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## Reversible directors' fees in cross-border situations: good or bad news?

Within multinational companies, the boards of directors of foreign subsidiaries normally include one or more employees (or directors) of the parent company or other group companies. Directors' fees recognised to such employees should often be reversed to the employer company. The qualification of such fees may differ among the countries involved. A recent ruling issued by the Italian tax authorities deals with the issue but not all news are good news.

### **The fact: an Italian director of a Spanish company**



An Italian resident person (the Director) is appointed as director of a Spanish company. The Director is an employee of the Italian parent company and the employment agreement stipulates that any fees received by the Director have to be reversed to the Italian employer. Under Spanish law, director's fees are recognised as fees of the Director him/herself and are taxed at source pursuant to Article 16 of the Italy-Spain treaty.

Under Italian law, director's fees are reversed to the employer and do not constitute income of the Director but rather as income of the employer.

### **Foreign tax credit: formal approach vs. substantive approach**

The issue dealt with by the ruling is whether the employer company is entitled to the foreign tax credit notwithstanding under Spanish law the relevant income was taxed as income of the Director. In case of negative answer, taxable income of the employer would have been limited to the amount actually reversed by the Director, i.e. net of the Spanish withholding tax. In the opposite case, fees would have to be included in the taxable income for their gross amount but a credit would have been granted to the employer for taxes levied in Spain, even though in such State taxes are due on income owned by the Director.

The answer is affirmative and this is a good news, as traditionally Italian tax authorities have taken a very formalistic approach as to the entitlement of credits for foreign taxes.

### **Are reversed directors' fees taxable in Spain?**

The rationale for this conclusion is that Spain had the right to tax the directors' fees notwithstanding they have to be reversed to the employer.

Tax authorities, indeed, state in the ruling that the application of the Spanish withholding tax is compliant with Article 16 of the Italy-Spain treaty that on the point strictly follows the OECD Model Convention.

No further clarifications can be found in the ruling.

A possible explanation is that under Spanish tax law director's fees are regarded as income of the Director, notwithstanding any contractual (internal) agreement to reverse such fees to the employer. The same income is thus regarded in one State (Spain) as income of a given person (the Director) and in the other State (Italy) as income of another person (the Director's employer). In such a context, the substantial approach taken by the authorities as to the entitlement of the foreign tax credit is very welcome.

### **What about directors' fees paid by Italian companies and reversed to foreign employers?**

Under Italian tax law it is debated whether Italy retains the authority to tax directors' fees paid by an Italian company where the directors are contractually obliged to reverse such fees to the foreign employer.

From an Italian tax perspective, income belongs to the foreign employer rather to the directors and this is a significant departure from the Spanish legal background. In this context, however, the issue is whether reversible directors' fees are taxable in the employer's hands in the absence of a permanent establishment in Italy. Tax authorities have officially never dealt with this issue although Article 16 of the OECD Treaty Model should not literally apply as it refers only to income earned and owned by the directors themselves.

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