Italy:
Treatment of interest on certain medium or long-term loans clarified

In a ruling dated 29 September 2016, Italy’s tax authorities clarified that if interest qualifies for the domestic withholding tax exemption for certain medium and long-term loans, the interest is not subject to tax in Italy as financial income and the nonresident lender is not required to file an Italian tax return.

Background

Under Italian tax law, foreign companies with a permanent establishment (PE) in Italy are subject to Italian taxation on the income realized through, and attributable to, the PE. Foreign companies without an Italian PE are taxed on Italian-source income based on the specific rules provided for the category of income realized (financial income, real estate income, etc.).

Financial income (such as interest) paid by an Italian company generally is subject to a specific withholding tax regime, under which interest payments made by an Italian company to a foreign company are subject to a domestic withholding tax of 26% (12.5% before 1 July 2014). However, an exemption or a reduction in the withholding tax rate may apply under the EU interest and royalties directive or an applicable tax treaty.

Italy’s legislation was amended in 2014 to introduce a domestic withholding tax exemption that applies to interest payments and other income arising from medium or long-term loans (generally, loans with a duration longer than 18 months) granted to Italian companies by certain nonresident entities. The provision targeted interest payments to the following recipients: (i) banks established in the EU; (ii) insurance companies incorporated under the provisions of an EU member state; and (iii) certain nonleveraged collective investment undertakings (OICRs) based in the EU (or a European Economic Area country included on Italy’s “white list”), even if the OICR was transparent for tax purposes.

The domestic exemption provision was modified in January 2015, and again in February 2016. As a result of the modifications:

- The reference to nonleveraged OICRs has been replaced by a reference to foreign institutional investors subject to regulatory supervision in their country of establishment, even if the investor is transparent for tax purposes; and
- Qualifying loans must be granted in accordance with the rules provided by the Italian banking law.

Ruling

The ruling was based on a request by an Austrian bank that granted a long-term loan to an Italian company as to whether the interest payments from the Italian borrower that qualified for the withholding tax exemption still would be taxable in Italy as financial income realized by a nonresident company without an Italian PE, and whether an Italian tax return had to be filed to declare and pay tax on the income.

The tax authorities clarified that, if all the requirements necessary to qualify for the withholding tax exemption are met, the interest income earned by the foreign lender is not taxable in Italy and, thus, no tax return has to be filed; such interest is taxable only in the lender’s country of residence (in this case, Austria).

The tax authorities also clarified that, in line with the modifications to the exemption described above, the bank granting the loan must meet certain requirements provided by the Italian banking law concerning the authorization to carry out banking and financing activities with the public.

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