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Languishing Italy-U.S. Tax Treaty Would Revise Mutual Agreement Procedure

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A tax treaty signed by the United States and Italy on 25 August 1999, and subsequently ratified by the U.S. Senate, still has not been ratified by Italy, leaving the 1984 treaty between the two countries in force. Following is an analysis of the provisions contained in article 25 (mutual agreement procedure) of the new treaty.

Under the new treaty, when a taxpayer believes that it has been, or could be, affected by measures taken by the tax administration of either the United States or Italy that are not in accordance with the treaty, the taxpayer may present its case to the competent authority of the country where it is resident (or a citizen).[1] That administrative remedy is provided in addition to the ordinary administrative and judicial remedies available to the taxpayer under the domestic tax laws of its country of residence.[2]

Before a mutual agreement procedure (or MAP) can actually begin, the competent authority must consider a taxpayer's objection justified. In addition, the competent authority must not be able to arrive at a satisfactory solution without the intervention of the competent authority of the other country. Therefore, if for any reason the competent authority considers a case unworthy of resolution, or decides to adopt a unilateral measure to solve the case, the mutual agreement procedure will not begin.[3]

The 1999 treaty provides that a taxpayer must submit its case before the competent authority within three years of the initial notice of assessment that is deemed inconsistent with the provisions of the treaty. That provision, which is similar to one in the OECD Model, is intended to protect the tax administrations from late objections by taxpayers.

Several treaty provisions call for the involvement of the competent authorities to address specific issues.[4] In addition, article 25 not only delegates

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[1]Article 3(1)(e) identifies the competent authorities as, in the United States, the Secretary of the Treasury or his delegate and, in Italy, the Ministry of Finance.

[2]Under Article 1(15) of the 1984 treaty protocol, in the case of Italy, invoking the MAP did not relieve a taxpayer of the obligation to initiate domestic legal procedures for resolving tax disputes. That provision has not been reproduced in the 1999 treaty. Therefore, an Italian taxpayer presumably now may opt not to initiate the appeals process under Italian domestic law, without limiting its rights to double taxation relief under the treaty.

[3]In both Italy and the United States, the decision of the competent authority about whether to assist a taxpayer is not subject to judicial review. *See* C. Garbarino, *La Tassazione del Reddito Transnazionale*, Padova, 1990, p. 585; P.H Blessing, *Income Tax Treaties of the United States*, 1996, pp. 23-30.

[4]Protocol article 1(16) gives the competent authorities power to apply the provisions of paragraphs 1 and 2 of article 19 (government service) to employees of organizations that perform functions of a governmental nature; protocol article 1(19) provides that the competent authorities may agree that the conditions for the application of paragraph 10 of article 10 (dividends), paragraph 9 of article 11 (interest), paragraph 8 of article 12 (royalties), or paragraph 3 of article 22 (other income) of the treaty are met.

to the competent authorities the general resolution of questions about the interpretation and application of the treaty, but also the elimination of double taxation cases falling beyond the scope of the treaty.[5]

The new treaty's MAP provisions encourage informal communication between the two tax administrations.

The competent authorities are under no obligation to resolve the case. In fact, the treaty provides that the tax administrations must merely "endeavor" to reach a solution.[6] While the U.S. competent authority claims to have successfully resolved most of the cases presented to date, the Italian competent authority's approach to resolving double taxation cases is questionable.

Once the competent authorities have settled a case, the new MAP provisions of the 1999 treaty mandate implementation of the measures adopted, regardless of any time limits provided by the Italian or U.S. domestic tax systems. That is a strong improvement over the MAP provisions under the 1984 treaty, and it will assist taxpayers initiating MAPs in cases for which the time limit for refund claims under the domestic tax laws has already expired.

The new treaty's MAP provisions encourage informal communication between the two tax administrations. The competent authorities are not required to access diplomatic channels in order to communicate. Furthermore, they may form ad hoc commissions for the purposes of exchanging opinions and reaching agreements. Those provisions are in line with the recommendations of the OECD Committee on Fiscal Affairs, according to which any unnecessary formalities involved in the MAP should be eliminated.[7]

Provisions addressing the possible introduction of an arbitration procedure are perhaps the most innovative measures in the 1999 treaty. The purpose of those provisions is to ensure that double taxation disputes are not left unresolved because of conflicting views by the two competent authorities. Under that circumstance, and subject to the consent of both competent authorities and the taxpayer, a case may be remitted to an arbitration board for resolution. The decision of the arbitration board is binding for all the parties involved. Unfortunately, the treaty does not, of itself, implement the arbitration procedure. It merely requires the United States and Italy to consult, within three years of the treaty's entry into force, to evaluate the appropriateness of implementing the arbitration procedure.

As a result, while it is unlikely that any arbitration process would be implemented without a delay of a number of years, the competent authorities may choose not to take advantage of the arbitration provisions until both sides gain sufficient experience with the arbitration of international

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[5]For example, in triangular cases involving third-country-resident permanent establishments.

[6]Under article 1(15) of the 1984 treaty protocol, any adjustment to tax under the MAP could be made only before the "final determination" of tax. In addition, in the case of Italy, the MAP did not relieve a taxpayer of the obligation to initiate procedures required under Italian domestic law to resolve tax disputes. That was in sharp contrast to article 25(2) of the 1996 U.S. Model Treaty, under which any agreement reached by means of the MAP was to be implemented regardless of any time limits or other procedural limitations in the domestic laws of the contracting states. As a general rule, under Italian tax law, the statute of limitation is four years. However, until recently, a refund claim could be filed only within 18 months of payment of the tax. Accordingly, under the 1984 treaty, it was extremely difficult to obtain relief from double taxation in Italy unless a protective claim for a refund was filed.

[7]*See* OECD Model Commentary on article 25, paragraph 30(a).

tax disputes. While the U.S. competent authority has extensive experience resolving international double taxation issues in general, and transfer pricing disputes in particular, the same cannot be said of the Italian competent authority.

U.S. Competent Authority Carol Dunahoo told a Tax Council Policy Institute symposium in Washington in February that she is "in favor of exploring arbitration if [it is] properly designed" to resolve competent authority disputes. (For prior coverage, see *2002 WTD 31-6*, or *Doc 2002-3853 (3 original pages)*.) Hopefully, the Italian authorities gradually will also become more involved in that area, considering the required administration of the EU arbitration procedure.[8] ✦

[8]Convention 436 of 23 July 1990, ratified by Italy with law 99 of 22 March 1993. With that multilateral convention, EU members have agreed that certain cases of double taxation arising in the context of transfer pricing disputes that have not been resolved through the MAP must be submitted for arbitration.