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Notes on the legislation on tax credits for income produced abroad and on the application of the OECD Model Convention on Income and Capital

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1. Introduction

Article 2 of the Decree of the President of the Italian Republic no 917/1986 ("*Tuir*") lays down, for individuals residing in Italy, the so-called "principle of levying taxes on income wherever such income is produced" (*worldwide taxation principle*) and hence anyone having some form of relationship with the territory of the State is called upon to "contribute to public expenses", in accordance with and subject to the Law. For this reason:

- residents are under the obligation of paying taxes also for income they produce abroad;
- while non-residents are to pay taxes only on income produced in Italy.

In an international context, these provisions generate *issues of double taxation* deriving from a conflict of jurisdictional attribution between two different States when both, on the basis of their respective domestic legislation, claim the right to levy taxes on specific categories of income.

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The holders of the tax levying right may be both the *country of residence* of the individual and the *source country* where the income is produced.

The domestic provisions laid down in article 2 (2) of the *Tuir* state that the term *residents* indicates the **natural persons** who for most of the taxation period:

- are *registered* in the Register of residents in Italy [i];
- have their *domicile* (defined in accordance with Art. 43 (1) of the Civil Code as «*the place where he/she* [namely "the natural person"] *conducts most of his/her business and has most of his/her interests* ») in the territory of the State;
- have their *residence* (defined in accordance with Art. 43, (2) of the Civil Code as «*the place where the person usually lives*») in the territory of the State.

A person is fiscally resident in Italy where even only one of the above conditions is fulfilled.

On the other hand, *fiscal residence* for bodies other than natural persons is governed by Art. 5 (2), letter d) of the *Tuir* [ii] for partnerships, and by Art. 73, (5-bis) of the *Tuir* [iii] for companies. In both cases the criteria for establishing personal involvement are to be sought at:

- *"head office"*;
- *"administrative office"*;
- *"business activity"*.

Conventional legislation generally tends to identify the *fiscal residence* of an individual on the basis of the requirements established in Art. 4 (1) of the OECD Model with specific reference to:

- *"domicile"*;
- *"residence"*;
- *"place of management"*;
- "any other *criterion of a similar nature"*.

In the case in which, on the basis of the above-mentioned criteria, an **individual** has his/her residence in both States, the Conventional

regulations lay down further criteria in Art. 4 (2) for defining the residence in one of the Contracting States, which include (according to the order laid out below):

- *"permanent home available"*;
- *"State with which his personal and economic relations are closer*" or "*centre of vital interests*;
- *"State in which he has an habitual abode*"
- *"State of which he is a national*"

If, after checking the above-mentioned criteria it were still difficult to define a person's place of residence, «*the competent authorities [*of the Contracting States…*] shall settle the question by* ***mutual agreement***».

Finally **for persons other than individuals**, in the case in which on the basis of the criteria highlighted in paragraph 1, the *company* is considered as being a resident of both Contracting States, in accordance with paragraph 4 of Art. 4 of the *OECD Model*, the "*place of effective management"* shall be the residence of the business.

2. Juridical and economic double taxation

The conditions that make each Country the holder of tax-levying powers for specific types of income are based on (i) a connection between *fact* and *State* and (ii) a relationship between the *person or company producing the income* and the *State*, that confers in the former case the right to the *source country* to levy taxes on specific types of income produced on its territory and, on the other, the tax levying right to the *country of residence* on the basis of the *worldwide taxation principle*.

These are the reasons that lead to income being taxable both in the *country of residence* of the income producer and in the *source country* thus leading to the so-called *juridical* or *economic* double taxationo

Juridical double taxation occurs whenever the *country of residence* and the *source country* levy tax on the same income produced by the same person or company.

Economic double taxation occurs when the *country of residence* and the *source country* (or, as the case may be, the tax levying authority) levy tax on the same income produced by different persons or companies.

In international practice, the main case studies of double taxation are of the type defined as *juridical double taxation* since the principle on which it is based (*worldwide taxation principle*) draws origin from the national tax regulations (*residence country*) in conflict with elements of another tax territoriality (*source country*) whose attenuation, if not elimination, occurs by applying the *OECD Model Convention.*

In particular there are three situations of double taxation [iv]:

- **Residence vs. Source conflicts**. Both Countries feel they are holders of the tax-levying right on grounds that they are the *Country of residence* of the income producer (even if the income is produced abroad) and, as such, it has the right to attract such income onto its territory on the basis of the *worldwide taxation principle*) and, on the other, for the fact that the *source* of the income has accrued in another country. In the absence of treaties against double taxation, most countries (including Italy) are in any case endowed with a domestic legislation that (unilaterally) "attenuates the effect of double taxation" applicable to its residents (for instance through the recognition of tax credits for taxes paid abroad);
- **Residence vs Residence conflicts (dual-residence)**. in such case *an individual* or *a company* or *any other body of persons* is identified as being a *resident* of two (or more) Contracting States, each of which may consider such individual, company or other body of persons as fiscal resident on the basis of its domestic provisions. In such case the *Convention* intervenes through the so-called *tie-break rule* of the OECD Model [v] that indeed "downgrades" the status of *resident* in one of the two (or more) Countries to that of a *non-resident*;
- **Source vs Source conflicts**. This is the case not governed by the conventions of the *OECD Model* in which two or more Contracting States may be defined as *source country* and, as such, each deems it is the holder of the right to levy taxes on such income. In this situation, in the absence of a domestic (unilateral) provision, the income is taxed

in both States. It is pointed out here that levying taxes at the *source* arises from the assumption that the State in which the income is produced is entitled to levying taxes irrespective of the fact that such income is produced by a resident or a non-resident. In particular, the domestic legislation should deal with the modalities used to determine the taxable income and the tax rate imposed on non-residents.

According to common practice, taxes are levied by withholding taxes at the source. This means that the "person" who distributes the income will have to withhold the tax on the gross amount paid: in this way the tax burden falls entirely on the foreigner receiving payment. Under the *worldwide taxation principle* the income of the foreign recipient will be taxed twice: once as resident in the *country of residence* (hereinafter also **R**) and then as non-resident in the *source country* (hereinafter also **S**). At this point the bilateral agreements (if any) between **R** and **S** step in to decide the limits and conditions for subdividing the tax levying powers on such income, considering the fact that there will be situations in which:

- **R** may remain the sole holder of the tax levying right and **S** refrains from levying taxes;
- **S** may (or may not) be the exclusive holder of the right to levy taxes and **R**, on the basis of the *worldwide taxation principle*, applies the provisions laid down by Articles 23 A and 23 B of the *OECD Model Treaty* (for *double taxation relief*);
- **S** may be the holder of the right to levy taxes and for the resident of **R** no other forms are envisaged for avoiding double taxation **(***US Model 2006*).

3. Brief remarks on the elimination of juridical double taxation in the OECD Model

The OECD Model (*OECD Model Convention on Income and Capital,* hereinafter also *"OECD Model Treaty"*) provides indications for solving tax conflicts in Chapter 5 "*Methods for elimination of double taxation*", namely:

- **article 23A** (*Exemption method*) – the *Country of residence* allows a (limited or unlimited) deduction from the tax on the **income** [vi]

produced in the *source country* or in a third country through *permanent establishment;*

- **article 23B** (*Credit method*) - the *country of residence* calculates its overall tax on the gross income produced abroad (*worldwide taxation principle*), and subtracts from the tax [vii], owed locally, the proportion of tax credit entitled to for taxes paid abroad (at the domestic level this rule is subject to a series of limitations as per Art. 165 of the *Tuir*).

The Commentary of the Model Convention (hereinafter also "*Commentary*") clarifies that:

- *paragraph 1*: the provisions highlighted by **Articles 23 A** and **23 B** apply exclusively to the cases of *juridical double taxation* [viii];
- *paragraph 2*: the *economic double taxation* is not governed by the provisions of articles 23 A and 23 B [ix], leaving it up to the Contracting States the solutions to any case of double taxation that were to arise.

Hence the perimeter within which the above-mentioned modalities of *double taxation relief* operate (envisaged by the *OECD Model Treaty*) includes cases where:

- the Contracting States, under their domestic legislation, consider an individual or company or any other body of persons as *resident* in both Countries and hence apply full taxes under the *worldwide taxation principle;*
- the Contracting States levy taxes on the same individual or company or any other body of persons on the same income produced anywhere in the world (the Country of residence under the *worldwide taxation principle* and the *source country* because the income is produced on its territory);
- an individual or a company or any other body of persons that is the resident of a State has a *permanent establishment* in a third Country through which income is produced in another Contracting State (*source country*).

A brief example will clarify how the two methods apply. The working hypotheses are:

- overall income equal to 100 (80 produced in **R** and 20 in **S**)
- tax rate **R** = 35% (in case of a progressive rate on an income of 100)
- tax rate **R** = 30% (in case of a progressive rate on an income of 80)
- tax rate **S** = 20% (case 1)
- tax rate **S** = 40% (case 2)

Where there is no Convention, a resident would incur a total tax burden of 39 (case 1) or 43 (case 2), namely:

	Income	Tax rate	Taxes
R	100	35%	35
S	20	20%	4
Effective taxation R			**39** (a)

	Income	Tax rate	Taxes
R	100	35%	35
S	20	40%	8
Effective taxation R			**43** (b)

By applying the *Convention* with *full exemption*, namely full recognition of the income produced in the *source country* for the purposes of deducting such amount from the taxable income, we would have (the tax burden in **R** is calculated only on the income produced in the same State);

	Income	Tax rate	Taxes
R	80	30%	24
S	20	20%	4
Effective taxation R			**28** (c)
Double taxation relief			**11** (a)-(c)

	Income	Tax rate	Taxes
R	80	30%	24
S	20	40%	8
Effective taxation R			**32** (d)
Double taxation relief			**11** (b)-(d)

The "*exemption with progress*" method envisages that the tax rate in the country of residence is calculated on the basis of the average rate that would be applied if the entire income were produced at home (namely on a "theoretical" income of 100 at a tax rate of 35%):

	Income	Tax rate	Taxes
R	80	35%	28
S	20	20%	4
Effective taxation R			**32** (e)
Double taxation relief			**7** (a)-(e)

	Income	Tax rate	Taxes
R	80	35%	28
S	20	40%	8
Effective taxation R			**36** (f)
Double taxation relief			**7** (b)-(f)

As clearly pointed out inArticles 23 A-23 B (21) of the *Commentary*, in all the above-mentioned cases the tax burden in the *source country* does not affect the amount of taxes owed in the *country of residence*, except the case where (as in the examples) the tax burden in the *source country* is greater than the benefits deriving from the application of double conventions. In such situation (on the basis of the examples presented earlier) it would be more convenient to concentrate the entire source of income in the *country of residence*, at a tax rate of 35% on an income of 100, because the theoretical tax burden (35, see the column "Tax rate 35%) would be less than the actual tax burden (36):

	Tax (S)	**Relief**	**Tax (S) > or < than relief ?**	**Tax (R)**	**Tax (R+S)**	**Tax rate 35%**	**Diff**
Full exemption (tax rate **20%)**	4	11	*less*	24	28	35	(7)
Full exemption (tax rate **40%)**	8	11	*less*	24	32	35	(3)

	Tax (S)	**Relief**	**Tax (S) > or < than relief ?**	**Tax (R)**	**Tax (R+S)**	**Tax rate 35%**	**Diff**
Progressive exemption (tax rate **20%**)	4	7	*less*	28	32	35	(3)
Progressive exemption (tax rate **40%**)	8	7	**greater**	28	36	35	**+1**

Here are some thoughts about the *credit method* (the method most commonly adopted in OECD Countries). In most cases (among which Italy) the *ordinary credit* [x] method is used instead of the *full credit* method, that is to say a tax credit is recognized <u>within the tax bracket that would apply in the country for that type of income</u>. The *rationale* of this limitation consists in setting a ceiling on certain forms of high tax rates that would have to be shouldered by the Contracting States instead of the tax-payers (with all due exceptions, as we shall see further down in the analysis of the instances envisaged by Article 165 of the *Tuir* and the *roll-forward* and *roll-back* mechanism).

Let us consider the <u>*full credit*</u> method (the working hypotheses are the same as those used above), namely full recognition of tax credit accrued in the *source country* (by using the *credit method* the tax burden in **R** is calculated on the overall income wherever it is produced):

	Income	**Tax rate**	**Taxes**
R	100	35%	35
S	20	20%	4
Tot. R			**39**
(credit for S)			**(4)**
Effective taxation R			**35** (g)
Double taxation relief			**4** (a)-(g)

Vice-versa by applying the <u>*ordinary method*</u> two different situations may come about, namely the first in which the tax paid abroad is lower than the

tax that would have to be paid domestically, and the second is the case in which it is higher:

a) if the foreign tax is **lower** than the national tax [xi] (case 1), the taxes owed are **35** and *double taxation relief* in **R** is 4 (the same result as if the *full credit system* were used);

b) if the foreign tax is **higher** than the national tax (case 2), then the maximum relief would be within the bracket of the national tax (in the above example it would be 35%). In this case we would get:

	Income	Tax rate	Taxes
R	100	35%	35
S	20	40%	8
Tot. R			**43**
(credit for S)		(20*35%)	**(7)**
Effective taxation R			**36** (g)
Double taxation relief			**7** (b)-(g)

4. Typical aspects of foreign tax credit with a view to national taxation

Within the scope of the methods suggested by Art. 23 of the *OECD Model Treaty*, the Italian legislator has adopted the tax credit system for income produced abroad (*foreign tax credit*).

As per Art. 165 (2) of the *Tuir*, the income categories indicated in Art. 23 of the *Tuir* ("Taxes levied on non-residents") are considered as being produced abroad and hence come under the *foreign tax credit* method. In other words a so-called 'mirror' reading is made of Art. 23 of the *Tuir,* that identifies the income produced in the territory of the State, by non-residents, that are subject to taxes to be paid in Italy. This category includes:

- income from immovable property;
- capital gains paid by the State or by residents;
- income from employment in the territory of the State;
- income from self-employment produced by activities carried out in the territory of the State;

- profits deriving from business activities carried out in the territory of the State through permanent establishments;
- other income from activities carried out in the territory of the State and from assets located on the territory of the State;
- capital gains from transfers of stocks held in resident companies.

On the other hand the tax credit method does not apply to income produced abroad that is totally exempt or subject in Italy to withholding tax: the *rationale* being that this income does not contribute to the overall taxable income of persons and companies.

In order for the tax credit mechanism to apply, it is not enough to claim that one is a tax-payer, and in any case such claim must be evidence-based, and more precisely the tax-payer must be subject to unlimited taxes in Italy on the basis of the *worldwide taxation principle*. In other words this instrument is granted to residents in the territory of the State with the aim of eliminating (or at least mitigating) juridical double taxationo This can be inferred from Art. 165 (1) of the *Tuir* where it states: «*if income produced abroad contributes to the formation of the overall taxable income […]*»: hence since foreign income contributes to forming the overall income only for residents, then this provision applies to persons and companies subject to IRES (*corporate tax*) and IRPEF (*individual tax*) who are resident in the State.

Taxes paid abroad on a permanent basis (the term excludes all taxes paid in advance) can be deducted from the net taxes owed up to the tax rate corresponding to the ratio between income produced abroad and the total income net of losses from previous tax periods eligible for deductiono The first and dutiful remark to be made here concerns the characteristics of the taxes on the income to which the credit is to be applied, whose structure and function must be comparable with a personal or juridical tax. Summarizing:

1. tax credits apply to income produced in a foreign country with which there is a specific Convention on double taxation and with Countries with which there is no such Convention (unilateral recognition);
2. tax credits apply only when taxes are paid abroad on a permanent basis (these are taxes that have been paid entirely once and for all,

they are not provisional and hence subject to payment of a balance, nor are they only an instalment, nor are they taxes liable to partial or total refund);

3. for the recognition of the tax period to which the income produced abroad belongs, the *payment* on a permanent basis must occur *within the date of filing* the income statement relevant to the period to which the taxes refer;
4. for the case in which the final *payment* is made after such date, a *new liquidation* is provided for taking into account any additional foreign income, and in such case the deduction is calculated on the taxes owed for the tax period of when the application was made;
5. in the case of income deriving from *permanent establishments abroad* or from *consolidated subsidiaries*, the deadline before which the tax paid abroad can be deducted corresponds to the deadline for filing the income statement for the tax period *subsequent* to that to which the income refers;
6. the credit for taxes paid abroad is *restricted* to the Italian tax rate corresponding to the ratio between the income produced abroad and the total income declared in Italy (inclusive of income accrued abroad), calculated by using the following formula:

$$\frac{\text{(foreign income x Italian tax rate)}}{\text{(total income – past losses deducted)}}$$

An example may illustrate how this calculation is made;

- italian income = 700
- foreign income (income produced abroad) = 100
- overall income = 800
- italian tax = (800 * 27,5%) = 220
- taxes paid abroad = 25
- maximum credit recognized in Italy =(100*220)/800 = 27,5
- tax to be paid in Italy = (220 – 25) = 195

Since the foreign taxes (25) are lower than the maximum limit recognized in Italy (27,5), they can be fully deducted from the taxes to be paid.

The tax rate can be calculated in different ways:

- method of the so-called *overall limitation;*
- method of the so-called *per country limitation;*
- method of the so-called *per item of income limitation* or *income basket limitation.*

The *overall limitation* method considers all foreign income from all foreign States. However our Legislation has adopted the so-called *per country limitation method* (Art. 165 (3)) under which the calculations for deductions of foreign tax paid on income (wherever produced) are made for each foreign State. The last method, the *per item of income limitation* o *income basket limitation*, envisages that tax credit calculation should consider not only the origin of the income, but also the breakdown of such income by type and nature[xii].

Referring to the concept of *taxes paid on a permanent basis* (that will be further discussed in Chapter 5), I would like to point out that current discussion has focused on the characteristics that link taxes paid abroad to this concept, namely:

- Newsletter of the Ministry of Finance no 3 of 08/02/1980: «the concept of taxes paid on a permanent basis coincides with the unrepeatability of that tax being paid again and hence the term excludes all taxes paid in advance, on provisional bases and those for which settlement payments with total or partial refunds are envisaged» («*il concetto di definitività dell'imposta pagata coincide quindi con la irripetibilità dell'imposta stessa e quindi non possono considerarsi definitive quelle pagate in acconto, in via provvisoria, e quelle in genere, per le quali è previsto il conguaglio con possibilità di rimborso totale o parziale*»);
- Newsletter ("*Circolare*") of the Italian Revenue Agency no 50 of 12/06/2002: «Taxes paid abroad can be deducted if they are unrepeatable and, consequently this term excludes all those taxes that may undergo changes to the benefit of the taxpayer. Taxes paid abroad in the current year, provided they have been declared abroad

> and paid before filing the income statement in Italy can be considered to be "unrepeatable" and hence deductible provided they comply with the requirement of 'not being subject to change'. If they are subject to refunds, taxes paid abroad can be deducted in the current year, net of the refund, only if such refund has already been applied for and obtained before filing the income statement in Italy, and its amount can hence be considered final».
> («*le imposte pagate all'estero sono detraibili se divenute irripetibili e, di conseguenza, non possono essere considerate tali quelle suscettibili di modificazioni a favore del contribuente […]. Si possono considerare "non ripetibili", e quindi detraibili, anche le imposte pagate all'estero nell'anno in corso, qualora siano già state dichiarate all'estero e pagate prima di effettuare la dichiarazione dei redditi in Italia e soddisfino i predetti requisiti di immodificabilità. Se sono suscettibili di rimborso, le imposte pagate all'estero si possono detrarre nell'anno in corso, al netto del rimborso, solo se questo è già stato richiesto ed ottenuto prima di effettuare la dichiarazione in Italia e si possa considerare certo nel suo ammontare*».

On this same issue the reader may refer to Resolution of the Italian Revenue Agency no 134 of 25/09/2001, Resolution of the Italian Revenue Agency no 12 of 18/01/2002, Resolution of the Italian Revenue Agency no 115 of 12/04/2002 and Resolution of the Italian Revenue Agency no 281 of 13/08/2002.

At this point a comment needs to be made about how the amount of foreign taxes paid in excess of Italian taxes is dealt with. There may very well be cases in which the foreign tax is higher than the amount fiscally recognized by the Italian regulations and hence the issue as to how such excess taxes be correctly treated.

This aspect is provided for in paragraphs 5 [xiii] and 6 [xiv] of Art. 165 *Tuir*.

In particular paragraph 6, after the IRES reform made through the so-called *Tremonti Reform* (Law no 80 of 07/04/2003 and Legislative Decree no 344 of 12/12/2003), to offset the elimination of the specific corrective measure for past losses has introduced the possibility of offsetting the excess taxes paid abroad with the excess amount of Italian tax over a time period of 16 years (8 years for the *roll-forward* and 8 years for the *roll-back*).

Unlike the general concept of *foreign tax credit*, the applicability of the *roll-forward* or *roll-back* mechanism of excess foreign tax paid compared to the Italian tax *is restricted only* to resident companies, but only and exclusively for the types of income classified as company income produced abroad. Hence any surplus taxes paid by *persons who do not carry out entrepreneurial activities* are *excluded* from this mechanism.

Let us now consider how the *roll-forward* and *roll-back* mechanism works.

First of all any excess of foreign tax over the Italian tax that is actually deductible under Art. 165 of the *Tuir* must be attributed to an "*ad hoc*" category that we shall define as *Basket (A).* By the same token any excess in the Italian tax quota over a foreign amount must be attributed to a category that we shall define *Basket (B).* So, if in any year an excess is formed in *Basket (A)* we need to check whether there is an excess in *Basket (B)* formed in the previous eight years (so-called *roll-back*), such that one could recover what we shall define as an Italian tax reserve over foreign tax. If, vice-versa, there is no excess in *Basket (B),* then the excess that has originated in *Basket (A)* will have to be carried forward up until the eighth fiscal year (so-called *roll-forward*) to be used as *tax credit* only when some future surplus is formed in *Basket (B).*

An example may help understand the above explanation:

Type		**year 1**
Foreign income		100
Taxes paid abroad		40
Italian income		200
Total income	(100+200)	300
Italian tax	(300 * 27,5%)	82,5
Maximum taxes recognized in Italy	(100 * 82,5) / 300	27,5
Surplus of foreign taxes to be carried forward up (*roll-forward*)	*Basket (A)* = (40 - 27,5)	12,5

Type		**year 2**
Foreign income		100
Taxes paid abroad		20

Italian income		200
Total income	(100+200)	300
Italian tax	(300 * 27,5%)	82,5
Maximum taxes recognized in Italy	(100 * 82,5) / 300	27,5
Recovering of surplus of foreign taxes **year 1**	(27,5 – 20)	7,5
Surplus of foreign taxes to be carried forward up to **year 3** (*roll-forward*)	(12,5 – 7,5)	5

Hence the foreign tax surplus over the Italian tax (*Basket A*) that had formed in Year 1 (for 12,5) is partially used in Year 2 when there forms an Italian tax surplus over the foreign tax and, a part of the surplus produced in the previous year in *Basket A* (for 7,5) is deducted from the difference. The remaining amount is rolled forward to Year 3 (5).

5. Certification of taxes paid abroad

As regards the documentation suited to proving the effective (and permanent) payment of taxes abroad with regard to the so-called *foreign tax credit*, the Italian Revenue Agency has often adopted measures on this issue.

Without prejudice to the contents of the "Modello UNICO 2012" (*Tax Return 2012*) [xv] we herewith recall, among others, the specifications set forth in Resolution of the Italian Revenue Agency no 104 of 03/07/2001 and in Newsletter of the Italian Revenue Agency no 50 of 12/06/2002.

In connection with the recovery of taxes paid abroad (fully) it is stated that the tax-payer shall provide the financial administration with evidence proving that the taxes have actually been paid (useful to this end, alternately, is the certification *issued by the intermediary* or other documentation *issued by the foreign tax authority*). The following items must also be kept:

- copy of the Tax Return filed abroad, if any;
- any application for reimbursement (where the previous point is not applicable)
- receipt of the payment of the foreign taxes.

Likewise, special attention is paid to the certifications issued by *authorized intermediaries* in accordance with Presidencial Decree no 322/1998, Art. 4 (6-ter [xvi] and 6-quater [xvii]): even though this type of certification constitutes a probative burden by a "*non-official*[xviii]" source, it does represent, nevertheless, an instrument that is useful and suited to certifying (full) payment of taxes abroad since, according to the so-called *mirror interpretation*, certifications issued by authorized intermediaries may be used by non-resident persons who produce income in Italy in order to obtain in their Country of residence the tax credit for taxes paid in Italy. Hence, for mutuality, the same behaviour must necessarily apply for taxes paid abroad by a person who resides in Italy [xix].

As regards the request for refunds I would like to point out that also the intervention of *Assonime* in its explanatory note no 1/2012 that recalls what was specified by the financial administration, puts the emphasis on situations where the tax-payer addresses the institute for a refund of taxes paid abroad and not directly deductible from the Italian taxes in the specific case in which, in the presence of Conventions on double taxation signed by Italy, the Contracting State in any case levies an amount that exceeds the conventional tax rate.

In such case the difference (between the effective taxes paid and the Conventional rate) cannot be recovered directly through the *foreign tax credit* but through an "*ad hoc*" application for refund addressed to the foreign tax authorities in compliance with the modalities and deadlines envisaged by the legislation.

6. Conclusion

International taxation is becoming a topical issue that is constantly evolving. The development of the new emerging economies (that apply «aggressive» tax policies aimed at attracting investments to their territories) has made it necessary to ratify new bilateral treaties between Contracting Countries and update, in 2010, the *OECD Model Treaty* (and of the relevant *Commentary*) also with a view to fighting against a distorted use of the so-called *treaty shopping*, namely the application of the *Conventions* not with the

(lawful) aim of obtaining the maximum tax benefit allowed by the regulations, but for tax evasion (or tax avoidance) purposes.

Having said this the approach to the subject adopted in this article is more theoretical, while a future article will present the functional analysis of the tax credit mechanism for income produced abroad and of the Conventions against double taxation on Income between two (or more) Contracting States *("OECD Model Convention on Income and Capital")*.

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i In this connection it is clarified that being registered with AIRE (*Register of Italian citizens residing abroad*) has no effect on the presumption of non-residence, if at least one of the other three conditions envisaged by Art. 2 (2) of the *Tuir* (domicile and/or residence in the State) applies.

ii «For the purposes of income taxes:
d) the companies and associations that have their registered office or administrative offices or their main object in the territory of the State are considered to be residents. The main object is determined on the basis of their articles of association if one does exist in the form of public deed or authenticated private contract or, in the absence of thereof, on the basis of the business that is actually carried out»
(«*d) si considerano residenti le società e le associazioni che per la maggior parte del periodo d'imposta hanno la sede legale o la sede dell'amministrazione o l'oggetto principale nel territorio dello Stato. L'oggetto principale è determinato in base all'atto costitutivo, se esistente in forma di atto pubblico o di scrittura privata autenticata, e, in mancanza, in base all'attività effettivamente esercitata*»).

iii «Unless otherwise stated, the head administrative office of a company or body holding majority shares, in accordance with Article 2359 (1) of the Civil Code, in the bodies mentioned in letters a) and b) of paragraph 1, is considered to be based in the Italian territory if :

a) they are controlled, even indirectly, in accordance with Article 2359 (1) of the Civil Code, by companies that are residents in the territory of the State;
b) they are administered by a board of directors, or other equivalent management body, made up mainly of directors who are resident in the Italian territory».

(«*Salvo prova contraria, si considera esistente nel territorio dello Stato la sede dell'amministrazione di società ed enti, che detengono partecipazioni di controllo, ai sensi dell'articolo 2359, primo comma, del codice civile, nei soggetti di cui alle lettere a) e b) del comma 1, se, in alternativa:*

a) sono controllati, anche indirettamente, ai sensi dell'articolo 2359, primo comma, del codice civile, da soggetti residenti nel territorio dello Stato;
b) sono amministrati da un consiglio di amministrazione, o altro organo equivalente di gestione, composto in prevalenza di consiglieri residenti nel territorio dello Stato»).

iv Brian J Arnold – Michael J. McIntyre - *International Tax Primer* (Second Edition 2002) – Wolters Kluwer, Law & Business

v *Article 4* of the *OECD Model Treaty*, *paragraph 3* (individuals) and *paragraph 4* (corporate)

vi *Commentary of the Model Convention, article 23, paragraph 17 «[…] the exemptions methods look at income […]»*

vii *Commentary of the Model Convention, article 23, paragraph 17 «[…] the credit methods look at tax […]»*

viii [Juridical double taxation] «*These Articles deal with the so-called juridical double taxation where the same income or capital is taxable in the hands of the same person by more than one State*»

ix [Economic double taxation out of scope] «*This case has to be distinguished especially from the so-called economic double taxation, i.e. where two different persons are taxable in respect of the same income of capital. If two State wish to solve problems of economic double taxation, they must do so in bilateral negotiations*»

x *Commentary of the Model Convention, article 23, paragraph 16, letter b)*

xi Among the hypotheses of foreign tax being lower than the national tax there are also the cases of "tax sparing credit" and of "matching credit", i.e. the so-called *figurative tax credit*. In brief, some Conventions against double taxation (especially those of emerging Countries) contain provisions aimed at attracting investments to their territory: the incentive consists in granting the investor a credit on an unpaid amount in the *source country*. By way of example, the Convention between Italy and Argentina envisages, in its Article 24 (4), letter c) that «*For the purposes of application of paragraph 2 of this Article, the Argentine tax shall be always deemed as paid at the rate of 20% of the gross amount of royalties as defined in paragraph 3 of Article 12*».
In other words, even though the State of Argentina levies taxes ranging between 10 percent and 18 percent on the royalties (in pursuance of Article 12 (3), it considers that a foreign tax of 20 percent is paid. In this way it grants a *figurative tax credit* of respectively 10 percent and 2 percent.

xii Siegfried Mayr – *La disciplina del credito d'imposta per i redditi esteri (Speciale Riforma fiscale)*

xiii «For company income produced abroad through permanent establishments or through subsidiaries, as laid down in Section II of Chapter II of Title II, the deduction may be calculated from the tax for the period even though the full payment is made before the deadline for filing the Income Statement referring to the first subsequent tax period. Exercising the right relevant to the previous period is subject to indicating, in the Income Statement, the foreign taxes deducted but not yet fully paid».
(«*Per i redditi d'impresa prodotti all'estero mediante stabile organizzazione o da società controllate di cui alla sezione III del capo II del Titolo II, la detrazione può essere calcolata dall'imposta del periodo di competenza anche se il pagamento a titolo definitivo avviene entro il termine di presentazione della dichiarazione relativa al primo periodo d'imposta successivo. L'esercizio della facoltà di cui al periodo precedente è condizionato all'indicazione, nelle dichiarazioni dei redditi, delle imposte estere detratte per le quali ancora non è avvenuto il pagamento a titolo definitivo*»).

xiv «In the case of company income produced by resident companies in the same foreign Country, the foreign tax fully paid there on the income in excess of the Italian tax rate on the same foreign income, constitutes a tax credit only up to an amount equal to the excess amount of Italian tax over the foreign fully paid tax on the same foreign income that had accrued in the past eight fiscal years. In the case that in previous fiscal years there had been no surplus amount, the foreign tax paid in excess can be carried (rolled) forward up to the eighth year and be used as tax credit in the case that the Italian tax rate is higher than the foreign tax rate on the same income as per the first sub-paragraph of this paragraph. The provisions of this paragraph concerning the roll forward and roll back of the excess taxes paid apply also to the company income produced abroad by the individual companies that participate in the national and world consolidated financial statements even though they reside in the same country, with the exception of the provision of Article 136 (6)».
(«*Nel caso di reddito d'impresa prodotto, da imprese residenti, nello stesso Paese estero, l'imposta estera ivi pagata a titolo definitivo su tale reddito eccedente la quota d'imposta italiana relativa al medesimo reddito estero, costituisce un credito d'imposta fino a concorrenza della eccedenza della quota d'imposta italiana rispetto a quella estera pagata a titolo definitivo in relazione allo stesso reddito estero, verificatasi negli esercizi precedenti fino all'ottavo. Nel caso in cui negli esercizi precedenti non si sia verificata tale eccedenza, l'eccedenza dell'imposta estera può essere riportata a nuovo fino all'ottavo esercizio successivo ed essere utilizzata quale credito d'imposta nel caso in cui si produca l'eccedenza della quota di imposta italiana rispetto a quella estera relativa allo stesso reddito di cui al primo periodo del presente comma. Le disposizioni di cui al presente comma relative al riporto in avanti e all'indietro dell'eccedenza si applicano anche ai redditi d'impresa prodotti all'estero dalle singole società partecipanti al consolidato nazionale e mondiale, anche se residenti nello stesso*

paese, salvo quanto previsto dall'articolo 136, comma 6»).

xv Instructions to "Modello UNICO 2012" (*Tax Return 2012*), p. 168.

xvi «The bodies indicated in paragraph 1 issue an ad hoc single certification also for contributions owed to the National Institute for Social Security (I.N.P.S.) certifying the total amount of such sums and values, the total withholding tax, the deductions of taxes and health and social security dues paid, and the other data laid down in the administrative measure approving the single comprehensive certificate. The certification is a single comprehensive document which includes also the amounts paid into other pension schemes and funds. Implementation modalities are laid down in the Decree of the Economy and Finance Minister issued jointly with the Minister of Labour and of Social Policies. The single comprehensive certificate replaces all the papers envisaged for tax payment purposes».
(«*I soggetti indicati nel comma 1 rilasciano un'apposita certificazione unica anche ai fini dei contributi dovuti all'Istituto nazionale per la previdenza sociale (I.N.P.S.) attestante l'ammontare complessivo delle dette somme e valori, l'ammontare delle ritenute operate, delle detrazioni di imposta effettuate e dei contributi previdenziali e assistenziali, nonché gli altri dati stabiliti con il provvedimento amministrativo di approvazione dello schema di certificazione unica. La certificazione è unica anche ai fini dei contributi dovuti agli altri enti e casse previdenziali. Con decreto del Ministro dell'economia e delle finanze, emanato di concerto con il Ministro del lavoro e delle politiche sociali, sono stabilite le relative modalità di attuazione. La certificazione unica sostituisce quelle previste ai fini contributivi*»).

xvii «The certificates mentioned in paragraph 6-ter, signed also in electronic format, shall be delivered to the taxpayers by 28 February of the year following the fiscal year to which the amounts refer or within twelve days from the application by the taxpayer in case the working relationship has ended. In the cases laid down in Article 27 of Presidential Decree no 600 of 29 September 1973, the certificate may be replaced by a copy of the communication referred to in Articles 7, 8, 9 and 11 of Act no 1745 of 29 December 1962»
(«*Le certificazioni di cui al comma 6-ter, sottoscritte anche mediante sistemi di elaborazione automatica, sono consegnate agli interessati entro il 28 febbraio dell'anno successivo a quello in cui le somme e i valori sono stati corrisposti ovvero entro dodici giorni dalla richiesta degli stessi in caso di interruzione del rapporto di lavoro. Nelle ipotesi di cui all'articolo 27 del decreto del Presidente della Repubblica 29 settembre 1973, no 600, la certificazione può essere sostituita dalla copia della comunicazione prevista dagli articoli 7, 8, 9 e 11 della legge 29 dicembre 1962, no 1745*»).

xviii *Assonime* - Explanatory Note no 1/2012, p. 3

xix *Newsletter of the Italian Revenue Agency no 68/E of 19/03/2009: «[…]* «it is deemed that the taxpayer is entitled to deducting taxes withheld, provided he can produce evidence of the payment of such withholding taxes by submitting the invoice and relevant documentation, provided by banks or other financial brokers»

(«[…] si ritiene che il contribuente sia comunque legittimato allo scomputo delle ritenute subite, a condizione che sia in grado di documentare l'effettivo assoggettamento a ritenute tramite esibizione congiunta della fattura e della relativa documentazione, proveniente da banche o altri intermediari finanziari»).

Resolution of the Italian Revenue Agency no 104 of 03/07/2001: «With a view to recovering taxes paid fully abroad, the certificates issued by the broker are considered to be valid […]»

(«Ai fini del recupero delle imposte pagate all'estero in via definitiva si ritiene validamente utilizzata la certificazione rilasciata dall'intermediario […]»).

E.A.PALMITESSA, ***Notes on the legislation on tax credits for income produced abroad and on the application of the OECD Model Convention on Income and Capital***, 4 Businessjus 28 (2013)