The Italian Supreme Court issues a decision dealing with the abuse of the Parent-Subsidiary Directive and the subject-to-tax requirement

The Italian Supreme Court has recently issued decision no. 25490/2019, dealing with the application of Directive 90/435/EEC (now Directive 2011/96/EU of 30 November 2011, hereinafter "Directive", or "PSD") to dividends distributed by an Italian subsidiary to its EU parent, a Luxembourg holding company. The decision is relevant because it contains, amongst others, important statements concerning the relevance of the place of effective management, for the purpose of assessing the existence of an abuse of the Directive, as well as the interpretation of the subject-to-tax requirement.

The Supreme Court held that an abuse of the PSD could exist where the place of effective management of the parent company is located outside the EU State of residence (Luxembourg, in the case at hand). Indeed, according to the Supreme Court, the concept of place of effective management not only serves as tie-breaker rule in dual resident cases, but also functions as an anti-avoidance provision. This conclusion, in the Court's view, is confirmed by art. 2(1)(a)(ii) of the PSD which precludes the applicability of the Directive in cases where either the parent company, or its subsidiary, is considered to be resident for tax purposes outside the European Union under a tax treaty, as most tax treaties include at article 4(3) a tie-breaker rule based on the place of effective management. In this respect, the Supreme Court added that, in assessing where the place of effective management is located, Italian tax authorities are not bound by the certificates issued by the tax authorities of other EU Member States.

In addition, the Supreme Court dealt with the-subject-tax requirement provided for in the Directive, clarifying that it requires an effective taxation of the dividends in the hands of the parent company. The Supreme Court held that such condition was not met in the case at hand, because the dividends received by the Luxembourg parent were not taxed in Luxembourg due to the application of the domestic participation exemption regime. The conclusion confirms an increasing trend in the case law of the Supreme Court (see also decision no. 32255 of 13 December 2018, also dealing with dividends paid to a Luxembourg parent company). The Supreme Court's outcome is controversial for at least two reasons. First, it ignores that the exemption is one of the two optional methods envisaged in the PSD to relieve economic double taxation. Luxembourg opted for such a method and therefore the exemption is, in the case at hand, in line with the specific requirement laid down by the Directive. Second, the Supreme Court overlooks the case law of the Court of Justice of the European Union (see decision of 8 March 2017, in case C-448/15, Wereldhave), which seems to take the opposite position with regard to the PSD, thus interpreting the subject-to-tax requirement as demanding the entity as whole to be exempt in order for the Directive not to apply.

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