



The Italian Supreme Court ruled on the tax treaty entitlement of foreign trusts

The Italian Supreme Court has recently published decisions No. 2617/2020 and No. 2618/2020 concerning the application of the 1988 Italy-United Kingdom tax treaty to a UK trust ("**Treaty**"). The claimant was the trustee of a trust governed by English law and tax resident of the UK ("**Trust**") that received dividends from Italian companies.

The Italian tax authorities denied that the Trust might benefit from the imputation credit refund set forth in Article 10(4) of the Treaty on the ground that the Trust was not a "person" for treaty purposes and, therefore, was not even entitled to treaty benefits. The trustee challenged the denial of the refund before the Tax Court and provided a tax residence certificate issued by the UK tax authorities, confirming that the Trust was tax resident and subject to taxation in the UK. The Tax Court and the Tax Court of Appeals upheld the conclusion of the Italian tax authorities arguing that (i) the Trust did not fall within the definition of "person" provided by Article 3(1)(d) of the Treaty, (ii) the trustee did not prove that the Trust was the beneficial owner of the dividends, nor it proved that (iii) the dividends were effectively taxed in the UK.

The Italian Supreme Court, though confirming the denial of the imputation credit to the Trust, clarified that trusts may in principle qualify as "persons" for tax treaty purposes. In particular, according to the Supreme Court, the definition of the term "person" set forth in Article 3(1)(d) of the Treaty should be interpreted in a broad sense, taking also into account whether the relevant entities/arrangements are recognized as autonomous legal persons under the laws of the two Contracting States, regardless of whether they are expressly mentioned in the treaty definition. This interpretation is supported by the text of Article 3(1) of the Treaty, according to which the definitions provided thereby apply unless the "context" requires an alternative interpretation. The Court, in particular, highlighted that trusts are arrangements generally recognized in the present social, legal and economic environment and that their characterization as "persons" for tax treaty purposes finds also support in the Commentary on Article 3 of the OECD Model Tax Convention, according to which the definition of "person" is not exhaustive and must be interpreted in a very wide sense.

The conclusion reached by the Supreme Court on this matter is extremely relevant, as it recognizes that trusts are in principle entitled to treaty benefits where they also qualify as tax residents of one or both Contracting States.

In the same vein, the Court confirmed that trusts may equally be regarded as the beneficial owners of the relevant item of income, if they are not fiscally transparent and are not subject to an obligation to pass on that item. However, in the case at stake, the trustee did not provide sufficient evidence of the qualification of the Trust for tax purposes (i.e. as fiscally opaque or transparent) and

of whether the trustee was under an obligation to transfer the dividends received from the Italian companies to other persons (e.g. the beneficiaries of the Trust).

Lastly, the Supreme Court found that the granting of the treaty benefit was also subject to the proof that the dividends had been effectively subject to tax in the UK. While this requirement might be derived from the text of the specific provision of the Treaty, according to which the tax credit refund *"shall not apply if the recipient of the dividend and of the tax credit is not subject to United Kingdom tax in respect thereof"*, the Court unconvincingly supported its conclusion by referring to certain of its previous decisions (such as decision No. n. 25490/2019) dealing with the application of the Parent-Subsidiary Directive, where the Judges (wrongly) denied the withholding tax exemption based on the argument that double taxation had been already eliminated by the dividend exemption granted by the State of the Parent company. It is worth highlighting, in this respect, that the Parent-Subsidiary Directive and most Italian tax treaties do not make the granting of their tax benefits subject to the condition that the relevant items of income are effectively subject to tax in the Residence State of the recipient. The argument developed by the Supreme Court in the cases at hand, which appears to extend the above-mentioned subject to tax requirement to the Parent-Subsidiary Directive and all Italian tax treaties, is thus regrettable and departs from some of its most recent decisions dealing with both the application of tax treaty benefits and the dividend exemption under the Parent-Subsidiary Directive, which reached the opposite conclusion (e.g. decisions No. 2313/2020, see our **EU TAX ALERT 2020/02**; No. 30140/2019; No. 29635/2019; No. 10706/2019; No. 25219/2018).

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