Taxation of Foreign Dividends

Dividends represent profits deriving from the possession of a shareholding. This article will analyze the taxation of dividends from foreign sources deriving from participation in a foreign company, received by a non-entrepreneurial natural person (i.e., individual) resident in Italy, or a company based in Italy.

Foreign dividends received by individuals resident in Italy

Dividends received by natural persons (outside the earnings of an individual business) are considered, from the fiscal point of view, capital income. In particular, the dividend from a company is considered capital gain if:

- The income derives from participation in the capital or assets of a non-resident company;
- The foreign entity does not deduct the remuneration in question from its income.

Currently, Italian tax legislation provides that dividends received by non-entrepreneurial individuals from both Italian and foreign sources, regardless of the percentage of participation in the capital of the company that pays the dividend, call for a fixed taxation of 26%.

It should be noted that the dividend from a foreign source, at the time it is disbursed, is generally subject to outgoing tax withholding, if the regulations of the country of origin of the dividend provide for it. However, bilateral agreements against double taxation establish exemptions or reductions to the application of withholding taxes on dividends, generally providing that they do not exceed 15%.

This means that the person, an individual fiscally resident in Italy, who receives the dividend, is subject to:

- a first taxation at source (normally not exceeding 15%), deriving from the application of the withholding tax from the country of payment of the dividend;
- a subsequent 26% taxation in Italy on the foreign dividend received.

This Italian tax of 26%, for the purpose of mitigating double taxation, has as its tax base the entire original dividend paid. The taxable amount to be subjected to 26% taxation in Italy corresponds in fact to the amount of the dividend net of the withholding tax withdrawn from the country of origin (so-called "net border").

Finally, it must be kept in mind that if the dividend comes from a company resident in a state or territory with a privileged tax regime (see below for the definition of "privileged tax regime") in Italy it is taxable for the entire amount, with rate-progressive IRPEF (from 23% to 43%) instead of taxation at a flat rate of 26% as described above.

Foreign dividends received by companies resident in Italy

With regard to individuals who operate as an enterprise in Italy and to companies resident in Italy, the dividend received represents business income (rather than capital income).

In principle, 95% of the profits distributed by foreign entities to companies resident in Italy are excluded from the formation of the company's income. Therefore, based on current Italian tax legislation, dividends received by resident companies are taxable only to the extent of 5% in the tax period in which the dividends are collected (cash regime).

The exclusion from the tax base of 95% of dividends from foreign sources is provided for with the exception of those coming from subjects resident in the States or territories with a privileged tax regime (so-called "tax havens" or "black list" countries).

In this case the dividends contribute in full to the formation of the taxable base of the business income.

In order to establish whether a State is to be considered as a privileged tax system, it is necessary to verify whether the foreign country's tax level is 50% lower than the Italian tax regime.

In particular, a foreign State, other than those belonging to the European Union or to the European Economic Area, with which Italy has entered into an agreement that ensures an effective exchange of information, are considered to have a privileged tax regime:

- in the event that the foreign company is controlled by a resident individual and is subject to effective taxation of less than 50% of that to which it would have been subjected if said foreign company were resident in Italy;
- in the absence of the control requirement, if the nominal level of taxation is less than 50% of that applicable in Italy.

If at least one of the above conditions is met, foreign dividends will be fully taxable in Italy.

The full taxation of profits from "tax havens" can be disregarded by demonstrating that the foreign dividends do not result in the effect of situating the earnings in States or territories with a privileged tax regime.

– by MGI Vannucci e Associati