

COMPETENT AUTHORITY ARRANGEMENT

The Competent Authorities of the United States and Italy enter into the following arrangement (“Arrangement”) regarding the application of paragraph 1 of Article 19 (Government Service) under the 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, signed at Washington on August 25, 1999 (the “Treaty”), and the Protocol, also signed at Washington on August 25, 1999 (the “Protocol”), both of which entered into force on December 16, 2009. The Arrangement is entered into under paragraph 3 of Article 25 (Mutual Agreement Procedure).

Paragraph 1 of Article 19 (Government Service) of the Treaty states:

(a) Remuneration, other than a pension, paid by a Contracting State or a political or administrative subdivision or local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

(b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:

- (i) is a national of that State and is not a national of the other State; or
- (ii) did not become a resident of that State solely for the purpose of rendering the services;

provided that the provisions of clause (ii) shall not apply to the spouse or dependent children of an individual who is receiving remuneration to which the provisions of subparagraph (a) apply and who does not come within the terms of clause (i) or (ii).

Thus, of particular relevance for purposes of this Arrangement, pursuant to subparagraph 1(b) of Article 19, remuneration shall be taxable only in the Contracting State where the services are rendered (i.e., the host State) if either clause (i) or (ii) of that subparagraph is satisfied, subject to the Treaty’s saving clause of paragraph 2 of Article 1 (Personal Scope).

It has come to the attention of the Competent Authorities, however, that difficulties have arisen as to the application of subparagraph 1(b) of Article 19 with respect to remuneration paid by the United States to U.S. citizens or dual nationals who are residents of Italy and who are rendering services to the United States in U.S. embassies and consulates in Italy. The U.S. Treasury Department’s Technical Explanation of paragraph 1 of Article 19 of the Treaty (“TE”) states:

Subparagraph (a) provides that remuneration paid by one of the States or its political subdivisions or local authorities to any individual who is rendering services to that State, political subdivision or local authority, is exempt from tax

by the other State. Under subparagraph (b), such payments are, however, taxable exclusively in the other State (i.e., the host State) if the services are rendered in that other State and the individual is a resident of that State who is either (i) a national of that State who is not also a national of the other State, or (ii) a person who did not become resident of that State solely for purposes of rendering the services.

The Competent Authorities understand that an example that follows this explanation in the TE may cause confusion because it does not comprehensively describe the application of subparagraph 1(b) of Article 19 of the Treaty. The TE example at issue states:

[A]ssume that the U.S. Embassy in Rome hires a local resident who did not become a resident of Italy solely for purposes of rendering services to the Embassy. If that individual is an Italian national and not a U.S. citizen, the salary paid to him will be taxable only by Italy. However, if the individual is not an Italian national, or is both an Italian national and a U.S. citizen, the salary will be taxable only by the United States.

The third sentence in the TE example illustrates the application of clause (i) of subparagraph 1(b) of Article 19. It is incomplete, however, because it does not consider nor provide guidance on the application of clause (ii) of subparagraph 1(b) of Article 19 which might modify the result. Because the TE does not consider nor provide an example of how to apply clause (ii) of subparagraph 1(b) of Article 19, there has been confusion regarding how, in particular, subparagraph 1(b) of Article 19 should be applied in the case of remuneration, other than a pension, paid by the United States to a resident of Italy who is also a U.S. citizen or dual national and who is a local hire who did not become an Italian resident solely for purposes of rendering services to the United States at a U.S. embassy or consulate in Italy.

Therefore, the Competent Authorities have entered into this Arrangement to clarify the application of subparagraph 1(b) of Article 19 of the Treaty. It is understood that under subparagraph 1(b)(ii) of Article 19, remuneration, other than a pension, paid by the United States to a resident of Italy who is also a U.S. citizen or dual national of the United States and Italy, who renders services to the United States in Italy, and who did not become an Italian resident (as determined under Article 4 (Resident)) solely for purposes of rendering services to the United States shall be taxable only in Italy, subject to the Treaty's saving clause of paragraph 2 of Article 1 (Personal Scope).

Pursuant to the saving clause of paragraph 2 of Article 1, the United States retains its right to tax the income of its citizens and lawful permanent residents "as if there were no 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." As such, a U.S. citizen or lawful permanent resident would not be entitled to claim the benefit of subparagraph

1(b) of Article 19 to exempt remuneration from U.S. federal income tax. Rather, the individual would be subject to tax in both the United States and Italy.

Further, in the case where the United States asserts its right to tax its citizens solely under paragraph 2 of Article 1, the individual may be able to mitigate double taxation under Article 23 (Relief from Double Taxation) of the Treaty.

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