



## **DTC exemption not subject to effective taxation in Residence State confirmed by Supreme Court**

In decision no. 25219 of 11 October 2018, the Italian Supreme Court confirmed that the provisions limiting source taxation, encompassed in Italian Tax Conventions (hereafter "DTCs"), also apply where the Residence State does not actually tax the relevant item of income. In such cases, where the DTC provisions allocate the exclusive taxing right to the Residence State, the item of income remains effectively untaxed.

According to the Supreme Court, however, this result is consistent with the structure and systematics of DTCs and does not justify the levy of source taxation, which would be contrary to the ordinary meaning of the DTC provisions (the decision is in line with previous case law of the Supreme Court, e.g. decisions no. 23984 of 24 November 2018, no 24248 of 18 November 2011 and no. 1231 of 29 January 2001).

The dispute arose from a claim of the Italian Revenue Agency against a German resident company (hereafter "taxpayer"), according to which the latter failed to declare and tax in Italy the capital gain derived from the sale of the shares of an Italian resident company.

The taxpayer appealed against the Revenue Agency decision, arguing that Italy was prevented from taxing the capital gain by article 13(4) of the 1989 Italy-Germany DTC, which provides that "*[g]ains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3 shall be taxable only in the Contracting State of which the alienator is a resident*". The German company also contended that the capital gain was exempted in Germany under the relevant domestic law provision.

Both the First and Second Instance Courts rejected the appeal on the basis that the capital gain had not been taxed in Germany, which made the 1989 Italy-Germany DTC not applicable due to the absence of an actual risk of double taxation (see Provincial Tax Court of Bologna, decision no. 409 of 12 December 2007; Regional Tax Court of Emilia Romagna, decision no. 74 of 5 July 2010).

As mentioned at the outset, the Supreme Court overturned these decisions.

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