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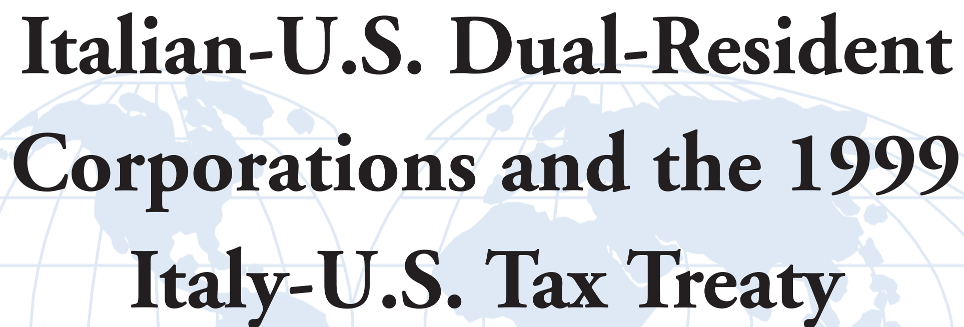

Italian-U.S. Dual-Resident Corporations and the 1999 Italy-U.S. Tax Treaty

by Luigi Perin

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Practitioners' Corner

Italian-U.S. Dual-Resident Corporations And the 1999 Italy-U.S. Tax Treaty

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In Italy, income tax code article 73(3) provides that a corporation is considered resident in Italy if either its registered office, place of management, or main business is in Italy for more than half of the tax year. Accordingly, the determination of residency of corporations for Italian tax purposes occurs regardless of the country of incorporation. Italian-resident corporations are subject to corporate income tax on their worldwide income.

In the U.S., Internal Revenue Code section 7701(a)(4) defines domestic corporations as corporations created or organized in the United States or under the laws of the United States or any state. U.S. domestic corporations are subject to corporate income tax on their worldwide income. Therefore, a domestic corporation under U.S. law may be considered an Italian-resident corporation under Italian law. Such corporations are known as dual-resident corporations.

A corporation would generally want to avoid dual-resident status because that status effectively subjects it to a higher combined tax burden. This happens because an item of income not subject to tax in Italy is generally taxable in the U.S. and vice versa. Similarly, tax-deductible items in one jurisdiction could be nondeductible in the other. Differences in income sourcing rules may also reduce the availability of foreign tax credits in one of the two countries and create double taxation. Dual-resident status was sought in the past by U.S. corporations as a technique to double-dip losses by using them to offset the incomes of both the U.S. affiliated group and the foreign affiliated group. However, IRC section 1503(d) disallows the use of a dual consolidated loss to reduce the taxable income of any member of a U.S. consolidated group.

When the currently in force 1984 Italy-U.S. income tax treaty was signed, the U.S. represented that no cases of corporate dual residence were known to exist. Accordingly, double taxation of dual-resident corporations (for example, a company incorporated in the U.S. but effectively managed and controlled in Italy) is permissible under the current treaty. Currently, cases of Italian-U.S. dual-resident corporations do exist, and in at least one case known to the author and submitted to the competent authorities for consideration under the 1984 treaty's mutual agreement procedure, the issue of dual residency remained unresolved.

In 2006 Italy introduced rules that affect the residency status of foreign entities. (For prior coverage, see *Tax Notes Int'l*, Feb. 12, 2007, p. 556.) A foreign entity is now presumed to be resident in Italy for tax purposes if it is controlled, directly or indirectly, by Italian residents, or if the majority of the members of the board of directors are Italian residents. While the new rules on the presumption

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of residency are rebuttable, the number of Italian-U.S. dual-resident corporations is expected to increase.

Under the 1999 treaty, which is yet to be ratified by Italy (for prior coverage, see *Tax Notes Int'l*, Apr. 10, 2006, p. 93), dual-resident companies, trusts, or estates are addressed by article 4(4). If a person is found to be a resident in both Italy and the U.S., the competent authorities will seek to determine a single country of residence for that person for purposes of the treaty or otherwise to avoid double taxation. However, the 1999 treaty is silent on the consequences of failure by the competent authorities to resolve the issue. A logical solution to this problem would be to provide for binding arbitration in each case when the competent authorities fail to reach an agreement. In recent months, the United States has concluded two double taxation agreements — one with Germany and the other with Belgium — that contain mandatory arbitration clauses. (For prior coverage, see *Tax Notes Int'l*, Feb. 26, 2007, p. 791.) Also, the OECD's Committee on Fiscal Affairs announced February 7 that the next edition of the OECD model income tax treaty will provide for mandatory binding arbitration of competent authority disputes.

The 1999 treaty introduced measures concerning a voluntary arbitration procedure whereby a resolution will eventually be compelled only if both the competent authority and the taxpayer agree to submit the dispute to the arbitration board. One question is if the voluntary arbitration procedure will be effective. However, the more pressing question is whether the 1999 Italy-U.S. treaty will ever enter into effect. ◆

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