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RECENT TRENDS OF THE ITALIAN SUPREME COURT ON BENEFICIAL OWNERSHIP PROVISIONS, by LUCA A. PANGRAZZI AND ANGELO R. BONISSONI (CBA STUDIO LEGALE E TRIBUTARIO)

1. Premises: the view of the Italian Tax Authority on LBO exit phases

The Italian Tax Authority ("ITA") with the Circular letter n. 6/E of March 30 2016 outlined some important clarifications concerning – inter alia – (i) the tax treatment applicable to dividends and interests paid by Italian companies to EU holding entities (controlled by foreign private equity funds) and (ii) the tax treatment applicable to capital gains realized be the mentioned EU holding companies with the sale of the Italian target stake.

In both the mentioned exit cases, the presence of the EU holding company that receives dividends and/or capital gains may result - according to the applicable Parent Subsidiary EU Directive or Bilateral Tax Treaty - in a tax reduction or exemption of the Italian taxes applicable to the outbound dividends paid by the Italian company or to the capital gains realized with the selling of the Italian company.

At this regards, the Circular letter 6/2016 stated that the mentioned tax reduction/exemption could be challenged by ITA (i) if the EU holding vehicle hasn't sufficient substance in the foreign country (i.e. soft structure, no equipment and employees, no effective and business activities, no decision-making powers - "conduit company") or if the financing structure is back-to-back (i.e. automatic repayments in favour of the foreign private equity fund - "conduit transaction").

2. The judgment of the Italian Supreme Court

The Italian Supreme Court with the recent judgment n. 27113 of December 28 2016 overruled the mentioned ITA guidance and rejected the previous lower court decision (that agreed with ITA views), declaring that the beneficial ownership provisions of the Double Tax Treaty must be interpreted taking care of the real nature and effective functions of the foreign holding company that received the proceeds.

More in particular, in the case in hand, an Italian company distributed dividends to a French holding company controlled by a U.S. entity. At the time of the dividend distribution, the French holding company applied – as beneficial owner of the Italian dividends – the Italy/France Double Tax Treaty to Italian source-dividends.

ITA denied the application of the mentioned Italy/France Double Tax Treaty arguing that the French holding company was not the "beneficial owner" of the Italian dividends for the following main

reasons: (i) it was controlled by a US entity, (ii) it was a mere conduit company with the sole function to get tax advantages through the Italy/France DTT and then transfer immediately to its US shareholders the gross dividends received, (iii) it had no legal and economic powers to manage the dividends received, (iv) it had no real structures and organizations in France, no employees, no relevant business receivables, no effective services provided to its subsidiaries, (v) it had no decision-making powers and cannot be qualified as the real place of effective management.

In other words, according to ITA view, the French holding company was a mere conduit entity and the real beneficial owner of the dividends paid by the Italian company were the US investors.

The Supreme Court firstly stated that the French holding company was the real "beneficial owner" of the Italian proceeds as it had the power to manage the Italian stake and the dividends received, that were booked into its annual balance sheet and were freely available for company's creditors.

Secondly the Supreme Court stated that the French holding company had its "effective place of management" in France as it was a statutory entity carrying on a corporate activity in accordance with the French law, it was set-up in France, it had its registered office in France, it was subjected to French tax law, its company's directors were French, and its board of directors resolved company's main decisions in France.

So, for the Italian Supreme Judgments, general aspects relevant for operating companies are not so relevant for the holding companies in order to check the beneficial owner condition.

3. Conclusion

From our perspective the mentioned judgment is relevant because, after the issuance of the mentioned ITA Circular Letter 6/2016 – and based on the information and views at our disposal – (i) assessments by ITA's offices have been increased on application of Parent Subsidiary EU Directive and Bilateral Tax Treaty when holding companies are involved, and, on the other hand, (ii) the Italian Supreme Court seems to be in line with EU Judgments (i.e. Halifax C-255/02 and Cadbury Schweppes C-196/04).

The mentioned judgment should therefore constitute a valid and authoritative document to be used and invoked by Italian (and EU holding) companies in order to try to settle previous and/or future ITA assessments based on the beneficial owner condition of holding companies.