4 February 2019

Global Tax Alert

Italian Supreme Court denies withholding tax exemption under EU Parent-Subsidiary Directive in absence of actual dividend taxation at EU parent company level

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

Executive summary

The Italian Supreme Court (the Court), in its decision n. 32255 of 13 December 2018, denied the Italian withholding tax exemption under the European Union (EU) Parent Subsidiary Directive[1] (the EU Directive) by claiming that no double taxation existed given the fact that the Luxembourg parent benefitted from a local dividend exemption regime.

The reasoning followed by the judges does not appear to be in line with a correct interpretation of the EU Directive nor in line with previous decisions by the same Supreme Court.

This Alert examines the Court's reasoning in the instant case as well as its recent (and contrasting) position on the same principles stated in the decision.

Detailed discussion

Supreme Court case n. 32255/2018

The case originates from a dividend withholding tax refund claimed by a Luxembourg company. In the lack of an official reply by the Tax Office, the company successfully appealed before the tax court of first degree. However, the tax court of second degree denied the refund on the position that the Luxembourg company did not meet all of the EU Directive's requirements and specifically due to the lack of an actual taxation of the dividend in the hands of the recipient.[2]

Building a better working world

Thus, although the Luxembourg company demonstrated that it had been subject to the local income tax (the *Impot sur le revenue des collectivites*) as required by the EU Directive, the judges disallowed its application.

The company appealed to the Supreme Court which confirmed the second degree tax court's decision by stating that the refund of the Italian withholding tax would have entailed a double tax exemption since the dividend would have not been subject to tax in Italy (in the case of a withholding tax refund) nor in Luxembourg (due to the local dividend exemption regime).

The Supreme Court stated that the dividend exemption regime provided for by the Luxembourg legislation was per se able to avoid any double taxation, without making any reference to the difference between "juridical double taxation" (avoided via the dividend exemption regime) and "economic double taxation" which in the instant case would clearly not be avoided since the profits generated by the Italian company would remain subject both to Italian corporate income tax and, upon distribution, to the Italian dividend withholding tax.

To support the risk of a double tax exemption, the Supreme Court referenced a previous decision issued in 2016 (see below). However, it is important to note that the conclusions of the 2016 case, though they appear correct in principle, also appear to be not applicable to the 2018 decision as they were based on a different set of facts.[3]

Supreme Court case n. 27111/2016

The 2016 case originated from a refund request filed by a German company of the underlying foreign tax credit (FTC) associated with an Italian source dividend benefitting from the withholding tax exemption under the EU Directive.

The claimant argued its right to benefit from the FTC under the Double Tax Treaty (DTT) with France along with the withholding tax exemption provided for by the EU Directive.[4]

In that occasion, after an accurate and detailed description of the mechanism set forth by the EU Directive, the Court denied the FTC by stating that the withholding tax exemption already avoided any sort of double taxation, so that the granting of a FTC would have simply added an (undue) benefit, by triggering a de facto double tax exemption.

Therefore, it appears that the purported risk of double-exemption in the 3225/2018 case is based on facts and circumstances that differ from those in the 27111/2016 case.

Supreme Court case n. 26377/2018

In addition, it is important to note that in another recent decision, the Supreme Court explicitly stated that notwithstanding that a dividend exemption regime applies at the level of an EU parent company, the latter would suffer economic double taxation if a dividend withholding tax were to apply in Italy.[5]

While the facts concerning this decision do not relate to the application of the EU Directive,[6] the judges clearly explained that *it is not correct to subordinate the reimbursement of the withholding tax to the fact that the foreign company has actually "disbursed" the tax on the Italian dividend in the EU country of residence; on the contrary, it is (necessary and) sufficient that this dividend is included in the total income even though there is no effective tax levy. This conclusion holds true also in the light of the economic double taxation principle; (...) the same income would be taxed both at the level of the subsidiary that generated the profits and at the level of the recipient of the dividend*.

Supreme Court case n. 25219/2018

In another recent case,[7] the Supreme Court affirmed principles which again seem inconsistent with the conclusions achieved by the judges in the instant case, decision n. 3255/2018.

This case related to the taxation of the capital gain arising from the sale of an Italian participation held by a German company. As known, based on Article 13 of the DTT between Italy and Germany, such income shall be taxable only in the seller's Country of residence (i.e., Germany).

According to the Italian tax office, since Germany had not taxed the gain, the gain should have been subject to Italian corporate income tax to avoid a case of double exemption. The Supreme Court did not uphold the tax office's position by ruling that: (i) the DTT may not be overridden by domestic provisions; and (ii) the lack of an actual taxation in Germany does not allow the disapplication of the DTT.

While the Court did not provide additional technical positions underlying its decision, one may infer that they considered that a lack of actual taxation of the gain in the residence country should not cause the denial of a DTT application, being sufficient that the taxpayer is "liable to tax" without being actually "subject to tax."

Implications

In addition to the above considerations, Supreme Court case 32255/2018 seems to be in contrast with the rationale and language of the EU Directive. Article 4(1)(a) allows the EU Member State of the parent company to refrain from taxing the dividends (alternatively to providing a credit under Article 4(1)(b)) while Article 5 mandates that, at the same time, profits which a qualifying EU subsidiary distributes to its EU parent shall be exempt from any withholding tax.

Endnotes

1. Directive 90/435/EC transposed in the Italian legislation by Article 27-bis of Presidential Decree n. 600 of 29 September 1973.
2. A similar decision was issued in case 25264 of 25 October 2017 where a Dutch shareholder was denied a dividend withholding tax refund. However, from the reported facts, it is not clear whether the denial was based on the lack of formal filing requirements or on the existence of a dividend exemption regime in the Netherlands.
3. Case n. 27111 of 28 December 2016.
4. While the Italy-Germany DTT did not provide for any FTC, the attorney claimed the application of the DTT between Italy and France (Article 10.4.b) on the basis the EU freedom of establishment and the EU principle of free movement of capital by stating that a German company could not be treated less favorably than another EU (French) company.
5. Case n. 26377 of 19 October 2018.
6. The case concerned a United Kingdom (UK) company claiming the refund of the Italian FTC (under Article 10(4) of the Italy-UK DTT) on the dividends paid by its Italian subsidiary. The Court confirmed the right to the refund stating that the fact that the dividend benefitted from an exemption regime in the UK was not sufficient by itself to avoid the economic double taxation. While concluding as such, the judges made a parallel by saying that, as a principle, economic double taxation could (alternatively) be avoided by recognizing a withholding tax exemption.
7. Case n. 25219 of 11 October 2018.

For additional information with respect to this Alert, please contact the following:

Studio Legale Tributario, International Tax Services, Milan
- Marco Magenta marco.magenta@it.ey.com
- Simone De Giovanni simone.de-giovanni@it.ey.com

Studio Legale Tributario, International Tax Services, Rome
- Daniele Ascoli daniele.ascoli@it.ey.com

Studio Legale Tributario, International Tax Services, Bologna
- Mario Ferrol mario.ferrol@it.ey.com

Ernst & Young LLP (United Kingdom), Italian Tax Desk, London
- Domenico Borzumato domenico.borzumato@it.ey.com

Ernst & Young LLP (United States), Italian Tax Desk, New York
- Emiliano Zanotti emiliano.zanotti2@ey.com
- Anna Rizzi anna.rizzi1@ey.com
- Michela Antonella Prencipe michela.antonella.prencipe1@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 000316-19Gbl

1508-1600216 NY
ED None

ey.com