THE ITALIAN VOLUNTARY DISCLOSURE

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INTRODUCTION

Italy has a long history of tax amnesty programs[1] established under a broad variety of names and rules. Interestingly, every new program has been described as "the last chance" for tax evaders to comply with the Italian tax code. It is no wonder that, as in all prior cases, Italy's most recent voluntary disclosure program (the "V.D.") has been defined as the "last call." Having said that, and sensitive to prior performance, we firmly believe that for a wide range of reasons the V.D. will truly be the last opportunity for Italian citizens and residents to get their tax matters in order.

One indicator is heightened criticism of the typical Italian *de facto* tolerance toward tax evasion, which is now being blamed for the country's ongoing economic crisis. Accordingly, the war against tax havens, as initiated by the U.S. under F.A.T.C.A. and subsequent inter-governmental agreements, has changed the way the whole world approaches such matters. Today, there is a new sensitivity toward tax compliance and no discernable government or media tolerance towards tax avoidance.

In addition, a different approach is now being taken with respect to tax amnesty matters. In the past, there was a sort of "reward" for the penitent evaders. Such individuals were granted the opportunity to regularize their positions by paying a low flat-rate extraordinary tax. The V.D. is different. Under the new provisions of the Law n. 186, dated December 15, 2014, (the "V.D. Act"), a taxpayer who enters the V.D. procedure ("V.D. Applicant") will be required to pay every single euro of unpaid tax; the only benefit lies in the reduction of penalties, which are less than those applicable in an ordinary tax audit procedure.

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Beyond the elimination of rewards, the procedure requires an "all-in" disclosure. This means that (i) it will not be possible to regularize only a portion of foreign assets and/or foreign-source items of income while continuing to hide other assets and/or items of income, and (ii) the V.D. must cover all the taxable years with respect to which the statute of limitations has not expired.

Lastly, it should be noted that the V.D. is not a permanent procedure. In order to participate, the taxpayer must submit a specific request no later than September 30, 2015.

THE ITALIAN TAX SYSTEM: ORDINARY DISCIPLINE

To properly understand the objective scope of the V.D., the following discussion

[1] Between 1991 and 2009, Italy approved four tax amnesty programs.

briefly describes the various tax compliance obligations that may be "cleared" through the disclosure program.

Italian Taxes

The V.D. covers noncompliance for income taxes (and related substitutive taxes), V.A.T., and I.R.A.P.[2] (collectively, the "Relevant Taxes"). Violations related to other taxes (*e.g.*, those regarding inheritance and donation or gift tax) are not covered by the V.D.

Under Italian tax law, the noncompliant tax return (*i.e.*, a tax return that fails to report the entire taxable base of the Relevant Taxes) is ordinarily penalized as follows:

- For Italian-source income, penalties range from 100% to 200% of the unpaid tax, and
- For foreign-source income, penalties range between 133% and 266% of the unpaid tax.

In addition, if assets and related items of income are located in a blacklisted jurisdiction:

- The statute of limitations is doubled from four to eight years[3] for the Relevant Taxes; and
- The penalties related to the unpaid taxes are doubled, ranging from 266% to 532% of the alleged unpaid tax.

"In addition to tax and penalties, Italian-resident individuals or entities other than companies that hold assets abroad must comply with declaratory duties and make certain disclosures to the Italian tax authorities."

R.W. Form

In addition to tax and penalties, Italian-resident individuals or entities other than companies that hold assets abroad must comply with declaratory duties and make certain disclosures to the Italian tax authorities ("I.T.A.") by filing a specific form (the "R.W. Form") as part of the taxpayer's return. This is the functional equivalent of the F.B.A.R. form that has galvanized the attention of U.S. taxpayers with foreign financial accounts, their tax advisers, and banks outside the U.S.

If the taxpayer is not compliant with R.W. Form filing duties, the penalties per year range as follows:

- From 3% to 15% of the value of the assets, if they are located in a whitelisted jurisdiction, and
- From 6% to 30% of the value of the assets, if they are located in a blacklisted jurisdiction.

Also, in the case of assets and related items of income located in a blacklisted jurisdiction:

- The statute of limitations with regard to the R.W. Form is increased from five to ten years, and

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[2] The regional tax on business activities.

[3] The statute of limitations is extended from five to ten years in the case of an omitted tax return.

- The assets are deemed to represent items of income not subject to tax, meaning that additional tax and penalties will be due. This is a rebuttable presumption.

Criminal Tax Penalties

In the event of breaches of Italian tax law, criminal issues also may arise. In particular, a tax return with undeclared income and tax qualifies as a criminal offense if two conditions are met: (i) unpaid taxes amount to €50,000 or more, and (ii) the undeclared tax base exceeds the greater of €2,000,000 or 10% of the declared tax base.

In the case of tax fraud, the criminal liability arises without reference to a specific threshold.

SUBJECTIVE SCOPE

Italian resident individuals or entities other than companies can initiate the V.D. program if the resident did not comply with R.W. Form filing duties in the relevant taxable years.

However, in order to include noncompliant taxpayers that did not hold assets abroad, a domestic V.D. program has also been introduced (the "Domestic V.D."). Often, Italian resident companies have been used by Italian resident individuals to divert untaxed income abroad.[4] In such cases, the V.D. allows the individual to clear the funds directly or indirectly deposited abroad in his or her name, while the Domestic V.D. allows the company to clear its position vis-à-vis the I.T.A.

Neither the V.D. nor the Domestic V.D. may be undertaken by those taxpayers (*i.e.*, individuals and/or companies) that have been officially informed that a tax audit or criminal tax investigation has been initiated against them. Again, this is similar to the program in the U.S., where taxpayers under I.R.S. examination, either directly or through a partnership or L.L.C., are not permitted to participate. The view is that these taxpayers are not acting voluntarily and the government does not benefit from disclosure because the persons are already known.

OBJECTIVE SCOPE

Benefits of Participation

Italian Taxes

There is no beneficial treatment concerning the evaded taxes. All taxes must be paid in full.

The only beneficial treatment concerns penalties, which are reduced. Within the

[4] For example, the tax record of an Italian resident company may reflect goods sold abroad at an amount below the actual price paid by the foreign customer. The difference is then diverted to a tax haven jurisdiction in the name of the Italian resident individual who owns the company. Conversely, the Italian resident company may record a higher price for goods acquired from abroad than the actual price paid to a foreign supplier, with the difference being diverted to a tax haven jurisdiction in the name of the Italian resident individual who owns the company.

applicable range, the lower rate will apply, with an additional 25% deduction. Interest on unpaid tax is due at an annual rate of 3.5%.

In addition, should the I.T.A. serve a notice of assessment on the basis of this disclosure, the taxpayer may achieve a further reduction in penalties. By accepting the notice, the taxpayer will be eligible for a reduced penalty rate of one-sixth of the amount imposed. Accordingly, the ultimate rate for penalties would be as follows:

- 12.5% of the assessed unpaid taxes with regard to domestic-source income, and
- 16.67% of the assessed unpaid taxes with regard to foreign-source income.

R.W. Form

Beneficial treatment for sanctions related to the omitted R.W. Form ("R.W. Sanctions") varies with respect to both the number of relevant taxable years and the rate of the sanctions. The V.D. distinguishes between income generated by (i) assets held in blacklisted jurisdictions and (ii) assets held in whitelisted jurisdictions or in blacklisted jurisdictions that have entered into an exchange of information agreement with Italy ("Quasi-White Jurisdictions").[5]

With respect to assets held in a whitelisted jurisdiction or Quasi-White Jurisdiction:

- Five taxable years are relevant (2009 to 2013), and
- The ultimate amount of the penalty corresponds to 0.5% of the value of the assets held abroad in each of those taxable years.

With respect to assets held in a blacklisted jurisdiction:

- Ten taxable years are relevant (2004 to 2013), and
- The ultimate amount of the penalty corresponds to 1% of the value of the assets held abroad in each of those taxable years.

In order to qualify for favorable treatment concerning the R.W. penalties, one of the following conditions must be fulfilled (the "R.W. Conditions"):

- The assets must be transferred to or held in Italy or in an E.E.A. Member State that allows for adequate exchange of information with Italy (an "Eligible State"), or
- If the assets remain in a jurisdiction other than an Eligible State, the V.D. Applicant must sign an authorization pursuant to which the financial institution where the assets are deposited is authorized to exchange information with the I.T.A. ("Waiver").

Should the R.W. Conditions not be met, the R.W. Sanction rates are increased as follows:

- 0.75% per year for assets held in a whitelisted jurisdiction or Quasi-White Jurisdiction; and

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[5] These include Switzerland, the Principality of Liechtenstein, and the Principality of Monaco.

- 1.5% per year for assets held in a blacklisted jurisdiction.

Criminal Tax Penalties

In the case of a successfully completed V.D., criminal tax offenses are no longer punishable. Therefore, in this respect, the V.D. qualifies as a form of amnesty.

Anti-Money Laundering Provisions

As suggested by G.A.F.I.,[6] voluntary disclosure programs adopted by individual Member States must not affect broader anti-money laundering provisions. Italy has been consistent in its compliance with this recommendation and the anti-money laundering provisions found in Italian domestic law are not violated by the V.D.

Additionally, the V.D. Act provides for a "self-laundering" offense to be inserted in the Italian criminal code. This new offense is not applicable with respect to the disclosures of a V.D. Applicant. Furthermore, the V.D. Applicant will not be prosecuted for criminal offenses related to pre-existing anti-money laundering provisions.

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Related Taxpayers

The V.D. Act requires the V.D. Applicant to report the names of any individual or corporate taxpayers involved in the evasion of tax or in the holding of the foreign assets ("Related Taxpayers"). This includes any Italian resident person that participated in any way in the tax fraud that allowed the V.D. Applicant to hold undeclared assets abroad. Examples are any Italian resident person that either (i) managed the assets by proxy or (ii) was the co-owner of such assets. For example, consider a case where assets have been held abroad in the name of a husband and wife who issued a proxy entitling their son or daughter to manage the assets. Here, all parties should participate as V.D. Applicants, and each must report the names of the others on his or her V.D. application.

The objective of the broad reporting net is to provide the I.T.A. with a full and clear understanding of the roles of all Related Taxpayers, thereby allowing the I.T.A. to verify that the taxpayers autonomously chose to clear their positions through the V.D. procedure.

Interposed Persons

Where it is evident that assets were kept in the name of one party (the "Interposed Person")[7] while the actual rights to disposal and management of those assets belonged to another party, the Interposed Person may be disregarded. Consequently, the other party may consider itself to be the owner of the assets and any related items of income and may initiate the V.D. procedure with respect to the funds.

Procedural Aspects

The V.D. procedure requires the Italian taxpayer to submit an application to the I.T.A. for each of the relevant taxable years. In order to provide a better understanding of the related facts and circumstances, reporting must include the following:

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6 F.A.T.F., October 2012, "Best Practices: Managing the Anti-Money Laundering and Counter-Terrorist Financing Policy Implications of Voluntary Tax Compliance Programmes."

7 *E.g.*, a company, trust, foundation, or insurance company.

- The relevant taxable base and related taxes to be paid,
- Total assets kept abroad and the amount of R.W. Sanctions,
- Detailed information concerning the acquisition and maintenance of the foreign assets, and
- An itemized breakdown of unreported income with relevant supporting documentation.

CONCLUSIONS

In light of the foregoing, it is clear that the V.D. is similar in many aspects to the U.S. O.V.D.P. in its attempt to bring in recalcitrant taxpayers hiding assets abroad and to obtain information on financial and other enablers. It is an expensive procedure for noncompliant Italian taxpayers, especially when compared to previous tax amnesty programs enacted in Italy.

However, given the new global environment with regard to exchanges of information and recent treaty agreements between Italy and the Quasi-White Jurisdictions, the possibility of remaining hidden to the I.T.A. for future taxable years is almost nil. For depositors with Italian indicia who have closed accounts and transferred assets abroad, the I.T.A. may request data from tax authorities in the Quasi-White Jurisdictions, as well as of any jurisdiction that has committed to apply the Common Reporting Standard ("C.R.S.").[8] Undeniably, automatic exchange of information, as provided for by the O.E.C.D. Convention on Mutual Administrative Assistance in Tax Matters (which also imposes application of the C.R.S.), should make it difficult for an Italian resident to continue hiding undeclared foreign assets.

In light of the new criminal offenses enacted by the V.D. Act and the extremely onerous sanctions related to possession of undisclosed assets and income, the financial risk associated with remaining outside of the V.D. seems justified only by a vain and improbable hope that past practice will continue, with tax evaders receiving only a slap on the wrist. Italy has stepped into the global arena formed to stop cross-border tax evasion, and those who look to past practice may do so to their detriment.

[8] *I.e.*, a reporting standard based on the requirements imposed by the F.A.T.C.A. agreements.