



Italy: Entry into force of the double taxation treaties with Barbados and Panama

Tax Alert
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Of the numerous conventions for the avoidance of double taxation on income (double taxation treaties or 'DTTs') to which Italy is a signatory, the latest ones to come into force are those with Barbados and Panama. These are substantially OECD-compliant DTTs (see the 2014 OECD Model, pre-BEPS).

The effects of a DTT are far-reaching. For instance, it limits the taxing rights of the source state with respect to dividends, interest and royalties. Therefore, payments made by an Italian resident to a beneficiary resident in Barbados or Panama and eligible for the DTT may benefit from a withholding tax (WHT) rate that is lower than the standard domestic one. In addition, capital gains from the transfer, by a resident of Barbados or Panama, of shares in an Italian company will generally not be taxable in Italy. Moreover, enterprises resident in Barbados or Panama will benefit from the permanent establishment (PE) definition contained in article 5 of the DTT, which is more favourable to the taxpayer and will generally prevail over the domestic one (as recently amended in the light of the OECD BEPS Action 7 Final Report). The DTTs with these countries may also be a step towards their exclusion from the List of Low-Tax Jurisdictions for individuals and, in the case of Panama, towards its inclusion in the List of Cooperative Jurisdictions, with a positive effect on the taxation of financial income. More generally, the DTTs may improve relations with these countries and encourage investment in Italy.

Italy-Barbados DTT

On 17 October 2017, the date when the exchange of ratification instruments was completed, the DTT between Italy and Barbados came into force. The entry into force of the DTT was announced by a Notice of the Ministry of Foreign Affairs and International Cooperation, published in Official Gazette no. 14 of 18 January 2018. The DTT was signed on 24 August 2015 and ratified in Italy by Law no. 84 of 16 May 2017. Under article 30 of the DTT, its provisions are effective as of 1 January 2018⁽¹⁾.

(1) 'The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

- (a) in respect of taxes withheld at source, to amounts derived on or after 1st January in the calendar year next following that in which this Convention enters into force;
- (b) in respect of other taxes on income, to taxes chargeable for any taxable period beginning on or after 1st January in the calendar year next following that in which this Convention enters into force'.

This DTT seems to be substantially OECD-compliant (see the OECD Model dated July 2014 - pre-BEPS).

Below is a summary of the main DTT WHT rates for income from Italy. If a company resident in Italy pays dividends, interest or royalties to a resident of Barbados, entitled to the DTT benefits, the WHT rate cannot exceed that indicated in the table (while the standard domestic WHT rates are 26 percent for dividends and interest, unless special domestic exemptions apply, and 30 percent for royalties). Payments for independent professional services are only subject to tax in the residence State.

Income	Dividends	Interest	Royalties
DTT rate	5% if the beneficial owner is a company which directly holds at least 10 percent of the capital of the company paying the dividends	5%	5%
	15% in other cases	0 if interest is paid to public entities (e.g. government or central bank)	

Under the DTT, capital gains are taxable only in the state of the seller. Notably, however, article 13 (4), regarding capital gains from the transfer of shares in real-estate companies, grants taxing rights also to the state where the real estate is located⁽²⁾.

Article 5 contains a definition of PE which is substantially compliant with that of article 5 of the OECD Model (2014 edition, pre-BEPS). The entry into effect of the DTT is important because enterprises resident in Barbados may rely on the PE definition contained in the DTT, which is more favourable to taxpayers than the domestic one (as amended post-BEPS): under article 169 of the Italian Income Tax Code (IIRC), the provisions of DTTs prevail over those of domestic law, unless the latter are more favourable to taxpayers.

Article 26 contains an OECD-compliant exchange of information clause.

Italy and Barbados have both signed the MLI⁽³⁾ and the Italy-Barbados DTT is one of Italy's 'covered DTTs'.

(2) 'Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.'

(3) Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.

Barbados is one of the countries on the List of Cooperative Jurisdictions⁽⁴⁾, which indicates states that allow an adequate exchange of information with Italy. The list currently names 134 countries. Barbados was included by Ministerial Decree of 23 March 2017, published in the Official Gazette of 3 April 2017 (see our [Tax Alert of 21 April 2017](#)), following the entry into force of an exchange of information agreement with Italy. Its inclusion is particularly relevant for the purposes of taxation of financial income (e.g. Italian-source interest, capital gains from the sale of shares in Italian companies, proceeds from units of Italian REIFs) because certain domestic laws grant an exemption if the beneficial owner is resident in a country on the list.

On the other hand, Barbados is still on the List of Low-tax Jurisdictions⁽⁵⁾ for individuals. Under article 2 of the IIRC, individuals who move their residence to one of the countries on this list are still deemed to be resident in Italy for tax purposes, unless they can prove the contrary. This list includes many countries which are also on the List of Cooperative Jurisdictions, such as (besides Barbados) Hong Kong, Liechtenstein and Switzerland.

Barbados was one of the countries on the List of Low-tax Jurisdictions for the purposes of the Italian CFC rule (and of the rule that provides for full taxation of inbound dividends)⁽⁶⁾. Since 2016 this list no longer exists, and low-tax jurisdictions are defined as countries, other than EU/EEA Member States, whose ordinary or special regime provides for a nominal tax rate that is lower than 50 percent of the Italian rate - i.e. currently lower than half of 27.9 percent⁽⁷⁾. Therefore, a controlled company established in Barbados, a country whose ordinary corporate income tax rate is currently 25 percent, would no longer be subject to the Italian CFC rule (unless it benefits from a special regime that leads to taxation of less than 13.95 percent).

Italy-Panama DTT

On 1 June 2017, the date when the exchange of ratification instruments was completed, the DTT between Italy and Panama entered into force. The completion of the process and entry into force of the DTT was announced by a Notice of the Ministry of Foreign Affairs and International Cooperation, published in Official Gazette no. 60 of 13 March 2018. The DTT was signed on 30 December 2010 and ratified in Italy by Law no. 208 of 3 November 2016. Under article 27 of the DTT, its provisions are effective as of 1 January 2018⁽⁸⁾.

(4) Contained in the Ministerial Decree of 4 September 1996, as subsequently amended.

(5) Contained in the Ministerial Decree of 4 May 1999.

(6) Contained in a Ministerial Decree of 21 November 2001.

(7) Twenty-four percent for IRES + 3.9 percent for IRAP.

(8) 'The Convention shall enter into force on the first day of the fourth month following the date of receipt of the later of the notifications referred to in paragraph 1 and its provisions shall have effect: a) with respect to withholding taxes, on income derived on or after January 1st of the calendar year following the year in which this Convention enters into force; b) with respect to income taxes and other taxes (other than withholding taxes), for any tax year beginning on or after January 1st of the calendar year following the year in which this Convention enters into force; c) with respect to the exchange of information, the requests may be performed with regards to information relating to any date within 3 years prior to the entry into force of this Convention.'

The DTT became a priority due to the publication of information about alleged cases of tax evasion emerging from the files of the law firm Mossack Fonseca (so called 'Panama Papers'), made public by the International Consortium of Investigative Journalists.

This DTT seems to be substantially OECD-compliant (see the OECD Model dated July 2014). Below is a summary of the DTT rates (i.e. maximum WHT rate applicable in Italy) for Italian-source dividends, interest and royalties. The DTT also contains a specific provision regarding professional, technical and consulting services.

Income	Dividends	Interest	Royalties	Services
DTT rate	5% if the beneficial owner is a company (other than a partnership) which directly holds at least 25 percent of the capital of the company paying the dividends	5% if the beneficial owner is a bank	10%	10%
	10% in other cases	10% in other cases		
		0 if the beneficial owner of the interest is a public entity (e.g. the government or central bank)		

As a general rule, capital gains are taxable only in the country of the seller. Notably, however, article 13 (4), regarding capital gains from the transfer of shares in real-estate companies, grants taxing rights also to the state where the real estate is located⁽⁹⁾.

(9) 'Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.'

Article 5 contains a definition of PE which is substantially compliant with the OECD Model (2014 edition, pre-BEPS). As an exception to the majority of DTTs signed by Italy, and differently from domestic law, the DTT with Panama contains a 'service PE' definition⁽¹⁰⁾. Enterprises resident in Panama may rely on the PE definition contained in it, which is generally more favourable to taxpayers than the domestic one (as amended post-BEPS), except in the case of the service PE.

Italy and Panama have both signed the MLI but the Italy-Panama DTT is not one of Italy's 'covered DTTs'.

Panama is still on the List of Low-tax Jurisdictions for individuals.

Panama is not on the List of Cooperative Jurisdictions, which is particularly relevant for Italian-source financial income. The entry into effect of the DTT, which contains an OECD-compliant exchange of information clause⁽¹¹⁾, may be a step towards the inclusion of Panama in the list.

With regard to the Italian CFC rule, Panama was, with respect to certain activities, on the List of Low-tax Jurisdictions, but was removed from it as of 11 May 2015⁽¹²⁾. According to the Italian rules in force since 2016, which focus on the nominal (ordinary or special) tax rate applicable in the foreign country, a controlled company resident in Panama, whose standard corporate income tax rate is 25 percent, should not be subject to the Italian CFC rule unless a special regime applies and leads to a nominal rate that is lower than 13.95 percent.

(10) Under article 5, par. 3, of the DTT, 'The term "permanent establishment" also encompasses: [...] b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period'.

(11) Under article 25 of the DTT.

(12) The removal followed a change of criteria under which Italy defined low-tax jurisdictions.

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