

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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INTERNATIONAL TAXATION



► SUBJECT

UNITED STATES-ITALY INCOME TAX TREATY ENTERS INTO FORCE

► SUMMARY

On December 16, 2009, the United States Treasury Department announced that representatives of the United States and Italy completed the exchange of instruments of ratification and that the United States-Italy Income Tax Treaty¹ has entered into force.

► AFFECTING

United States and Italian individuals and entities engaged in activities within the United States and Italy.

► BACKGROUND

The United States Senate ratified the 1999 Treaty and the accompanying protocol (the "1999 Treaty") in 1999. On March 3, 2009, the 1999 Treaty was ratified by the Italian Parliament.

The 1999 Treaty replaces the 1984 Treaty between the United States and Italy. The most significant changes include:

- Elimination of the ten-percent rate on source withholding on dividends paid to a one-percent beneficial owner of dividends;
- Reduction in the beneficial ownership requirement from 50 percent to 25 percent of voting stock for the five-percent source country withholding rate on dividends;

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¹ Convention between the Government of the United States of America and the Government of the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion.

- Elimination of the prohibition on use of the five-percent rate when the paying company has substantial passive income. The 15-percent source country rate is maintained for individuals receiving dividends and for corporate owners owning less than 25 percent of the paying corporation's voting stock;
- Reduction of the branch profits tax rate to five percent. The branch profits tax on excess interest is reduced to ten percent;
- Elimination of source country withholding on certain interest paid to, or guaranteed or insured by, governmental entities, interest paid with respect to a sale on credit of goods, merchandise, services, or industrial, commercial, or scientific equipment, and reduction in the source country withholding on all other interest from 15 percent to ten percent (Italy had previously reduced its statutory rate of withholding on interest to 12.5 percent);
- Elimination of source country withholding on royalties for certain literary, artistic, or scientific works; a limit of five percent source country withholding on royalties, for the use of, or the right to use, computer software or industrial, commercial, or scientific equipment, and a limit of eight percent on the source withholding on royalty payments;
- Expansion of the Limitation on Benefits article so that it more closely resembles other treaties entered into by the United States.

The 1999 Treaty also provides certainty to United States taxpayers that a portion of the Italian regional tax on productive activities (commonly known as the IRAP) will be creditable for purposes of the United States foreign tax credit. The controversial IRAP, which taxes a company's revenue without taking into account passive interest and the cost of labor, should otherwise not be creditable under United States domestic laws. With respect to manufacturing companies, for example, the IRAP tax base generally equals gross revenues from sales in Italy, with certain deductions for costs of goods sold, rent, and depreciation. However, no deduction is allowed for interest or the cost of labor.

► ENTRY INTO FORCE

The 1999 Treaty will be effective, with respect to taxes withheld at the source, for amounts paid or credited on or after the first day of the second month following the date of entry into force. With respect to other taxes, the 1999 Treaty will be effective with respect to taxable periods beginning on or after the first day of January immediately following the date of entry into force. Therefore, the entry into force of the source withholding will be effective for amounts paid or credited after February 1, 2010. For all other taxes the new provisions will apply to taxable years beginning on or after January 1, 2010.

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