WTS Global files a complaint with the European Commission against the Italian Supreme Court's case law on the Parent-Subsidiary Directive

In two recent cases the Italian Supreme Court denied the application of the Parent-Subsidiary Directive on the reasoning that the dividend paid by an Italian subsidiary to its foreign EU parent was not subject to effective taxation in the hands of the receiving parent company. Several professionals from WTS Global European Tax Law Center have submitted a complaint against these decisions with the European Commission arguing that this case law of the Italian Supreme Court is alarming and in breach of EU law.

The Parent-Subsidiary Directive aims to encourage the grouping of companies located in different EU member states through the elimination of economic (and juridical) double taxation. To this end, the Parent-Subsidiary Directive provides for a withholding tax exemption on dividends in the EU member state of the distributing company and the exemption from taxation – or an 'indirect' tax credit – on such dividends in the hands of the parent company. In order to benefit from the Parent-Subsidiary Directive, certain requirements must be fulfilled.
The two decisions of the Italian Supreme Court, issued on 13 December 2018 and 10 October 2019, dealt with the subject-to-tax requirement. This requirement has traditionally been interpreted as the necessity for the parent company as a whole to be subject to corporate tax.

In the two cases, an Italian subsidiary paid dividends to its Luxembourg parent company, which benefitted from the application of the domestic participation exemption regime. Hence, the dividends were not effectively taxed in Luxembourg. On this basis the Italian Supreme Court ruled that the subject-to-tax requirement was not met and denied the application of the Parent-Subsidiary Directive.

The underlying reasoning of the Italian Supreme Court in these cases seems logical and simple: the dividend withholding tax exemption aims to eliminate double taxation of dividends, and if the dividend is not subject to effective taxation in the hands of the parent company, there is no double taxation to eliminate.
However, this reasoning is not in line with the wording of the Parent-Subsidiary Directive, nor is it in line with the purpose and intention of such Directive. The Italian Supreme Court mistakenly interprets the subject-to-tax requirement as referring to the dividends received by the parent company and not as simply requiring the parent itself to be a taxable entity, albeit being exempt on the dividends received.

Therefore, subjecting the application of the withholding tax exemption to the condition that the dividend is effectively taxed in the state of residence of the parent company – as required by the Italian Supreme Court in these decisions – is inconsistent with the wording and objectives of the Directive, to the extent that economic double taxation on profits generated by the Italian subsidiary would not be eliminated. For these reasons, the European Tax Law Centre of WTS Global has submitted a complaint with the European Commission against these decisions. Under the standard procedure, within the following 12 months, the European Commission will assess the complaints and decide whether to initiate a formal infringement procedure against Italy.

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Editorial Team

Koen Morbée
koen.morbee@tiberghien.com
T +32 2 773 40 00
Tiberghien
Tour & Taxis, Havenlaan | Avenue du Port 86C
B.419
BE-1000 Brussels, Belgium
www.tiberghien.com

Thomas De Meyer
thomas.demeyer@tiberghien.com
T +32 2 773 40 00
Tiberghien
Tour & Taxis, Havenlaan | Avenue du Port 86C
B.419
BE-1000 Brussels, Belgium
www.tiberghien.com

Inés Blanco
ines.blanco@wts.com
T +32 (0)2 801 30 60
WTS Global
Esplanade Oscar van de Voorde 1
BE-9000 Ghent, Belgium
wts.com

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The WTS Global European Tax Law Center ("ETLC") consists of dedicated tax experts from WTS Global specializing on recent news, developments and court decisions at EU level.

The ETLC newsflash will bundle the most relevant information and provide first hand analysis by tax experts from WTS Global.

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WTS Global
P.O. Box 19201 | 3001 BE Rotterdam
Netherlands
T +31 (10) 217 91 71 | F +31 (10) 217 91 70
wts.com info@wts.de