

## Supreme Court Confirms General Antiavoidance Principle

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# COUNTRY DIGEST

## Supreme Court Confirms General Antiavoidance Principle

In two decisions on December 23, 2008, the Italian Supreme Court has for the first time held that the Italian tax system contains a general antiavoidance principle derived directly from the Italian Constitution, under which the tax administration can disregard a transaction entered into for the sole purpose of obtaining a tax advantage.

According to the Court, the general antiavoidance principle derives from article 53 of the Italian Constitution establishing that all must pay taxes according to their ability to pay, at higher rates for higher income. It is a general principle of the Italian tax system that applies in addition to any other specific antiavoidance provisions of the tax code.

From now on, any transaction that generates a significant tax benefit must be tested under this general antiavoidance rule, which requires that the transaction be entered into for significant economic reasons beyond obtaining a tax advantage, as well as under any specific antiabuse provisions that may apply to that transaction.

The first decision, Ruling 30055, concerned a dividend washing transaction. An Italian company purchased stock from an Italian investment fund immediately before the payment of a dividend declared on the stock at a purchase price reflecting the amount of the dividend declared and payable on the stock.

The Italian company collected the dividend and received a tax (imputation) credit for an amount equal to the underlying corporate taxes paid by the issuer of the stock on the profits out of which the dividend was paid, which eliminated the tax on the dividend for the buyer. If collected by the investment fund, the dividend would have been subject to a gross basis withholding tax.

Immediately thereafter, the Italian company sold the stock back to the investment fund at a price equal to the purchase price less the amount of the dividend, thereby realizing a taxable loss that reduced its taxable income.

The tax administration denied the benefit of the tax loss under the theory that the real beneficial owner of the dividend was the investment fund and the Italian company acted merely as a conduit for the collection of the dividend on behalf of the fund.

At the time, article 14, paragraph 6-*bis* of the tax code — which denies the dividend tax credit for dividends distributed to companies that have bought stock from investment funds after the declaration but before the payment of the dividends had not been enacted.

The second decision, Ruling 30057, concerned a dividend stripping transaction. A U.S. company not engaged in business in Italy owned stock of an Italian company and transferred the right of use of that stock (usufruct), including the right to collect the dividends on the stock, to another Italian company at a price reflecting the amount of the dividends that were reasonably expected to be declared on the stock during the time of the contract.

Italian tax law treats the dividend equivalent amount paid to the transferor of the usufruct as foreign-source income not taxable in Italy.

The Italian company collected the dividends and received a tax (imputation) credit for an amount equal to the underlying corporate taxes paid by the issuer of the stock on the profits out of which the dividend was distributed, which eliminated the tax on the dividend and took amortization deductions for the cost of the usufruct, which reduced its taxable income. If paid to the U.S. company, the dividends would have been subject to a gross basis withholding tax.

The tax administration denied the amortization deduction for the price of the usufruct on the grounds that the Italian company was not the real beneficial owner of the income but acted merely as a conduit for the collection of the dividends on behalf of the U.S. company.

At the time, article 14, paragraph 7-*bis*, which denies the tax credit for dividends collected by Italian companies that purchased the usufruct on the stock from foreign companies, had not been enacted.

The Supreme Court held that the transactions lacked significant economic reasons other than tax benefits and could be disregarded under the general antiavoidance principle.

With these decisions, the Italian Supreme Court has completed its controversial path toward the creation of a general antiavoidance principle in the Italian tax system.

In two 2005 decisions (Ruling 20398 of October 21 and Ruling 22932 of November 14), the Supreme Court disregarded the tax benefits of a dividend washing and dividend stripping transaction on the grounds that they lacked a valid legal cause and therefore were null and void under the general principles of Italian contract law, which should be interpreted consistently with a general antiabuse of law doctrine deriving from EU law. (For prior coverage, see *Doc 2007-17358* or *2007 WTD 144-4*.)

In two later decisions (Ruling 21221 of September 29, 2006, and Ruling 10257 of April 31, 2008), the

Supreme Court held that the antiabuse doctrine deriving from EU VAT law, as interpreted and applied by the European Court of Justice in *Halifax* (C-255/02), is also directly applicable at the national level to direct taxes. More recently, the Supreme Court's Ruling 25374 of October 17, 2008, confirmed the applicability of the EU abuse of rights principle regarding VAT. (For the ECJ decision in *Halifax*, see *Doc 2006-3356* or *2006 WTD 35-19*; for prior coverage of Ruling 25374, see *Tax Notes Int'l*, May 26, 2008, p. 673, *Doc 2008-26072*, or *2008 WTD 240- 3*.) ◆

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