Italian tax authorities clarify the scope of application of foreign tax credit under tax treaties

In rulings no. 157/2018, no. 161/2018 and no. 23/2019, the Italian tax authorities addressed certain issues regarding the application of the foreign tax credit ("FTC") provisions under tax treaties ("DTC").

Income from real estate investment funds

Ruling no. 157/2018 concerned an Italian resident entity investing in Real Estate Investment Funds ("REIFs") established in Ireland, UK, US and Australia. The States of establishment of the REIFs treated them as fiscally transparent entities and taxed the income received by the REIFs as if such income were derived directly by the investors (including the Italian entity). Based on this approach, the States of establishment of the REIFs characterized the income received by the funds, and attributed for tax purposes to the Italian investor, as dividends, interest, or capital gains depending on the nature of the underlying income.

The Italian entity asked to the tax authorities whether the FTC provisions had to be applied based on how the States of establishment of the REIFs characterized the income. The Italian tax authorities held that a characterization of the income based on the Italian domestic tax law, rather than on the foreign laws, should apply for the purposes of granting the FTC. From an Italian tax perspective, non-resident REIFs are treated as non-transparent and all income stemming from the investment in foreign REIFs is characterized as income from capital (i.e. interest, according to the tax authorities). As a consequence, the Italian entity was entitled to the FTC exclusively up to an amount equal to the tax that the State of establishment of the REITs could have levied under Article 11 of the relevant DTC (generally 10% of the gross amount of the income).

The conclusion of the tax authorities might have been affected by the fact that, in the case at stake, taxation in the source States had apparently not been reduced based on the provisions of the DTCs.

The French *prélèvement sociaux*

Ruling no. 161/2018 concerned an individual, tax resident of Italy, who derived income from real estate situated in France. This income was subject in France to a levy named *prélèvement sociaux*. The taxpayer asked to the tax authorities whether the *prélèvement sociaux* qualified as a tax on income for FTC purposes.

The tax authorities drew the following distinction. On the one hand, the *prélèvement sociaux* paid in relation to tax years up to 31 December 2015 did not qualify as a tax on income under Article 2 of the Italy-France DTC and, therefore, no FTC might be granted under the DTC. On the other hand, the *prélèvement sociaux* paid in relation to subsequent tax years qualified as a tax on income under the mentioned Article 2.
The reason for the distinction was that, as specified by the French tax authorities on their website, up to the end of 2015 the *prélèvement sociaux* was meant to

specifically fund the provision of social services and, therefore, it qualified as social contribution rather than as a tax on income. Indeed, in case C-623/13 De Ruyter, the Court of Justice of the European Union considered the *prélèvement sociaux* as falling within the scope of Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes in the EU (and subsequent amendments). On the contrary, since tax year 2016 the French legislation has been changed and now provides that the revenues from the *prélèvement sociaux* must be used to fund general public expenses, as for ordinary income taxes, which makes the *prélèvement sociaux* a tax covered by Article 2 of the Italy-France DTC.

Payments for technical services

Ruling no. 23/2019 concerned an Italian company that provided engineering services to a non-resident company in connection with the construction of a hotel. The payments made to the Italian company were subject to withholding tax in the source State as technical service fees. The Italian company asked to the Italian tax authorities how the income should be characterized for tax treaty purposes and whether Italy should grant FTC in respect of these foreign taxes.

The Italian tax authorities concluded that the payments fell within the scope of article 7 of the relevant DTC (business profits) and, as a consequence, no FTC was due in the absence of a permanent establishment in the source State.

The tax authorities explicitly excluded that those payments could be characterized as royalties for "*the use of, or the right to use, […] design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience*" under Article 12(2) of the DTC. This conclusion was based on the provisions of the contract between the two companies and on the guidelines provided by the Commentary on Article 12 of the OECD Model. In particular, the tax authorities highlighted that (i) paragraph 10.2 of the Commentary excludes payments for the development of a new design, model or plan from the scope of Article 12; (ii) the contract did not grant to the non-resident company any property right over the projects, designs, technical information or any other document drafted by the Italian company; (iii) based of the criteria laid down in paragraph 11.3 of the Commentary, there was no transfer of know-how, as the Italian company was expected to provide the engineering services by using its specific knowledge, skill and expertise, but not to transfer such knowledge, skill or expertise to the other party.

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