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New China – Italy double tax treaty

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On 19 June 2019, the Italian Council of Ministers approved the China - Italy Double Tax Treaty ("New DTT"), signed in Rome on 23 March 2019. The New DTT will enter into force 30 days after the exchange of the ratification instruments replacing the China - Italy Double Tax Treaty signed on 31 October 1986 ("Old DTT").

The New DTT is generally in line with the 2017 OECD Model Tax Convention and the OECD Multilateral Convention, which both China and Italy signed in Paris in 2017. Provisions related to dividends, interest, royalties and capital gains introduce relevant changes compared to the Old DTT.

Hereinafter some brief comments to the New DTT:

- **Preamble**: in line with the 2017 OECD Model Tax Convention, it is clarified that the aim of the New DTT is the elimination of double taxation with respect to taxes on income without creating opportunities for non-taxation or reduced taxation by means of tax evasion or avoidance.
- **Dual residence of persons other than individuals (article 4, paragraph 3)**: in line with the 2017 OECD Model Tax Convention, the mutual agreement procedure replaces the test of the place of effective management. Indeed, under the New DTT, where a person other than an individual is a resident of both China and Italy, the competent authorities of both Countries shall endeavour to determine by mutual agreement in which State it is resident for the purposes of the treaty.

- **Permanent establishment (article 5):** the New DTT (i) maintains the service permanent establish- ment definition, already included in the Old DTT; (ii) introduces a new definition of independent agent which does not include a person who acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related and (iii) does not introduce the definition of digital permanent establishment, which was implemented in Italian domestic law.

- **Dividend (article 10):** the New DTT provides for (i) a **5%** withholding tax if the beneficial owner is a company owning at least **25%** of the capital of the company paying the dividends throughout a 365 day period and (ii) a **10%** withholding tax in all other cases where the recipient is the beneficial owner.

- **Interest (article 11):** the New DTT provides for a **0%** withholding tax (i) if the interest is paid by the Government or by a local authority, or (ii) if the interest is paid to the Government or other public entities, or (iii) if the interest is paid on loans guaranteed by the Government or other public entities or (iv) if the interest is paid by certain Italian financial institution to Chines beneficial owners. An **8%** withholding tax applies if the interest is paid to a financial institution on a loan with a term of at least 3 years for the financing of investment projects. A **10%** withholding tax applies in all other cases where the recipient is the beneficial owner.

- **Royalties (article 12):** the New DTT provides for (i) a **5%** withholding tax on payments for the use of, or the right to use, industrial, commercial, or scientific equipment or (ii) a **10%** withholding tax on royalty payments in all other cases where the recipient is the beneficial owner.

- **Capital gains (article 13):** the New DTT (i) confirms the concurrent source State taxation in case of alienation of shares deriving more than 50% of their value from immovable property, (ii) confirms with some modifications the concurrent source State taxation in case of alienation of shares of a company if the alienator at any time during the 12 month period preceding such alienation, had a participation, directly or indirectly, of at least 25 per cent in the capital of that company and (iii) introduces the taxation only in the residence State for all the capital gains not explicitly disciplined by article 13 ("Residual Cases"). The latter represents a relevant change compared to the Old DTT, which allowed the concurrent source State taxation in the Residual Cases.

- **Principal Purpose Test Clause (article 24):** the New DTT includes a clause according to which a benefit under the New DTT shall not be granted where obtaining that benefit was one of the principal purposes of any arrangement or transaction.

- **Mutual Agreement Procedure (article 26):** the Mutual Agreement Procedure clause does not include the arbitration process if the competent authorities are unable to reach an agreement to resolve the case.

Taxpayers with relationships with both China and Italy should start evaluating any planning or restructuring activities before the New DTT enters into force.