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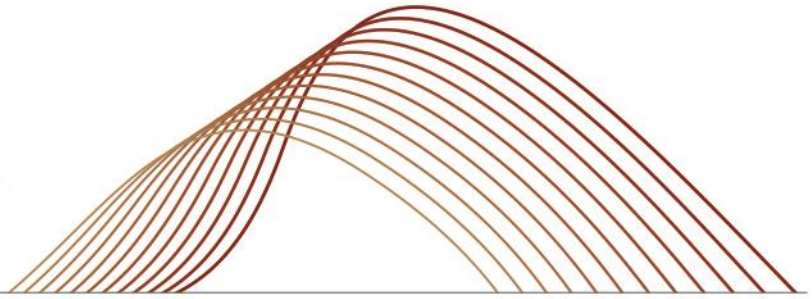

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Italy: Cayman Funds under the Spotlight

By Patrizio Braccioni

Background

In a ruling (*risposta ad interpello*) delivered last week (Ruling n. 78/E of 27 June, or "Ruling 78") the Italian Tax Agency ("ITA") ruled on the evidence requirements a U.S. asset manager of a Cayman Fund should provide in order to obtain withholding tax exemption on proceeds paid by an Italian real estate fund to the Cayman entity.

Art. 7, par. 3 of Decree Law 25 September 2001 n. 351, which deeply reformed real estate funds in Italy, provides that the proceeds of real estate funds are not subject to withholding tax when paid, inter alia, to funds set up in white-listed countries where the fund or its asset manager are locally regulated.

The initial interpretation of ITA in Circular n. 2 of 2012 about such requirements was that the evidence being regulated should be provided through a statement released by local regulators that the entity was in fact regulated.

Cayman Islands, like many other low-tax countries, were inserted in the Italian white list last August (see our previous Alert on the subject matter) thanks to the tax information agreement signed with Italy. The "white list" is in fact the list of countries who exchange tax information with Italy, which gives rise to tax benefits in Italy—mainly exemption from withholding tax of interest and other payments.

Cayman Funds are normally managed by U.S.-based asset managers, who are regulated by the Securities and Exchange Commission ("SEC"). In the case at hand, in fact, the asset manager was based in Delaware.

The SEC does not deliver any specific form, certificate, or statement related to entities under its regulatory control.

The lack of such formality and the subsequent denial of exemption from withholding tax could have been an obstacle for Cayman funds investing into Italian real estate funds.

The ruling request proposed the solution that, instead of submitting a statement from the SEC, the "Form ADV," which is the official form by which asset managers submit to SEC their regulatory requests, should have the same effects from a tax perspective.

ITA expressly admitted this solution as correct and viable.

The Importance of the Ruling

In our view, the issue of the SEC statement vs. Form ADV addressed by the ruling is not the main important item of the ruling, though it has "per se" some importance.

Formalities and certifications still have a relevant role in international taxation matters, especially in Italy, and they should never be under-evaluated by foreign investors.

However, the relevant points derived from Ruling 78 go further than the above.

At first, ITA, which has described the legal nature of the Cayman Fund as an exempted limited partnership, has also accepted its qualification as "fund" according to art. 1, par. 1, lett. j) of the Italian Finance Law, (*Testo Unico della Finanza* or "*TUF*") , Law 28 February 1998 n. 28, which is the basic comprehensive law related to Italian financial markets.

This directly implies that, from a tax perspective, the Cayman exempted limited partnerships are qualified as "funds," thus benefitting from the tax exemption on proceeds of real estate funds provided by Law 351/2001.

Though ITA is not a public authority competent for regulatory matters but only for tax matters, the qualification provided for tax purposes under a regulatory background is extremely important and reasonably gives ground to minimize doubts on the qualification of Cayman Funds also under Italian regulatory provisions.

Secondly, the attitude of ITA has been flexible, while in the past any hint toward entities resident in low-tax jurisdictions (like the Cayman Islands) brought an attitude of suspicion and of a strong formalistic approach. In Ruling 78, on the contrary, ITA has shown a solution-oriented and practical attitude, which was not the case in the past.

Thirdly, ITA has also stated that the control over the asset manager being a regulated entity, thus allowing the withholding tax exemption, will be checked by examining the SEC internet site.

We have not made a deep analysis on specific precedents; however, it was uncommon in the past that ITA could rely on internet sites of foreign authorities. ITA wanted "sheets of paper" in their hands to make the controls, while now full reliance is attributed to information directly derived from internet sites.

From an institutional perspective, responses to rulings are limited to the specific case submitted to ITA, and nobody should rely on them for cases different from the one examined. However, it is likely that this position could be taken in cases similar to the one at hand with regulatory authorities different from the SEC.

Nonetheless, to be certain of receiving a confirmation of the said principle, a new ruling should be submitted.

Conclusion

Ruling 78 unofficially opens the Italian gates to Cayman Islands funds investments into Italy.

The ruling deals specifically with investments into Italian real estate funds, but the same principle could also apply in respect to Italian debt (e.g., bonds, including securitisation notes) and other financial instruments, where, for the foreign investor (e.g., the fund or the asset manager), being resident in white-list countries and providing all regulatory requirements are in place both become essential keys for investing into the Italian financial market at very attractive tax conditions.

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