



Italy: Beneficial ownership

Tax Alert
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On 28 December 2016, in Decision no. 27113/2016, the Italian Supreme Court issued important guidance on the 'beneficial ownership' concept in the Italian legislative framework. The Supreme Court stated that the lack of an organizational structure and employees, coupled with limited operating costs and receivables, does not in itself prevent a holding or sub-holding company from qualifying as the 'beneficial owner' of dividends for Double Tax Treaty (DTT) purposes.

Background facts

The case involved a French company (fully owned by a US ultimate parent company) which received dividends from its Italian subsidiary in 2002. Dividends were distributed to the French shareholder net of withholding tax. The French company claimed the tax credit under the Italy- France DTT; however, the Italian Tax Authorities denied the tax refund, stating that (i) the French company was not the beneficial owner of the dividends, as it was a mere conduit company, being 100% owned by the American parent company, and that (ii) the French company did not have its place of effective management in France, since it did not have any administrative/managerial structure or employees there, and thus did not bear the related costs.

The Regional Tax Court (the second-tier tax court in Italy) sided with the Italian Tax Authorities, defining the French company as a mere conduit company, whose only aim was to take advantage of the tax benefits deriving from the DTT and to transfer all profits to the 'real' beneficial owner in the US (at that time, dividends directly paid from Italy to US would have been subject to a permanent withholding tax). In particular, the Regional Tax Court based its conclusion on the following arguments.

- The Italian dividend payer was controlled through a chain of ownership, which included the French recipient but showed the US parent company to be the real beneficial owner of the dividends.
- The French company owned a large amount of shares but was entitled to a relatively low amount of operating receivables.

- The French company had neither employees nor an organizational structure; moreover, it did not bill a significant amount to its subsidiaries for any services.
- Considering the lack of economic substance, the French company did not meet the ‘beneficial owner’ requirement and could not have its place of effective management in France.

The Supreme Court decision

The Supreme Court disagreed with the Regional Tax Court, pointing out that the ‘beneficial owner’ and ‘place of effective management’ requisites must both be verified, considering the actual nature and scope of a holding (or sub-holding) company.

With respect to the ‘beneficial owner’ concept, the lack of an organizational structure and employees, coupled with limited operating costs and receivables, does not in itself prevent a holding or sub-holding company from qualifying as the ‘beneficial owner’ of dividends under a DTT. The beneficial ownership condition should, instead, be assessed only by considering whether the (sub)holding company: i) was created only to benefit from a tax relief, ii) has the effective power to manage and control its subsidiaries, iii) has the legal and the economic right to use the dividends. The Supreme Court found that neither the Italian Tax Authorities nor the Regional Tax Court were able to prove that any of those conditions were not met.

With respect to the ‘place of effective management’, the Supreme Court noted that the French company’s registered office was in France, it was subject to tax in France, the directors were resident in France, and most of the decisions concerning the management of the company were also taken in France. Therefore, also explicitly considering the definition provided by the OECD Commentary on the Model Convention, the Supreme Court stated that it had not been proved that the ‘place of effective management’ was not France.

KPMG comments

The Italian Supreme Court’s decision is of significant importance in the debate about the substance that a holding company must demonstrate in order to qualify for DTT benefits. It should also be noted that the Supreme Court, in addressing the concept of ‘beneficial owner’, made broad reference to CJEU case law, pointing out that the fundamental principles established in the context of the Parent-Subsidiary Directive should be considered when interpreting and applying the DTTs.

In the context of this gradual harmonization of the ‘beneficial owner’ definition across different sources of law, it is useful to highlight a very recent request for a preliminary ruling, submitted to the CJEU by a Danish tax court (Case C-682/16) and concerning the concept of ‘beneficial owner’ found in article 1(1) of the Interest and Royalties Directive. The referring court asked the CJEU to clarify: i) if the concept should be interpreted in accordance with the corresponding concept in article 11 of the OECD 1977 Model Tax Convention; ii) if so, if the concept should be interpreted solely in the light of the commentary on article 11 of the 1977 Model Tax Convention (paragraph 8), or if subsequent commentaries could be incorporated into the interpretation, including the additions made in 2003 regarding ‘conduit companies’ (paragraph 8.1, now paragraph 10.1), and the additions made in 2014 regarding ‘contractual or legal obligations’; iii) whether the interest recipient must be deemed to be a ‘beneficial owner’ for the purposes of the Interest and Royalties Directive if the referring court, following an assessment of the facts of the case, concludes that the recipient - without having been contractually or legally bound to pass the interest received to another person - did not have the ‘full’ right to ‘use and enjoy’ the interest as referred to in the 2014 Commentaries on the 1977 Model Tax Convention.

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