



Directors' fees fall outside Article 16 OECD Model Convention if the director is bound to remit the income to its employer in the other Contracting State

According to the Italian Revenue Agency, if an Italian resident company remunerates an individual for its role as director but the director is contractually bound to remit the fees to the employer company residing in the other Contracting State (so-called "*compensi reversibili*"), such fees paid by the Italian company fall within the scope of Article 7 (Business Profits) and not under Article 16 (Directors' fees) of tax treaties. This is the position expressed in Ruling Reply no. 330 of 22 May 2023.

Within multinational groups, it is quite common that a parent company appoints one or more of its employees as directors of group subsidiaries. Fees paid to these employees in their capacity as directors of a company are often mandatorily remitted to the employer company under specific clauses of the employment agreements.

In the case at issue, the applicant was an Italian resident company ("**ItaCo**"). One of its directors was an employee of an affiliate company resident in another EU Member State ("**EUCo**"). The Ruling Reply does not indicate the name of the EU Member State and therefore the applicable tax treaty. EUCo had an agreement with the employee according to which he was obliged to remit his director's fees to EUCo. ItaCo also represented that, because of such agreement, it resolved to pay the director's fees directly to EUCo.

Under Italian domestic law, directors' fees that an employee is contractually obliged to remit to the employer are not employment income and are not taxable in the hands of the employee because the employee does not own such income. Moreover, under Italian law, directors' fees are deductible for the company only upon payment (and not according to the accrual principle).

ItaCo submitted a ruling application asking whether (a) the fees paid to EUCo could be deducted according to the accrual principle, and (b) the payment had to be taxed at source in Italy.

The Italian Revenue Agency stated that, in this case, the fees paid to EUCo:

- a) must be deducted by ItaCo based on the accrual principle because they are not treated as directors' fees for Italian tax law purposes but as ordinary business expenses. This interpretation is in line with recent case law of the Italian Supreme Court (see decision no. 22479 of 16 October 2020 and decision no. 2067 of 29 January 2021; *contra*, see decision no. 1542 of 20 January 2017);
- b) are business income for domestic law purposes and fall under Article 7 of the applicable tax treaty, which means that they can only be taxed in

the Contracting State where EUCo is tax resident because this company does not have any permanent establishment in Italy.

In the opinion of the Revenue Agency, Article 16 of the relevant tax treaty does not apply because the fees were directly paid to EUCo and not to the individual acting as director. However, the conclusion should be the same even if the fees are paid to the employee who is then obliged to remit them to his employer.

Ruling Reply no. 330/2023 comes after a previous reply of the same division of the Italian Revenue Agency on a similar topic (see Ruling Reply no. 167 of 28 May 2019). In that case, the Revenue Agency dealt with the case of directors' fees paid by a foreign (Spanish) company to an Italian-resident director, who then remitted the fees to his employer, an Italian-resident company. The Revenue Agency stated that, under Italian domestic law, "remitted directors' fees" are not taxable in the hands of the employee but can only be taxed in the hands of his employer. However, it maintained that the Italian employer was entitled to the foreign tax credit for the Spanish taxes withheld on the fees paid to the director. Although the 2019 reply is quite ambiguous on this specific point, it seems that the Revenue Agency might have come to this conclusion because it accepted, for the purposes of granting double taxation relief and in line with the OECD's position on conflicts of qualification, the Spanish qualification of the fees as falling under Article 16 of the Italy-Spain tax treaty.

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