Italian Supreme Court requires effective taxation of dividends in the Member State of the parent company for the withholding tax exemption under the EU Parent-Subsidiary Directive to apply

In decision no. 32255 of 13 December 2018, the Italian Supreme Court held that effective taxation of the dividends in the Member State of the parent company is required for the latter to benefit from the withholding tax exemption provided for in the EU Parent-Subsidiary Directive.

The dispute dealt with a Luxembourg parent company (hereinafter LuxCo), which challenged the Italian tax authorities' denial to refund the withholding tax applied by its Italian subsidiary on dividends paid in 2004. According to LuxCo, article 27-*bis* of Presidential Decree no. 600 of 29 September 1973, which transposed the EU Parent-Subsidiary Directive into the Italian legal system, entitled it to a full refund of the withholding tax. While the Provincial Tax Court of Pescara upheld the complaint filed by LuxCo, the Regional Tax Court of Abruzzo held that LuxCo was not entitled to the refund as the dividends received had been exempted in Luxembourg under article 166 of the Luxembourg Corporate Income Tax Code.

LuxCo appealed to the Supreme Court, claiming that the exemption of the dividends in Luxembourg was irrelevant for the purpose of application of the Parent-Subsidiary Directive.

The Supreme Court surprisingly confirmed the decision of the Regional Tax Court of Abruzzo, holding that (i) the Italian withholding tax exemption cannot be combined with the Luxembourg dividend exemption regime and (ii) the fact that LuxCo is generally subject to Luxembourg corporate income tax is irrelevant. According to the Supreme Court the Luxembourg dividend exemption regime suffices *per se* to achieve the objective pursued by the Parent-Subsidiary Directive, i.e. eliminating double taxation.

The Court also rejected the argument that Italian source taxation was discriminatory and that the refund was therefore compelled by the freedom of establishment and the free movement of capital, as Italian parents receiving Italian source dividends would have benefitted from a 95% exemption.

The decision of Supreme Court appears questionable. First, it fails to recognize that the withholding tax exemption in the State of the subsidiary and the elimination of double taxation in the State of the parent must be granted together by the relevant Member States under a plain reading of articles 4 and 5 of the Parent-Subsidiary Directive. Second, it erroneously holds that the Luxembourg dividend exemption regime suffices in eliminating double taxation. Indeed, while it is correct that the Luxemburg exemption removes the juridical double taxation of the dividends, as long as Italy applies a withholding tax on the profits distribution, economic double taxation of the subsidiary profits persists, since those profits have already been taxed by the latter State when accrued to the subsidiary.

For further information: **Maisto e Associati**

Milan
Piazza F. Meda 5
20121
T: +39.02.776931

Rome
Piazza d'Aracoeli 1
00186
T: +39.06.45441410

London
2, Throgmorton Avenue
EC2N 2DG
T: +44.207.3740299