Italy: Concept of beneficial ownership clarified

Italy’s Supreme Court issued four decisions on 28 December 2016 in which the court clarified the concept of “beneficial ownership” for purposes of obtaining a reduced rate of withholding tax under Italy’s tax treaties or based on the application of the EU parent-subsidiary or interest and royalties directives. The decisions will be of interest to multinational groups owning participations in Italian subsidiaries through non-Italian holding companies.

Under Italian tax law, dividends, interest and royalties paid to nonresident entities are subject to withholding tax that can be reduced (or fully exempted) based on the provisions of an applicable tax treaty or an EU directive, but only if the foreign recipient of the payment qualifies as the beneficial owner (i.e. the ultimate owner) of the income.

The beneficial owner status of nonresident holding companies, for which neither Italian tax law nor the OECD provides explicit guidelines, is often challenged by the Italian tax authorities, usually based on the absence of economic substance at the level of the holding company.

Supreme Court decisions

The decisions of the Supreme Court clarify the main requirements for a foreign holding company to be considered the beneficial owner of income paid by an Italian resident.

In the cases before the court, an Italian company paid dividends to a French holding company that was ultimately held by a US corporation. In each case, the Italian tax authorities challenged the availability of the reduced withholding rate provided under the Italy-France tax treaty on the grounds that the holding company lacked economic substance and, therefore, was merely an interposed agent or trustee and not the beneficial owner of the income. The tax authorities determined that the beneficial owner of the income was the ultimate US parent of the group and denied the lower rate of withholding tax. The taxpayer appealed the decision of the tax authorities.

The Supreme Court held that, in the case of a pure holding company (an entity primarily owning and managing participations in subsidiaries), the absence of economic substance does not automatically mean that the recipient of income will not be considered the beneficial owner of income. In other words, the absence of certain factors like premises, personnel, operating expenses or the provision of managerial services to its subsidiaries may not be used to deny beneficial owner status to holding companies.

Instead, the court affirmed that the analysis of beneficial owner status for holding companies must exclusively take the following two key factors into account:

- Whether the recipient is the legal owner of the remittances; and
- The independence of the recipient, e.g. whether the recipient exercises control over how the income received from the Italian company is used.

Comments

The Supreme Court decisions could significantly affect the determination of whether a nonresident holding company is the beneficial owner of income (and, thus, whether dividends, interest and royalty payments to a foreign holding company by an Italian resident may qualify for reduced rates), and potentially could affect existing structures, pending tax audits and litigation, tax refund claims and related financial statement reserves.

— Stefano Schiavello (New York)
Partner/Client Service Executive
Deloitte Tax LLP
stschiavello@deloitte.com

— Alessandro Fasolino (Rome)
Director
Deloitte Italy
afasolino@sts.deloitte.it