

The concept of beneficial ownership as recently interpreted by the Italian Supreme Court (Decision n. 27113, 28 December 2016)



The Italian Supreme Court reckoned, in a recent decision, that the lack of organizational structure of an holding company is not decisive in order to exclude its entitlement to double taxation treaty benefits reserved to the income beneficial owner. On the contrary, the entitlement is connected to the recipient power to enjoy and dispose of the income from an economic and legal perspective. The principles elaborated by the Supreme Court originated from the analysis of a case where it has been examined whether a company resident for tax purposes in France (“*French Co*”) was eligible to obtain a dividend tax credit as provided for by the relevant tax treaty between Italy and France.

Facts

A multinational company resident in the United States (“*US Co*”), leader in the packaging for pharmaceutical and alimentary products, fully owned French Co.

French Co, the European sub-holding, was the holding company with respect to all European subsidiaries of the group and fully owned a company resident for tax purposes in Italy (“*Ita Co*”).

On 2002, Ita Co distributed dividends to French Co net of the withholding taxes. Article 10(4) of the relevant double taxation treaty (Italy-France) entitles the French resident shareholder, if it is the beneficial owner of the dividends, to receive a credit as relief from economic double taxation. Accordingly, French Co requested the Italian tax administration to pay the tax credit provided for by the tax treaty between Italy and France. The Italian tax administration did not reply to the request of French Co as a sign of denial.

The trial

French Co appealed against the Italian tax administration denial. The Tax Court of first instance decided in favor of the taxpayer while the Court of second instance reversed the decision. According to the Court of second instance, French Co could not be deemed the beneficial owner of the dividends because it had to be considered as mere conduit company and so it could not enjoy the benefits provided for by treaty. The Court based its position by arguing that the only scope of the company structure was to attract the dividends to French Co in order to obtain tax credit provided for by the treaty with Italy. French Co, in the Court view, (i) did not have a relevant organizational structure and

employees, (ii) did not perform management functions and (iii) did not bear sufficient operating costs. The Court concluded that US Co (and not French Co) was the actual recipient of the dividend payments and the tax treaty between Italy and the United States did not provide for the dividend tax credit.

The French Co appealed the Court decision before the Italian Supreme Court, which decided in favor of the taxpayer setting a number of very significant principles.

The Supreme Court's decision

The Supreme Court did not share the conclusions of the Court of second instance due to the following reasons:

- according to the Supreme Court judges, the Court gave a wrong interpretation of the treaty term “*beneficial owner*”. In this respect, the Supreme Court underlined that French Co was the real owner of the shareholdings and the actual dividends recipient. Moreover, those dividends were reflected on the balance sheet of French Co and could have been freely disposed by the latter;
- the Supreme Court emphasized that the group structure existed since 1946, while the Italy-France treaty was signed in 1989 only and ratified in 1992. Moreover, according to the Supreme Court, the structure at stake could not be conceived in order to get the benefits of the treaty.

Therefore, the Supreme Court requested to another section of the Regional Court to re-consider the case in light of the following principles:

1. the “*beneficial owner*” concept shall be interpreted in light of the nature of the parent company. The fact that a holding or a sub-holding company do not have a relevant organizational structure cannot influence the conclusions regarding whether the taxpayer is the beneficial owner of the dividends;
2. limited operating costs and operating receivables, absence of management service charges to the subsidiary and the fact that the parent company is itself wholly owned by a company that is not a resident of the contracting state cannot influence the analysis for the purposes of the concepts of “beneficial ownership”;
3. the term “*beneficial ownership*” shall be interpreted by considering whether the recipient of the dividends is eligible to freely enjoy and dispose of those dividends.

Comments on the Supreme Court's Decision

The principles elaborated by the Supreme Court in this decision give an important contribution to set a well-balanced interpretative attitude towards the term “beneficial owner”; in particular, the difficulties in correctly interpreting the term arise any time we face situations in which pure (sub)holding companies are part of a holding chain and they receive dividends distributed by their subsidiaries. We reckon that, among others, the following points should be regarded as relevant in the case under discussion and have a general interpretative importance:

1. whether the (sub)holding company was set up or it acquired the interest in the subsidiary in the context of an abusive plan. In the case at stake, French Co owned Ita Co since 1946 and the former was the group (sub)holding company for the entire European Region rather than for Italy only;
2. whether the (sub)holding company has full control over flow of funds arising from the dividends distributed by the subsidiaries or is a pure flow-through entity. In order to assess this matter it is of utmost importance to examine the way the (sub)holding uses of the funds;
3. whether the (sub)holding company is autonomous *vis-à-vis* its parent company in dealing with its subsidiaries. This is a quite delicate issue especially in those situations where the (sub)holding company has no personnel or organizational structure and its board members sit in the board of the ultimate parent company. In any case, the full ownership of the

(sub)holding by a parent company resident in a different State is not by itself sufficient to weaken the autonomy of the former.

In conclusion, according to the Supreme Court's decision the concept of the "beneficial owner" which is relevant for tax treaty purposes shall be assessed having regard to the activity of the relevant company. The lack of personnel and organizational structure together with a light functional organization alone are not decisive for the characterization of pure (sub)holding companies as conduit vehicles. This in consideration of the fact that, by nature, a (sub)holding company does not need a relevant and heavy structure to genuinely and effectively perform its economic and juridical functions.

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