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CHARTERED ACCOUNTANTS

Italian tax treatment of inbound and outbound royalties

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1. Foreword

Italian tax rules on the cross-border taxation of royalties 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 royalties.

The taxation of the relevant payment may vary depending on several features (including the legal arrangement the royalty derives from); accordingly, only some of the main tax regimes applicable to royalty payments will be described below.

2. Outbound royalties

According to Art. 23 of Presidential Decree no. 917/1986 ("**TUIR**") royalties are 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 in connection with the use of any copyright patent, trade-mark, or process, formulas and information concerning industrial, commercial or scientific experience;
- they are paid in connection to rights/assets located in Italy.

Royalties that are 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 royalties 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 royalty is subject to tax in the payor jurisdiction;
- the payor qualifies as the beneficial owner of the royalty;
- 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 distribution, the non-resident recipient entity will only be entitled to claim for a refund of the withholding suffered.

Royalties paid to Swiss companies

A similar set of rules is also provided for by outbound royalties 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-*quater* lies in the holding period (in the EU-Switzerland agreement it is equal to 2 years).

Interest&Royalty Directive (European companies as recipients)

REQUIREMENTS (ART. 26-*QUATER* PRESIDENTIAL DECREE 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 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 royalties (as, in most of its treaties, contrary to the provisions of the OECD Model, Italy has agreed on a tax sharing clause with respect to royalties - usually 5% 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 above are not met.

The Italian Tax Authorities have issued a specific form to that extent (**Form C**, 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).

2.3 Domestic Withholding Tax

Where none of the regimes described above may apply, Italian domestic law provides for a final 30% rate withholding on outbound royalty payments.

Depending on the kind of royalty, the taxable base to which the withholding is applied may vary.

Outbound royalty

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 **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 (Tax Treaty Reduction)	Withholding tax provided in the Tax Treaty (usually, 5% or 10%)	Form C (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 (30%)	None

3. Inbound royalties

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, the royalties derived form part of the business income of the relevant fiscal year and are ordinary taxed in the hands of the entrepreneur pursuant to the relevant **income tax rates**;
- if an individual is not engaged in an entrepreneurial activity, the income might be reduced for tax purposes depending on its nature (see table below).

TYPE OF INCOME	TAXABLE BASE
Income derived from the use of copyrights, patents, formulas, etc., by the author or inventor	Amount received reduced by 25%, or 40% if the recipient is under 35
Income derived from the use of copyrights, patents, formulas, etc., by a person other than the author or inventor	Amount received reduced by 25% if the rights were acquired against compensation
Other residual royalties types	Difference between the amount received and the related expenses

If the source country has applied a withholding on the royalty inbound payment, then such withholding may usually be considered as a foreign tax credit and be off-set against taxes paid in Italy.

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**).

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) has a 24% flat rate, reduced to 12% for some no-profit organisations and increased to 27.5% for banks and other financial institutions.

Form C

Form needed to claim for the application of reduced rates or refund on royalties 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 28.000 EUR);
- 35% (28.001 to 50.000 EUR);
- 43% (over 50.000 EUR).

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.

IRAP

Regional tax on productive activities levied on companies at 3.9% rate (which may vary depending on several factors).

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.).

TUIR ("Testo Unico delle imposte sui redditi")

Italian Income Tax Code, enacted through Presidential Decree no. 917/1986.

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