

# International Tax Alert

News from the Global Tax Desk Network

## Italian Supreme Court issues important guidance on beneficial ownership conditions for pure holding companies

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### Executive summary

On 28 December 2016, Italy's Supreme Court issued Decision n. 27113 (the Decision) on the concept of beneficial ownership in the context of dividends received by a holding company under the France-Italy income tax treaty.

The Supreme Court held that the status of beneficial owner is ultimately to be determined, as a matter of fact, based on the particular nature of the recipient holding company and the functions typically performed in its operations.

For a pure holding company, a level of organizational structure able to carry out an activity of mere coordination and control over the subsidiary, attend the shareholders' meetings and collect dividends, should be deemed as adequate. In fact, the Decision makes clear that beneficial ownership conditions for a pure holding company should not be tested based on the presence of a significant organizational structure, typical of an operative company, nor based on the presence of a non-treaty country along the chain of control. The analysis should instead be based on the actual capability of retaining the dividends received as opposed to having the obligation to repay them to another entity.

## Detailed discussion

### Background

In 2002, an Italian resident company distributed dividends to its French parent company applying the 5% reduced withholding tax rate under Article 10 of the France-Italy income tax treaty (the Treaty). According to para. 4 b) of Article 10 of the Treaty and the Italian law in effect at the time, the French parent company claimed the payment of a tax credit from the Italian Treasury, net of the 5% withholding tax.

The aforementioned tax relief was granted if the recipient: (i) was the beneficial owner of dividends; and (ii) was resident in France under the meaning of the Treaty i.e., it had its place of effective management in France.

The Italian tax authorities rejected the claim on the basis that the French company should be viewed as a mere conduit established for the sole purpose of obtaining treaty benefits and passing on the dividends to the ultimate parent company in the United States (US).

The company appealed and won before the tax court of first instance. However, following the Italian tax authorities appeal, the tax court of second instance reversed the decision, thereby denying the treaty benefits to the French company, on the following basis:

- ▶ The Italian company was controlled through a chain of ownership and the beneficial owner was actually the ultimate US holding company, for which a tax credit relief was not available under Italy-US income tax treaty
- ▶ The French parent company had no personnel and very limited operating assets, thus lacking of business substance
- ▶ The French parent company did not carry on significant investment or service activities during the period for which the tax credit was claimed
- ▶ The French parent company did not have its place of effective management in France

The French company appealed to the Supreme Court arguing that the concept of beneficial owner as well as the ancillary requirement of place of effective management should be interpreted taking into account the particular nature of activities of holding companies.

The Supreme Court overruled the lower court, holding that the tax authorities misinterpreted the concepts of beneficial owner and place of effective management and erroneously did not take into consideration all the relevant facts.

### Decision

The Supreme Court primarily noted that the beneficial ownership clause is aimed at ensuring that the Treaty relief is granted only to companies having full juridical and economic availability of the dividends and that are the final recipient of the latter. Therefore, such relief, under a substance over form approach, should be denied to a company without substance and instrumentally interposed only for tax reasons. In fact, the beneficial ownership clause represents a specific anti-abuse provision in the context of tax treaties, in line with other domestic and European Union anti-avoidance provisions.

The Court then proceeded to review the facts supporting the decision of the lower court, and concluded that none of them led to the conclusion that the French company was not the beneficial owner of the dividend paid by its Italian subsidiary.

In particular, the Supreme Court did not find any merit to the proposition that the French company should be regarded as a conduit, concluding that the fact that a holding company does not have the same organizational structure (premises, personnel, etc.) as the one of an operating company does not necessarily mean that it would be regarded as not being the beneficial owner of dividends. In fact, the assessment of the beneficial owner status is to be conducted taking into account the specific nature of activities of the recipient, meaning that the degree of substance that can be considered adequate for an operating or for a mixed holding company cannot be the same as that to assess the substance of a pure holding company. In this regard, for a pure holding company, like the French shareholder claiming the treaty relief in the case at stake, a level of organizational structure able to carry out an activity of mere coordination and control over the subsidiary, attend the shareholders' meetings and collect dividends, should be deemed as adequate.

This Decision makes clear that beneficial ownership conditions for a pure holding company should not be tested based on the presence of a significant organizational structure, typical of an operating company, nor based on the presence of a non-treaty country along the chain of control. The analysis should instead be based on the actual capability of retaining the dividends received as opposed to having the obligation to repay them to another entity. While the key factors to assess the place of effective management of a pure holding company are the place where the main management and administrative decisions as well as the ones concerning the coordination of the participations are taken.

As a background, neither the Italian treaties in force nor the domestic law contain a definition of beneficial owner. The interpretation of the Italian tax authorities generally relies on the guidelines provided in the commentary to the Organisation for Economic Co-operation and Development Model Tax Convention.

The Italian tax authorities and courts have become steadily more focused on a substance-over-form approach, which, together with an increasingly complex framework of anti-abusive provisions, raise considerable uncertainty in the application of the concept.

In a context where the concepts of lack of beneficial ownership and treaty abuse often overlap, substance requirements have become in most cases the lead argument for tax authorities to challenge treaty benefits, especially in the case of pure holding structures with limited substance.

The Supreme Court's decision represents an important step to clarify what the term beneficial owner means in the context of tax treaties.

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