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Global Tax Alert

Italy's Supreme Court recognizes beneficial ownership of a Luxembourg sub-holding in light of CJEU Danish Cases

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Executive summary

Italy's Supreme Court (the Court), in decision n. 14756 of 10 July 2020, relied on the principles adopted by the Court of Justice of the European Union (CJEU) on the Danish Cases[1] to clarify certain prerequisites for the application of the withholding tax (WHT) exemption under Directive 2003/49/EC (Interest and Royalty Directive or IRD) and established the conditions for a foreign sub-holding to meet the beneficial owner (BO) status.

Detailed discussion

In the case brought before the Court, the Italian Tax Authorities (ITA) challenged the application of the WHT exemption under the IRD[2] on interest paid by an Italian company to its Luxembourg parent, a sub-holding with financial and treasury functions (HoldCo). The interest related to a loan connected with a merger leverage buy out (MLBO) transaction involving the acquisition of an Italian and a Swedish target.

The ITA argued that HoldCo could not be considered as the BO of the Italian income since, under a back-to-back financial scheme, it passed on the interest, shortly after, to another group entity by retaining a very low margin (0.125%). According to the ITA, these facts resulted in the qualification of HoldCo as a mere conduit.

The Court rejected the arguments of the ITA and confirmed the decision of the Tax Court of Appeals that had recognized HoldCo as the BO of the income, thus entitled to the IRD WHT exemption.

The Court relied, for the first time, on the principles expressed in the mentioned CJEU Danish Cases according to which the notion of BO for IRD purposes resembles that of Article 11 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention. On such basis, the Court confirmed that HoldCo qualified as the BO since it had the right to use and enjoy the Italian source income with no contractual or legal obligation to pass on the said proceeds to another entity.

Regarding the existence of tax abuse, the Court confirmed its approach (Case n. 27112 of 28 December 2016) to not automatically consider a foreign holding company as an entity lacking economic substance. Considering the specific nature and activities of a holding company, a "light" assets structure is not at odds with the market standards. The key point is instead to verify whether it makes independent management decisions, especially with regards to the income received.

In the instant case, the Court stated that no tax abuse could be assessed in connection with the Italian payments since HoldCo performed financial and treasury functions for the group (and not for the Italian subsidiary only), eventually retaining adequate profits. In this respect, the Court specified that the functions performed by HoldCo should be evaluated globally, not only by focusing on the Italian flow but by considering all the agreements concluded with other group entities and its broader function in the management of group financial flows including its key role in the mentioned MLBO transaction.

Endnotes

1. See EY Global Tax Alert, *CJEU rules on application of Danish withholding tax on dividends and interest payments*, dated 26 February 2019.
2. The IRD has been implemented in Italy through Article 26-quater of Presidential Decree 29 September 1973, n. 600.

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

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

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

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

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

Ernst & Young LLP (United States), Italian Tax Desk, New York
- Emiliano Zanotti emiliano.zanotti2@ey.com
- Andrea Ajovalasit andrea.ajovalasit1@ey.com
- Luigi Caltagirone luigi.caltagirone1@ey.com

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