MAISTO E ASSOCIATI

EU TAX ALERT 2020/02

Italian Supreme Court clarifies requirements for the application of dividends exemption and tax credit under the PSD and tax treaties

The Italian Supreme Court has recently published decision No. 2313/2020, concerning the application of the 1988 tax treaty between Italy and the United Kingdom (hereinafter the "**Treaty**") and its relationship with the Parent Subsidiary Directive (Directive 90/435/EEC, hereinafter the "**PSD**").

The claimant was a UK parent company (the "**Claimant**") that received dividends from its Italian subsidiary. The Claimant was denied the imputation credit set forth in article 10(4) of the Treaty. The Italian Tax Authorities denied such credit arguing that the dividends had been already exempted from Italian withholding tax, in accordance with article 5 of the PSD. That exemption eliminated the risk of double taxation of the dividends, which made unnecessary to grant also the imputation credit.

The Supreme Court upheld the position of the Claimant on the basis of the following reasoning. First, the Court drew a difference between economic and juridical double taxation and highlighted that both the PSD and article 10(4) of the Treaty were aimed at eliminating economic double taxation. Second, the Supreme Court held that the withholding tax exemption under the PSD did not ensure, *per se*, the full elimination of economic double taxation and the non-discriminatory tax treatment of cross-border dividends.

The argument developed by the Court is extremely relevant, as it is built on the view that elimination of economic double taxation on intercompany dividends requires concurrent application of both withholding tax exemption at source and exemption/credit at the level of the parent company. This argument may (and should) be extended to other, more straightforward cases, such as those where the foreign parent benefits from an exemption (under a domestic participation exemption regime) in its Member State of residence on the dividends received from its Italian subsidiary. In these cases, thus, the exemption granted by the Member State of the parent should not preclude the application of the withholding tax exemption in Italy, as both measures must be concurrently applied in order to ensure the elimination of economic double taxation.

From this perspective, the decision of the Supreme Court seems to leave some room for a *revirement* of the Court's case law on the application of the PSD (see, *inter alia*, decisions No. 3255/2018, 25490/2019 and 2617/2020), which denies the application of the withholding tax exemption in Italy where the dividends are not subject to taxation in the State of the parent company (due to the application of a domestic participation exemption regime). A similar approach, indeed, has already been taken by the Court with regard to the interpretation of article 24(2)(b) of the 1989 Italy-Germany tax treaty, which requires the residence State to fully exempt dividends paid by subsidiaries resident of the other contracting State (see recent decisions No. 30140/2019 and 29635/2019, where the Court held that an Italian parent could benefit from the exemption in Italy regardless of the fact that no withholding tax had been applied in Germany).

It should be noted that also the Italian tax authorities appear to have taken the view that the application of the participation exemption regime in the State where the parent company is resident should not jeopardize the application of the Italian withholding tax exemption (see ruling No. 57/2019, relating to the application of the EU-Switzerland saving agreement, which, *inter alia*, provides for a withholding tax exemption regime similar to article 5 of the PSD).

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