MAISTO E ASSOCIATI

TAX TREATY ALERT 2019/02

Italian Supreme Court takes a stand on tax treaty residence issues

In its decisions no. 33234 and no. 33235 of 21 December 2018 and no. 32992 of 20 December 2018 the Italian Supreme Court (tax chamber) discussed certain issues regarding the tax residence of individuals and corporations under article 4 of tax treaties (DTC) patterned on the OECD Model Tax Convention.

Tax residence of corporations

In decisions no. 33234 and no. 33235 of 21 December 2018, the Supreme Court dealt with the case of a Luxembourg company that the Tax Authorities challenged to be tax resident of Italy based on the argument that it was effectively managed by the directors of its parent company situated in Italy.

Both the Court of First Instance and the Court of Appeal upheld the claim of the Tax Authorities.

The Supreme Court quashed the decision of the Court of Appeal, relying on principles stemming from the case law of the Court of Justice of the European Union (Case C-196/04, *Cadbury Schweppes*) and its own previous judgments (Supreme Court, criminal chamber, decision no. 43809 of 30 October 2015).

In particular, with regard to the place of effective management, as tie-breaker criterion under article 4(3) DTC, the Supreme Court held that:

- it substantially corresponds to the management seat criterion used under Italian domestic law;
- in the case of controlled foreign companies, the place of effective management cannot be simply equated to the headquarters of the parent company where the overall management of the group takes place;
- in order to identify the place of effective management of a company, it is not sufficient to establish where its key decisions are taken, but it is also necessary to determine where its day-to-day management is carried out.

Tax residence of individuals

In decision no. 32992 of 20 December 2018, the Supreme Court dealt with a case regarding the tax residence of an individual under article 4(2) of the Italy-Romania DTC.

The case concerned an Italian citizen (the taxpayer), enrolled in the Italian registry of the resident population, owning a house and having a large bank account in Italy. In the relevant tax years, the taxpayer did not file a tax return in Italy as a resident person, based on the fact that he spent most of his time in Romania, where he acted as the sole director of a Romanian operating company owned by his son (also resident in Romania and working for that company).

The Tax Authorities challenged the foreign tax residence of the taxpayer based on the fact that his wife and daughter were living in Italy and on his enrolment in the registry of the resident population. While the Court of First Instance upheld the tax assessment, the Court of Second Instance granted the appeal.

The Tax Authorities brought the issue before the Supreme Court, which decided in favour of the taxpayer and held that:

- the provisions of a DTC, in particular article 4(2) thereof, prevail over the domestic rule deeming all individuals enrolled in the registry of the resident population to be tax resident of Italy;
- contrary to some of its previous decisions on the matter, the centre of vital interests under article 4(2) DTC cannot be established by attributing paramount relevance to the personal and family circumstances over the economic relations of the taxpayer; on the contrary, the centre of vital interests must be ascertained on the basis of the overall facts and circumstances of the case (see, to the same extent, Supreme Court, decision no. 6501 of 31 March 2015).

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