Italian Supreme Court rules on domestic implementation of EU Parent-Subsidiary Directive

February 18, 2019

In brief

The Italian Supreme Court on December 13, 2018, issued a decision (n. 32255/2018) in a case concerning the domestic implementation of the European Union (EU) Parent-Subsidiary Directive.

The case originates from a refund claim submitted to the Italian tax authorities in 2005 by a Luxembourg-resident company. That company requested reimbursement of withholding tax imposed on a dividend payment it received from its Italian subsidiary in 2004. The reimbursement request and the claim are based on the domestic implementation of the EU Parent-Subsidiary Directive.

Following the tax authorities' silent rejection, the taxpayer appealed to the Provincial Tax Court of Pescara, which ruled in the taxpayer's favor. The Provincial Tax Court determined that the taxpayer satisfied all requirements of the EU Parent-Subsidiary Directive as implemented by Italy. These requirements include:

a) residence in an EU Member State

b) incorporation under one of the legal forms listed in the law

c) direct participation of at least 25% (10% starting from January 1, 2009) in the capital of the company distributing the dividends for an interrupted period of at least one year and

d) subjection to one of the taxes listed in the law (the Luxembourgish "*impot sur le revenues des collectivites*").

The Italian tax authorities appealed the decision to the Regional Tax Court of Pescara, which dismissed the Provincial Tax Court's decision. The Regional Tax Court determined that since the dividends were not subject to tax in Luxembourg under article 166 of the Luxembourg Corporate Income Tax Code, not subjecting it to withholding tax in the country of origin (Italy) would be equivalent to excluding the dividend from any taxation.

The Italian Supreme Court confirmed the Regional Tax Court's decision, stating that article 27-bis of Presidential Decree no. 600 of September 29, 1973 (which provides an exemption from dividend withholding tax for EU-parent companies in accordance with the EU Parent-Subsidiary Directive) did not apply in this case since the Luxembourg company already benefited from a dividend exemption in its country of residence.

According to the Supreme Court, the aforementioned exemption was sufficient to eliminate the risk of double taxation with respect to the dividends. In addition, it stated that the dividends at issue would have been exempt from taxation even without applying the withholding tax.

Furthermore, the Supreme Court rejected the taxpayer's argument that the dividend exemption granted in Luxembourg did not preclude reimbursement of the withholding tax in Italy. The Supreme Court's reasoning was that the 'subject-to-tax' requirement of the EU Parent-Subsidiary Directive relates to the parent company being subject to one of the taxes listed in the law, and not specifically to taxation of the dividend it received. It also rejected the taxpayer's secondary argument about a potential freedom of establishment breach, holding that the Court of Justice of the European Union decision in *Commission v. Italy* (C-540/07) did not apply to this case.

The Supreme Court's decision is surprising, as its interpretation (and the Regional Tax Court of Pescara's interpretation) of the domestic implementation of the EU Parent-Subsidiary Directive appears to contradict the directive's purposes and aims, as well as its text. The directive provides for elimination of both juridical (through the exemption from withholding taxes in the source jurisdiction) and economic double taxation (through the dividend exemption in the parent jurisdiction). This is based on the assumption that the taxation of profits in the hands of the distributing company grants single taxation, thus banning additional taxation in the hands of the receiving parent company.

The takeaway

The Italian Supreme Court held that there must be at least partial taxation of the dividends in the Member State of the parent company in order to benefit from the withholding tax exemption provided in the EU Parent-Subsidiary Directive.

The decision contradicts EU law and the directive's purposes and aims, as well as its text. Although the Italian Tax Authorities may not publicly endorse the decision, some tax auditors might leverage the content of the decision and deny the Directive's benefit where the dividend was not taxed in the hand of the parent company in its country of residence.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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