



Newsletter



INTERNATIONAL TAX INSIDER

Italian Supreme Court in line with the Danish cases on the beneficial ownership requirement

On 10 July 2020, the Italian Supreme Court published the decision no. 14756, which interprets the beneficial ownership requirement under the Interest and Royalty Directive (IRD) by making reference to the judgement of the Court of Justice of the European Union (CJEU) on the Danish cases (i.e. joined cases C-115/16, C-118/16, C-119/16 and C-299/16).

Description of the case

In the context of a merger leverage buy out transaction, an Italian company paid interest to its Luxembourg shareholder, which carried on financial and treasury activities, applying the withholding tax exemption under the IRD.

The Italian tax authorities challenged the withholding tax exemption arguing that the Lux sub-holding did not qualify as beneficial owner of the interest based on the following reasons:

- the Lux sub-holding carried on pure holding functions without performing any other significant activity;
- shortly after the receipt of the interest, the Lux sub-holding transferred it to its controlling company retaining a low margin of 0.125%;
- the beneficial ownership analysis must be focused on the single financing agreement between the Italian company and the Lux sub-holding, not on the activity carried on by the Lux sub-holding for the group as financial coordinator.

Key points

The Italian Supreme Court in interpreting the beneficial ownership requirement referred to the CJEU Danish cases, to the OECD Commentary and to previous Supreme Court decisions specifying that:

- the beneficial owner clause is aimed at counteracting treaty abuse through treaty shopping practices;
- in case of agent, nominee, conduit company acting as a fiduciary or administrator, the direct recipient of the interest is not the “beneficial owner” because its right to use and enjoy the interest is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation, which normally derives from relevant legal documents but may also be found to exist on the basis of facts and circumstances, must be related to the specific payment received (the

- Court explicitly refers to the OECD Commentary);
- in order to address conduit companies, anti-abuse provisions introducing a substance-over-form approach as well as economic substance rules must be applied (the Court explicitly refers to paragraph 7 of the CJEU's judgement on the Danish cases);
 - a pure holding company can qualify as beneficial owner to the extent that it has the autonomy both in the management of its shareholdings and in the use of the income received (the Court refers to its decision no. 27112/2016 although related to dividends);
 - in relation to the beneficial owner requirement for IRD purposes, proof of an abusive practice requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it (the Court explicitly refers to paragraph 124 of the CJEU's judgement on the Danish cases);
 - the artificiality of an arrangement is capable of being borne out by the fact that the relevant group of companies is structured in such a way that the company which receives the interest paid by the debtor company must itself pass that interest on to a third company which does not fulfil the conditions for the application of IRD, with the consequence that it makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds from the debtor company to the entity which is the beneficial owner of the sums paid. The fact that a company acts as a conduit company may be established where its sole activity is the receipt of interest and its transmission to the beneficial owner (the Court explicitly refers to paragraphs 130 and 131 of the CJEU's judgement on the Danish cases);
 - in order to refuse to accord a company the status of beneficial owner of interest, the national authority is not required to identify the entity or entities which it regards as being the beneficial owner(s) of that interest (the Court explicitly refers to paragraph 145 of the CJEU's judgement on the Danish cases).

In light of the above, the Italian Supreme Court concluded that the Lux sub-holding was the beneficial owner of the interests because:

- the Lux sub-holding, carrying on financial and treasury activities for the entire group, received the financial proceeds of the companies of the group and not only the ones of its Italian subsidiary;
- the Lux sub-holding had the right to use and enjoy the interest received and there was not an obligation to pass them on to another person;
- the income derived by the Lux sub-holding was adequate in relation to the activity performed and it was taxed in Luxembourg;
- the beneficial ownership analysis must be focused not on the single financing agreement between the Italian company and the Lux sub-holding, but on the role of the Lux sub-holding as financial coordinator of the group.

Conclusions

Regarding the beneficial ownership requirement under the IRD, foreign investors can rely on an interpretation of the Italian Supreme Court which is in line with the CJEU Danish cases.

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