Special Reports

Overview of the Italian Tax System for U.S. Investors

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This paper is not a legal opinion, and the author disclaims all responsibility as such. Anyone wishing to act in connection with any of the subjects discussed in this paper should seek competent professional advice before acting and should not rely on the contents of this paper alone.

I. In General

A. Jurisdiction

There are three types of tax jurisdictions Italy asserts over the income of an individual or a corporation: residence, source, and what is known as "doing business."

1. Residence Jurisdiction

Residence jurisdiction is asserted over Italian-resident individuals and corporations on their worldwide gross income less deductions. Currently, tax is imposed at rates up to 45 percent[1] and up to 40.25 percent on individuals and corporations, respectively.

To determine whether a corporation is a resident of Italy, Italian tax law classifies corporations not only by citizenship (which country has issued their incorporation papers), but also by their physical activities (management, control, and assets) in Italy. Thus, a corporation is considered resident in Italy if either its registered office, its main activity, or its place of management is in Italy for 183 days or more during a tax year.[2]

In comparison to the U.S. concept of residence, Italian tax law has additional and more substantive tests. The United States asserts full residence jurisdiction over the income of a corporation incorporated under domestic law only.

While the incorporation test adopted by the U.S. has the advantage of certainty, the management test adopted by Italy has the advantage of economic reality. The management test does not apply to corporations incorporated under Italian law and conducting their business abroad. In other words, these corporations are resident for Italian tax purposes regardless of how much of their activities are physically located abroad. Italy asserts full jurisdiction over individuals who physically reside here and not over citizens, too.[3]

2. Source Jurisdiction

Generally, source jurisdiction is asserted over nonresident aliens and foreign corporations on the gross amount of their Italian-source nonbusiness income at a flat rate ranging from 12.5 to 30 percent.[4]

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[1] *See Testo Unico delle Imposte sui Redditi* (TUIR), art. 11(1)(*e*).

[2] TUIR art. 87(3).

[3] TUIR art. 2(1). However, under TUIR art. 2(2-*bis*), there is an exception for Italian citizens who give up their residence to become residents of certain low-tax countries.

[4] Different rules apply for real estate and royalty income.

3. Doing Business Jurisdiction

"Doing business" jurisdiction is asserted over nonresident aliens and foreign corporations on their Italian net business income attributable to an Italian permanent establishment.[5] Tax is imposed at the same rates as it is for residents.

Because the Italian statute does not define the term "permanent establishment," tax authorities accept the definition given to this term by the OECD Model Income Tax Treaty.[6] However, as in the United States, there are no precise guidelines. Court decisions to the contrary notwithstanding, it is not unusual for the Italian Revenue Bureau to treat even minimal Italian activity by a foreign entity as engaging in Italian trade or business though a permanent establishment.

B. Gross Income: Concept and Inclusions

Italian tax law does not have an all-inclusive definition of income. Rather, income is included in gross income only if it falls into one of the specific categories provided for by the statute. By way of comparison, section 61(a) of the U.S. Internal Revenue Code (IRC) defines the term "gross income" as "all income from whatever source defined."

The term income is defined under TUIR article 6 to include the following categories: income from real estate property, investment income, income from dependent personal services, self-employment income, business income, and other income.

Despite the terminology, "other income" is not a catch-all category. Rather, under TUIR article 81, this category includes only certain sources of income including, but not limited to, capital gains.

C. Principal Taxes

The principal taxes imposed on Italian corporations are the corporate income tax (*Imposta sul Reddito delle Persone Giuridiche*, or IRPEG) and a local tax, IRAP (*Imposta Regionale sulle Attività Produttive*).

There is no corporate alternative minimum tax (but for some "sham" corporations that do not meet certain activity requirements),[7] nor a branch profits tax on Italian branches of foreign corporations. Unlike the United States, excessive retention of earnings beyond the reasonable needs of a business does not result in the imposition of an accumulated earnings tax.

> It is not unusual for the Italian Revenue Bureau to treat even minimal Italian activity by a foreign entity as engaging in Italian trade or business through a PE.

D. The Controlled Foreign Companies (CFC) Regime

Following the release of the 1998 OECD Report on Harmful Tax Competition, Italy enacted specific CFC rules (not yet entered into force). These rules provide that when certain foreign companies are controlled by Italian shareholders, such shareholders are taxed on some of the foreign entity's undistributed earnings, as well as on its distributed earnings.[8] A CFC generally is one in which an Italian shareholder, actually or constructively, owns 25 percent or more of the voting stock. Alternatively, a corporation is a CFC if an Italian shareholder's interest in the CFC is ITL 15 billion or more. In addition, the foreign entity must be a resident of a country or territory included on a "black list" yet to be issued by the Italian tax authorities. The CFC provisions do not apply to income earned through low-taxed entities that are primarily engaged in actual "industrial or trading" activities within the country or territory in which their place of business is located.

E. Ruling Request

Similar to a U.S. private letter ruling, under Italian tax procedure letter rulings are issued directly to taxpayers who formally request advice about the consequences applicable to a specific business transaction.[9] Interestingly, a letter ruling is not binding on either the taxpayer or the authorities. However, in disposing of a case and determining the tax treatment of a transaction, the party not relying on a letter ruling will bear the burden of proving that the ruling was disregarded due to reasonable cause and that there was an absence of willful neglect.

II. Avoidance of Double Taxation

A. Foreign Tax Credit

Corporations (as well as individuals) may claim a tax credit for foreign income tax paid on income earned and subject to tax in another country.[10] Unlike the United States,[11] Italian taxpayers

[5] TUIR art. 20.

[6] *See Circolare Ministeriale* No. 7/1946 of 30 April 1977.

[7] *See* art. 30 of Law No. 724 of 23 December 1994, art. 27 of *D.L.* No. 41 of 23 February 1995, and art. 3 of Law No. 662 of 23 December 1996.

[8] *See* Law No. 342 of 21 November 2000.

[9] *See* art 21(9) of Law No. 413 of 30 December 1991, *D.M.* No. 195 of 13 June 1997, and *Circ. Min.* No. 135/E of 28 May 1998.

[10] TUIR art. 15.

[11] IRC section 164.

cannot claim — if advantageous — a deduction instead of a credit. Under Italian tax law, neither income tax[12] nor foreign and real property taxes are deductible. In addition, taxes cannot be credited unless actually paid. There is no credit for deemed paid foreign taxes to provide equivalent treatment for branches and subsidiaries of Italian corporations.

Similar to the United States, there is a ceiling limitation formula under which the foreign tax credit (FTC) allowed is the lesser of the foreign taxes paid or the limitation determined according to the following formula:

$$\frac{\text{Foreign-source taxable income}^{13}}{\text{Worldwide taxable income}} \times \text{Italian tax on worldwide taxable income before FTC}$$

Unlike the method used in the United States, unused FTCs cannot be carried back or forward. Also, the FTC limitation is computed separately for each foreign country (this being potentially advantageous for the taxpayer because any losses from a given foreign country would not reduce income from other foreign sources and, therefore, would not reduce the amount of foreign taxes that can be used as a credit against Italian tax), but is not computed separately — as in the United States — for different baskets of income.

B. Dividends

Any distribution paid out of current or accumulated profits is a taxable dividend. To prevent a corporation from paying its assets in dividends and leaving nothing for payments to creditors, the Italian statute makes dividends illegal when there is a deficit.[14] It allows distribution of dividends only to the extent of such profits, so that there could not be a distribution in excess of earnings. In the United States, said distribution would constitute a return of capital and, possibly, a capital gain.

As a general rule under the Italian imputation system of taxation, double or triple taxation of dividend distributions among domestic corporations is eliminated or reduced. This is not done by a dividend received deduction, like in the United States, but by providing to Italian shareholders of an Italian corporation a tax credit equal to 56.25 percent[15] of the dividends received.

However, a U.S. shareholder receiving a dividend distribution from an Italian corporation is not entitled to the Italian dividend tax credit; rather, the U.S. shareholder is subject to a 5, 10, or 15 percent (depending on the percentage of ownership) Italian withholding tax on the dividend distribution.[16] Accordingly, a U.S. shareholder of an Italian corporation might be subject to a greater Italian tax burden than an Italian shareholder of an Italian corporation. Some tax practitioners have observed that this disparate tax treatment might be in violation of article 24 on nondiscrimination of the income tax treaty between Italy and the United States.[17] U.S. and Italian authorities did not address this issue in their recent renegotiation of the treaty.

A U.S. shareholder of an Italian corporation might be subject to a greater Italian tax burden than an Italian shareholder of an Italian corporation.

1. The 60 Percent and 95 Percent Exemptions

Different rules apply for dividends received by an Italian corporation from a foreign corporation. In such instances, the Italian corporation is currently entitled to include in its gross income only 40 percent of the dividends received from a "20 percent corporation," a corporation having at least 20 percent (or 10 percent if it is a public company) of its voting stock owned by the recipient Italian corporation.[18] This 60 percent exemption is not allowed for dividends received from a corporation resident in a country that the Italian Ministry of Finance has identified as a tax haven.

Only 5 percent of the dividends received by an Italian parent from a subsidiary that is a resident of a country that is a member of the European Union are included in the Italian parent's gross income if the Italian parent owns at least 25 percent of the stock of the distributing corporation.[19]

Legislation that was already passed but is not yet in force will extend the 95 percent exemption to dividends received by an Italian corporation regardless of whether the payor is an EU resident.

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[12] TUIR art. 64.

[13] While there are no rules to determine when income derives from foreign sources, the statute provides a list of types of income deemed to be derived from Italian sources. *See* TUIR art. 20.

[14] *See* Civil Code (*Codice civile*) art. 2433.

[15] *I.e.*: 36/(100-36).

[16] Conversely, dividends distributed by Italian corporations to EU-resident companies are exempt from Italian withholding tax.

[17] Art. 24 states that "nationals of a Contracting State shall not be subject in the other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected."

[18] *See* TUIR art. 96 and Civil Code art. 2359(3).

[19] TUIR art. 96-*bis*.

III. Types of Legal Entities

A. Per Se Corporations

The corporation in Italy offers the same major advantages to investors as the corporate form does in the United States. Shareholder liability is limited to the amount invested, ownership is easily transferred, and continuity of the business is assured regardless of death or changes in management or ownership.

Italian law provides for different types of corporations, including the *Società per Azioni* (SpA) and the *Società a Responsabilità Limitata* (SRL). The main difference between the two is that the capital of a SpA is represented by stock certificates, whereas the capital of an SRL is represented by shares. While the tax treatment and legal requirements for an SRL are much the same as for an SpA, small and medium size businesses may find it advantageous to adopt the SRL form because of the following differences:

- the minimum capital required is ITL 20 million as opposed to ITL 200 million;
- the appointment of statutory auditors is required only if the capital exceeds ITL 200 million; and
- only one shareholder is needed to form an SRL (an SpA must be formed by at least two stockholders, even though it may subsequently be owned by only one shareholder. In such an event, however, the sole shareholder will no longer enjoy limited liability).

An SRL may not issue bonds or debentures, however, and it may not redeem its own equity capital.

B. Entities Eligible for the 'Check-the-Box' Election

The list of per se foreign entities that are classified as corporations for purposes of the U.S. "check-the-box" regulations includes the SpA (which, therefore, may not elect out of classification as a corporation), but it does not include the SRL. Accordingly, this entity is eligible for the check-the-box election by U.S. companies.

C. The Commission Agent Under Italian Civil Law

Generally, U.S. corporations market their products in Italy through a distributor contracting in its own name and on its own behalf, or through a commission agent contracting in the name and on behalf of the principal.

By using a commission agent, the U.S. principal limits the risks (such as credit and inventory risks) associated with the Italian agent's operations and transfers them to the principal. If the activities and risks of the commission agent are reduced, the profit allocable to Italy should be reduced, too. Transferring the risks and additional profits to the principal may produce a tax benefit for the group, for example by allowing U.S. corporations to minimize their foreign profits (and thus their foreign taxes); commission agents' arrangements help minimize these companies' excess foreign tax credit position.

A primary issue that arises in connection with commission agents is whether the foreign principal has a PE in Italy arising from the activities of its Italian agent.

A primary issue that arises in connection with commission agents is whether the foreign principal (say, a U.S. corporation) has a permanent establishment in Italy arising from the activities of its Italian agent. If the Italian agent is found to be dependent (both legally and economically) on the U.S. principal, and if said agent has and habitually exercises in Italy an authority to conclude contracts in the name of the U.S. manufacturer, then, for tax purposes, the Italian agent may be treated as a PE in Italy of the U.S. company. It should be observed that in Italy, unlike in the United States, the issue is particularly significant. It is not unusual for the tax examiners — in the context of an audit of intercompany transactions — to challenge the taxpayer on issues such as whether a permanent establishment may exist, rather than focusing on the transfer pricing methods themselves.

The critical factor in determining whether there is a permanent establishment is deciding whether contracts entered into by a dependent (legally and economically) agent bind the principal. In this respect, there is a fundamental difference between Italian civil law and U.S. common law in the legal result arising out of the same factual situation.[20] The difference is when an agent enters into a contract in his or her own name, but on behalf of an undisclosed principal. As a general rule under U.S. common law, the principal is bound by the contract. Under Italian civil law, only the agent, and not the principal, is bound by the contract.

Thus, to avoid a dependent commission agent being treated as a permanent establishment, the U.S. principal could operate in Italy through a "hybrid" (from a U.S. perspective) agent.[21] Said agent does not take legal title to

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[20] *See* Avery Jones, Ward, *et al*., European Taxation, 154, 155-6 (1993).

[21] *See* Civil Code arts. 1731- 1736.

goods, so title passes directly from the principal to the customer. When an agent enters into a contract, however, it does it in its own name, although on behalf of the principal.[22] As a result, the agent does not bind the principal.

D. The 'Associazione in Partecipazione' (Silent Partnership)

An *associazione in partecipazione*, or silent partnership, is formed when the owner of a business and another person (the silent partner) conclude a partnership agreement that commits the silent partner to make a capital contribution in return for a share of the profits of the business.[23] The silent partnership is merely an internal relationship, and it does not of itself constitute a trade or business. The silent partnership can be particularly advantageous when used in connection with financing and investment purposes. It permits capitalization without creating any personal liability on the part of the investor and without involving public disclosure. The silent partners' contribution becomes the property of the entrepreneur and the silent partner does not participate in management affairs.

E. Classes of Stock

Stock can be common or preferred. In addition, corporations listed on an Italian stock exchange may issue savings shares. These shares have priority (with respect to both dividends and distribution of capital on dissolution of the corporation) over both common and preferred stock, but they are nonvoting. It should be observed that, unlike in the United States, Italian tax law is notable for the absence of thin capitalization provisions to limit the deductibility of interest paid. However, with both the IRAP and the dual income tax (DIT) system discussed below, the Italian tax authorities have tried to make equity financing more attractive.

IV. Branch vs. Subsidiary

A. Branch

To establish a branch in Italy, a foreign company must qualify to do business under Italian law. Qualification consists of furnishing certain information to, and obtaining a certificate from, the Italian authorities. Financial statements must be prepared and filed with the competent agency, and the branch must maintain its books and records in accordance with the law.

1. Advantages

Currently, a branch has the advantage of not being liable for Italian withholding tax on the remittance of profits to its head office or for any other tax similar to the U.S. branch profits tax, so the Italian effective tax rate is not higher than that paid by a subsidiary. In addition, there would be an immediate U.S. tax benefit for losses incurred in Italy and a direct U.S. credit for Italian taxes paid or accrued. Also, transfers of tangible or intangible assets to a foreign branch would not be subject to U.S. excise tax under U.S. IRC section 1491. Finally, directors and statutory auditors are not required, and there are no minimum capital requirements.

> While branches can be converted to Italian subsidiaries at a later time, tax disadvantages may arise in doing so.

2. Disadvantages

A branch does not confer the ability to defer U.S. tax on foreign income. Also, from a U.S. perspective, an incorporation of branch assets may be subject to U.S. IRC section 367 and to recapture of previously deducted branch losses. In addition, there are the same formalities (bookkeeping, financial statements, and registration costs) as for a subsidiary and full liability of the head office, as opposed to the limited liability of a subsidiary.

While branches can be converted to Italian subsidiaries at a later time, tax disadvantages may arise in doing so. For example, capital gains realized by the branch on the transfer of assets (including goodwill) to the newly incorporated subsidiary would be subject to income tax. If, however, the assets of the Italian branch have been held for at least three years, the branch could elect to be taxed at the more favorable 19 percent rate, and the transferee — the newly incorporated subsidiary — would benefit from a step-up in the basis of the assets received.

B. Subsidiary

1. Advantages

A subsidiary has the following advantages: (i) deferral of U.S. tax on Italian earnings, that is, no U.S. shareholder level tax until actual distribution; (ii) opportunity to utilize the U.S.-Italy tax treaty to reduce Italian withholding taxes; (iii) deemed paid Italian tax credit benefits; (iv) Italian entities — even though they may not file combined returns — can, to some extent, offset their tax positions (see more below); and (v) opportunity for a check-the-box election for SRLs.

2. Disadvantages

The most significant disadvantages of a subsidiary are: (i) that it

[22] *See* Civil Code art. 1705.

[23] *See* Civil Code art. 2549.

might be subject to CFC, PFIC, and FPHC tax regimes; (ii) it has no U.S. tax benefit for Italian losses, resulting in higher worldwide effective tax rates; and (iii) it has more stringent U.S. tax reporting requirements.

V. Determining Taxable Income

A. IRPEG Tax

As a general rule, corporations and Italian permanent establishments of foreign companies are subject to a fixed IRPEG rate of 36 percent[24] on their taxable income. The effective tax rate might be considerably lower than 36 percent because a portion of the taxable income can be subject to a reduced 19 percent IRPEG rate. In the case of a company going public, the reduced rate is 7 percent for the thre years following the initial public offering.[25, 26]

Namely, the portion of taxable income subject to the reduced rate is a deemed interest income computed by multiplying certain increases[27] in the net equity (in turn, increased by 20 percent for the year 2000, and by 40 percent for 2001 and the subsequent years; in Italian tax parlance, this benefit is known as the "SuperDIT") of the corporation by an average interest rate adjusted annually for inflation.[28]

This combination cannot result in an effective IRPEG rate lower than 27 percent; any net equity increase resulting from this limitation can be carried forward to subsequent years. Effective 2001, the "floor" previously applicable to public companies in the three years following the initial public offering is no longer applicable. Thus, a public company might enjoy a tax rate as low as 7 percent for the three years following the initial public offering.

B. IRAP Tax

For a manufacturing company, IRAP is based on gross revenues, less cost of materials and certain business expenses, such as rent and depreciation. The IRAP tax base is not reduced, however, for labor costs and interest expenses. As a result, the creditability of IRAP — levied at a 4.25 percent rate[29] — has been questioned in the United States. To be creditable in the United States, a tax must qualify as either an income tax, in the U.S. sense of that phrase, or a tax in lieu of an income tax. Otherwise, there is no double taxation of the same items of income and no reason for a foreign tax credit. The problem for U.S. taxpayers has been solved by IR-INT-98-6, in which the U.S. and Italian tax authorities have reached a mutual agreement under the income tax treaty between the two countries.

Corporations and Italian PEs of foreign companies are subject to a fixed IRPEG rate of 36 percent on their taxable income.

Said agreement, the provisions of which have been included in art. 23(2)(c) of the new tax treaty signed in 1999 by the two countries (but not yet entered into force), caps or limits the amount of the Italian regional tax on the net value of production activity that can be claimed as a creditable income tax under sections 901 and 902 for U.S. tax purposes. Namely, the two countries have mutually agreed that the United States will allow as a credit against U.S. income tax only a portion of the amount paid or accrued, calculated as follows:

$$\text{Amount Creditable} = \frac{\text{IRAP Base - Labor and Interest Expenses}}{\text{IRAP Base}} \times \text{Total Amount of IRAP Paid}$$

For companies with no local loans on the books and low labor costs, the difference between the IRAP tax in Italy and the amount of IRAP creditable in the United States will be minimal. Thus, capital-intensive businesses, in which rent and depreciation represent a larger portion of the expenses, will incur an IRAP tax in Italy that may result in a larger foreign tax credit for U.S. tax purposes, depending on their labor costs. The IRAP provisions also are intended to reward companies that are adequately capitalized. Businesses that are over-leveraged or under-capitalized, that incur high interest or borrowing costs, will be subject to a higher IRAP tax.

Because the IRAP is a local tax, foreign-source income is excluded from taxable income for this tax.

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[24]TUIR art. 91.

[25]The 7 percent rate is not available to public companies with a net equity exceeding ITL 500 billion (equivalent to approximately US $250 million using April 2001 lira/dollar exchange rates).

[26]For the purpose of this article, the provisions of Law 133/99 — commonly referred to as "Legge Visco," after the name of the minister of finance under whose administration this law was enacted — since only temporary in nature, are ignored.

[27]To qualify, increases must be in the form of contribution of cash or actual earnings of the company. As a result, increases resulting from the transfer of reserves to capital or from contributions of assets would not benefit from DIT benefits.

[28]This rate reflects the return of bonds (issued by both the government and corporations) listed on the Italian markets, plus 2 percent. The rate is 7 percent for 2000.

[29]The IRAP tax rate is 5.4 percent for banks and other financial institutions.

Therefore, Italian corporations that receive dividend distributions from, say, a U.S. subsidiary, will not have to pay IRAP on that income.

From a planning perspective, the IRAP might be extremely advantageous because it applies only to income from "productive activities," whereas gains from the sale of assets (such as stocks and fixed assets) — as long as extraordinary in nature — will be subject to the 36 percent (or lower) IRPEG rate only.

C. Treatment of Capital Gains

As a general rule, all capital gains realized by corporate taxpayers are treated as ordinary business income for Italian tax purposes. They are therefore taken into account in computing income subject to regular corporate income tax rates.

By the same token, capital losses are generally treated as ordinary losses. There is a limitation to the deductibility of losses from the sale of an investment in a non-Italian resident corporation (say, in a U.S. company), to reflect the fact that the dividends paid by those corporations are partly exempt (see the discussion on the 60 percent or 95 percent exemption, above) from Italian income tax.

A special rule allows companies to defer the taxation of capital gains from the sale or exchange of assets held for at least three years by spreading these gains in equal installments over a period of up to five years.[30]

In addition, gains from the sale of assets constituting a trade or business or of certain stock may be subject — if so elected by the taxpayer — to a lower 19 percent income tax rate.[31]

Capital gains and losses are treated differently if realized by individuals. Capital gains on investments in stocks and bonds are taxed at a 12.5 percent rate. The rate is 27 percent for capital gains from the sale of derivatives. Though investors are subject to capital gains tax, they may deduct capital losses.

VI. Tax Returns

A. Absence of Consolidated Return Provisions

A group of corporations is not a relevant entity for tax purposes; therefore, there is no consolidated return under Italian tax law.

Through proper procedure, corporations may surrender to other corporations any claims for refunds for overpayments of income taxes made on the appropriate tax returns.[32] This procedure is simplified for transfers between related parties. In general, only refunds generated in prior years can be transferred (any overpayment for the current year to be credited to the following year cannot be transferred to another company). Because it is traditionally a long process to receive refunds in Italy, this provision might be extremely useful to the extent that it allows corporations to offset their taxable incomes.

From a planning perspective, the IRAP might be extremely advantageous.

In addition, unlike in the United States under the separate-return limitation year rule, there is no specific rule preventing the acquisition of a loss corporation to apply its net operating loss deductions against the income of the more prosperous members of the group. The limitations imposed by the provisions dealing with the carryover of tax attributes must be taken into account, however, as discussed below.

B. Time for Filing and Payment

Tax returns for corporations are due one month from approval of the financial statements at the annual general shareholders meeting (which, in turn, must generally be held within four months from the end of the tax year). It should be noted that although a tax return filed more than 30 days after the date of the meeting is not valid for the taxpayer, it may be used by the tax authorities to make an assessment within five years after the original return is filed.

Amended returns are allowable and start a new statute of limitations running to the extent:

- they claim a higher tax liability (returns claiming a lower tax are acceptable only at the discretion of the revenue bureau if filed within 30 days of the original return);[33] and
- they are filed before filing the return for the second following year (for a calendar year corporation, the 2000 return is generally due on or before 30 May 2001; an amended return for the same year would be valid if filed before the return for 2002

[30]TUIR art. 54(4).

[31]*See* art. 1 of *Decreto legislativo* No. 358 of 8 October 1997 as amended by art. 6(1) of Law No. 342 of 21 November 2000.

[32]*See* arts. 43-*bis* and 43-*ter* of *D.P.R.* 602/1973.

[33]There is an exception, though, for reduction of income to reflect adjustments to transfer prices resulting from mutual agreement procedures with certain foreign competent authorities. *See* TUIR art. 76(5).

is filed in May of the year 2003).

In Italy, unlike in the United States, there is no automatic time extension to file the return. As a general rule, the tax shown on an income tax return must be paid at the time fixed for filing the return.

A corporation that anticipates a tax bill must estimate its income tax liability for the current tax year and pay two (rather than four, like in the United States) estimated tax installments during that year. For calendar year corporations, estimated tax installments are due on the due date of the income tax return for the prior year and on 30 November.

To avoid a penalty, the two installments must equal at least 93.5 percent of the lesser of (i) 93.5 percent of the tax shown on the current year's tax return, or (ii) 93.5 percent of the tax shown on the corporation's return for the preceding tax year.

C. Penalties Imposed on Understatements of Income

While as a general rule penalties for understatement of income tax are much heavier in Italy than in the United States,[34] under Italian tax law — unlike in the United States — there are no accuracy-related penalty provisions specifically applicable to transfer pricing adjustments.[35] Therefore, there is no statutory requirement for the taxpayer to prepare contemporaneous documentation.

Notwithstanding, adequate documentation seems to be crucial to prove to the Italian tax examiners that a transfer pricing policy is at arm's-length (for example, to overcome the royalties' safe harbors).

In absence of specific domestic rules, Italy follows the OECD Transfer Pricing Guidelines adopted by the OECD on 13 July 1995. According to these guidelines, the taxpayer has discretion on how to gather and keep documentation on its transfer pricing policy. In the OECD's view, "any documentation requirement at the tax return filing stage should be limited to requiring the taxpayer to provide information sufficient to allow the tax administration to determine approximately which taxpayers need further examination."

Although taxpayers can be expected to have developed their transfer pricing strategy and to have kept the supporting documentation thereof by the time the return is due, they are not penalized for lack of such documentation at that time.

In the absence of specific domestic rules, Italy follows the OECD Transfer Pricing Guidelines.

VII. Current Expense Items

A. In General

In general, all costs and expenses are allowed as deductions from taxable income provided that the taxpayer can show that they have been incurred during the taxable year to obtain or earn taxable income. No deduction is available for expenses incurred in connection with income exempt from taxation.[36]

There is an exception to the general rule for costs arising from transactions with businesses located in tax havens.[37] A revised black list, inspired by the same broad criteria of the black list to be used for purposes of the CFC rules discussed above, will indicate the countries and territories deemed to be tax havens and will replace the black list currently in effect.[38]

To qualify as deductions, expenses must have been paid during the tax year or must have acquired the character of a definite liability by the end of it and must be recorded as such in the corporate books.[39] If total revenues include tax-exempt income, however, costs and expenses that cannot be specifically attributed to the generation of taxable income may only be deducted in the same proportion as taxable income bears to total income.[40]

B. Repairs and Maintenance

Repairs and maintenance expenses may be deducted up to an amount equal to 5 percent of the total cost of the tangible assets as resulting from the "Depreciable Assets Journal" as of the beginning of the tax year.[41] Any excess over this 5 percent can be carried forward evenly in the following five years.

As in the United States, expenditures that add to the value or useful life of the property are not deductible on a current basis, but

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[34]Under *Decreto Legislativo* No. 471/1997 art. 1(2), penalties range from 100 percent to 200 percent of the adjustment to tax.

[35]For a general discussion of Italian transfer pricing provisions, *see* A.A. Rossi and L. Perin in *Transfer Pricing International, A Country-by-Country Guide*, edited by Robert Feinschreiber, John Wiley, and Sons 2000, at 25-1.

[36]TUIR art. 75.

[37]TUIR art. 76(7-*bis*).

[38]*See Decreto Ministeriale* of 22 April 1992.

[39]TUIR art. 75(1) and (4).

[40]TUIR art. 75(5).

[41]TUIR art. 67(7).

must be capitalized and depreciated over the life of the asset.

C. Carryover of Capital/Operating Losses

As a general rule, net operating losses can be carried forward to the year immediately following the loss year, then to the second year following the loss year and so on for a maximum of five years, or until the loss is used up. The same rules generally apply to corporate capital losses. There is an exception for net operating losses incurred during an entity's first three tax years. In this case, losses may be carried forward for an unlimited number of years.[42]

D. Depreciation and Amortization Expenses

The method of depreciation is not dependent on when the property was placed in service, as is the case in the United States. Depreciation of property used in a trade or business, or of property held for the production of income, is based on the acquisition cost or manufacturing cost and may include any interest capitalized until the asset is utilized.

The only allowable method is the straight-line method. Similar to practice in the United States, this method assumes that the depreciation sustained is uniform during the useful life of the property. The government periodically sets rates of depreciation.

There is something similar to the U.S. half-year convention. Depreciation must be calculated using half of the highest rate allowed for the first tax year.[43] As a practical matter, there is no difference from saying that property is deemed to be placed in service as of the middle of the tax year, and depreciation deductions are prorated accordingly.

The cost of property up to ITL 1 million can be treated as an expense rather than as a capital expenditure. This is the Italian counterpart to U.S. IRC section 179, although the amount is considerably smaller and there is no need to file an election similar to that made in the United States on Form 4562.

In addition to normal depreciation, a taxpayer may use an accelerated depreciation method during the first three years of an asset's useful life. Under this method, the rate of depreciation is twice the ordinary rate. The accelerated depreciation may only be taken during the first tax year for second-hand assets.[44]

1. Amortization of Intangible Assets

The deduction for the cost of patents and licenses cannot exceed one-third of the cost of such assets, while the deduction for the cost of trademarks cannot exceed one-tenth of the cost. The cost of licenses is deductible over the period of the license's useful life, as provided by contract or by law.

Taxpayers may use an accelerated depreciation method during the first three years of an asset's useful life.

The capitalized cost of goodwill can also be amortized for tax purposes over a number of years for an amount up to one-tenth of the cost of the goodwill for each tax year. Thus, goodwill might be amortized over a period of at least (but not necessarily) 10 years, as opposed to the 15-year period provided for by U.S. tax law.[45]

E. Treatment of Start-Up Costs

Start-up and organization expenses must be capitalized and amortized over a number of years in amounts not exceeding the pro rata share attributable to each year.[46] These expenses include, but are not limited to, incorporation fees and fees for accounting and legal services. There is no need to make an election; thus, taxpayers do not run the risk of deducting these expenses only when corporation is dissolved, as occurs in the United States when taxpayers do not file such an election. Unlike in the United States, amortization of these costs begins with the first tax year during which the corporation has taxable income.

Reorganization expenses are not deductible, nor may they be amortized. Legal expenses that do not fall into the categories of organization or start-up expenses are generally deductible.

F. Treatment of Royalty Fees

The Ministry of Finance has determined[47] "safe harbors" that serve as guidelines in establishing the arm's-length character of a royalty rate.[48]

The following are the requirements for a royalty fee to be acceptable:

1. Royalties Up to 2 percent of Sales

(a) a written contract already in existence prior to the payment of the royalties; and

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[42]TUIR art. 102(1-*bis*).

[43]TUIR art. 67(2).

[44]TUIR art. 67(3).

[45]TUIR art. 68(3).

[46]TUIR art. 74(4).

[47]*See Circolare Ministeriale* No. 32 (Prot. No. 9/2267) of 22 September 1980.

[48]For a discussion of issues arising in the application of the safe harbors, *see Commissione Tributaria* I of Genoa, *Sezione* VIII, Dec. No. 547 of 2 February 1992.

(b) utilization and business purpose of the intangible are properly documented.

2. Royalties From 2 Percent to 5 Percent of Sales

(a) all the above conditions apply; and

(b) technical evidence to justify the rate (R&D expenses, obsolescence of one year or less, technical life, originality, results achieved);

(c) legal evidence to justify the rate (exclusivity and right to sub-license); and

(d) evidence of the economic benefit received by the licensee.

3. Royalties Higher Than 5 Percent of Sales

These fees will be appropriate only under exceptional circumstances, for example in the case of highly technological industries. As a practical matter, because the 20-year old safe harbors often depart from the reality of the transactions in today's economy, the Italian examiners — consistent with the OECD approach — seem open to accepting "exceptional" rates when appropriate documentation exists and safe harbors would otherwise create distortions in the application of the arm's-length standard.

G. Treatment of Interest Expenses

As a general rule, interest is deductible in proportion to the ratio that a corporation's taxable income bears to its gross income.[49] Interest expenses may not be deductible for IRAP purposes (but exceptions apply for certain industries, such as banking).

VIII. Incorporation, Acquisitions, and Reorganizations

A. Transfer of Assets

As a general rule, on incorporation the transferor must recognize any gains realized in a transfer of assets that represents a taxable event. But because the basis is set by virtue of an appraisal, the transferee obtains a fair market value basis.

In addition, a transfer of assets involving real estate would be subject — on incorporation — to a registration tax equal to 8 percent of the real property contributed. Under Italian business law,[50] services may not be contributed to the capital of a corporation. In the event of a contribution of assets constituting a trade or business in exchange for stock, the assets can be transferred tax-free if they have been held for at least three years.[51] Under this method, both the transferor and the transferee will retain the historical tax basis of the assets transferred (substituted basis and carryover basis for the transferor and the transferee, respectively).

No gain or loss is recognized in a merger of two corporate entities.

Alternatively, the transferor can elect a 19 percent (down from 27 percent) tax in lieu of the ordinary income tax. Under this option, the transferee obtains a step-up in the basis of the assets received.[52]

Unlike the provisions of U.S. IRC section 351, the transferor need not be in control of the transferee after the contribution to elect one of the three tax accounting methods described above.

B. Transfer of Stock

Under the general rule,[53] a contribution of stock is deemed to be a sale, and the amount realized is the fair market value of the stock. There is an exception, however.[54] If both the transferor and the transferee are Italian residents[55] and do business in Italy, the amount realized is the book value in the hands of the transferor or, if higher, the book value as determined by the transferee. Therefore, if both parties report the stock using the same book value, there would be no taxable gain.

If a gain is realized, however, it is taxed as ordinary income. Nevertheless, if the stock has been held and reflected as an investment on the transferor's financial statements for at least three years, the transferor can elect to be taxed at the lower 19 percent rate.

C. Mergers

No gain or loss is recognized in a merger of two corporate entities. The entity resulting from the merger retains the same basis in the assets of the absorbed entity. The surviving entity may receive a step-up in basis by electing to pay a 19 percent tax in lieu of the ordinary income tax on any gains resulting from the mergers.

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[49] TUIR art. 63(1).

[50] *See* Civil Code art. 2342.

[51] *See* art. 4(1) of *Decreto Legislativo* No. 358 of 8 October 1997 as amended by art. 6(1) of Law No. 342 of 21 November 2000.

[52] *See* art. 4(2) of *Decreto Legislativo* No. 358 of 8 October 1997 as amended by Art. 6(1) of Law No. 342 of 21 November 2000.

[53] *See* TUIR art. 9.

[54] *See* art. 3 D. Lgs. 358/97

[55] This exception applies only to the contribution of assets located in Italy if either the transferor or the transferee is a nonresident.

D. Carryovers of Corporate Tax Attributes

If an entity undergoes both an ownership change (defined as a sale of more than 50 percent interest in voting rights) *and* a change in the principal business activity, then all net operating loss carry-forwards will be disallowed for post-change tax years. The 50 percent ownership change requirement will not be deemed to be met when stock of a company is transferred to affiliate group members. In addition, the limitation will not apply if the company undergoing an ownership change meets certain tests related to its sales, payroll expenses, and number of employees.[56]

In measuring the more than 50 percent ownership change, there is no application of a testing period similar to the three-year testing period set forth by U.S. IRC section 382(i). In theory, a corporation could avoid the limits on loss carry-forwards by acquiring only 49 percent of the voting stock in a year and deferring the purchase of the remaining shares until the subsequent year. Conversely, a three-year testing period applies to the change of the activity test.

Moreover, unlike under U.S. IRC section 382, the amount of operating loss available to the buyer annually is not limited to a portion of the purchase price of the seller's stock. Under Italian law, there are no tax attributes similar to the "earnings and profits" as defined for U.S. tax purposes.

IX. Withholding Tax Rates

A. Nontreaty Rate

The statutory withholding rates that will be applicable to nonresident recipients of dividends, interest, and royalties are summarized below. Treaty rates apply when lower than statutory rates.

1. Dividends

The withholding rate on dividends paid to non-Italian resident taxpayers with no permanent establishment in Italy or to residents of nontreaty countries is 27 percent.[57] A lower rate of 12.5 percent applies to "saving shares."

Nonresident taxpayers may apply for a refund of four-ninths of the withholding tax if they can prove the payment of a definitive tax abroad on the same income. Dividends are exempt from withholding whenever the EU parent-subsidiary directive applies.[58]

2. Interest and Other Income From Capital

Interest earned by a nonresident on Italian bank accounts is not Italian-source income and, as such, is not subject to tax.[59] In addition, the following income is exempt from withholding[60] provided that the recipient is a resident of a country (for example, the United States) with which Italy has a tax treaty containing an exchange of information provision and is not a resident of a tax haven:[61]

Nonresident taxpayers may apply for a refund of four-ninths of the withholding tax if they can prove the payment of a definitive tax abroad on the same income.

- annuities, guarantor fees, currency, and securities swaps; and
- interest on government bonds and securities issued by banks and public companies.[62]

For interest on bonds issued by privately-held companies, a 12.5 percent rate applies to bonds payable after at least 18 months if the interest rate on the bond does not exceed either two-thirds or one-third of the official discount rate,[63] depending on the type of issue. Otherwise, a 27 percent rate applies.

3. Other Income From Capital

All other income from capital — including interest on loans — will be subject to a 12.5 percent rate,[64] unless the recipient is a resident of a tax haven, in which case a 27 percent rate will apply.

4. Royalties

Royalties paid to nonresident taxpayers with no permanent establishment in Italy are taxable at a 30 percent rate on 75 percent of the royalties' gross amount, resulting in a 22.5 percent (30 percent x 75 percent) effective tax rate.[65]

B. Withholding Tax Rates on Distributions to U.S. Shareholders

The current Italy-U.S. treaty provides for lower withholding rates on a reciprocal basis, thus altering the withholding obligations of Italian payors.

Namely, the treaty currently in force provides for the following withholding rates:

- *Dividends*: 5 percent, 10 percent, or 15 percent if the U.S. company has owned more than

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[56]TUIR art. 102(1-ter).

[57]*D.P.R.* 600/1973 art. 27 (3).

[58]*D.P.R.* 600/1973 art. 27-*bis* (3).

[59]TUIR art. 20(1)(*b*).

[60]*D.P.R.* 600/1973 art. 26-*bis*.

[61]*See D.M.* of 4 September 1996.

[62]*See D. Lgs.* n. 239/1996.

[63]*D.P.R.* 600/1973 art. 26(1)

[64]*D.P.R.* 600/1973 art. 26(5).

[65]*D.P.R.* 600/1973 art. 26-*bis*, *D.P.R.* 917/1986 art. 49(2)(b) and art. 50(8).

50 percent, at least 10 percent, or less than 10 percent, respectively, of the Italian corporation's voting stock;

- *Interest*: 15 percent
- *Royalties*: 5 percent for literary, artistic, or scientific work; 8 percent for motion pictures, films, and tapes; 10 percent in all other cases.

X. The New U.S.-Italy Tax Treaty

Italy and the United States signed a new income tax treaty and protocol on 25 August 1999. It will replace the current treaty and protocol, which entered into force on 20 December 1985. The treaty must be ratified by both countries and will enter into force once the instruments of ratification are exchanged. The U.S. Senate has resolved to ratify it subject to the following reservations, which will be included in the instrument of ratification and will be binding on the president: articles 10(10) (dividends), 11(9) (interest), 12(8) (royalties), and 22(3) (other income) of the convention, and article 1(19) of the protocol [dealing with art. 25 (mutual agreement procedure) of the convention] will be stricken in their entirety, and article 1(20) of the protocol will be renumbered as article 1(19).

The following is an overview of the new provisions:

A. Article 2 — Taxes Covered

The treaty includes the IRAP as a partially creditable tax, as discussed above.

B. Article 9 — Associated Enterprises

The associated enterprises article addresses business dealings between related persons. The treaty includes a provision:[66] when a country includes additional profits of an enterprise in that country and taxes those profits accordingly, and when the other country has taxed the identical profits, the other country will make an appropriate adjustment to the amount of tax charged on those profits. The treaty further provides that the adjustment must be made only in accordance with the mutual agreement procedures in article 25 of the convention (see discussion below). This wording indicates that both the U.S. and Italian tax authorities are aware that transfer-pricing adjustments are common and need to be dealt with appropriately to avoid double taxation.

C. Article 10 — Dividends

The prior treaty provided that dividends could be taxed in the country of the company paying the dividends. But if the beneficial owner of the dividends was a resident of the other country, the tax charged could not exceed: (i) 5 percent if the beneficial owner is a company which owned more than 50 percent of the voting stock for a 12-month period ending on the date the dividend is declared; and (ii) 10 percent if the beneficial owner is a company that owned 10 percent or more of the voting stock for a 12-month period; and (iii) 15 percent in all other cases.

> The United States required the inclusion of the BPT in the U.S.-Italy income tax treaty.

The treaty now provides that the tax charged will not exceed: (i) 5 percent if the beneficial owner is a company which has owned at least 25 percent of the voting stock of the company paying the dividends for a 12-month period ending on the date the dividend is declared; and (ii) 15 percent in all other cases.

Therefore, the 5 percent rate has been expanded and the 10 percent rate has been eliminated.

D. Branch Profits Tax (BPT)

The article on dividends provides for a BPT at the rate of 5 percent. There was no BPT provision in the prior treaty. The BPT tax may be imposed by the source country on that portion of business profits, or other income, of the foreign corporation:

- attributable to a permanent establishment therein;
- on the corporation's source-country real property income subject to tax on a net basis; and
- on the corporation's gains from the disposition of directly or indirectly held source-country real property.[67]

The United States required the inclusion of the BPT in the treaty, because its domestic legislation — unlike Italy's — provides for a BPT. Thus, it is unlikely that Italy will apply the BPT because it is not geared to enforce a provision that is inconsistent with its domestic income tax legislation as well as its normal treaty obligations, and because — under an internationally accepted principle

[66] A similar provision was included in the prior treaty in the protocol.

[67] The amount subject to tax is the Dividend Equivalent Amount (DEA). The DEA is an amount equal to the earnings and profits attributable to the permanent establishment, plus an additional amount representing any decrease in the company's U.S. net equity, and minus an amount representing any increase in U.S. net equity. The purpose of this tax is to maintain a similar tax situation for an entity operating in the United States as a subsidiary with one operating as a branch.

— a treaty can limit, but never amplify, a country's jurisdiction to tax.

E. Article 11 — Interest

The prior treaty provided that interest may be taxed in the country in which it arises, but if the beneficial owner of the interest is a resident of the other country, the tax so charged will not exceed 15 percent of the gross amount of the interest. The treaty now reduces this rate to 10 percent. In addition, article 11 now provides that interest will not be taxed in the country in which it arises, if (i) the interest is paid or accrued with respect to a sale on credit of goods, merchandise, or services provided by one enterprise to another enterprise; or if (ii) the interest is paid or accrued in connection with the sale on credit of industrial, commercial, or scientific equipment.

F. Article 12 — Royalties

The earlier treaty provided that royalties could be taxed in the country in which they arose. If the beneficial owner of the royalties is a resident of the other country, the tax could not exceed: (i) 5 percent of the royalties in respect of payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work; (ii) 8 percent of the amount of royalties in respect of payments of any kind received as consideration for the use of, or the right to use, motion pictures and films, tapes, or other means of reproduction used for radio or television broadcasting; and (iii) 10 percent of the gross amount of royalties in all other cases.

The treaty now provides that the tax will not exceed: (i) 5 percent of the gross amount in the case of royalties for the use of, or the right to use, computer software or industrial, commercial, or scientific equipment; and (ii) 8 percent of the gross amount in all other cases.

Notwithstanding these rates, royalties arising in a country and paid to a resident of the other country for the use of, or right to use, a copyright of literary, artistic, or scientific work (excluding royalties for computer software, motion pictures, films, tapes, or other means of reproduction used for radio or television broadcasting) will be taxable only in that other country if the resident is the beneficial owner thereof. Therefore, under the new treaty, the 5 percent category in the prior treaty is no longer subject to any withholding tax.

The pensions article contains several new and interesting provisions.

G. Article 14 — Independent Personal Services

The prior treaty provided that income derived by an individual who is a resident of a country from the performance of services in an independent capacity will be taxable only in that country unless the services are performed in the other country and (i) the individual has a fixed base regularly available to him in that other country for the purpose of performing his activities, but only so much of the income as is attributable to that fixed base may be taxed in that other country; or (ii) the individual is present in that other country for a period or periods aggregating more than 183 days in the fiscal year concerned.

The treaty now eliminates the 183-day rule. Therefore, independent personal services would be taxed in the other country only if the individual is operating from a fixed base.

H. Article 17 — Artistes and Athletes

The change in this provision will have little or no impact. The prior treaty provided that income derived by a resident of a country as an entertainer, athlete, or the like from his personal activities exercised in the other country may be taxed in that other country, if: (i) the amount of the gross receipts derived, including expenses reimbursed to him or borne on his behalf, from the activities exceeds US $12,000 or its equivalent in Italian lira for the fiscal year concerned; or (ii) said person is present in that other country for a period or periods aggregating more than 90 days in the fiscal year concerned.

The treaty increases the gross receipts provision to US $20,000.

I. Article 18 — Pensions

The pensions article contains several new and interesting provisions. First, this article provides that payments made by a country under provisions of the social security and similar legislation of that country to a resident of the other country will be taxable only in the other country. Previously, the protocol contained a similar provision. Unless the person is an Italian national, however, the savings clause will require the income to be reflected as U.S. source income.

Second, the treaty provides for the taxation of severance pay. It provides that if a resident of one country becomes a resident of the other country, severance payments received after the change of residence and that are paid with respect to employment exercised in the first-mentioned country (while a resident thereof), will be taxable

only in the first country. This provision implies that because the severance was earned as a resident of a given country, that country would tax it.

The treaty also provides a provision suggested by the OECD Model Treaty for employee contributions to home country retirement schemes. Employees sent abroad to work often wish to continue contributing to a pension scheme in their home country, and paragraph 6 of the treaty now allows for these contributions.

J. Article 23 — Relief From Double Taxation

The treaty provides a mechanism for relief from double taxation for U.S. citizens who are resident in Italy. The new provision is as follows:

Where a U.S. citizen is a resident of Italy:

> a. with respect to items of income that under the provisions of the treaty are exempt from U.S. tax or that are subject to a reduced rate of U.S. tax when derived by a resident of Italy who is not a U.S. citizen, Italy shall allow as a credit against Italian tax an amount not exceeding the tax that would be due to the U.S. if the resident of Italy were not a citizen of the U.S.;
>
> b. for purposes of computing U.S. tax on those items of income referred to in subparagraph (a), the U.S. shall allow as a credit against U.S. tax the income tax paid to Italy after the credit referred to in subparagraph (a); the credit so allowed shall not reduce the portion of the U.S. tax that is creditable against the Italian tax in accordance with subparagraph (a); and
>
> c. for the exclusive purpose of relieving double taxation in the U.S. under subparagraph (b), items of income referred to in subparagraph (a) shall be deemed to arise in Italy to the extent necessary to avoid the double taxation of such income under subparagraph (b).

K. Article 25 — Mutual Agreement Procedure

This article includes several interesting additions. First, the general provision providing for the involvement of the competent authority now includes a specific time frame. The case must be presented within three years from the first notification of the action resulting in taxation that was not in accordance with the provisions of the convention.

The treaty provides a mechanism for relief of double taxation for U.S. citizens resident in Italy.

The OECD Commentary suggests that the limitation periods should be construed favorably to the taxpayer. For example, the period would run from the time of a notice of assessment or official demand or other instrument for the collection or levy of tax, rather than from any earlier administrative decision or action of general application on which the individual action is based.

The treaty provides that the competent authority will endeavor to arrive at a satisfactory solution to resolve the case by mutual agreement. The treaty now provides that any agreement reached will be implemented, notwithstanding any time limits in the domestic law of the contracting states.

Additionally, the treaty now provides that if an agreement cannot be reached by the competent authorities, the case may be submitted for arbitration if both competent authorities and the taxpayer agree — provided that the taxpayer agrees in writing to be bound by the decision of the arbitration board.

L. The Protocol — Article 2 — Limitation on Benefits

The limitation on benefits provision is now similar to those in several other treaties. It does not include a "derivative benefits" concept, however, whereby third-country residents meeting appropriate criteria may count toward meeting an ownership/base reduction test.

M. Effective Dates

After the instruments of ratification are exchanged, the treaty will enter into force and be effective for taxable periods beginning on or after the first day of January following the date of entry into force. The withholding tax provisions will have effect for amounts paid or credited on or after the first day of the second month following the date of entry into force. Notwithstanding, if a taxpayer so elects, the prior treaty will continue to have effect in its entirety for a period of 12 months following the entry into force of the new treaty. ✦

Full Text Citations

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