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FAMILIES, CHARITIES AND HNWIs

To be or not to be ... a "disregarded" entity

Two recent public rulings released by the Italian Revenue Agency address the issue of entity "interposition", offering new interpretative hints as to when an entity should be considered as "disregarded" for tax purposes and its assets/income be imputed directly to the interposing party.

Disregarded entities

Under Italian tax law an entity – although existing from a legal standpoint – can be considered as disregarded from a tax perspective when it is proven to be only a "formal" owner of the underlying assets and income, which shall be attributed to their "actual" owner.
The provision on "tax interposition" is codified in the tax rules for income tax purposes but the concept is very blurry and often has a very broad application in tax assessments, also in relation to indirect taxes, and is frequently applied in association with the general anti-avoidance rule.
Moreover, the interposition can concern all types of entities (including corporations, partnerships, and trusts) whether resident in Italy or abroad, although in practice most cases of interposition concern foreign entities, especially resident outside the European Community.

Ruling No. 274 of May 18, 2022: the Cayman ManCo

The first Ruling concerns a limited partnership established in the Cayman Islands and participated by a group of managers of a private equity firm. According to a scheme that is typical of the private equity industry, the partnership was aimed at pooling in a common vehicle ("**ManCo**") the investment made by the managers in the relevant private equity fund, established in Luxembourg. ManCo served governance purposes, allowing the private equity firm – that acted as the general partner – full control over the entity.
The Applicant, an Italian resident manager partner of ManCo, requested the Revenue Agency to confirm that ManCo was a disregarded vehicle and that he had to be considered the actual owner of the profits deriving from the Luxembourg fund, thus being subject to a more favorable tax treatment

(26% final withholding tax) compared to the one applicable to profits deriving from a Cayman partnership (subject to progressive personal income tax up to 45%).
The Revenue Agency concluded in the Ruling that the ManCo was instead an effective entity, not to be disregarded, especially in the light of the fact that the Italian applicant was just one of the partners of ManCo and could not exercise any control on the entity and its assets.

Ruling No. 282 of May 20, 2022: the UK "HoldCo"

The second Ruling concerns a limited liability company ("**HoldCo**") tax resident in the UK (ordinarily subject to corporation tax), incorporated by a UK citizen, who at the time of incorporation was resident in the United Kingdom and subsequently relocated to Italy. The company – initially administered by the same shareholder and, after his relocation to Italy, by his mother – was a pure holding company, owning (i) the image and sponsorship rights related to the shareholder (nothing was paid to the shareholder for the exploitation of such rights), (ii) a 50% shareholding in another company and (iii) financial receivables, some of which interest-bearing (although no interest had ever been paid to HoldCo).
The Applicant requested the Agency to confirm that HoldCo was not a disregarded vehicle and that he had not to be considered as the actual owner of the profits realized by the same HoldCo, unless in case of their distribution (i.e. with a potential deferral of taxation).
Tax Agency concluded in the Ruling that HoldCo was instead a disregarded entity and that the profits realized by the company had to be directly taxed in the hands of its Italian shareholder, regardless of their distribution.

What matters

Based on the two Rulings, what matters in order to exclude the interposition of an entity are the followings:

i. the consistency of the entity with the economic objectives it is intended to achieve. In the case of ManCo, the Agency noted that "*The company scheme is consistent with the Group's choice to have its managers investing in FIAs indirectly, through a single company"* while in the case of the UK HoldCo observed that *"although theoretically the company seems to have been set up to carry out various activities, at present, it has not made any relevant investments" and "the company's activity is not clearly defined"*;

ii. the existence of an actual autonomous and organized management body such that the entity can be considered as a distinct person from its shareholders/partners. While in the case of ManCo, the Revenue Agency noted that from an administrative point of view, the company is administered by the general partner and the partners do not have any controlling power, in the case of UK HoldCo, the Revenue Agency considered the managerial autonomy of the company, wholly owned by a shareholder and administered by a person belonging to his family sphere, to be only formal;

iii. the existence of arm's length contractual relationships. In the UK HoldCo's case, the Revenue Agency did assess as negative elements the fact that the image and sponsorship rights were granted to the company by the shareholder without the charge of any royalty and that the interest accrued on loans advanced by UK HoldCo had never been collected by the same company.

Finally, the existence of a number of shareholders/partners – particularly if not linked by family or personal ties – seems also to be a decisive element supporting the effectiveness of the entity (as in the case of ManCo).

What seems less conclusive

For the purposes of excluding the interposition of an entity other elements seems less conclusive *per se*, in the view of the Revenue Agency. Those elements include:

i. the absence of a structure in terms of personnel, depreciable assets and offices;
ii. the absence of accounting and balance sheet obligations;
iii. the fact that no actual activity is carried out in the State where the entity has its legal seat;
iv. the payment of taxes in the Country of residence.

Final remarks

The conclusions reached by the Italian Revenue Agency seem to give more weight to substantial parameters rather than formal ones and – in this sense – are warmly welcome. Hopefully, the same parameters will be used consistently in the future, regardless of whether the outcome of the interposition analysis is unfavorable to the taxpayer (as in the two rulings here discussed) or favorable. The feeling is that the question will remain uncertain and the taxpayers, like Prince Hamlet, will still have to struggle to find their answer.

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