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Considerations Regarding the Double Taxation Agreement (DTA) between Italy and Liechtenstein. Future Perspectives.

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Abstract

<< The paper "Considerations regarding the Double Taxation Agreement (DTA) between Italy and Liechtenstein" critically examines the recently signed DTA, aligning with OECD standards and the OECD/G20 BEPS project, aimed at combating profit reduction and shifting in cross-border contexts. This DTA is a milestone in the tax relations between the two countries, marking significant progress in their financial strategy and legal certainty in investments. It addresses the elimination of double taxation, particularly in income taxes, and includes provisions for zero-rate withholding taxes on group dividends, arbitration for complex cases, and adherence to international standards in information exchange. The DTA with Italy, one of Liechtenstein's key trading partners, exemplifies Liechtenstein's commitment to expanding its DTA network and the mutual commitment to fair and transparent taxation.The influence of the OECD and UN Models on bilateral tax treaties is profound, reflecting a shift towards a harmonized approach in exercising global taxing powers. However, the applicability of these Models in interpreting treaties remains a challenge, particularly in terms of technical correctness and legal uncertainties due to potential divergences from Model patterns. This scenario necessitates a thorough analysis to understand options and divergences in tax treaty practices.The paper provides a concrete example of the DTA application between Italy and Liechtenstein, illustrating its operation in a practical scenario. The example considers Mr. Rossi, an Italian resident earning from investments in Liechtenstein, and Ms. Müller, a Liechtenstein resident generating income in Italy. The DTA's application shows how it manages the taxation of such cross-border incomes, addressing issues like residency-based taxation, source-based taxation, avoidance of double taxation, and non-discrimination. The agreement aligns with both global taxation principles and, where applicable, EU taxation principles, promoting cross-border economic activities by eliminating tax obstacles and ensuring fair tax practices.In conclusion, the DTA between Italy and Liechtenstein serves as a practical illustration of the principles and challenges in international tax laws and agreements. It demonstrates the application of nexus norms in practice and the resulting tax implications for individuals involved in cross-border economic activities. The paper underscores the necessity of consistent, fair, and transparent tax practices in a globalized economic environment, highlighting the role of international standards and effective addressal of cross-border taxation challenges.>>

I. Introduction

In a virtual ceremony, Prime Minister Daniel Risch and his Italian counterpart Giancarlo Giorgetti signed the Double Taxation Agreement (DTA) between Liechtenstein and Italy. The agreement, initially initialed in 2019, will come into force following domestic legislative processes, marking a significant milestone for both countries. The DTA, aligning with OECD standards and the OECD/G20 **BEPS project**, aims to combat profit reduction and shifting in cross-border contexts. It regulates the elimination of double taxation and tax reduction, especially in income taxes, and includes a zero rate for withholding taxes on group dividends to promote cross-border investments. Additionally, it features arbitration provisions for resolving complex double taxation cases. The agreement's information exchange provisions meet international standards, including enforcement assistance, while continuing the automatic exchange of information on financial accounts (AEOI) under the AIA Agreement between Liechtenstein and the European Union. This signed agreement with one of Liechtenstein's key trading partners is testament to the government's successful financial strategy and an important step in expanding Liechtenstein's DTA network. It enhances legal certainty in investments and fosters cooperation between Liechtenstein and Italy, laying a foundation for improved economic collaboration and a solid basis for future investments and business relations between the two nations. The signing signifies both parties' commitment to fair and transparent taxation in cross-border contexts. Liechtenstein, a nation outside the OECD, has recently begun crafting a comprehensive array of double taxation treaties. This initiative includes advanced-stage negotiations with countries like Germany and the UK. The treaties Liechtenstein has established, encompassing both OECD and non-OECD member countries, predominantly align with the OECD Model Tax Convention on Income and Capital. This alignment underscores the significance of the OECD Model in the context of Liechtenstein's tax agreements.

However, the application of the OECD Model and its Commentaries in interpreting these treaties is still a relatively uncharted territory.The utility of the OECD Commentaries in treaty interpretation has been somewhat limited. To date, there has been minimal experience in this area, with the Austria-Liechtenstein treaty being the sole long-standing agreement to undergo interpretation by tax courts. A key interpretive challenge identified in jurisprudence concerns the delineation between business profits (Article 7) and independent personal services (Article 14), particularly when such income is derived through a permanent establishment or fixed base in Liechtenstein by a resident of Austria. Under the treaty, only income from independent personal services is exempt, while business profits are subjected to the credit method. Notably, it appears that any post-treaty amendments in the OECD Commentaries are unlikely to influence the interpretation of the treaty. For instance, during a mutual agreement procedure with Austria in 2001, Liechtenstein adopted a static approach to Article 3(2) of their treaty, referencing only the domestic laws as they stood at the time of the treaty's conclusion. This method of interpretation, focusing on the initial context of the treaty, is expected to extend to the application of the OECD Commentary as well. In the absence of substantial interpretative experience, Switzerland's administrative practices may offer valuable guidance for Liechtenstein. Given their close political, legal, and economic connections, Liechtenstein often mirrors Swiss practices in areas where it lacks specific provisions or administrative guidelines, such as tax law related to reorganizations prior to its tax reform.

2. Influence of OECD Model on bilateral tax treaties

Tax treaties have undergone considerable evolution throughout the twentieth century, primarily under the influence of the OECD and UN. These organizations have been instrumental in drafting Model Tax Conventions, which form the backbone of many bilateral tax treaties worldwide. This evolution reflects a shift towards a more coordinated and harmonized approach in the exercise of taxing powers globally, particularly in minimizing overlaps and negative impacts of taxation on cross-border economic activities.

Relevance of OECD and UN Model Conventions: The OECD Model Tax Convention on Income and on Capital has progressively gained prominence in shaping the structure and clauses of bilateral tax treaties, even influencing those between non-OECD member countries. This trend signifies a move towards a common international tax policy. However, the influence of the UN Model has seen a relative decline, with its role now limited to certain specific clauses or treaties, especially those involving non-OECD countries that aim to maintain stronger taxing rights for the source state.

Controversies and Challenges: A significant challenge in this realm is the interpretation of tax treaty clauses. The influence of the Models on the interpretation of tax treaties has been a controversial issue, leading to a substantial body of judicial decisions globally. The assumption is often that the wording of tax treaty clauses, which matches the Models, is a result of intentional outcomes from tax treaty negotiations. This assumption underlines the technical correctness of interpreting bilateral and multilateral treaties based on these Models.

Tax Treaty Clauses and Divergence: Not all clauses in tax treaties strictly adhere to the patterns set by the Models. This divergence often leads to regional debates or analyses focused on their consistency with national tax treaty practices. Moreover, the determination of the actual influence of the Models is still underexplored, leading to potential misinterpretations and legal uncertainties. This aspect necessitates a detailed analysis of tax treaties to understand the various options and divergences in tax treaty practices across countries.

2.1 Concrete Example of the Double Taxation Agreement (DTA) Application Between Italy and Liechtenstein

In the context of the Double Taxation Agreement (DTA) between Italy and Liechtenstein, let's explore a practical scenario demonstrating its application:
Background:Mr. Rossi, an Italian resident, earns income from his investments in Liechtenstein.
Ms. Müller, residing in Liechtenstein, generates income through professional services provided in Italy.
Application of DTA: For Mr. Rossi (Italian Resident): According to the DTA provisions, Mr. Rossi must include his investment income from Liechtenstein in his taxable income in Italy. The Italian tax system permits him to deduct the taxes paid in Liechtenstein from his Italian tax liability. However, this deduction is limited to the portion of the Italian tax that corresponds to the income earned in Liechtenstein.
For Ms. Müller (Liechtenstein Resident): When Ms. Müller earns income in Italy, the DTA stipulates that Liechtenstein exempts this income from its taxation. Nonetheless, if her income falls into specific categories outlined in Articles 10, 11, 12, 13, 15, 16, and 18 of the DTA, such as dividends, interests, royalties, etc., and is taxable in Italy, then Liechtenstein will credit the Italian tax against Ms. Müller’s tax liability in Liechtenstein. Importantly, the credited amount cannot exceed what would be due in Liechtenstein for the income earned in Italy.
Outcome:Mr. Rossi effectively avoids double taxation on his investment income from Liechtenstein. He fulfills his tax obligations in Liechtenstein and benefits from a tax relief in Italy, corresponding to the tax already paid in Liechtenstein. Ms. Müller experiences a similar advantage for her professional income earned in Italy. Liechtenstein either exempts this income from tax or credits the Italian tax against her tax liability in Liechtenstein. This scenario underscores the collaborative efforts of Italy and Liechtenstein to prevent double taxation for their residents through the DTA. It highlights the commitment of both countries to ensuring fair taxation and preventing tax evasion.

2.2 Example Scenario:
Mr. Rossi: An Italian resident deriving €100,000 income from investments in Liechtenstein.
Ms. Müller: A Liechtenstein resident earning €80,000 income from professional services rendered in Italy.
Taxation Legislation: Italy (For Mr. Rossi):
Corporate Income Tax (IRES): 24%
Regional Production Tax (IRAP): 3.9%
Liechtenstein (For Ms. Müller):
Corporate Income Tax: 12.5%
Application of DTA:
For Mr. Rossi (Italian Resident):
Income from Liechtenstein: €100,000
Liechtenstein Tax: 12.5% (€12,500)
Italian IRES on €100,000: 24% (€24,000)
Italian IRAP: 3.9% (€3,900)
Total Italian Tax: €27,900
Tax Credit in Italy for Tax Paid in Liechtenstein: €12,500
Net Italian Tax Payable by Mr. Rossi: €27,900 - €12,500 = €15,400
For Ms. Müller (Liechtenstein Resident):
Income from Italy: €80,000
Italian Tax: For the purpose of this example, we need to determine the exact Italian tax rate for Ms. Müller’s professional services income. As the exact rate can vary based on several factors, we'll use a hypothetical rate of 25% for simplicity. However, in a real-world scenario, this rate would depend on the specific details of her income, tax bracket, and any applicable deductions or credits. Therefore, the Italian tax would be 25% of €80,000, which is €20,000.
The 25% tax rate used for Ms. Müller's income from Italy in the example was an assumed rate for the purposes of illustration, and not an exact figure from the current Italian tax legislation. In reality, the tax

rates, especially for personal income or income from professional services, can vary based on several factors including the nature of the income, the individual's total income level, and specific tax laws applicable at that time. In Italy, the tax rates for individual income are progressive, meaning they increase with the level of income. The tax brackets can range from as low as 23% for lower income levels (up to €15,000.00, from €15,001.00 up to €28,000.00-25%, from €28,001 up to €50,000-35%) to as high as 43% for higher income brackets (over €50,001). Therefore, the 25% rate in the example was chosen as a representative figure within this range, to simplify the illustration of the DTA's application. For a more accurate calculation of Ms. Müller's tax liability in Italy, one would need to consider the specific details of her income type and total income level, along with the applicable tax year's rates and rules. The example was meant to provide a general understanding of how the DTA between Italy and Liechtenstein might function in a typical scenario, rather than to give precise tax advice.

2.3. Outcome:

Mr. Rossi has a total tax liability of €27,900 on his investment income, with €12,500 paid in Liechtenstein and €15,400 in Italy.

Ms. Müller pays her total tax liability of €20,000 in Italy. Since the DTA between Italy and Liechtenstein might allow for a credit or exemption in Liechtenstein for taxes paid in Italy, she would likely owe no additional tax in Liechtenstein.This example demonstrates the application of the DTA between Italy and Liechtenstein using estimated but realistic tax rates. The DTA aims to prevent double taxation and facilitate cross-border economic activities between the two countries. For more accurate tax calculations, it is advisable to consult with a tax professional or refer to the latest tax regulations in both countries.

2.4 EU taxation principles

The numerical example provided illustrates the application of the Double Taxation Agreement (DTA) between Italy and Liechtenstein, showing how it aligns with general taxation principles and, where relevant, with EU taxation principles:

General Taxation Principles:

Residency-Based Taxation: Typically, countries tax their residents on their worldwide income. In our example, Mr. Rossi, a resident of Italy, is subject to Italian tax on his global income, including income from investments in Liechtenstein.

Source-Based Taxation: Countries also tax non-residents on income sourced within their jurisdiction. Ms. Müller, though a resident of Liechtenstein, earns income in Italy and is therefore subject to Italian tax on that income.

Avoidance of Double Taxation: DTAs are designed to prevent the same income from being taxed by two different jurisdictions. In the example:

Mr. Rossi's investment income is initially taxed in Liechtenstein (source country) and then included in his overall taxable income in Italy (residence country). However, Italy allows a tax credit for taxes paid in Liechtenstein, reducing his Italian tax liability.

Ms. Müller's professional income earned in Italy is taxed in Italy, but Liechtenstein exempts this income from taxation or credits the Italian tax against her Liechtenstein tax liability.

Non-Discrimination: DTAs ensure that residents of one country are not discriminated against in the other country. Both Mr. Rossi and Ms. Müller are taxed in a manner consistent with residents of the source country.

EU Taxation Principles:

While Liechtenstein is not an EU member, it follows many EU directives through its relationship with the European Economic Area (EEA). Key EU taxation principles that can be applicable include:

Freedom of Movement of Capital: EU principles support the free movement of capital between member states. This principle encourages cross-border investments like Mr. Rossi's without facing restrictive taxation.
Avoidance of Double Taxation within the EU: The EU encourages agreements between member states to eliminate double taxation, which is in line with the objectives of the DTA between Italy and Liechtenstein.
Mutual Agreement Procedure (MAP): In cases of tax disputes, especially regarding residency status for taxation, the DTA provides for a mutual agreement procedure akin to the mechanisms encouraged by the EU to resolve cross-border tax issues.
Transparency and Exchange of Information: The EU advocates for transparency and information exchange to combat tax evasion. Such principles are often embedded in DTAs to ensure fair taxation and compliance with international standards.
In summary, the DTA between Italy and Liechtenstein, as demonstrated in the example, aligns with both general global taxation principles and, where applicable, with the principles upheld by the European Union, even though Liechtenstein is not an EU member. The agreement's aim is to promote cross-border economic activities by eliminating tax obstacles, such as double taxation, and ensuring fair tax practices.

4. Conclusions:

When applying these principles to the context of the Double Taxation Agreement (DTA) between Italy and Liechtenstein, as discussed in Filippo Convegno's paper, several aspects become apparent:
Influence of OECD and UN Models: The DTA between Italy and Liechtenstein likely reflects the influence of the OECD Model, considering the general trend in international tax treaty formulation. This influence would shape the treaty's structure and specific clauses, aligning them with widely accepted international tax practices.
Interpretation Challenges: The interpretation of specific provisions within the Italy-Liechtenstein DTA may be subject to the principles and guidelines provided in the OECD Model. However, any unique or divergent clauses would require careful analysis in the context of both countries' tax policies and international obligations.
Adaptation to Global Tax Practices: The DTA should be seen as part of a broader movement towards adapting and aligning national tax systems to global standards, promoting consistency, and reducing tax barriers for cross-border economic activities.
Ensuring Fair and Effective Taxation: The principles highlighted in the General Report underscore the importance of ensuring that DTAs like the one between Italy and Liechtenstein are fair, effective, and in line with current international taxation standards.
The evolution of tax treaties under the guidance of the OECD and UN Models has significant implications for bilateral agreements like the Italy-Liechtenstein DTA. These developments emphasize the need for consistent, fair, and transparent tax practices in an increasingly globalized economic environment. The principles from the General Report provide a valuable framework for understanding and analyzing these complex tax agreements, ensuring they align with international standards and effectively address the challenges of cross-border taxation. Concluding remarks regarding the Double Taxation Agreement (DTA) between Italy and Liechtenstein, can be summarized as follows:
Nexus Requirement and Sovereign Taxing Powers: The document exemplifies the principle that there must be a sufficient connection (nexus) between the taxing authority of a state and the taxable event. This is observed in the DTA application for Mr. Rossi and Ms. Müller, where their tax obligations are determined based on their residency and the source of their income.
Territoriality and Nationality Principles: These principles are reflected in the DTA. Mr. Rossi's investment income from Liechtenstein is taxed in Italy (his country of residence), while Ms. Müller's professional income earned in Italy is subject to Italian tax laws, showcasing the territoriality principle.

Fiscal Residence and Source of Income Concepts: The DTA considers both fiscal residence (Mr. Rossi in Italy) and the source of income (Ms. Müller's income in Italy), aligning with the international tax law principles. Each country taxes income based on either the residency of the taxpayer or the location where the income is generated.
Policy Choices in Defining Nexus for Taxation: The DTA between Italy and Liechtenstein illustrates how states make policy choices in defining nexus requirements for taxation of non-residents' business income, particularly in the way Liechtenstein exempts or credits the Italian tax against Ms. Müller's tax liability.
Tax Equity and Legitimacy: The DTA aims to ensure fair and legitimate taxation. Mr. Rossi and Ms. Müller are not subjected to double taxation, and their tax liabilities are consistent with the principles of tax equity and legitimacy.
Challenges in Global Economy and Tax Treaty Practice: The DTA reflects the need to adapt traditional nexus norms to the contemporary global economy. It accommodates different types of income and offers relief measures, indicating flexibility in tax treaty practice.
Normative Evaluation of Nexus Norms: The DTA between Italy and Liechtenstein demonstrates the application of nexus norms in practice. It provides a concrete example of how these norms are implemented and the resulting tax implications for individuals involved in cross-border economic activities.
Possible Issues: The key issues that could arise in the application of the DTA, based on the general conclusions, include the interpretation of nexus norms, especially in the context of rapidly evolving global trade and economic conditions, and the challenges of ensuring equitable taxation in an increasingly interconnected world economy.
Overall, the DTA serves as a practical illustration of the principles and challenges outlined in the conclusions, demonstrating how international tax laws and agreements are applied in real-world scenarios.

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