Hong Kong and Italy sign comprehensive avoidance of double tax agreement

Executive summary

On 14 January 2013 Hong Kong and Italy signed a comprehensive avoidance of double taxation agreement (CDTA). The CDTA contains several favorable provisions which are expected to boost closer economic and trade ties between Hong Kong and Italy. This alert summarizes the salient points of the provisions as applicable to Hong Kong residents.

Highlights of the CDTA

Article 5 - Permanent establishment (PE)
In addition to the general definitions of the term PE, a Hong Kong resident enterprise will be considered as maintaining a PE in Italy in the following situations:

• having a building site, a construction, assembly or installation or supervisory activities in connection therewith, but only if such site, project or activities last more than six months; or

• the furnishing of services (including consultancy services) by a Hong Kong resident enterprise directly or through employees or other personnel, in connection with a site, a project or supervisory activities referred to in (i) above, if those services continue in Italy for a period or periods aggregating more than six months within any 12-month period.

Article 7 - Business profits
Active business profits of a Hong Kong resident enterprise will not be subject to tax in Italy unless they are attributable to a PE maintained by the Hong Kong enterprise in Italy and only profits attributable to the PE will be liable to tax in Italy.
**Article 8 - Shipping and Air Transport**
Hong Kong resident airliners and ship owners will not be subject to tax in Italy in respect of profits derived from international traffic. However, income of a Hong Kong resident airliner so exempt from taxation in Italy under the CDTA will be subject to tax in Hong Kong under the relevant provisions of the Hong Kong tax code.

**Article 9 - Associated Enterprises**
Where a Hong Kong resident enterprise transacts business with an associated Italian resident enterprise in such a way that the profits that accrue to the Italian resident enterprise are less than would accrue on an arm's length basis, the Italian tax authorities can make a primary adjustment to increase the profits of the Italian resident enterprise to an arm's length result. In such a case, the Hong Kong tax authorities will make an appropriate adjustment to the profits of the Hong Kong resident enterprise in accordance with the mutual agreement procedure provided for in Article 24 (Mutual Agreement Procedure) of the CDTA.

**Articles 10, 11 & 12 - Exemption or reduction of tax on dividends, interest and royalties**
Subject to a specific anti-avoidance provision, the following table summarizes the applicable withholding rates for the captioned income flows received from Italy by a Hong Kong resident as beneficial owner.

<table>
<thead>
<tr>
<th>Tax rate</th>
<th>Passive income</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal withholding rate</td>
<td>20%¹</td>
<td>20%¹</td>
<td>30%¹,⁴</td>
<td></td>
</tr>
<tr>
<td>Reduced rate</td>
<td>10%²</td>
<td>0%/12.5%²³</td>
<td>15%²</td>
<td></td>
</tr>
</tbody>
</table>

**Notes**
1. For nonresidents who are not European Union resident corporations or Swiss resident corporations.
2. The mode of application of the reduction in the rates of withholding taxes will be settled by mutual agreement between the competent authorities of Hong Kong and Italy.
3. 0% rate applies in the following situations:
   (i) the interest is paid by the Italian government or a local authority thereof;
   (2) the interest is paid to the Hong Kong government, a political or administrative subdivision or a local authority of the Hong Kong government, or any agency or instrumentality wholly owned or appointed by the Hong Kong government or any of its political or administrative subdivision or local authority and which carries out activities of a government nature.
   For other cases, 12.5% rate applies.
4. In certain circumstances, the tax applies to 75% of the gross amount, resulting in an effective tax rate of 22.5%.

**Article 13 - Capital gains on disposal of shares**
Capital gains derived by a Hong Kong resident investor on the disposal of shares in an Italian entity will generally be exempt from tax in Italy under the CDTA, unless the shares being disposed of are in respect of a company holding substantial immovable property located in Italy and the shares are not quoted on the stock exchanges of Hong Kong, Italy or any other stock exchanges agreed between the competent authorities.
**Article 14 - Independent personal services**
Income derived by a Hong Kong resident individual from the provision of professional services or other independent activities of a similar character may be liable to tax in Italy if:

- he has a fixed base regularly available to him in Italy for the purpose of performing his activities, but only to the extent of the income attributable to that fixed base; or
- he stays in Italy for a period or periods amounting to or exceeding in the aggregate of 183 days in any twelve-month period commencing or ending in the taxable period concerned, but only to the extent of the income derived from his activities performed in Italy.

**Article 24 - Mutual Agreement Procedure (MAP) and arbitration**
Similar to all other CDTAs Hong Kong has concluded, the CDTA contains a MAP Article. Under the MAP Article, if the actions of one or both contracting parties result, or will result, in a person being assessed to tax in a manner not in accordance with the provisions of the CDTA, the competent authority of the contracting party of which such person is a resident will then consider and resolve the case on its own if possible or, where necessary, endeavor to resolve the case with the competent authority of the other contracting party.

However, if within two years from the presentation of a case the competent authorities are unable to reach an agreement to resolve the case, the CDTA provides an arbitration mechanism. Under the arbitration mechanism, the person initiating the MAP can generally request that any unresolved issues arising from their case be submitted for arbitration, subject to both competent authorities and the person agreeing in writing to be bound by the decision of the arbitration board.

**Article 25 - Exchange of Information**
In the same manner as other CDTAs which Hong Kong has signed since 2010, the CDTA has restricted the exchange of information (EoI) in respect of taxpayers between the two contracting parties to only the types of direct taxes covered by the CDTA.

The Protocol to the CDTA however specifically provides that if in the future, under any agreements between Hong Kong and a third jurisdiction which is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, Hong Kong agrees to exchange information on taxes other than those covered by this CDTA, Hong Kong will pursue with expedition a negotiation with Italy to extend the scope of the EoI article of this CDTA to apply to such other taxes.

**Article 28 - Effective date of the CDTA**
The CDTA will only come into force in the tax year following the calendar year in which the relevant ratification procedures are completed. Assuming that the ratification procedures can be completed in 2013, the CDTA will have effect as follows:

- Hong Kong: for any year of assessment beginning on or after 1 April 2014;
- Italy: for any income year beginning on or after 1 January 2014.
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