect of the residence of the Italian incorporated company.

Assuming that the tax treaty between Italy and Member State C follows the OECD MC, the tie-breaker rule under Art. 4 (3) of the tax treaty between Italy and Member State C will designate Member State C, where the effective management is located, as the country of residence for tax treaty purposes. The interest or royalty payment will be deemed to arise in Member State C, so that Italy will be prevented from applying a withholding tax, unless the interest or royalty deduction is attributable to a permanent establishment in Italy under Art. 7 of the treaty.

Where the interest or royalty payment is effectively connected to a permanent establishment in Italy, Italy will have to apply the withholding tax exemption under the Italian rules implementing the Directive in respect of the royalties paid by the Italian permanent establishment to an associated company A in Member State A.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

a. The paying party requirements

The paying party may be either a company or an entity fiscally resident in Italy or an Italian permanent establishment of a company fiscally resident in another EU Member State.

According to Art. 26 quater of the D.P.R. 600/73, a company or an entity fiscally resident in Italy must meet all the following conditions:

- having one of the legal forms provided for by Annex A to the D.P.R. 600/73 and
- being subject to corporate income tax (IRES) without being exempted.

Article 26 quater provides that an Italian permanent establishment of a company fiscally resident in a EU Member State must meet all the following conditions:

- its head office must be a company having one of the legal forms provided for by Annex A;
- its head office must be fiscally resident in an EU Member State and not considered resident outside the European Union according to a double taxation convention with a third State;
- its head office must be subject to one of the taxes listed in Annex B to the D.P.R. 600/73 (hereinafter "Annex B"), without being exempted, or subject to an identical or substantially similar tax applied in addition or instead of those listed taxes;
- being subject to corporate income tax (IRES) without being exempted.

b. The receiving party requirements

The receiving party may be either (i) a company fiscally resident in an EU Member State or (ii) a permanent establishment situated in a EU Member State of a company fiscally resident in a EU Member State. According to Art. 26 quater of the D.P.R. 600/73 a company fiscally resident in an EU Member State must meet all the following conditions:

- having one of the legal forms provided for by Annex A;
- being fiscally resident in a EU Member State and not considered as resident outside the European Union according to a double taxation convention with a third State;
- being subject to one of the taxes listed in Annex B, without being exempted, or to an identical or substantially similar tax applied in addition or instead of those listed taxes.

A permanent establishment situated in an EU Member State of a company fiscally resident in an EU Member State must meet the following conditions:

- its head office must be a company having one of the legal forms provided for by Annex A;
- its head office must be fiscally resident in an EU Member State and not considered resident outside the European Union according to a double taxation convention with a third State;
- its head office must be subject to one of the taxes listed in Annex B in the state where the permanent establishment is located, without being exempted, or to an identical or substantially similar tax applied in addition or instead of those listed taxes.

Regarding the requirement of being subject to corporate income tax (IRES), the Guideline No 47/E clarifies that it must be a “general” subject-to-tax requirement not only referring to Italian corporate income tax (IRES). Therefore, companies, which are normally subject to corporate

income tax but benefit from a tax relief provided by a regime that is compatible with EU tax law, would qualify for the exemption.

c. Subject-to-tax clause

According to Art. 26 quater (4) of the D.P.R. 600/73, in any case, the withholding tax exemption is applicable only if the interest and royalties paid to a non-resident company are subject in the hands of the receiving party to one of the taxes listed in Annex B of the D. Lgs. n. 143/2005. In this respect, the Guideline No 47/E of the Tax Administration Office specifies that interest and royalties may not be subject to a preferential tax regime in the state of the recipient, that is not compatible with EU tax law.

2.2.4. Associated company (Art. 3(b))

According to Art. 26 quater (2) of the D.P.R. 600/73, a further condition requires that the company that makes the payment, and the company that benefits from the payment, must be "associated" (*società consociate*) as per the wording of the Directive, i.e.:

- the first company directly holds a participation equal to at least 25% of the voting rights in the second company; or
- the second company directly holds a participation equal to at least 25% of the voting rights in the first company; or
- a third company, fulfilling the requirements under Annexes A and B of the Decree, directly holds a participation equal to at least 25% of the voting rights in both the first and the second companies.

In the last case, Art. 26 quater expressly excludes from the entitlement of the exemption, interest and royalties payments made by a third company that is considered resident outside the European Union according to a double taxation convention with a third state.

It should be noted that the holding must be direct; indirect holdings should not be taken into account.

Article 26 quater provides that the voting rights in Italian entities must be exercised in the Ordinary shareholders meeting contained in articles 2364, 2364-bis and 2479-bis of the Italian Civil Code.

According to the Guideline No 47/E of Tax Administration, the exemption applies when a company holds a participation equal to at least 25% of the voting rights not only through a property title but also through all other titles on the shares attributing voting rights in the shareholders meeting (e.g. lien on shares).

2.2.5. Beneficial ownership (Art. 1(4))

The withholding tax exemption is applicable only if the receiving party is the beneficial owner of the interest and royalties. According to Art. 26 quater (4)(c) of the D.P.R. 600/73 the recipient is treated as the beneficial owner of interest and royalties in the following situations:

a) the receiving company is the final beneficiary and not acting as an intermediary, an agent, a delegate or a fiduciary of another person;
b) the permanent establishment if the debt claim, the right, the use or the information generating interest or royalty payments are effectively connected to such permanent establishment (see below).

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The beneficial owner requirement as provided in Art. 26 quater (4)(c) is linked to the subject to tax requirement (see 2.2.3. *b. The receiving party requirements).*

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

A definition of the term "permanent establishment" has been introduced into domestic legislation with effect from financial years staring on or after 1 January 2004 (Art. 162 T.U.I.R.). The definition follows the wording of Art. 5 of the OECD MC, with the following deviations:
computers and auxiliary equipment for the collection of information and the transmission of data for the sale of goods or services will not of themselves constitute a permanent establishment; and
maritime trade agents or trade brokers entitled to manage vessels of non-residents will not of themselves constitute a permanent establishment.

Art. 5(2) of the OECD MC contains a list of examples a priori permanent establishment under domestic law that will be regarded as permanent establishments, including a place of management, a branch, an office, a factory, a workshop, a mine, quarry or any other place of extraction of natural resources. Furthermore, according to Art. 5(3) OECD MC a building site or construction or installation project constitutes a permanent establishment only if it lasts for more than 12 months (3 month under domestic law).

The treaties concluded by Italy generally follow the definition of a permanent establishment contained in Art. 5 of the 1963 version of the OECD MC, even if they are concluded after publication of later versions of the OECD MC.

Several treaties, however, contain deviations from the OECD MC. With respect to Art. 5(2), the list is in some cases extended by "a farm or plantation" (e.g. the treaty with Malaysia) or "a warehouse in relation to a person providing storage facilities for others" and "premises used as a sales outlet or for receiving or soliciting orders" and the like (e.g. Ivory Coast). There are many deviations regarding the duration that a building site or assembly (or installation in several treaties) project must have to be considered a permanent establishment; the duration ranges from 6 months (e.g. India) or 9 month (e.g. Estonia) to 36 months (the former USSR).

Moreover, it is not uncommon to find a clause equal or similar to the UN Model Treaty with regard to supervisory activities on building sites (e.g. China (People's Rep.), Malaysia, Malta, New Zealand) or provisions of services through specific personnel (e.g. Indonesia, Pakistan).

Under several treaties, a "dependent agent" constitutes a permanent establishment if he, though not having the authority to conclude contract for the enterprise he represents, has a stock of goods or merchandise from which he regularly fills orders for such enterprise (e.g. Indonesia, Malaysia, Thailand, Turkey). With regard to the definition of "independent agent", some treaties (e.g. Estonia, Mexico, Pakistan) provide that an independent agent constitutes a permanent establishment of a non-resident enterprise if his activities are devoted mainly to servicing that enterprise.

In some cases, the insurance of risks in one state by an enterprise of the other state can also give rise to permanent establishment tax liability (e.g. Brazil, Mexico, Indonesia).

With respect to the concept of permanent establishments under tax treaties, it is not clear whether the definitions of a permanent establishment in each particular treaty concluded by Italy and another EU Member State could also apply for the implementation of the Directive.

2.3.2. Application of source rules (Art. 1(2))

At this stage, we are not aware of any instances where the source state would have interpreted Art. 3 of the Directive more narrowly than Art. 5 of the OECD MC and as consequence would have imposed withholding tax on interest or royalty payments from its sources to an associated company in another Member State.

2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

The Art. 26 quater (1) of the D.P.R. 600/73 provides that when the paying party is a permanent establishment located in Italy, in addition to all general conditions that must be fulfilled by the paying party (2.1.5. a. *The paying party requirements),* it is required that interest and royalties paid must be connected with the activities carried on by such permanent establishment and attributable to it.

2.3.4. Beneficial ownership (Art. 1(5))

The withholding tax exemption is applicable only if the receiving party is the beneficial owner of interest and royalties (see 2.2.5 Beneficial ownership, above). For this reason, Art. 26 quater (4)(c)(2) of the D.P.R. 600/73 introduced the definition of beneficial owner of interest and royalties referred to a permanent establishment.

A permanent establishment must be considered as beneficial owner of interest and royalties if:

- the debt claim, the right, the use or the information generating interest or royalty payments are effectively connected to such permanent establishment ;
- the interest or royalty payments represent income in respect of which that permanent establishment is subject in the Member State in which is situated to one of the taxes mentioned in the Annex B or in the case of Belgium to the “*impôte des non-rèsidents/belasting der niet-verblijfhouders*” or in the case of Spain to the “*Impuesto sobre la Renta de no residentes*” or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of the Directive in addition to, or in place of, those existing taxes.

To exempt payments to a permanent establishment that is the beneficial owner of an interest or royalty payment, in addition it is required that all the other conditions are fulfilled. Therefore, the paying and the receiving companies must be associated companies, listed in Annex A and subject to tax (see above).

2.3.5. Permanent establishment in a third country (Art. 1(8))

The exemption under the Directive does not apply to permanent establishments located in a non-EU Member State. One of the conditions laid down under the Decree No 143/2005 for application of the withholding tax exemption is that the income derived by the permanent establishment must be subject to a corporate income tax as listed in Annex B or to any equivalent tax in the member state of the permanent establishment. This requirement excludes payments to a permanent establishment in a third state from the scope of application of implementing provisions.

3. PROCEDURE

The requests for the application of the exemption are substantiated by an attestation of the beneficial owner's residence issued by the tax authorities of the relevant Member State, and by a declaration of the beneficial owner regarding the fulfillment of the requirements laid down in annexes A and B of the of the D.P.R. 600/73. In addition, the attestation must demonstrate that the payer and the recipient of the interest and royalties have been associated for an interrupted period of at least 1 year (see 3.1 Minimum holding period, below). In case the receiving company does not submit the attestation, it is not entitled to the withholding tax exemption at the time of the income payment. However, the receiving company may submit a claim (istanza di rimobrso) at the end of the 1-year holding period in order to obtain a refund of the withholding tax levied at source (see 3.4 Application for refund, below).

3.1 MINIMUM HOLDING PERIOD (ART. 1(10))

3.1.1. General

The Italian legislator implemented the minimum 1-year holding period by following the same solution adopted for the implementation of the Parent-Subsidiary Directive, as contained in the Art. 27-bis of D.P.R. 600/73.

3.1.2. Relief before the holding period requirement is satisfied

The Italian guideline No 47/E of Italian Tax Administration, clarified that if at time of the income payment the 1-year minimum holding period is not yet satisfied the recipient will not be exempt from the withholding tax. When the minimum period will pass and all conditions for the application of the exemption will be fulfilled, the receiving company may claim a refund of the withholding tax levied at source before the holding period elapsed. The refund can be claimed with the special Italian Tax Office “Centro Operativo di Pescara dell`Agenzia delle Entrate”.

3.1.3. Appeals

Italian law does not require the taxpayer to submit a request for obtaining benefits of the Directive.

3.2. ATTESTATION (ART. 1(11) AND 1(13))

3.2.1. General

a) Beneficial owner's attestation
The Italian law implementing the Directive provides that to benefit from the withholding tax exemption, the beneficiary company must submit an attestation before the interest and royalty payment is made. The beneficiary must submit such attestation to the payer of the income before the actual payment is effected.

According to Art. 26 quater (6) of the D.P.R. 600/73 the attestation must include the following information regarding the beneficiary:

- it has one of the legal forms provided for by Annex A to the Decree No 143/2005;

- it is fiscally resident in an EU Member State and not considered in addition resident in a third non-EU country (*dual residence*), which has a double taxation convention with the first that State in which the third state has the right to tax;
- it is subject to one of the taxes listed in Annex B, without being exempted, or to an identical or substantially similar tax applied in addition or instead of those listed taxes;
- the interest and royalties received are subject to one of the taxes listed in Annex B of the Decree No. 143/2005;
- it is the beneficial owner of the interest and royalty payment;
- it has the *status* of "associated company";
- it holds the shares in the associated company for at least 1-year.

b) Tax Authority's attestation
In addition to the attestation of the beneficial owner itself, the tax authorities of the relevant Member State must issue an attestation confirming the residence of the beneficial owner. If the beneficial owner is a permanent establishment, the attestation must confirm the existence of the permanent establishment.

3.2.2. Appeals

In case the receiving company does not fulfill the conditions described in 3.1.1, the latter is not entitled to the withholding tax exemption at the time of the income payment. However, the receiving company may claim a refund of the withholding tax levied at source with the special Italian Tax Office "Centro Operativo di Pescara dell`Agenzia delle Entrate".

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

Italian law does not require a decision on the application of the relief.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

In case the withholding tax has been unduly levied at source, Italy provides for a refund procedure. Such withholding tax refund may take place in the situation where the withholding tax exemption was not applied at source, because the 1-year holding period was not fulfilled, and the conditions described above in 3.1.1 were not met.

3.4.1. General

In case the withholding tax was unduly levied at source, companies may submit an application for refund to the tax administration including all the documents mentioned above (see 3.2 Attestation). According to Art. 2 of the Decree No 143/2005 that amended Art. 38 of the D.P.R. n. 602/1973, the withholding tax must be refunded:
- within 1 year after the date of the application for refund; or
- within 1 year after the date on which the Tax Administration acquired the knowledge of all requested information.

In case the withholding tax is refunded more than one year after the request, it will include a payment of interest for late payments provided in Art. 44 (1) of the D.P.R. n. 602/1973. Currently, the interest rate for late payments on tax refund are 2,75% per year and 1,75% per six months.

3.4.2. Asking for refund for income accrued after 1 January 2004

The Decree No 143/2005 that implemented the Directive applies retroactively to interest and royalties accrued as of 1 January 2004. Therefore qualified interest and royalties falling under the regime described above and accrued as of 1 January 2004 are in principle exempt from Italian withholding taxes.

As a consequence:

(i) the receiving party of qualified interest and royalties accrued as of 1 January 2004 and paid before the entry into force of the Decree No 143/2005 (26 July 2005) may ask to the paying party for the refund of any withholding tax levied (subject to documentary requirements);

(ii) the receiving party of qualified interest and royalties accrued as of 1 January 2004 and paid after the entry into force of the Decree No 143/2005 (26 July 2005) may either ask to the paying party to directly apply the exemption regime (subject to documentary requirements) or ask to the competent Italian tax authority for refund of the withholding tax levied (subject to documentary requirements).

In the case (i), according to Art. 4 of the Decree No 143/2005 the refund must be paid directly by the withholding agent that levied the withholding tax without the interest for late payments.

According to Art. 17 of Legislative Decree No 241 of 1997, the withholding agent may request a refund of the tax withheld in the form of the tax credit. In both cases (i) and (ii) the beneficial owner's request for refund must include the two attestation mentioned above (see 3.2 Attestation) to proof that all the requirement for the exemption are met.

The Guideline No 47/E of Italian Tax Administration clarified that when the date of such attestation is subsequent to the date of levy of withholding tax, the attestation must prove that all the requirements to benefit from the withholding tax exemption were fulfilled at the moment of the withholding tax payment.

If at the time of the attestation the requirements are not still fulfilled, the attestation must specify the date since those requirement are not fulfilled.

When the substitute payer is in a bad debt situation the beneficial owner may submit the application for refund directly to Tax Authority, according to Art. 38 of the D.P.R. n. 602/1973.

Finally, it must be considered that the Decree limits the applicability of the withholding tax exemption and related refund procedures to interest and royalties accrued as of 1 January 2004. It could be argued that such a limitation is not a correct implementation of the Directive, thus opening the possibility to ask for the refund of any withholding tax applied on interest and royalties paid after 1 January 2004 even if accrued before such date. It is likely that such a refund would not be granted by the Italian tax authorities.

3.4.3. Appeals

In case the tax administration did not answer the in deadlines as described in 3.4.1, the taxpayer may bring its case to the lower Administrative court.

3.5. Transitional rules for Italian recipients (Art. 6)

Art. 6 of the Directive, as amended by the Directive 2004/76/EC, provided some transitional measures for Greece, Spain, Portugal, Czech Republic, Lithuania, Latvia, Slovenia and Poland.

According to Guideline No 47/E of the Italian Tax Administration, an Italian company or an Italian permanent establishment of a company of an EU Member State receiving:

- interest and royalty payments from an associated company located in Greece, Latvia, Lithuania, Poland and Portugal; or
- royalty payments from an associated company located in Czech Republic, Spain or in Slovenia; or
- interest and royalty payments from a permanent establishment of an associated company of a EU Member State and located in Greece, Latvia, Lithuania, Poland and Portugal; or
- royalty payments from a permanent establishment of an associated company of a EU Member State and located in Czech Republic, Spain or in Slovenia, are entitled to a foreign tax credit equal to the amount of withholding tax paid abroad, as contained in Art. 165 of the Italian Income Tax Act.

4. FRAUD AND ABUSE (Art. 5)

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

Italian tax law does not contain a general anti-avoidance provision allowing the tax authorities to disregard all tax-motivated transactions. Tax avoidance is dealt with through specific provisions intended to counter specific tax avoidance practices.

According to Art. 37-bis of the D.P.R. 600/73, the tax authorities may disallow the tax advantages obtained through any act or transaction carried out without valid economic reasons and for the purposes of circumventing obligations or prohibitions contained in Italian law and of obtaining a tax saving. This applies only if the tax advantage results from:

- mergers, divisions, transformations and liquidations and distributions to shareholders of reserves not consisting of profits;
- contributions to companies and transactions for the transfer or utilization of business assets;
- transfers of debt claims and tax credits;
- EU mergers, divisions, transfers of assets and exchanges of shares;
- transactions concerning securities and financial instruments; or
- transfers of assets between companies within the same consolidated tax group.

In order to disregard the above operations for tax purposes, the tax authorities must first inform the taxpayer of the reasons for the application of the anti-avoidance provision. The taxpayer has the right to provide justifications. If such justifications are rejected, the tax authorities must expressly state the reasons for such rejection in the notice of assessment. In such situation the beneficial owner may request for an advance ruling as contained in Art. 21 of Law No 413/91 to prove to the tax authorities that the principal purpose, or one of the principal purposes, of the chain of participation is not to benefit from the withholding tax relief.

4.1.2. Agreement-based

Certain tax treaties concluded between Italy and certain Member States contain anti-abuse provisions. It is not clear whether the tax authorities will apply such anti-abuse provisions for transactions covered by the Directive.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

The scope of Art. 37-bis of the D.P.R. 600/73 has been extended to payments of interest or royalties made to persons who are directly or indirectly controlled by one or more persons established outside the European Union.

4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES.

As mentioned above Art. 37-bis of the D.P.R. 600/73 applies to transactions covered by the Merger Directive and as from 2005 to transactions falling under the Directive. On the other hand, no express provision covers payment of dividend.

5. SUMMARY

On 26 July 2005 the Legislative Decree No. 143/2005 implementing the Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated enterprises, has been published on the Official Gazette and entered into force on the same date.

The Decree introduces various new provisions into the Italian tax system and provides some amendments to existing rules.

In particular, the Decree provides that, under certain conditions, interest or royalties paid by an Italian resident company or by the Italian permanent establishment of a company resident in another EU Member State (the paying party) to a company resident in another EU Member State or to the permanent establishment situated in another EU Member State of a company of a EU Member State (the receiving party) will be exempt from Italian withholding taxes.

The new provisions are applied to “qualified” interest and royalties accrued as of 1 January 2004.

Objective scope

The Decree contains a definition of interest and royalties benefiting from the withholding tax exemption.

Interest is defined as income from debt-claims of every kind, whether or not secured by mortgage and, in particular, income deriving from securities, bonds and loans, including other proceeds deriving from the securities and loans mentioned above.

Royalties are defined as the remuneration of any kind received for the use of, or the right to use:
a) copyright of literary, artistic or scientific works, including cinematograph films and software;
b) patents, trade marks, designs or models, plans, secret formula or processes, or information concerning industrial, commercial or scientific experiences;
c) industrial, commercial or scientific equipments.

In any case, the withholding tax exemption under discussion is not applicable to interest and royalties exceeding the arm’s length value.

Subjective scope

Italy implemented the provisions laid down in Art. 3 (a) and 3(b) of the Directive. Several conditions concerning the paying party, the receiving party and their relationship are provided.

The paying party may be either (i) a company or an entity fiscally resident in Italy or (ii) an Italian permanent establishment of a company fiscally resident in another EU Member State and must meet all the conditions mentioned in the Directive: having one of the legal forms provided for by Annex and being subject to corporate income tax (IRES) without being exempted. In case of a permanent establishment, its head office must fulfill all the requirements also and interest or royalties paid must be connected with the activities carried on by such permanent establishment.

The receiving party may be either (i) a company fiscally resident in a EU Member State or a permanent establishment situated in a EU Member State of a company fiscally resident in a EU Member State and must meet all the following conditions: having one of the legal forms provided for by Annex A; being fiscally resident in a EU Member State and not considered as resident outside the European Union according to a double taxation convention with a third State; being subject to one of the taxes listed in Annex B, without being exempted, or to an

identical or substantially similar tax applied in addition or instead of those listed taxes. In case of a permanent establishment, its head office must fulfill all the requirements also.

In order to benefit from the withholding tax exemption, it a special relationship between the paying and the receiving parties is required. Such a relationship is deemed to exist when:
a) one party (the paying party or the receiving party) directly owns a participation that gives right to not less than 25% of the voting rights of the other party (the receiving party or the paying party); or
b) a third company (having one of the legal forms provided for by Annex A, being fiscally resident in a EU Member State and not considered resident outside the European Union according to a double taxation convention with a third State, and subject to one of the taxes listed in Annex B, without being exempted, or to an identical or substantially similar tax applied in addition or instead of those listed taxes) directly owns a participation that gives right to not less than 25% of the voting rights of the paying and of the receiving party.

In any case, the participation must be uninterruptedly held for at least one year and must be a direct shareholding.

This strict interpretation of the Directive does not allow payments through a hybrid entity to benefit from the withholding tax exemption. The tax agency may deny the application of the withholding tax exemption on the basis of (i) the indirect character of the participation and (ii) the failure to meet the subject-to-tax test provided for in Art. 3 (a) (iii) of the Directive.

Procedure

Italy adopted the system of withholding tax exemption at source, by means of two attestations: the first submitted by the beneficial owner about the requirements requested for the benefit and the other by the tax authorities of the relevant Member State about the beneficial owner's residence.

The beneficiary of the payment may not benefit from the withholding tax exemption before the completion of the 1-year uninterrupted holding period provided that certain requirements are met. In addition, Italian law provides for a refund procedure in case the withholding tax was unduly levied. There is a particular procedure for the refund of interests and royalties accrued as 1 of January 2004 and paid before the entry into force of the Decree (26 of July 2005).

Fraud and abuse

In order to avoid abuses in the application of the newly enacted provisions under discussion, some anti-avoidance rules have been introduced:
(i) the withholding tax exemption is applicable only if the receiving party is the beneficial owner of interest and royalties;
(ii) in any case, the withholding tax exemption under discussion is applicable only if the interest and royalties paid are subject in the hands of the receiving party to one of the taxes listed in Annex B;
(iii) the withholding tax exemption may be denied if the recipient company is controlled by non-EU residents.

PART II. THE AGREEMENT

To date, there has been no legislative or other regulatory measures concerning the ratification or interpretation of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments or its Memorandum of Understanding in Italy.

Under the Italy-Switzerland tax treaty and protocol of 9 March 1976, as amended by the protocol of 28 April 1978, and in force from 27 March 1979, interests are subject to a 12,5% withholding tax and royalties to a 5% withholding tax in the source state. In addition, if the patent royalties, dividends or interests are derived through a permanent establishment which the Swiss company maintains in Italy, the income is included in the taxable profits of the permanent establishment and is subject to corporate income tax under the standard rules.

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ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Italy and the EU Member States.

EU Member State	Interest (%)	Royalties (%)
Austria	0/10<1>	0/10<4>
Belgium	15	5
Cyprus	10	0
Czech Republic	0	0/5<3>
Denmark	0/10<1>	0/5<5>
Estonia	10	5/10<6>
Finland	0/15<1>	0/5<2>
France	0/10<7>	0/5<2>
Germany	0/10<7>	0/5<3>
Greece	0/10<1>	0/5<3>
Hungary	0	0
Ireland	10	0
Lithuania	0/10<1>	5/10<6>
Luxembourg	0/10<1>	10
Netherlands	0/10<1>	5
Poland	0/10<1>	10
Portugal	0/15<1>	12
Slovak Republic	0	0/5<3>
Slovenia	10	10
Spain	0/12<1>	4/8<2>
Sweden	0/15<1>	5
United Kingdom	0/10<7>	8

<1> The 0% rate applies, inter alia, to interest paid by public bodies.
<2> The lower rate applies to copyright royalties, excluding films, etc.
<3> The lower rate applies to copyright royalties, including films, etc.

<4> The higher rate applies if the Austrian company owns more than 50% of the capital in the Italian company.

<5> The lower rate applies to copyrights of literary, artistic or scientific work, excluding royalties for software and films, etc.

<6> The lower rate applies to equipment leasing.

<7> The lower rate applies to interest on public bonds and trade credits, and to interest arising from the sale of equipment.