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Italian judgment on the treaty entitlement of an English trust

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Abstract

The Provincial Tax Court of Pescara (Italy) ruled over the treaty entitlement of an English trust subject to UK corporation tax. The Court upheld the assessment of the tax office, which, despite the official administrative guidelines, denied the treaty benefits because the trust does not qualify as a legal entity. The author criticizes the judgment in the light of the purpose of income tax treaties and of the clarifications laid down by the Organisation for Economic Co-operation and Development Commentary.

The Provincial tax court of Pescara (chamber IV, judgment No. 210 of 13 November 2012) ruled over a case involving a trust regulated by English law that was tax resident of the UK and cashed dividends from an Italian company in the years 1999 through 2002. The Court denied the entitlement of the trust to treaty benefits, particularly the refund of the imputation credit pursuant to Article 10(4) of the UK–Italy income tax treaty. The refund of the imputation credit is not granted any more, following the shift of the Italian system from an imputation credit regime to an exemption regime; however, the annotated judgment highlights the risk that the Italian tax authorities and courts might deny treaty benefits to non-resident trusts.

The Italian tax authorities denied the refund of the imputation credit on the ground that trust was not a 'person' for treaty purposes and, accordingly, was not entitled to treaty benefits. In particular, the tax authorities denied the qualification as 'company' on the ground that the trust, despite being subject to corporate income tax, was not a legal entity. In this regard, Article 3(1)(a) and (b) of the treaty stipulate respectively, along the lines of the Organisation for Economic Co-operation and Development (OECD) Model Convention, that:

> *the term 'person' includes an individual, a company and any other body of persons* and *the term 'company' means any body corporate or any entity that is treated as a body corporate for tax purposes* (emphasis added).

The taxpayer challenged the denial of the refund by arguing that the trust was subject to UK corporate income tax as a company pursuant to Article 468 of the Income and Corporation Taxes Act 1988 and therefore qualified as 'company' and, thus, 'person' for treaty purposes. The taxpayer further provided the Court with a residence certificate issued by the UK tax authorities and referred to the fact that, according to paragraph 2 of the Commentary on Article 3 of the OECD Model Convention, the definition of 'person' is not exhaustive and must be interpreted in a very wide sense.

The Court denied the refund for two reasons. First, the Court shared the tax authorities' view that the trust did not qualify as a 'company' for treaty purposes, despite being subject to corporate income tax as a company, since it was not a legal entity. Second, Article 10(4) of the treaty makes the refund

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conditional upon the fact that the dividends, as well as the refund, be subject to tax, whilst the taxpayer did not prove the effective payment of any UK taxes on the dividends.

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The judgment of the Court is to be strongly criticized to the extent that the qualification of the trust as 'company' was denied due to the lack of legal personality.

In this regard, paragraph 3 of the Commentary on Article 3 of the OECD Model Convention states that, in addition to body corporates, the term company:

> *covers any other taxable unit that is treated as a body corporate according to the tax laws of the Contracting State in which it is organised* (emphasis added).

The use of the words 'taxable unit', instead of 'entity' (used in Article 3 of the OECD Model Convention), is meant to clarify that a 'company' is deemed to exist whenever the tax legislation provides for a taxable unit, treated as a body corporate for tax purposes, even if such taxable unit is not a legal entity.

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The clarification of the Commentary is consistent with the purpose of income tax treaties of eliminating double taxation. Indeed, in the light of such purpose, the fact that the trust is not a legal entity is immaterial and the qualification as 'company' depends only on the corporate income tax regime of the trust.

Furthermore, the qualification of trusts as 'persons' is explicitly recognized by paragraph 6.10 of the Commentary on Article 1 of the OECD Model Convention, dealing with Collective Investment Vehicles in the form of trusts. In fact, such paragraph stipulates that:

> *... in some countries where the CIV is commonly established in the form of a trust, either the trust itself, or the trustees acting collectively in their capacity as such, is treated as a taxpayer or a person for domestic tax law purposes. In view of the wide meaning to be given to the term 'person', the fact that the tax law of the country where such a CIV is established would treat it as a taxpayer would be indicative that the CIV is a 'person' for treaty purposes....* (emphasis added).

The quoted paragraph confirms that the qualification of a trust as a taxable person triggers by itself the treaty qualification as 'person', notwithstanding the lack of legal personality of the trust. Particularly, the trust will qualify as 'company' if it is subject to corporate income tax, or as a 'person' other than a 'company' if it is subject to income tax.

The position of the tax authorities in the reported case law conflicts with the approach set out in their official administrative guidelines. Indeed, in the Circular letter No. 48 of 8 August 2007, they took the view, in relation to Italian resident trusts, that 'since trusts are taxable persons for Italian corporate income tax, they qualify as "persons" for treaty purposes'. *It is hoped that the tax authorities will stick to the approach laid down in the official guidelines also in relation to non-resident trusts*

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