

BO or Not BO, That Is the Question. The Italian Supreme Court's Soliloquy on the Danish Principles of the EU Court of Justice (Publication in Highlight & Insights on European Taxation)

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On 10 July 2020, the Italian Supreme Court (also 'Court') issued its decision No. 14756 ('Decision 14756/2020', published in [H&I 2020/470 with comments by Arginelli and Tenore](#)) dealing, amongst others, with the interpretation of the beneficial owner requirement under the Interest and Royalty Directive (Directive 2003/49/EC; 'IRD') and the abuse of the IRD.

The case concerned the payment of interest by an Italian company ('Itaco') to its controlling shareholder, a Luxembourg sub-holding ('Luxco') which, in turn, was controlled by another Luxembourg company.

Interest paid by Itaco accrued on a loan granted by Luxco in the context of a broader Mibo transaction, put in place for the purpose of acquiring certain target companies situated in Italy and Sweden.

The Italian Tax Authorities ('ITA') claimed that Luxco was a conduit company and, therefore, could not be regarded as the beneficial owner of the interest payments. Accordingly, ITA denied the withholding tax exemption, arguing in particular that

- Luxco was a holding company carrying out limited treasury activities;
- the conditions (in terms of duration, interest rate and amounts) of the loan between Luxco and Itaco were similar to those of the loan that Luxco received from its shareholder (as well as to those of other loans granted along the above controlling chain);
- Luxco transferred to its shareholder the interest it received from Itaco after a short period of time and derived from those transactions an allegedly limited mark-up of 0.125% as remuneration for its activities.

Both the Tax Court and the Tax Court of Appeals rejected the claim of the ITA, which appealed before the Supreme Court. However, the latter confirmed that Luxco was to be regarded as the beneficial owner of the interest payment and, therefore, was entitled to the benefits of the IRD.

In reaching this conclusion, the Court made abundant references to the judgment issued on 26 February 2019 by the Court of Justice of the European Union ('CJ') in joined cases N Luxembourg 1 (c-115/16), X Denmark A/S (c-118/16), C Danmark I (c-119/16) and Z Denmark ApS (c-299/16), dealing with the application of the IRD ('Danish cases').

The Supreme Court confirmed that the beneficial owner clause is a rule with anti-avoidance effects and it emphasized that the assessment of the beneficial owner requirement should be aimed exclusively at determining whether the recipient has full right to use and enjoy the income free from legal obligations to pass it on to another person.

In this respect, the Supreme Court also placed relevance on the (current) OECD commentary on Article 11 in order to construe the beneficial owner requirement under the IRD and upheld that Luxco was the beneficial owner of the interest and that the relevant transactions were not abusive, given that:

- the sole fact that Luxco acted as sub-holding and carried out limited treasury activities was not per se decisive in order to conclude that it was a conduit company not fulfilling the beneficial owner requirement;
- there was no contractual or legal obligation for Luxco to pass on the interest to another person;
- the net profits derived by Luxco were adequate, having regard to the specific activities carried out; and
- the loan granted by Luxco to Itaco was only one of several loans granted to other group companies in the context of the Mibo transaction aimed at acquiring target companies in Italy and Sweden.

The decision is important for a number of reasons.

First, the Supreme Court made an express reference to the CJ's Danish cases (prior to this decision, only lower courts made reference thereto), while confirming that the beneficial owner requirement is a rule with anti-avoidance effects and that, in order to rely on it, ITA must give adequate evidence that the recipient does not have the right to use the income unconstrained by legal (or contractual) obligations to pass it on to other persons.

Second, the Supreme Court reiterated that a (pure) holding company cannot be denied the benefits of the IRD only because it does not have a meaningful structure or substance, nor because it is controlled by an entity that would not be entitled to the benefits of the IRD. According to the Court, in order to benefit of the directive it is sufficient that the holding company has a sufficient autonomy in the management of the underlying asset (generating the relevant item of income), in addition to not being subject to a legal or contractual obligation to pay the income to a its controlling entity

Third, the Supreme Court did not focus on the specific loan granted by Luxco to Itaco and on the related loans granted along the participation chain, but it assessed the overall functions performed by Luxco within the group and in the light of the purpose of the relevant Mibo transaction, which was aimed at the acquisition of the Italian and Swedish target companies.

Finally the authors raise some criticism regarding the approach taken by the Supreme Court insofar as it tends to overlap the concept of beneficial ownership and that of abuse of tax law. The absence of a clear-cut distinction between the two concepts, which somehow also emerged in the CJ's judgments in the Danish cases, is regrettable and could raise contradictions in the interpretation and application of the beneficial owner clause.

To read more about this case, read the comment of Arginelli and Tenore in [Highlight & Insights on European Taxation \(H&I 2020/470\)](#), which is available here free of charge.