Analysis of the New China-Italy Tax Treaty

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Abstract

Since its inception in 1986, the China-Italy tax treaty has served as a crucial guideline for resolving issues of double taxation and preventing tax evasion and avoidance between the two countries. Over the years, with ongoing tax system reforms domestically in both nations, increasingly closer economic and trade exchanges, and new developments in international tax rules, an updated version of the China-Italy tax treaty has emerged. The tax treaty is divided into three parts: basic provisions, provisions on the elimination of double taxation, and provisions on the prevention of tax evasion and avoidance, each part has been revised to varying degrees. The tax treaty also has some shortcomings that deserve attention. However, it cannot be denied that the tax treaty enhances the consistency and coordination of bilateral tax policies and lays a solid foundation for future economic, trade, and cultural cooperation between the two countries.

Keywords: Tax law; China-Italy Tax Treaty; Elimination of Double Taxation; Prevention of Tax Evasion and Avoidance.

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On February 19, 2025, the Agreement between the Government of the People' s Republic of China and the Government of the Italian Republic for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance (hereinafter referred to as the "New Agreement") officially came into effect, marking a significant step in deepening tax cooperation and addressing new challenges of tax avoidance between China and Italy. The Agreement came into effect on February 19, 2025, and applies to taxes withheld at source on income derived on or after January 1, 2026, as well as to other taxes on income imposed with respect to any taxable period beginning on or after January 1, 2026. The revision of this agreement reflects distinct contemporary characteristics. On the one hand, global tax governance is undergoing profound changes. On the other hand, the rapid development of the digital economy poses challenges to the traditional division of tax jurisdiction. The initial tax agreement signed by China and Italy in 1986 laid the foundation for bilateral trade and investment, but the original framework has become increasingly inadequate to meet the demands of a new era. By introducing several innovative provisions, the New Agreement strengthens information exchange and administrative cooperation between the two countries, adapting to the rapid development of the global economy and the restructuring of international tax rules. It represents an important milestone in the deepening economic cooperation and addressing global tax challenges between China and Italy. Furthermore, the Agreement reflects the evolving trends in China's bilateral tax treaties: highlighting the aim of combating tax avoidance and evasion as well as shifting the stance on tax jurisdiction towards resident-country taxation rights. The legal and policy reasons behind this transformation include the implementation of the Enterprise Income Tax Law of the People' s Republic of China (hereinafter referred to as "China's Enterprise Income Tax Law") in 2008, its signing of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, as well as the promotion of the Belt and Road Initiative.[1] The deeper reason for the evolution of China's international agreements lies in the country's rapid economic growth over the past few decades, and the development of tax treaties can even be divided into three distinct stages.[2] The recent revisions to the Agreement reflect the underlying transformation of China's economic structure.

Whether before or after the revision, the entire tax treaty can be divided into three main parts. The first part sets out the basic provisions, including the scope of application and general definitions. The second part addresses the elimination of double taxation, which is carried out by delineating the taxing rights between the resident country and the source country. The third part focuses on provisions for preventing tax evasion and avoidance. This article will analyze and evaluate the revisions to the tax treaty according to this structure.

1. See Li Mao and Liu Sihai, *Trends and Countermeasures in China's Bilateral Tax Treaties*, in Journal of Henan Normal University (Philosophy and Social Sciences Edition), n. 5. 2020, p. 45.

2. See Weng Wuyao, *Tax Treaties in China's Legal Order: Effectiveness and Recent Developments*, in European Tax Studies, n.1. 2015, (ste.unibo.it), pp. 49-77.

1. Changes in the Basic Provisions

One of the most visible changes in the revision of this tax treaty is the update to the agreement's title. The name of the agreement has undergone two main changes: firstly, it shifts from "avoiding" double taxation on income to "eliminating" double taxation; Secondly, the Chinese version transitions from preventing "tax stealing and evasion" to "tax evasion and avoidance," with the corresponding English version changing from "the prevention of fiscal evasion" to "the prevention of tax evasion and avoidance," emphasizing "avoidance." The change from "avoiding" to "eliminating" double taxation reflects a shift in international tax cooperation from a passive approach to prevention to an active commitment to resolving issues.

Similarly, the transition from "tax stealing and evasion" to "tax evasion and avoidance" represents several significant developments. Firstly, it signifies the improvement of the China' s tax law system. The definition of "tax stealing" can be found in the Tax Collection and Administration Law of the People' s Republic of China (hereinafter referred to as "China's Tax Collection and Administration Law"), which states that "a taxpayer forges, alters, conceals or, without authorization, destroys accounting books or vouchers for the accounts, or overstates expenses or omits or understates incomes in the accounting books, or, after being notified by the tax authority to file tax returns, refuses to do so or files false tax returns, or fails to pay or underpays the amount of tax payable." Since there is overlap between tax stealing and tax evasion in terms of behavior patterns, and Criminal Law of the People' s Republic of China(hereinafter referred to as "China's Criminal Law") has replaced "tax stealing" with "tax evasion," describing offenses as acts of filing a false tax return or failing to file a tax return by means of deception or concealment to evade taxes, there arises the issue of aligning the concept of tax stealing in the China's Tax Collection and Administration Law with tax evasion in China's Criminal law.[3]The latest draft of the Tax Collection and Administration Law of the People' s Republic of China (Revised Draft for Public Comment) addresses this issue by removing the concept of tax stealing and replacing it with the concept of tax evasion.[4] Secondly, the scope of tax evasion and avoidance has expanded. Traditional concepts of "tax stealing and evasion" primarily referred to illegal means of evading taxes (e.g., forging accounts, concealing income) but did not cover formally legal but substantively illegal tax avoidance behaviors (e.g., abuse of tax treaties, transfer pricing). The new terminology encompasses both "illegal tax evasion" and "legally exploitative tax avoidance," aligning better with modern tax regulatory needs. Finally, this change aligns with international standards. In combating base erosion and profit shifting, the international community explicitly regulates "avoidance" alongside "evasion".[5]

1.1. Persons Covered

The New Agreement adds a second paragraph to Article 1, expanding the persons covered eligible for treaty benefits to include tax-transparent entities such as partnerships. This change aligns with the OECD Model Tax Convention. Under paragraph 1 of Article 1 of the Agreement, only residents of one of the Contracting States are eligible for treaty benefits. A partnership does not necessarily constitute a "resident" of one of the Contracting States,[6] because according to the domestic law of one of the Contracting States, when a partnership is regarded as a company or taxed in the same way as a company (a tax entity), it is considered a resident of that Contracting State and is eligible to enjoy the benefits of the tax treaty; Conversely, if the partnership is treated as a fiscally transparent entity (tax-transparent) in that state, it does not have tax obligations there and therefore does not

3. See Weng Wuyao and Chen Haobin, *Revision of the Tax Collection and Administration Law from the Perspective of Legal Coordination*, in China Taxation News, June 26, 2024, Edition 5.

4. State Taxation Administration. The Tax Collection and Administration Law of the People' s Republic of China (Revised Draft for Public Comment) is Open for Public Consultation. Retrieved from https://www.chinatax.gov.cn/chinatax/n810356/n810961/c5239263/content.html. Last accessed: April 28, 2025.

5. Model Tax Convention on Income and on Capital 2017 (Full Version),INTRODUCTION: Paragraph 15.6.

6. Model Tax Convention on Income and on Capital 2014 (Full Version), Article 1: Concerning the Persons Covered by the Convention, Paragraph 4.

qualify as a tax resident under the terms of the tax treaty, in such a case, the partnership may be denied tax treaty benefits, unless otherwise provided for in the treaty.[7] Nevertheless, when the income of the partnership is attributed to its partners, those partners may be eligible for treaty benefits between their country of residence and the source country of the income.[8]

According to relevant Chinese regulations, this can be further divided into three scenarios.[9] This premise is based on the provisions of Partnership Enterprise Law of the People' s Republic of China, which stipulates that the production and business operation incomes and other incomes of a partnership enterprise shall be subject to individual income tax paid separately by the partners. Scenario 1: assume there is a partnership established in China, and one of its partners is an Italian resident. The portion of the income that this Italian partner derives from the Chinese partnership and is subject to tax obligations in China can enjoy the treaty benefits provided under the China-Italy tax agreement; Scenario 2: a partnership established under Italian law has set up an office in China and is engaged in business activities. If the partnership is an Italian resident enterprise, meaning it is considered a taxable entity by Italy, then the income derived from its office in China can enjoy tax benefits in accordance with the provisions of the tax treaty; Scenario 3: if Italian law treats the partnership as a tax-transparent entity and the partnership has income derived from China, the Italian partner may enjoy treaty benefits.

Article 1 of the New Agreement also adds a third paragraph, which is the reservation clause regarding the taxing rights of the Contracting States. The core of this clause is that, except for provisions explicitly listed in the Agreement, the Agreement does not affect the taxing rights of one of the Contracting States over its residents. This prevents enterprises or taxpayers from using the Agreement as a basis to claim exemption from other tax obligations prescribed under domestic law, avoids over-expansion of the scope of the Agreement, and ensures the integrity of the tax system.

1.2. Taxes Covered

The changes in the taxes covered reflect the evolution of the tax systems in China and Italy. Under the old China-Italy tax treaty, the applicable taxes for China included individual income tax, income tax for Chinese-foreign joint ventures, income tax for foreign enterprises, and local income tax. In 1980, the Income Tax Law of the People's Republic of China for Chinese-Foreign Equity Joint Ventures (hereinafter referred to as "China's Income Tax Law for Chinese-Foreign Equity Joint

7. Model Tax Convention on Income and on Capital 2014 (Full Version), Article 1: Concerning the Persons Covered by the Convention, Paragraph 5.

8. Model Tax Convention on Income and on Capital 2014 (Full Version), Article 1: Concerning the Persons Covered by the Convention, Paragraph 5.

9. As per the Announcement of the State Administration of Taxation on Several Issues Regarding the Implementation of Tax Treaties (Announcement No. 11 of 2018):

Partnerships established under Chinese law: If a partner of a partnership established in China under Chinese law is a resident of the other Contracting State, the portion of the income derived from China that is subject to tax obligations in China and is considered the partner' s income under the laws of the Contracting State can enjoy treaty benefits in China.

Foreign-established partnerships: For partnerships established under the laws of a foreign jurisdiction whose actual management institution is not located in China but have established an office or place of business in China, or have income sourced from within China without establishing an office or place of business in China, they are considered non-resident enterprise taxpayers under Chinese Enterprise Income Tax Law. Unless otherwise stipulated in the tax treaty, only when the partnership is a resident of the other Contracting State can its income sourced from China enjoy treaty benefits. The tax residency certificate issued by the competent tax authority of the Contracting State, submitted by the partnership in accordance with Article 7 of the Measures for the Administration of Non-Resident Taxpayers Enjoying Tax Treaty Benefits (Announcement No. 60 of 2015 of the State Administration of Taxation), must prove that the partnership is subject to tax obligations in the Contracting State based on domicile, residence, place of establishment, location of the management institution, or other similar criteria under the domestic laws of the Contracting State.

Exceptions under the tax treaty refer to situations where the income of the partnership is deemed to be the income of its partners under the domestic laws of the Contracting State. In such cases, the resident partners of the Contracting State are entitled to enjoy treaty benefits for their respective share of income derived from the partnership.

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Ventures") was enacted, specifically targeting income tax collection from Chinese-foreign joint ventures. The tax rate was set at 30 per cent, with an additional 10 per cent local income tax levied on the taxable amount. In 1991, the Income Tax Law of the People's Republic of China for Foreign-Invested Enterprises and Foreign Enterprises (hereinafter referred to as "China's Income Tax Law for Foreign-Invested Enterprises and Foreign Enterprises") was introduced, merging the income tax systems for Chinese-foreign joint ventures and foreign enterprises. In 2008, the China's Enterprise Income Tax Law came into effect, repealing the Income Tax Law of the People' s Republic of China for Foreign-Invested Enterprises and Foreign Enterprises. This unified the income tax rate for both domestic and foreign-invested enterprises at 25 per cent. It also abolished the separate tax provisions previously applicable to Chinese-foreign joint ventures, incorporating them into a unified enterprise income tax framework. As a result, the income tax for Chinese-foreign joint ventures and the income tax for foreign enterprises ceased to exist in Chinese law. The local income tax, which was an additional tax stipulated under laws such as the China's Income Tax Law for Chinese-Foreign Equity Joint Ventures and the China's Income Tax Law for Foreign-Invested Enterprises and Foreign Enterprises, disappeared along with the invalidation of these laws. As a result, Article 2, paragraph 3 of the New Agreement retains only individual income tax and enterprise income tax as the applicable taxes. Currently in China, both individual income tax and enterprise income tax are shared taxes between the central and local governments.

1.3. General Definitions

1.3.1. Competent Authority

In Article 3, paragraph 1 of the New Agreement, the term "competent authority" has been changed on the Chinese side from "the Ministry of Finance or its authorised representative" to "the State Taxation Administration or its authorised representative." This change is due to the historical evolution of China' s State Taxation Administration. The predecessor of the State Administration of Taxation, known as the Tax Bureau of the Ministry of Finance, was originally under the Ministry of Finance. To adapt to the needs of the fiscal management system reform under the tax-sharing system and the tax system reform, in 1993, the State Taxation Bureau was renamed the State Taxation Administration and designated as a directly affiliated institution of the State Council. This marked the complete separation of the Taxation Administration from the Ministry of Finance' s management framework, establishing it as an independent tax authority.[10]

1.3.2. Handling of Undefined Terms

In the second paragraph of Article 3 of the New Agreement, a new provision has been added: "any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State." Terms in a tax treaty may have different definitions in various legal fields, such as civil laws or company laws. The newly added provision stipulates that when a term is not explicitly defined in the Agreement, the definition under the domestic tax laws of the Contracting State shall prevail, rather than the definitions in other laws. If interpretations from civil laws or company laws were allowed to take precedence over tax-related terms, it could lead to taxpayers circumventing treaty restrictions through non-tax rules.

For example, the term "dividends" in the Company Law of the People' s Republic of China (hereinafter referred to as "China's Company Law") refers only to cash or in-kind benefits distributed by a company to its shareholders from after-tax profits, and such distributions must strictly follow statutory procedures.[11] However, the scope of dividends subject to taxation under tax laws is much

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10. See Li Ping, *Building a Unified and Efficient Tax Collection and Management System*, in China Financial News, October 15, 2024, Edition 7.

11. Specific procedural requirements under the China's Company Law include that dividends must be sourced from "after-tax profits," losses must be covered before distribution, statutory reserves must be set aside, and profits from capital reserves (except for share premium) cannot be distributed.

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broader than the provisions of the China's Company Law. Article 47 of the China's Enterprise Income Tax Law states: "Where an enterprise lowers its taxable income or amount of income because it implements plans without reasonable business purposes, the tax authority shall have the right to make adjustment with appropriate methods." For instance, compared to directly investing in a company to receive dividends, shareholders may achieve a lower overall tax burden under certain conditions by lending money to the company and charging interest instead. However, according to the Notice of the State Administration of Taxation on Issues Concerning the Pre-Tax Deduction of Interest Expenses Paid by Enterprises to Natural Persons (Guoshui Han, 2009, No. 777), if the interest paid by an enterprise to a natural person shareholder exceeds the standard or lacks reasonable business purposes, it may be reclassified as dividends for tax purposes.

In addition, another example, compared to civil and commercial laws, the definition of "enterprise" under Chinese tax law is less restrictive. China's Enterprise Income Tax Law categorizes other organizations, with legal personality, that derive income from or have income accruing in China (including public institutions and social organizations, such as the China Law Society; as well as foundations and chambers of commerce, for example, the China-EU Chamber of Commerce) as enterprises.[12]

1.4. Residents

In Article 4, paragraph 1 of the New Agreement, the criteria for defining "residents" have been revised. The term "location of the head office" has been changed to "place of incorporation", and "location of the management institution" has been changed to "location of the actual management institution". These changes align with the terminology used in the China' s Enterprise Income Tax Law. Additionally, the definition of residents has been expanded to include the Contracting State and its administrative regions or local authorities. This adjustment is consistent with the 1995 amendment to the OECD Model Tax Convention. The commentary on the OECD Model explains that, based on the general understanding of most member states, the government of each country, as well as any political subdivision or local authority, should be considered a resident of that country under the Convention.[13]

Although under Chinese law, the Contracting State and its administrative regions or local authorities are not naturally liable for enterprise income tax, according to the Interpretation of the Articles and Protocol of the Agreement between the Government of the People' s Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, "This paragraph specifically states that residents of a Contracting State also include 'the Contracting State, its local authorities, or statutory bodies.' The term 'statutory body' was included at the request of Singapore and refers to entities established under Singaporean domestic law through acts of the Singaporean Parliament to perform governmental functions, such as the 'Singapore Economic Development Board' and the 'Singapore Tourism Board'." Therefore, the local authorities of the other Contracting State may qualify as "residents" under the Agreement. Moreover, this provision addresses the issue of how sovereign wealth funds are treated under Paragraph 1. When a sovereign wealth fund constitutes an integral part of the state, it likely falls within the scope of "the State and any political subdivision or local authority" under Article 4.[14] For example, China Investment Corporation, established on September 29, 2007, is a sovereign wealth fund created under the China's Company Law. Its mission is

12. Article 1 of the Enterprise Income Tax Law states: "Enterprises and other organizations that derive income from or have income accruing in the People' s Republic of China (hereinafter collectively referred to as 'enterprises') shall be corporate income tax payers with corporate income tax payable pursuant to the provisions of this Law. This Law shall not apply to sole proprietorship enterprises and partnership enterprises." Article 2 of the Enterprise Income Tax Law states: "Enterprises are divided into resident enterprises and non- resident enterprises."

13. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 4: Resident, History: Paragraph 8.4.

14. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 4: Resident, History: Paragraph 8.5.

to diversify the investment of national foreign exchange funds and maximize shareholder equity within acceptable risk limits.

Furthermore, the new provision explicitly states that the term "resident" does not include persons who are subject to tax obligations in a Contracting State solely due to income sourced from that State. This provision aligns with the "resident" criteria under China' s income tax laws. In short, China's determination of residency does not rely on the criterion of the source of income.

Article 4, paragraph 3 of the New Agreement addresses the issue of dual residency for non-individual entities such as companies. It shifts from the traditional approach of "priority to the head office or actual management institution" to a mechanism of "negotiation first, and if negotiation fails, denial of treaty benefits." The rationale behind this rule is that while instances of dual residency for non-individual entities are relatively rare, there have been some cases involving dual-resident companies engaged in tax avoidance. Therefore, a better approach to resolving dual residency issues for non-individual entities is to handle these cases on an individual basis.[15] This issue has become particularly relevant in the context of the digital wave, where the widespread application of information technology has significantly reduced the reliance of businesses on physical locations. As a result, traditional criteria for determining resident enterprises face significant challenges.[16] Under the revised Agreement, when applying the new provisions, the competent tax authorities of both Contracting States should consider various factors, including: where meetings of the entity's board of directors or similar governing body are usually held; where the CEO and other senior executives usually conduct their activities; where the entity's day-to-day senior management activities take place; the location of its headquarters; which country's laws determine the legal status of the entity; where its accounting records are maintained; and whether recognizing the entity as a resident of one Contracting State rather than the other would create a risk of abuse of the convention's provisions.[17]

1.5. Permanent Establishment

In Article 5, paragraph 3 of the New Agreement, the duration threshold for constituting a construction-type permanent establishment has been extended from six months under the old Agreement to 12 months. This modification aligns with the OECD Model Tax Convention. As China undertakes more international engineering projects in Italy, extending the threshold from six months to twelve months will help Chinese companies with short-term projects avoid being deemed as permanent establishments and thus prevent them from being taxed.[18] Additionally, the Agreement revises the time threshold for establishing a permanent establishment when an enterprise of one Contracting State sends employees or hires other personnel to provide services in the other Contracting State for the same project or related projects. It explicitly change "6 months" to an absolute standard of "183 days", eliminating the uncertainty associated with calculations based on calendar months, while also aligning with China' s domestic regulations.[19]

Article 5, paragraph 4 of the New Agreement adds a provision stating that the mere fact that a fixed place of business carries out any activities mentioned in items (a) to (f) does not, by itself, constitute

15. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 4: Resident, History: Paragraph 23.

16. See Zhang Zeping, *Challenges and Reforms of the International Tax Order in the Context of Global Governance*, in China Legal Science, n. 3. 2017, p. 188.

17. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 4: Resident, History: Paragraph 24.1.

18. See Jiang Yuesheng, *The Entry into Force of the China-Italy Tax Treaty: What's New in the Comparison Between the Old and New Versions, and How to Understand the Changes*. Retrieved from https://mp.weixin.qq.com/s/e09NimSfZHO44qjz3o1RnQ. Last accessed: April 28, 2025.

19. According to the Announcement of the State Administration of Taxation on Several Issues Regarding the Implementation of Tax Treaties (Announcement No. 11 of 2018), "For the purposes of the permanent establishment clause, the phrase 'continuously or cumulatively exceeding six months in any twelve-month period' regarding labor activities constituting a permanent establishment shall be interpreted as 'continuously or cumulatively exceeding 183 days in any twelve-month period.'"

a permanent establishment, provided that the overall activities of the fixed place of business are of a preparatory or auxiliary nature. Under the old version, if a fixed place of business engaged in any single activity listed in this paragraph, it was uncontroversially recognized as not constituting a permanent establishment. However, if the fixed place of business conducted multiple activities, ambiguities could arise. The New Agreement eliminates the vagueness of the old Agreement and resolves these disputes.

The core of Article 5, paragraph 6 of the New Agreement lies in distinguishing between independent agents and non-independent agents. The old version defined a non-independent agent as an agent whose activities were entirely or almost entirely on behalf of the enterprise. In contrast, the new version defines a non-independent agent as a person who acts exclusively or almost exclusively on behalf of one or more enterprises closely related to them, with specific provisions for what constitutes "close relationship". This change aims to prevent tax avoidance by ensuring that enterprises cannot evade permanent establishment tax obligations through agents affiliated with related parties. For example, under the old Agreement, an agent representing two associated enterprises could still qualify as an independent agent. However, under the New Agreement, such a scenario would no longer be considered as involving an independent arrangement.

The above-mentioned revision of the provisions is part of the overall effort to refine the criteria for determining permanent establishments. However, with regard to the definition of a permanent establishment, the New Agreement still defines it as "a fixed place of business through which the business of an enterprise is wholly or partly carried on." This definition requires that a permanent establishment has a fixed character. In traditional economic activities, it was necessary for a non-resident enterprise to establish a physical presence in the source state in order to conduct core economic activities, thus forming the understanding that "economic presence equals physical presence." According to this view, only when a non-resident enterprise constitutes either a place-based permanent establishment or an agent-based permanent establishment can the source state exercise its taxing rights over such enterprise.[20]

However, the rapid development of the digital economy has disrupted this traditional logic, posing unprecedented challenges to the rules for determining permanent establishments. Under the digital economy model, many activities that appear to be preparatory or auxiliary may in fact carry significant economic value. For example, consider a Chinese company whose main business involves selling products to Italian customers through internet-based transactions. After receiving orders from Italy, the company ships goods directly from China to Italy via international logistics providers, with no warehouses or logistics facilities located within Italy. Under existing tax treaties, it would be very difficult to identify the Chinese company as having a permanent establishment in Italy. Therefore, it is difficult for Italy to tax this amount. In response to online transactions, some European countries have proposed new criteria: even if a non-resident enterprise does not maintain a fixed place of business or facility in the source state, as long as it continuously engages in economically substantive business activities within the territory of the source state through the internet, digital technologies, or electronic means, and forms a close and effective economic nexus with that state, it may be deemed to have a "virtual permanent establishment." The business income derived from such activities should then fall within the taxable scope of the source state, thereby achieving fairness and balance in international tax allocation.[21]

Therefore, the current definition of permanent establishment under tax treaties is insufficient to meet the needs of the digital era. The concept of "virtual permanent establishment" provides useful experience that tax treaties could draw upon to improve and modernize the definition of permanent establishment, better adapting to the development of the digital economy.

20. See Cui Xiaojing, Zhao Zhou, *The Application of the Permanent Establishment Principle in the Digital Economy Era,* in Law Science, n. 11. 2016, p. 15.

21. See Yan Feng, Feng Wei, Cui Yuchen, *The Impact of the Digital Economy on International Taxation and Analysis of Representative Cases, in* International Taxation, n. 3 .2015, p. 16.

2. Changes to the Provisions for Eliminating Double Taxation

2.1. International Transport

In paragraph 1 of Article 3 of the Agreement, the term "international traffic" has been changed from "transport by a ship or aircraft operated by an enterprise which has its place of head office or its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State" to "transport by a ship or aircraft operated by an enterprise of a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State." Furthermore, according to the Agreement, the term "enterprise of a Contracting State" refers to an enterprise carried on by residents of a Contracting State. Correspondingly, paragraph 1 of Article 8 of the Agreement has also been revised. The original wording "profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of head office or the place of effective management of the enterprise is situated" has been changed to "profits from the operation of ships or aircrafts in international traffic by an enterprise of a Contracting State shall be taxable only in that Contracting State." This change reflects the shift from a standard based on the location of the head office or place of effective management to one based on residence, which is also linked to the corresponding revision concerning the definition of "residents" in the Agreement.

Paragraph 2 of Article 8 in the new Agreement, which previously addressed taxation rights for shipping enterprises whose head office or place of effective management was located aboard a ship, has been deleted. Under the revised paragraph 1 of the Article, the determination of tax rights for such enterprises is now sufficiently clear, making the previous provision unnecessary.

2.2. Associated Enterprises

Article 9 of the New Agreement adds a second paragraph, which addresses situations where the rewriting of transactions between associated enterprises, as envisioned in the first paragraph, may lead to double taxation—that is, the same income being taxed in the hands of different taxpayers. In such cases, the second paragraph provides for adjustments to eliminate this double taxation. For example, consider Company A in China as the parent company and Company B in Italy as the subsidiary. Company A sells precision instruments to Company B. The Italian tax authorities determine that the purchase price paid by Company B to Company A is too high under the arm's length principle and adjust Company B's taxable income upward, resulting in additional corporate income tax being levied on Company B. In this situation, according to the second paragraph, China should appropriately reduce the tax imposed on Company A to eliminate the double taxation.

The second paragraph added to Article 9 of the New Agreement provides a practical solution to the potential double taxation issues arising from the adjustment of transactions between associated enterprises. This adjustment mechanism is crucial for maintaining fairness and avoiding overtaxation in cross—border business scenarios. However, to fully understand the context of these adjustments and the scope of their application, it is essential to first grasp the definition of "associated enterprises" stipulated in the New Agreement. In Article 9, paragraph 1 of the New Agreement defines "associated enterprises" as enterprises in which an enterprise of one Contracting State directly or indirectly participates in the management, control, or capital of an enterprise in the other Contracting State, or where the same person or persons directly or indirectly participate in the management, control, or capital of enterprises in both Contracting States. In contrast, Article 109 of China's Implementation Regulations of the Enterprise Income Tax Law defines "related parties" as enterprises, organizations, or individuals that have any one of the following related relationships with a company: there exists a direct or indirect controlling relationship in terms of funds, operations, purchasing, sales, etc; both are directly or indirectly controlled by the same third party; there exist other relationships involving shared interests. In addition, the State Administration of Taxation Announcement on Improving Related Party Reporting and Contemporaneous Documentation Management (Announcement No. 42 of 2016) further supplements the definition of related-party relationships.[22]

Therefore, China's domestic regulations provide a broader definition of related party relationships compared to tax treaties. Chinese tax laws expands the scope of application to include situations where parties are not under common control but have substantial economic interdependence, through the catch-all provision of "other relationships involving shared interests." In contrast, tax treaties limit the concept of association to direct or indirect participation in management, control, or capital. It follows that, in practice, enterprises may refuse adjustments to taxable amounts proposed by Chinese competent tax authorities by arguing that they do not meet the treaty definition of "associated enterprises".[23] Accordingly, the tax treaty should be revised and adjusted to broaden the definition of associated enterprises, ensuring alignment and compatibility with China's domestic legal framework.

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22. Article 2 stipulates that an enterprise is considered to have a "related party relationship" as defined in this Announcement with another enterprise, organization, or individual if any of the following relationships exist:

(1) One party directly or indirectly holds a total of 25% or more of the shares of the other party; or both parties are directly or indirectly held by the same third party, and the combined shareholding reaches 25% or more.

If one party indirectly holds shares in another party through an intermediary, as long as its shareholding in the intermediary reaches 25% or more, then its shareholding in the other party shall be calculated based on the intermediary's shareholding in the other party.

Where two or more natural persons who are spouses, lineal relatives, siblings, or otherwise related through support or maintenance jointly hold shares in the same enterprise, their shareholding percentages shall be aggregated for the purpose of determining whether a related party relationship exists.

(2) The two parties have a shareholding relationship or are both held by a third party, although the shareholding percentage does not meet the threshold specified in item (1). However, the total amount of loans between them accounts for 50% or more of either party' s paid-in capital, or more than 10% of one party' s total loan amount is guaranteed by the other party (excluding loans or guarantees involving independent financial institutions).

The ratio of total loan amount to paid-in capital is calculated as follows:

Loan-to-Capital Ratio = Annual Weighted Average Loan Amount / Annual Weighted Average Paid-in Capital

Where:

Annual Weighted Average Loan Amount = Σ (i-th loan amount × number of days the i-th loan was actually outstanding during the year / 365)

Annual Weighted Average Paid-in Capital = Σ (i-th paid-in capital amount × number of days the i-th capital was actually outstanding during the year / 365)

(3) The two parties have a shareholding relationship or are both held by a third party, although the shareholding percentage does not reach the level specified in item (1). However, one party's production and business operations must rely on the provision of proprietary rights such as patents, non-patented technologies, trademarks, copyrights, or other forms of franchised rights from the other party in order to proceed normally.

(4) The two parties have a shareholding relationship or are both held by a third party, although the shareholding percentage does not meet the requirements set out in item (1). However, one party's purchasing, sales, receipt of services, or provision of services and other operational activities are controlled by the other party.

The term "control" here means that one party has the right to determine the other party's financial and operational policies and can thereby derive benefits from the other party's business activities.

(5) More than half of one party's board of directors or senior management (including the board secretary, general manager, deputy general manager, chief financial officer, and other personnel specified in the company's articles of association of a listed company) are appointed or dispatched by the other party, or the same individuals concurrently serve as directors or senior managers of the other party; or each party has more than half of its board of directors or senior management appointed or dispatched by the same third party.

(6) Two natural persons who are spouses, lineal relatives, siblings, or otherwise related through support or maintenance individually have one of the relationships described in items (1) through (5) with each of the two parties.

(7) The two parties have other substantial common interests.

23. See Liu Jianwen, *The Current Status and Development Trend of the China-Germany Tax Treaty*, in Modern Law Science, n.2. 2012, p. 132.

2.3. Investment Income

2.3.1. Dividends

Article 10 of the New Agreement introduces a new tax benefit for dividend income, allowing a company that qualifies as the beneficial owner to enjoy a reduced tax rate of no more than 5 per cent of the total dividend amount. However, the company must meet the condition of directly owning at least 25 per cent of the capital of the company paying the dividends during a 365-day period, including the date of the dividend payment. When calculating this 365-day period, changes in shareholding directly caused by corporate reorganizations, such as mergers or spin-offs involving either the holding company or the dividend-paying company, should not be considered. The tax benefit of not being subject to withholding tax exceeding 5 per cent on the total amount of dividends is a special preferential treatment granted by the Agreement to associated enterprises, facilitating their investment and financing activities. It limits the taxing rights of the source country, prevents excessive tax burdens on companies, and avoids double taxation.

2.3.2. Interests

In the second paragraph of Article 11 of the New Agreement, a new provision has been added regarding the taxation of interest on loans with a term of three years or more that are paid to financial institutions for investment projects. The tax on such interest should not exceed 8 per cent of the total interest amount. This is essentially because the source country typically taxes the total interest amount, thereby ignoring the funding costs of banks. For example, banks usually fund their loans using borrowed funds, particularly deposits. For this reason, many countries exempt interest payments to financial institutions such as banks from withholding tax at the source.[24] In addition to encouraging loans to financial institutions, this measure also promotes long-term investments of three years or more.

The third paragraph of Article 11 of the New Agreement expands the scope of tax exemptions to include "the Central Bank of the other Contracting State, or any public entity or any entity the capital of which is wholly owned by the Government of the other Contracting State, or paid on loans guaranteed or insured by the Government of the other Contracting State, or political subdivisions, local authorities thereof, the Central Bank of the other Contracting State or any public entity or any entity the capital of which is wholly owned by the Government of the other Contracting State." This encourages investment activities of a governmental nature.

The fifth paragraph of Article 11 of the New Agreement refines the definition of interest by adding "including any premium and bonus attached to the public debt, bond, or credit instrument." This provision aligns with the principle of economic substance. At the same time, penalties arising from delayed payments are explicitly excluded from the definition of interest. Such penalties are considered less as income from capital and more as a special form of compensation for losses caused to the creditor due to the debtor's failure to fulfill obligations on time.[25] This provision serves as a penalty for non-compliance by both parties. If either party fails to fulfill its obligations on time, both countries have the right to tax the penalty, and such penalties cannot enjoy the preferential treatment under the Agreement. This aims to encourage enterprises in both countries to engage in honest and reliable transactions.

2.3.3. Royalties

The new Article 12 of the agreement defines various payments made as remuneration for the use or the right to use software as royalties. The characterization of the income directly influences which

24. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 11: Commentary on Article 11 Concerning the Taxation of Interests, Paragraph 7.7.

25. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 11: Commentary on Article 11 Concerning the Taxation of Interests, Paragraph 22.

provisions of the OECD Model Tax Convention apply. Prior to the agreement's clarification regarding payments for the use of software, transactions involving software could potentially fall under the provisions concerning "royalties", "business profits", and "capital gains".[26] Naturally, applying different provisions leads to different tax rates. Therefore, by explicitly categorizing such payments as royalties, the agreement not only reduces disputes but also aligns with the developments of the times.

Moreover, the old Agreement did not differentiate between types of royalties and uniformly set the maximum tax rate at 10 per cent. The New Agreement clearly distinguishes between two types of royalties and establishes separate tax rate rules for each: For intellectual property rights (such as copyrights, patents, trademarks, etc.), the tax rate remains at 10 per cent. For equipment leasing (industrial, commercial, or scientific equipment), the concept of an "adjusted amount" is introduced, meaning that only 50 per cent of the total royalty amount is subject to taxation, effectively reducing the tax burden. By halving the taxable base for equipment leasing royalties, the New Agreement reduces the tax costs associated with cross-border equipment use, aiming to promote the flow of technical equipment between the Contracting States.

2.4. Capital Gains

Article 13, paragraph 6 of the New Agreement modifies the taxing rights for gains derived from other property. Previously, the rule stated that "Gains derived by a resident of a Contracting State from the alienation of any property other than that referred to in paragraphs 1 to 5 and arising in the other Contracting State may be taxed in that other Contracting State." This has been changed to "Gains from the alienation of any property, other than that referred to in paragraphs 1 to 5, shall be taxable only in the Contracting State of which the alienator is a resident." For example, under the old Agreement, if a Chinese company transferred movable property it owned in Italy and derived gains from the transfer, Italy would have the right to tax those gains. Additionally, according to Article 7 of the China's Implementation Regulations of the Enterprise Income Tax Law, income from the transfer of property, including gains from the transfer of movable property, is determined based on the location of the enterprise or establishment carrying out the transfer. Therefore, China would also have the right to tax the gains, resulting in potential double taxation. Under the New Agreement, however, such gains would only be taxable in China, thereby eliminating the issue of double taxation that existed under the old Agreement.

2.5. Income from Services

2.5.1. Employment Income

The New Agreement introduces a new paragraph 4 to Article 15. According to this provision, if a resident of one Contracting State ceases to be a resident of the other Contracting State, any severance indemnity or other similar lump sum payments received for employment in that other Contracting State shall only be taxable in that other Contracting State. Paragraph 1 establishes the general rule for taxing employment income (excluding pensions), under which both the resident State and the source State have the right to tax such income. However, paragraph 4 clarifies that severance payments are taxable only by the source State, thereby eliminating double taxation. For example, if a Chinese citizen, Mr. A, receives €100,000 as severance compensation upon leaving his job while working in Italy, under the old Agreement, Italy (as the source country) would impose individual income tax on this amount. After returning to China, China (as the resident country) might impose individual income tax on this €100,000, with applicable progressive tax rates that could include a top marginal rate of 45 per cent, resulting in double taxation. Under the New Agreement, only Italy would have the right to tax the severance payment, with China relinquishing its taxing rights, thus completely avoiding double taxation.

26. See Zhu Yiqing, Zeng Jing: *Taxation Nature Determination and Legal Significance of Computer Software Copyright Transactions,* in Journal of Chongqing University (Social Sciences Edition), n. 6. 2015, p. 152.

2.5.2. Artistes and Sportsmen

Article 17, paragraph 3 of the New Agreement broadens the scope of tax exemptions from "under a plan of cultural exchange between the Governments of both Contracting States" to include activities "are wholly or mainly supported by public funds of the first-mentioned State, or if such activities are performed in the other State under a plan of cultural exchange between the Governments of both Contracting States." This encourages government-supported cultural, artistic, and sports exchanges by reducing tax barriers for such activities.

Additionally, the provision introduces the clause "income derived by a resident of a Contracting State as an entertainer or as a sportsman, whether or not accruing to the entertainer or sportsman himself or to another person," resolving ambiguities under the old Agreement regarding situations where income from cultural exchanges conducted by artists or athletes might be attributed to third parties.

Furthermore, the provision modifies the rule from "such income shall be exempt from tax in the other Contracting State" to "such income shall only be taxable in the first-mentioned Contracting State." This explicitly limits the taxing rights of the source State, thereby eliminating double taxation.

2.5.3. Pensions

The second paragraph newly added to Article 18 of the new Agreement: "Notwithstanding the provisions of paragraph 1, pensions paid and other similar payments made under a public welfare scheme of a Contracting State, a political subdivision or a local authority thereof shall be taxable only in that State." This provision specifies that special pensions paid under public welfare programs are taxable only in the country where the welfare payment originates. Thus, this article distinguishes between pensions paid by enterprises due to employment relationships and those with a public welfare nature, further eliminating the risk of double taxation.

2.6. Other Income

Article 22 of the New Agreement deletes paragraph 3 of the old Agreement, which stated: "Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Agreement and arising in the other Contracting State may be taxed in that other Contracting State." The reason for this deletion is that such a provision could lead to double taxation on other income arising in the other Contracting State by both Contracting States. The modification in the New Agreement ensures that, regardless of where such other income arises, and if it is not otherwise covered by the preceding Articles of the Agreement, it shall only be taxable in the resident State.

2.7. Methods for Elimination Double Taxation

Paragraph 1 of Article 23 of the new Agreement provides that, in China, in accordance with the provisions of the law of China, double taxation shall be eliminated as follows: where the income derived from Italy is dividend paid by a company which is a resident of Italy to a company which is a resident of China and which owns not less than 20 per cent of the shares of the company paying the dividend, the credit shall take into account the tax paid to Italy by the company paying the dividend in respect of its income. The new Agreement has raised the threshold from at least 10 per cent to at least 20 per cent in shareholding, aligning it with China's Enterprise Income Tax Law and its Implementing Regulations.[27] However, this change implies that Chinese parent companies holding

27. Article 24 of the Enterprise Income Tax Law states: "Dividends, bonuses, or other equity investment income derived by a resident enterprise from foreign enterprises it directly or indirectly controls, which are sourced outside of China, may allow the portion of foreign corporate income tax paid abroad that corresponds to such income to be credited as a foreign tax credit within the limits specified in Article 23 of this Law." Article 80 of the Implementing Regulations of

between 10 per cent and 20 per cent of the shares in an Italian company will no longer qualify for the tax credit. As a result, after the pre-tax profits (from which dividends derive) are subject to corporate income tax in Italy, the corresponding foreign tax paid will no longer be deductible in China. This leads to an increased tax burden in China, as the Italian corporate income tax and the Chinese enterprise income tax will now overlap, thereby exacerbating economic double taxation on such companies.

Article 23 of the New Agreement also removes paragraph 4, which previously stated: "For the purposes of paragraphs 2 and 3 of this Article where a tax on business profits, dividends, interest or royalties arising in a Contracting State is exempted or reduced for a limited period of time in accordance with the laws and regulations of that State, such tax which has been exempted or reduced shall be deemed to have been paid at a full amount in the case of business profits and at an amount not exceeding: (a) 10 per cent of the gross amount of the dividends and interest referred to under Articles 10 and 11; (b) 15 per cent of the gross amount of the royalties referred to under Article 12."

For example, an Italian company A has a permanent establishment in China, which engages in a qualified environmental protection project. According to China's policies, income derived from such qualified environmental protection projects is exempt from corporate income tax for the first to the third taxable years starting from the year when the enterprise obtains its first operating or production revenue, and is subject to a 50 per cent reduced tax rate for the fourth to the sixth taxable years.[28] In the first year, the permanent establishment earns a profit of €1 million. Without this preferential policy, the profit earned by the permanent establishment would be subject to China's enterprise income tax at a rate of 25 per cent, under China's Enterprise Income Tax Law.[29] Therefore, the tax payable would be €250,000. Assuming the Italian corporate income tax rate is 20 per cent, Company A would owe €200,000 in taxes in Italy. Under the old tax treaty, Italy allowed a credit for the €250,000 of Chinese tax deemed paid, resulting in zero overall tax liability for Company A. However, under the new Agreement, no such credit is allowed. As a result, Company A remains subject to taxation in Italy at the rate of 20 per cent, that is €200,000, leading to a higher overall tax burden compared to the previous arrangement.

The core function of tax sparing credits is to ensure that tax incentives offered by the source country are actually enjoyed by investors, rather than being converted into tax revenue for the resident country. Prior to 2008, China implemented tax incentives for foreign investment under the Income Tax Law for Enterprises with Foreign Investment and Foreign Enterprises, and thus actively included tax sparing credit provisions in tax treaties to safeguard the effectiveness of these incentives. After the unification of the China's Enterprise Income Tax Law, with the abolition of preferential treatment for foreign investment, China ceased to advocate for tax sparing credits as a source country, leading to adjustments in related treaty policies. [30]Notably, although the New Agreement eliminates provisions for tax sparing credits, it does not result in double taxation.

the Enterprise Income Tax Law specifies: "Direct control under Article 24 of the Enterprise Income Tax Law refers to a resident enterprise directly holding at least 20 per cent of the shares of a foreign enterprise. Indirect control refers to a resident enterprise holding at least 20 per cent of the shares of a foreign enterprise through indirect shareholding, with specific determination methods to be formulated separately by the Ministry of Finance and the State Administration of Taxation."

28. State Taxation Administration: *Income from engaging in qualified environmental protection projects is eligible for periodic exemptions and reductions of corporate income tax*. Retrieved from https://www.chinatax.gov.cn/chinatax/c102155/c5178890/content.html. Last accessed: April 29, 2025.

29. As a non-resident enterprise as defined under China' s Enterprise Income Tax Law—meaning it was established under foreign (or regional) law, with its actual management not located within China, but having established an institution or place within China—Company A would be taxed on income sourced within China derived through its permanent establishment B. The applicable corporate income tax rate is 25 per cent.

30. See Xiong Yan, *Reflections on Issues Related to Tax Sparing Credits*, in International Taxation, n. 12. 2016, p. 35.

2.8. Mutual Agreement Procedure

In Article 26, paragraph 2 of the New Agreement, a new provision has been added: "Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States." For example, after a Chinese company A pays taxes on income sourced from Italy to China, Italy also seeks to impose taxes on the same income. However, due to differing interpretations of the nature of the payment, this results in an excessive tax burden for company A. Company A then initiates the mutual agreement procedure to resolve the issue of double taxation between China and Italy. After two years of negotiations, the two countries reach an agreement: Italy will tax a portion of the income at a certain rate, while China will tax another portion at a different rate. Without the new provision, there would have been obstacles for the Chinese company to claim a tax credit for the amount of tax paid in Italy. This is because, under Article 54 of the China' s Enterprise Income Tax Law, an enterprise shall, within 5 months after the end of each year, submit to the tax organ an annual enterprise income tax return for the settlement of tax payments and settle the payable or refundable amount of taxes. The enterprise income tax return includes provisions for cross-border tax credits. The effect of this new provision is to further eliminate double taxation by ensuring that agreements reached through the mutual agreement procedure can be implemented without being constrained by domestic legal time limits.

The mutual agreement procedure between the tax authorities of the two contracting states is essentially an administrative cooperation mechanism based on bilateral negotiation. However, it inevitably faces institutional limitations in fully and effectively resolving various types of tax disputes.[31] For example, the initiation and conclusion of the mutual agreement procedure under Article 26 of the tax treaty heavily depend on the cooperation between the competent tax authorities of both Contracting States. However, the treaty does not impose an obligation on the other Contracting State to accept the negotiation or reach an agreement. Moreover, the Agreement does not specify a time limit for the mutual agreement procedure. As a result, in practice, the mutual agreement procedure may last for several years, which could significantly affect the rights and interests of taxpayers.

To address such situations that may undermine taxpayer rights, the tax treaty could codify the obligation to engage in mutual agreement procedure by clearly stipulating that the competent authorities of the Contracting States must accept a request for mutual agreement unless it can be demonstrated that the dispute clearly falls outside the scope of the treaty provisions. In addition, although it would be ideal for the treaty to set a maximum time limit for mutual agreement procedure, if such a provision is not feasible, the treaty should at least require the competent authorities to provide timely updates to the taxpayer regarding the progress of the negotiations, in order to safeguard the taxpayer's legitimate rights and interests.

3. Changes to Provisions for Preventing Tax Evasion and Avoidance

3.1. Investment Income

3.1.1. Dividends

Articles 10, 11, and 12 of the New Agreement improve the provisions regarding "beneficial owners", requiring that the beneficial owner must be a resident of the other Contracting State. This prevents tax avoidance by residents of third countries, as under the old Agreement, residents of third countries could easily establish intermediary companies in one of the Contracting States to receive income sourced from the other Contracting State. By doing so, they could enjoy preferential

31. See Cui Xiaojing, *Research on Tax Treaty Benefits and Applicable Disputes between China and "Belt and Road" Countries*, in China Legal Science, n.2.2017, p. 215.

treatments, such as reduced tax rates, stipulated in the tax agreement between the two Contracting States. For example, consider a U.S.-based company A that wholly owns a Chinese company B, which in turn wholly owns an Italian company C. When company C pays dividends to company B, without the “beneficial owner” rule, these dividends could qualify for taxation at no more than 5 per cent of the total dividend amount under the China-Italy tax treaty. However, the ultimate beneficiary of these dividends is the U.S.-based company A. According to Article 1 of the Announcement of the State Administration of Taxation on Issues Concerning “Beneficial Owners” in Tax Treaties(Announcement No. 9 of 2018), a “beneficial owner” refers to a person who has ownership and control over the income or the rights or property from which the income arises. Thus, under the restriction of the “beneficial owner” rule, dividends paid between companies B and C, established by U.S.-based company A, do not qualify for the special preferential provisions of the China-Italy tax treaty.

3.2. Capital Gains

In Article 13, paragraph 4 of the New Agreement, the provision that “Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State” has been revised to state: “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.” The change from “principally” to “more than 50 per cent” establishes a clear standard, reducing the ambiguity present in the implementation of the old Agreement.

Paragraph 5 introduces a time restriction prior to the transfer, requiring that the shares must have been held for at least 12 months before the transfer. This amendment addresses situations where assets are injected into an entity shortly before the sale of its shares or similar rights, diluting the proportion of the value of those shares or rights attributable to immovable property located in one of the Contracting States.[32] For example, consider a Chinese company A that holds 100 per cent of the shares of an Italian company B. Company B’s core asset is a commercial real estate property located in Italy, valued at €8 million, with an additional €2 million in cash and other movable property, bringing the total asset value to €10 million. Company A plans to transfer its entire stake in company B. Suppose that three months before the share transfer, company A injects €8 million in financial assets into company B, diluting the proportion of immovable property in company B’s total assets to 44 per cent (€8 million / €18 million). Company A might argue that since immovable property does not exceed 50 per cent, Italy has no taxing rights. Under the new rules, if the injection of assets occurs within 12 months prior to the transfer, the determination of taxing rights will be based on the asset composition before the injection. In this case, since the original proportion of immovable property was 80 per cent, Italy would still have the right to tax the gains.

The New Agreement establishes the principle of exclusive taxing rights for the resident State through the catch-all provision in paragraph 6. The provisions in paragraphs 4 and 5 are exceptions, allowing limited taxing rights for the source State. Taxpayers might attempt to apply the catch-all rule in paragraph 6 to avoid tax obligations to the source State. Therefore, without corresponding revisions to the exception rules under the important amendments in paragraph 6, there could be significant opportunities for tax avoidance.

32. Model Tax Convention on Income and on Capital 2017 (Full Version), Article 13: Commentary on Article 13 Concerning the Taxation of Capital Gains, Paragraph 28.5.

3.3. Income from Services

3.3.1. Independent Personal Services

Under the old Agreement, the source State could only tax an individual if they stayed in the source State for a period or periods exceeding in the aggregate 183 days in the calendar year concerned; this provision created difficulties for Contracting States with fiscal or tax years that did not align with the calendar year and allowed taxpayers to exploit artificial arrangements to limit their stay in one Contracting State to avoid taxation. The New Agreement, under Article 14, stipulates that the source State may tax an individual only if they stay in the source State for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned.[33] This revision aligns with the provisions of Article 15, paragraph 2, item 1 of the New Agreement. Such wording eliminates opportunities for taxpayers to engage in tax avoidance. For example, consider an Italian resident A who is sent to China to work on a project. In 2026, A works in China from July 1 to December 31 (184 days). In 2027, A continues working in China from January 1 to June 30 (181 days). Under the old Agreement, since China's tax year runs from January 1 to December 31, China would not have the right to tax A's income sourced from China in 2027. However, under the New Agreement, China would have the right to tax A's income derived from China over the two-year period.

3.3.2. Income from Employment

Although there has been no change in the English version, Article 15, paragraph 2 of the New Agreement requires that all three conditions must be met for the resident State to have exclusive taxing rights. These conditions are: "a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State." Under the old Agreement's Chinese wording, ambiguity arose because it could be interpreted as requiring only one of the three conditions to be satisfied for the resident State to have exclusive taxing rights.[34] Therefore, the adoption of more precise Chinese wording in the New Agreement eliminates this ambiguity and prevents taxpayers from exploiting the old Agreement to arrange tax avoidance schemes.

3.4. Entitlement to Benefits

The New Agreement introduces a specific provision aimed at preventing tax evasion and avoidance as Article 24: "Notwithstanding the other provisions of this Agreement, a benefit under this Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Agreement." This provision aims to prevent taxpayers from obtaining tax benefits under the Agreement through artificial arrangements that are inconsistent with the objectives and purposes of the Agreement.

33. For an interpretation of this provision, see the 2007 Notice of the State Administration of Taxation on Certain Issues Regarding the Interpretation and Implementation of Articles of the Arrangement between the Mainland and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. The phrase "a continuous or cumulative stay of no more than 183 days in any 12 months beginning or ending in the relevant tax year" refers to a calculation based on any 12-month period counted forward from the month of entry or backward from the month of departure.

34. The old Chinese wording states that if … then the income should be taxed only in one Contracting State, meaning that even if only one condition is met, the taxation right belongs exclusively to that Contracting State. However, the New Agreement clearly stipulates that all three conditions must be met simultaneously for the income to be taxed solely in one Contracting State.

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Notwithstanding its advantages, this clause gives rise to a number of difficulties in application. This provision is highly subjective in nature, thereby significantly expanding the discretion of tax authorities. Due to its strong subjective character, taxpayers also face greater difficulty in providing sufficient evidence to support their position. Such rule design not only undermines the certainty of tax legal relationships, but may also lead to administrative disputes between taxpayers and tax authorities, as contracting states may differ in their standards and methods of determination. In extreme cases, it could even trigger cross-border tax coordination disagreements between competent authorities of the contracting states, thus potentially impeding the smooth conduct of transnational economic activities.[35]

Therefore, it is essential to introduce objective and quantifiable criteria when analyzing whether a tax avoidance arrangement exists. For example, the Agreement between the Government of the People's Republic of China and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income includes a Limitation on Benefits clause, which stipulates that only a resident who qualifies as an "eligible person" under paragraph 2 and meets other conditions required to enjoy treaty benefits shall be entitled to the full benefits of the Agreement. The provision further sets out the specific criteria for being considered an "eligible person".[36]

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35. See Li Haolan, *A Review and Legislative Reflection on China's Rules Against Treaty Abuse*, in Taxation Research, n. 8. 2018, p. 63.

36. Provisions under Article 23–Limitation on Benefits, specifically paragraphs 2 to 5 stipulates:

2. A resident of a Contracting State shall qualify as an "eligible person" for any taxable year only if it falls within one of the following categories:

(i) An individual;

(ii) A qualified government entity;

(iii) A company, provided that:

The company's primary class of shares is listed and regularly traded on one or more "recognized stock exchanges" as defined in sub-paragraphs (i) or (ii) of paragraph 6; or

At least 50% of both the voting power and value of the company' s shares is directly or indirectly owned by five or fewer companies which themselves qualify for benefits under item 1 above. However, in the case of indirect ownership, each intermediary owner must be a resident of either Contracting State;

(iv) A charitable institution or other tax-exempt entity, but if it is a pension trust or any other organization established specifically to provide pensions or similar benefits, more than 50% of its beneficiaries, members, or participants must be individuals who are residents of either Contracting State;

(v) A person other than an individual, provided that:

For at least half of the relevant taxable year, at least 50% of the voting power, share value, or other beneficial interest in that person is directly or indirectly owned by persons who qualify as "eligible persons" under items (i), (ii), (iv), or sub-item 1 of item (iii) of this paragraph; and

During the relevant taxable year, not more than 50% of that person's total income is directly or indirectly paid to or attributable to persons who are not residents of either Contracting State, and such payment or attribution is deductible in the resident State of that person before the taxation to which this Agreement applies (excluding, however, fair payments made in the ordinary course of business for services or tangible property, and excluding also payments to banks in respect of financial indebtedness, provided that if the bank were not a resident of a Contracting State, the payment would be attributable to a permanent establishment of the bank located in a Contracting State).

3.(i) A resident of a Contracting State shall be entitled to treaty benefits with respect to income derived from the other Contracting State, regardless of whether it is an eligible person, provided that:

The resident is engaged in active business operations in its own Contracting State (other than investment or investment management activities carried out solely for its own benefit, unless conducted by a bank, insurance company, or registered securities dealer carrying out banking, insurance, or securities business);

The income derived from the other Contracting State is related to or arises in connection with such business operations; and

The resident meets all other conditions for entitlement to treaty benefits under this Agreement.

(ii) If the resident of a Contracting State or any of its associated enterprises carries on business and derives income in the other Contracting State, the provisions of sub-paragraph (i) above shall apply to such income only if the business

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3.5. Exchange of Information

Article 27 of the New Agreement introduces a new paragraph 4: "If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes." This explicitly requires the requested party to assist in obtaining the information using administrative means, even if it has no domestic tax-related need for the information. This provision directly aligns with the requirements of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, aiming to combat cross-border tax evasion and avoidance.

A new paragraph 5 is also added to Article 27: "In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person." This requires the Contracting States not to refuse to provide information on the grounds that it involves financial institutions or ownership privacy. This provision is consistent with the Common Reporting Standard (CRS) rules, enhancing transparency of financial account information. By expanding the scope of information exchange and overcoming barriers to accessing financial institution data, tax authorities can more effectively identify cross-border tax avoidance arrangements.

The newly added paragraphs 4 and 5 of Article 27 in the New Agreement significantly strengthen the international cooperation framework for tax information exchange. Despite these progressive additions, the implementation of information exchange under Article 27 is not without challenges. For example, article 27, paragraph 3 of the Agreement allows a Contracting State to refuse to provide information on the grounds that its disclosure would violate "public policy." However, the concept of "public policy" is broad in scope and may include non-economic factors such as national security or social stability. Some countries may interpret it too broadly, thereby weakening the enforceability of the provision. In addition, the Agreement also permits the refusal of information on the ground that it "cannot be obtained through normal administrative channels." Yet, the Agree-

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operations in the first-mentioned Contracting State are substantial in relation to the business operations in the other Contracting State. Whether a business operation is substantial shall be determined based on all facts and circumstances.

(iii) In determining whether a person is engaged in the active business operations referred to in sub-paragraph (i) above, if the business activity is carried out through a partnership of which the person is a partner, then both the business activity of the partnership and any business activity conducted by persons associated with that person shall be deemed to be carried out by that person.

A person shall be considered to be associated with another person if:

The person owns at least 50% of the beneficial interest in the other person (or, in the case of a company, owns at least 50% of the voting power and value of the shares); or

A third person directly or indirectly owns at least 50% of the beneficial interest in both persons (or, in the case of companies, owns at least 50% of the voting power and value of the shares of both companies).

In any case, if all facts and circumstances indicate that one person controls the other, or that both are controlled by the same person or persons, the two persons shall be considered to be associated.

4. Notwithstanding the foregoing provisions of this Article, where a resident company of a Contracting State, or a company controlling such resident company, has issued and sold shares that meet the following conditions:

(i) The shares are subject to conditions or arrangements under which the holder is entitled to a share of the company's income derived from the other Contracting State that is greater than the share the holder would have been entitled to receive in the absence of such conditions or arrangements ("disproportionate share of income"); and

(ii) At least 50% of the voting power and value of the shares is owned by persons who are not eligible persons,

then the benefits of this Agreement shall not apply to the disproportionate share of income.

5. A resident of a Contracting State who is neither an eligible person as defined in paragraph 2 nor entitled to treaty benefits under paragraph 3 or 4 shall nevertheless be granted treaty benefits if the competent authority of the other Contracting State determines that the establishment, acquisition, or maintenance of the person and its business activities were not primarily motivated by obtaining the benefits of this Agreement.

ment does not specify who bears the burden of proof regarding this condition. This ambiguity may lead the requested party to reject information requests based on vague justifications, resulting in a lack of transparency. For example, the requested party may simply assert that the information "cannot be obtained through normal administrative channels" without providing concrete evidence, leaving the requesting party unable to effectively challenge the refusal, ultimately leading to the failure of the information exchange.

To address the above ambiguities in the treaty language, the Agreement could adopt an enumerative definition to limit the scope of "public policy," preventing it from becoming a catch-all justification for refusing tax information exchange. In addition, the allocation of the burden of proof regarding the phrase "cannot be obtained through normal administrative channels" should be clearly specified. The requested party should bear the responsibility of proving that the information indeed cannot be obtained in this manner, and should be required to provide a detailed written explanation when refusing to supply the requested information.

4. Conclusion

The revision of the China-Italy tax treaty represents a significant achievement in bilateral cooperation in international tax governance. From 1986 to 2025, the amendments to the treaty reflect both rapid economic development and major innovations in international tax theory. The revisions aim to fulfill the two fundamental functions of tax treaties: coordinating the distribution of rights and interests between the Contracting States and promoting administrative cooperation in taxation.[37]

In terms of rights and interests allocation, this revision eliminates ambiguities in the old Agreement, clarifies the division of taxing rights, and specifically introduces scenarios where taxing rights are exclusively reserved for the resident State. These changes aim to eliminate double taxation while providing tax benefits. Therefore, the entry into force of the Agreement will eliminate double taxation, provide tax incentives, and facilitate economic, trade, and cultural exchanges between the two countries. Yet, it has drawbacks. The definition of permanent establishment fails to adapt to the digital economy, and there are discrepancies between the definition of associated enterprises in the Agreement and China's domestic law, along with issues in determining treaty benefits.

In terms of administrative cooperation in taxation, the New Agreement incorporates a general provision aimed at preventing tax evasion and avoidance, closes loopholes for tax avoidance in the old Agreement, strengthens information exchange and mutual assistance in tax administration between the Contracting States, and effectively prevents tax evasion and avoidance in cross-border transactions. This protects the tax bases and revenue of both countries. However, the mutual agreement procedure lacks efficiency safeguards, and information exchange exclusionary clauses have ambiguous definitions, weakening cooperation effectiveness.

Despite the Agreement still having room for improvement in addressing the challenges posed by digitalization, as well as in striking a balance between enhancing tax administration efficiency and protecting taxpayers' rights and interests, these issues are sure to be properly resolved through the joint efforts of China and Italy as their tax cooperation continues to deepen. Meanwhile, the tax coordination mechanisms and the foundation of mutual trust established by the Agreement will serve as an important guarantee for the steady development of bilateral economic and trade relations, promoting higher-level taxation cooperation between China and Italy.

37. See Ren Wanli and Xiong Wei, *Adapting China's Tax Treaty Policies in a Globalized Context*, in International Taxation, n. 6. 2017, p. 25.