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In this number:

The Italian Supreme Court outlined a three-step approach to verify whether a company meets the conditions to be regarded as the "beneficial owner" of a payment (Cass. civ., Sez. V, Sent., 28 febbraio 2023, n. 6050)

The case sent before the Italian Supreme Court concerned a financing transaction arranged by a Luxemburg company in favor of its operative Italian sister companies in 2003. Later on, in the process of a Group restructuring, LuxCo transferred the loan to an Italian sub-holding company, which, on turn, entered with LUXCo a loan agreement of equal amount in order to finance the purchase of the credit. Ultimately, the Italian operative company would pay installments – burdened with interest – to the Italian sub-holding, which, on turn, would pay back LuxCo, minus a fee for its collecting activity. According to the Italian Tax Agency, the interest paid by the Italian operative company should have undergone withholding taxation (as per art. 26, par. 5, Presidential Decree n° 600/1973), given that LuxCo, while indeed qualifying as the real beneficial owner of the payment, did not allegedly meet the requirements for the exemption under Directive 2003/49/EC – the Interest and Royalties Directive (exemption introduced in national law under article 26-*quarter* Presidential Decree n° 600/1973). According to the Italian Tax Agency, therefore, the Italian subholding company was not the beneficial owner of the payment made by the operative entity, the latter therefore being in charge to apply the withholding tax on outbound interest payments toward LuxCo.

The Tax Agency's claim was not upheld by the Tax Courts, losing both in first and second degree, albeit due to an allegedly unsubstantial reasoning of its assessments, hence the case was then brought before the Supreme Court. With judgment n° 6050 issued on the 28th of February 2023, the Judges found that by failing to assess the conditions for the Italian sub-holding to be regarded as beneficial owner, the first and second instance courts had not approached the matter correctly. In doing so, also recalling the Danish cases decided by the ECJ, the Supreme Court outlined a three-step approach to verify whether a company can be regarded as a "beneficial owner", consisting in a series of tests: the substantive business activity test, the dominion test, and the business purpose test. The first test aims to ascertain whether the intermediary company conducts an actual and effective economic activity: if a company does not meet these standards it must be regarded as an abusive structure and it cannot benefit from any of the TFEU provisions. The second test is performed to evaluate the intermediary company's ability to freely dispose of the amounts it receives, which is not the case where the latter has no effective managing autonomy and is bound to pay back what it received (or most of it, anyway): the restitution obligation can result from formal findings, such as a contract, or from factual elements, such as the limited time frame between receipt and on-payment, the regularity of the transfers, the low profit margin on the interest received, the fact that the intermediary company and the ultimate recipient company share the same management. Finally, the business purpose test investigates the reasons for the deviation of the income flow, in order to assess whether the triangulation only aims at tax efficiency or, instead, if it actually meets other economic reasons.

All that being said, however, the Supreme Court also remarked that the exemption cannot be excluded solely based on the fact that the receiving company does not meet the requirements to qualify as the beneficial owner, given that in such a case a look-through approach is required in order to verify whether the subsequent receiver of the interest payments (LuxCo, in this case) would, as of itself, pass

all the aforementioned tests in order to be considered as the beneficial owner. If this were to be the case, the exemption has to be granted, regardless of the presence of an intermediary company that does not meet such requirements; whilst if the subsequent receiver also acts as a mere "conduit company" (perhaps in favor of another non-EU company, as the case may sometimes be), the exemption clearly would have to be denied.
The instructions offered by these decisions will have to be applied by the Second Degree Court in deciding the case, which was ultimately sent back for further evaluation, and will also likely further guide future assessments based on the assumption that the recipient of interest or royalties is a mere conduit company. In particular, the Supreme Court's stance appears to have a direct impact on the burden of proof in the trial that follows an assessment, given that according to the Court's reasoning the taxpayer is charged with demonstrating the requirements needed to be considered as the beneficial owner following the principle of the proof's proximity (*i.e.* the subject for whom is easier to give evidence of something is tasked with demonstrating it). Hence, once the Tax Agency detects one or more elements according to which the withholding exemption should not be granted, it falls upon the concerned companies to prove otherwise by fulfilling the three-step tests upon the first recipient of the payment or, alternatively, the following recipient/s in application of the look-through approach. In this regard, with decision no. 6079/2023 in relation to a similar case involving other companies of the same Group of decision no. 6050/2023, the Supreme Court considered that the lack of proof offered by the taxpayers regarding the beneficial owner of the installments mandated the exemption's denial.
It will be interesting to see how the newly drafted paragraph 5-bis of art. 7 of Legislative Decree no. 546/1992 (introduced by Law no. 130/2022) on the proper distribution of the burden of proof in tax trials – stating that it falls upon the Tax Agency to prove the elements to support a challenge, even in the cases in which an exemption or tax benefit is disregarded – will affect these kind of cases in accordance with the Supreme Court's instructions on the matter.

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Credits' write-off by shareholders does not constitute taxable income for the controlled company/debtor (Cass. civ., Sez. V, Sent., 12 giugno 2023, n. 16595)

The case presented to the Italian Supreme Court involved a loan made by a Luxemburg company to its Italian sister company, which was later transferred from the former to the Italian company's sole shareholder, which was also a company resident in Luxemburg. LuxCo parent company then waived its credit towards its Italian subsidiary/debtor, both for the principal and the related interest (the latter being equal to over six million euros). This being the case, the Italian subsidiary prudently applied the withholding tax over the interest it was dispensed from paying, in accordance with the Tax Agency's well-established opinion on the matter, as offered in previous rulings (see, most notably, Circular letter 73/E/1994), according to which when a shareholder waives a credit towards his company it must be fictitiously considered as if the said sum was collected indeed (so called, "incasso giuridico").
The company was however not persuaded by this reasoning, which it considered outdated after the amendments made by Legislative Decree no. 147/2015 on the Italian Income Tax Act regarding the

taxation as a windfall gain of credit's write-off, and therefore filed a reimbursement request arguing that since no payment took place, the withholding tax should not have been due. The first- and second-degree Tax Court's findings were conflicting, while the former favoured the company's reasoning, the latter considered the credit's waiver to be taxable, hence the case landed before the Supreme Court, which cleared the matter with its decision no. 16595 offered on the 12th of June 2023.

The Supreme Court observed that the thesis of the fictitious collection of the waived credit solely for taxation purposes was first introduced – and supported by the Supreme Court itself – in order to offset a potential tax arbitrage: whereas the debtor/company followed accrual taxation rules, and so could deduct the interest it should have paid on accrual, when the shareholder followed cash basis taxation rules it would suffer no taxation in waiving his credit; moreover, in waiving his credit the tax cost of its shares would be increased, whilst the company/debtor would suffer no additional taxation given that article 88 of the Income Tax Act excluded shareholders' waived credits from the taxable windfall gains (at least in its previous wording). This necessity, however, is no more present in the current regulatory framework, given that Legislative Decree no. 147/2015 amended the aforementioned article 88 by introducing a symmetry between the credit waived and the shareholder's possibility to increase its shares' tax basis. In fact, according to the new regime the credit's waiver by the shareholder effectively generates a windfall gain upon the company/debtor equal to the difference between its nominal value and the tax value that the said credit had in the hands of the shareholder/creditor (see par. 4-*bis*). Hence, where the tax value of the credit is zero (as is the case when the credit derives from an item of income which is taxed upon collection) the company will have to tax the whole nominal amount of the waived claim as a windfall gain and, at the same time, the shareholder's shares will not increase their relevant tax basis.

The principle at hand is consistent with the new rules on the matter, and the instructions offered by the Supreme Court should be applicable beyond the specific case examined; for example, this should also be the case when a Director/shareholder waives its severance pay, thus refuting the stance previously adopted by the Italian Tax Agency on such an example in a ruling it released a few years ago, in which it claimed that the thesis of the fictitious collection for tax purposes of the waived credit was still applicable to such cases (see ruling no. 124/2017).

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The Italian Supreme Court examined the case of a commissionaire agent qualified as a permanent establishment (Cass. civ., Sez. V, Sent., 19 gennaio 2023, n. 1648; Cass. civ., Sez. V, Sent., 27 gennaio 2023, n. 2597)

The Italian Supreme Court's decisions no. 1648/2023 and 2597/2023 stem from a case involving a Swiss-based company engaged in the manufacture and distribution of well-known sportswear, which sold its products across Europe for retail through a network of commissionaire companies. According to the Italian Tax Agency, however, SwissCo's Italian commissionaire (an Italian company whose name recalled the brand of the products being sold) was actually acting as SwissCo's PE in Italy under article 162 of the Italian Income Tax Act and Article 5 of the Italian-Swiss Tax Treaty against double taxation. In particular, the Tax Agency criticized ItaCo's arrangement with SwissCo for being inconsistent with that of a commissionaire agent, merely providing support for the distribution of the foreign entity's products: SwissCo would guarantee ItaCo a 2-3% commission on the sales, irrespective of the amount of sales made (hence, with no "well-performing bonus mechanism"); SwissCo would set up stores for retail sale, which would then be rented by ItaCo, only to have SwissCo cover all expenses (personnel included); and, finally, according to some substantial elements it seemed that ItaCo's employees would receive instructions on prices, shops furnishing and customer service directly from SwissCo. Collectively, these circumstances allegedly proved that ItaCo bore no effective business risk of its own, but rather largely managed the one of the Swiss entity on Italian territory, and this should have led to consider the activities performed by the former as not merely auxiliary and preparatory.

The commissionaire is a well-known operating model for selling and distributing tangible assets produced by multinational enterprises, often as a hybrid between a traditional distributor and an agent. According to previous interpretation on the subject, a commissionaire arrangement through which a Multinational distributes its products would usually not give rise to a PE, thus this mechanism has been heavily exploited in the past for aggressive tax planning, shifting profits from source/market countries to more favourable jurisdictions, prompting the OECD to tackle PE-avoiding commissionaire arrangements through Action 7 of the BEPS Project, following which the Italian legislator extensively reshaped the definition of PE under national rules by also narrowing the conditions at which a commissionaire does not trigger the existence of a PE.

The case at hand, however, did not fall within the scope of the newly drafted PE definition, and the Tax Agency's challenge did not persuade the Supreme Court, which dismissed the elements emphasized by the tax assessment: the fact that the commissionaire fee was set at a fixed percentage rate did not exclude ItaCo's business risk, given that its earnings still depended on the amount of sales concluded by the latter, although no "bonus mechanism" had been agreed; it is not clear whether all costs of the Italian entity were actually covered by the foreign entity; the instructions given by SwissCo had to be regarded as mere guidelines, which the principal is entitled to give to its commissionaire agent; and, anyway, the fact that SwissCo would cover the costs incurred by ItaCo was not so much as a reimbursement, but rather a basis for the remuneration of the intermediation activity.

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The Italian Tax Agency offers guidance on the correct taxation of mandatorily-reversed fees

It is common practice for International Groups to have employees of one company act as directors of affiliated companies, and in such cases the director fee received by the employee is usually mandatorily reversed to its employing company, as per the rules laid down in their employment contracts, and often such payments are made directly to the employee's/director's employer. This was precisely the situation presented to the Italian Tax Agency by an Italian company that counted amongst its directors an employee of a EU sister company, asking for clarification on the tax regime applicable to such payments. Specifically, with the ruling request the Italian company inquired whether the director fees paid to its sister company could be deducted according to the accrual principle and whether the payment had to be taxed at source in Italy.

With its legal opinion no. 330 of the 22nd of May 2023 the Italian Tax Agency first recalled that for tax purposes mandatorily remitted fees paid to directors are not accounted as employment income in the hands of their formal recipient (the employee/director), given that he has no actual control over such sums. Rather, considering that the payment had been made directly towards the sister-company/employer the Tax Agency states that the payment had to be regarded as business income (and so being deductible on an accrual basis), and, consequently, article 7 of the OECD Model Convention (*i.e.* of the relevant Tax Treaty against double taxation, to be more precise) should apply in this case, meaning that the income only had to be taxed in the Contracting State where the EU sister company is resident for tax purposes, provided that it has no permanent establishment in the source Country.

On the other hand, the Tax Agency excluded the application of article 16 of the OECD Model Convention, which would have entailed concurring taxing rights (for the source Country and the recipient's residence Country) over the director's fees, relying on the fact that the payment had been made directly in the hands of the sister-company/employer, and not to the individual acting as a director. In conclusion, the Italian company had no obligation as a withholding agent.

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Re-chargeable director fees paid to foreign parent company, tax regime and withholding tax

Tax ruling no. 330 of May 25, 2023

The Italian Tax Authority, in its ruling no. 330/2023, has taken a position on a thorny issue that has frequently been faced by corporate groups (namely, the correct tax regime to which re-chargeable director fees - in this case, paid to the EU parent company - should be subject).

Re-chargeable fees are applied in the typical situation in which a parent company appoints one of its directors or employees as director of its subsidiary, which pays the compensation for this position, not to the director, but to the parent company itself (by virtue of an agreement – known by the subsidiary - between the parent company and the director or employee).

With reference to the appliable tax regime, the above-mentioned tax ruling, accepting some principles expressed by the Supreme Court, confirms and specifies that re-chargeable director fees:

- do not contribute to the director's income, since they cannot, among other things, be qualified as income from employment and/or assimilated to it (pursuant to Art. 52, par. 2, let. e) TUIR);
- represent, for the company to which they are remitted, business income and, as such, are deductible on an accrual basis by the subsidiary company (since art. 95, par. 2 TUIR, which provides the cash deductibility of fees paid to directors, does not apply);
- also for conventional purposes, since the fees are paid directly by the subsidiary to the parent company, they must be considered business income with the subsequent application of Art. 7 of the Bilateral Double Taxation Convention. Taking into consideration what above, such incomes:
  - may be subject to taxation only in the country of residence of the recipient (unless the recipient has a permanent establishment in Italy); and
  - may not be subject to any withholding tax (otherwise provided for employment – or assimilated - incomes paid to nonresidents, by Art. 24, par. *1-ter*, Presidential Decree no. 600/1973).

The aforementioned tax ruling clarifies the tax regime of re-chargeable fees only with reference to direct taxes, not specifying whether they are subject to VAT.

In Italy, pursuant to the Ministry of Finance's dated Circular No. 17 of 1985, re-chargeable director fees have always been considered out of the VAT scope, because such fees have always been regarded as remuneration of activities rendered by the director himself (and, as such, to be considered income assimilated to that of employees) and not as remuneration of intra-group services provided by the parent company to the subsidiaries.

Considering the principles at last expressed in the tax ruling under comment, it is possible to wonder whether this, longstanding, stance can still be considered applicable. Such doubts are certainly not solved by two recent judgments of the Supreme Court (No. 2067 of 2021 and No. 22479 of 2020), which, for direct taxes purposes, have ruled that "*in these cases [...] the company [...] merely pays to the subsidiary a consideration for the utility received, consisting in the enjoyment of the corporate management activity performed by the human resource put at its disposal. [...] The inapplicability of the discipline of the deduction of the cost for directors' fees […] determines, in application of the general rules on the components of business income, the relevance of the cost as an expense for the provision of services and its deductibility according to the accrual principle.*"

In light of the above, if it is reached the conclusion that re-chargeable fees should be considered as consideration for intra-group services provided by the parent company, the latter could be subject to VAT, under Art. 3 of the Presidential Decree no. 633/1972.

Moreover, in case of intra-group services rendered by an EU parent company:

- the services could be considered as provided in the national territory and, therefore, to be taxed in Italy (pursuant to Art. 7-ter of the Presidential Decree no. 633/1972), with the consequence that
- it could be the subsidiary (that commissioned the services) that would have to pay the VAT, under the reverse charge regime (pursuant to Art. 17 of Presidential Decree 633/1972).

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Mandatory converting (or “convertendi”) investment agreements, tax treatment and holding period for participation exemption purposes

"New investment" tax ruling no. 1 of May 25, 2023

A recent new investments tax ruling (a particular type of tax ruling reserved for Italian or foreign investors, who intend to make major investments in Italy, having a value of not less than, as of January 1, 2023, 15 million euros, with significant and lasting employment effects) provides some clarifications with reference to the tax regime of the so-called "convertendi agreements".

This type of arrangement, typically used to invest in innovative and newly established companies, has the following characteristics:

- it is signed between target companies and investors (directly, or through vehicles controlled by the latter);
- it provides cash contributions (from investors) with no obligation to repay, recorded as a capital reserve in the target's net worth;
- it provides the automatic conversion of these contributions into shares (or quotas) of the target upon the occurrence of certain events (so-called “trigger events”), such as subsequent rounds of investments, or any disposals of the shares of the target itself;
- the abovementioned conversion (and its ratio) is determined (i) on the value of the target on the date of the trigger event and (ii) applying some adjustments justified by the fact that the contribution was made at an earlier date by the investor (i.e., value discounts and/or value cap as well as notional interest on the invested capital).

According to the Italian Tax Authority, these “convertendi” agreements (regardless of whether they involve the actual issuance of financial instruments by the target, or they only provide undertakings between the parties) could be considered as “converting instruments”, which, making the investor co-sharer of the business risks (*i.e.,* loss of capital and, after the conversion, participation in profits), must be considered as financial instruments assimilated, for tax purposes, to shares (pursuant to Art. 44 par. 2 let. a) TUIR and the Ministerial Decree of August 3, 2017).

From the abovementioned qualification, it follows that:

- the sums received by the target will not be considered income (being merely recorded as capital reserve in equity);
- moreover, for the investor, the amounts invested do not have any income effect, as to be recorded among intangible assets at their original cost. Similarly, the Italian Tax Authority has specified that possible adjustments to the target's valuation upon conversion (as well the recognition of representational interests) do not produce any income effect (since they are not actually received by the investor, as to have effect only on the determination of the conversion ratio).

The Tax Administration also clarified that, even in the case where, following the conversion, there is a subsequent, even immediate, sale of the shares (as, usually, when a trigger event is represented by the sale of the company itself), the so-called participation exemption or "PEX" (pursuant to Art. 87 of the TUIR, which entails the 95% tax exemption of the capital gain generated) may be applied, with the minimum holding period (one year) to be considered as started from the signing of the "convertendi agreement" and not from the date of conversion. Actually, the conversion represents, for the Italian Tax Authority, a "tax-neutral event" that does not interrupt the holding period, relevant for the application of the participation exemption.

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Supreme court decisions on the 10% surcharge on the variable remuneration paid in the financial industry

With landmark decisions no. 16875/2023 and no. 15861/2023, dated 13 June and 6 June 2023 respectively, the Italian Supreme Court reserved previous decisions on the scope of the 10% surcharge on variable remuneration paid to executives and directors "working for companies operating in the financial industry" (the "10% Surcharge"). The decisions should be carefully evaluated by taxpayers as the Italian tax authorities will certainly base future claims on the principles set therein.

Background

The 10% Surcharge has been introduced in the Italian tax law landscape with the aim at curbing the use of variable remuneration due to its "*distortionary effects on the financial system and the global economy* (…) *as highlighted in the G-20 summit*".

Under Article 33 of Law Decree No. 78 of 31 May 2010, the 10% Surcharge is levied on the variable remuneration (such as bonuses and stock options) paid to executives (*dirigenti*) and quasi-employees (such as members of the board of directors) working in the financial sector.

According to para. 2 of Article 33, the Italian employer is required to withhold the 10% Surcharge upon the payment of the variable remuneration and remit it to the Italian tax authorities. According to para. 1 of Article 33, the surcharge applies to the variable remuneration that exceeds three times the fixed annual salary. However, a new paragraph 2-bis was introduced by Law Decree No. 98 of 6 July 2011 providing that paragraphs 1 and 2 of Article 33 apply to the portion of the variable remuneration that exceeds the fixed annual salary.

The issues at stake

The definition of "financial sector"

Article 33 of Law Decree No. 78 of 31 May 2010 does not provide a specific definition of "financial sector", and this has generated some uncertainty. In Circular letter No. 4/2011, the Italian tax authorities clarified that the term financial sector should be interpreted in line with Legislative Decree No. 87 of 27 January 1992, according to which, *inter alia*, also holding companies and entities providing corporate finance advisory services would fall within its scope. This position was confirmed in a ruling of 2018, even if meanwhile Legislative Decree No. 87 of 1992 had been superseded in 2015 by Legislative Decree No. 136 of 18 August 2015, which does not list entities providing corporate finance advisory services, nor holding companies, as falling within the scope of the "financial sector".

Subsequently, Decree No. 136 of 2015 was itself repealed by Legislative Decree No. 142 of 29 November 2018, which, *inter alia*, introduced a new Article 162-bis in the Italian Tax Act (the "**ITA**") instituting a definition of financial intermediaries for direct tax purposes that includes:

- entities referred to in Article 2.1.c of Legislative Decree No. 38 of 28 February 2005; these include banks, parent companies of banking groups and conglomerates, securities investment firms, asset management companies, financial companies subject to registration under the Consolidated Banking Act, licensed pawnbrokers, electronic money institutions, payment institutions, parent companies of securities investment firms and parent companies of financial groups the financial statements of which are to be prepared in compliance with the Regulation of the Bank of Italy of 22 December 2017, as well as Italian permanent establishments of non-resident financial intermediaries having the same features of those listed above;
- credit consortia (s.c. "*confidi*");
- microcredit operators; and
- entities that exclusively or prevalently carry out the acquisition of shareholdings in financial intermediaries.

As a consequence of the new provisions set forth by Article 162-bis, industrial holding companies no longer qualify as "financial intermediary" for direct tax purposes.

On 12 January 2022, replying to a request from the Italian Parliament, the Ministry of Economy and Finance stated that, following the provisions set forth by the new Article 162-bis, ITA, the 10% tax surcharges shall apply only to executives hired by entities falling within the list of "financial intermediaries" provided under such new law provision. The Ministry expressly stated that the clarifications provided by the Italian tax authorities in the 2018 ruling should be considered as superseded.

The triggering event of the 10% Surcharge

While the original law provision clearly required the variable compensation to exceed at least three times the fixed component of the executives' remuneration for the 10% Surcharge to be applied, in the

light of subsequent law amendments - introduced by Law Decree No. 98 of 6 July 2011 - it is unclear whether the above remained valid (as maintained by certain practitioners) or, contrarily, the 10% Surcharge is due in case the variable compensation simply exceeds the fixed remuneration.

The supreme court decisions

With decision no. 16875/2023, the Italian Supreme Court reversed its previous position and stated that the 10% Surcharge applies to all those operating in the global financial scene who are able to generate, directly and/or indirectly, harmful distortions through abnormal remuneration incentives, hence including also executives working at industrial holding or asset management companies, disregarding whether they interact directly with the public or not.

This holds true, the Supreme Court argued, in light of the wording of the provision regulating the 10% Surcharge, which does not make any cross-reference to the definition of "financial industry" relevant for other purposes, e.g., regulatory or tax purposes. The stance taken by the Italian Supreme Court will certainly represent a cornerstone for future tax claims that the Italian tax authorities could raise towards entities who adopted a different interpretation.

At the same time, the current state of art leads to think that a further decision will be issued by the Italian Supreme Court in plenary session in order to solve the conflict which arose as consequence of decisions of different chambers. In fact, the previous stance taken by the Italian Supreme Court was based on the believe that the law provisions related to he 10% Surcharge contain an undeclared cross-reference to the definition of “financial industry” relevant for regulatory purposes that would not allow to include also industrial holding companies, as such entities do not carry out any activity towards the public there is no risk that variable remuneration granted to their employees would be able to generate, directly and/or indirectly, harmful distortions on the financial market.

On the other hand, with decision no. 15861/2023, the Italian Supreme Court decided that the 10% Surcharge shall be applied even if the variable remuneration simply exceeds the fixed one, as the amendments introduced by Law Decree No. 98 of 6 July 2011 were clearly intended to increase the number of taxpayers potentially subject to the surcharge. This interpretation is in line with that put forward by the Italian tax authorities in a number of tax ruling replies as well as in the Circular letter No. 41/2011.

The decisions above should be carefully evaluated by taxpayers that relied on the more favorable interpretations concerning the notion of “financial industry” and the triggering event for the purpose of the 10% Surcharge. In this respect, the conflicting decisions and the uncertainty regarding the matter at hand could be leveraged to claim that no administrative penalties could be applied in case of tax assessments.

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