CIRCULAR LETTER NO. 17/E CLARIFIES SPECIAL TAX REGIME FOR ITALIAN "NEW RESIDENTS"

Authors
Andrea Tavecchio
Riccardo Barone

Tags
Italy
Non-Domiciled Taxation
Pre-Immigration Planning
Tax Residency

INTRODUCTION

On December 7, 2016, the Italian Parliament approved the 2017 Budget Law, which entered into force on January 1, 2017. Article 1, paragraphs 152 through 159 of the law introduce a new tax regime for individuals who transfer their tax residence to Italy (the "New-Resident Regime"). This regime is meant to make the transfer of tax residence to Italy appealing and, in particular, to attract wealthy individuals and families. The Italian New-Resident Regime offers preferential tax treatment, which consists of a yearly lump-sum payment of €100,000 on any foreign income and gains, and exclusion from inheritance and gift tax on foreign assets, departing from ordinary treatment under Italian tax law.

The Italian tax authority (*Agenzia delle Entrate*) released Protocol No. 47060, the initial implementing rules, on March 8, 2017. Then, on May 23, 2017, it released Circular Letter No. 17/E (the "Circular"), which provides several clarifications and additional guidance for application of the regime.

WHO CAN APPLY?

The New-Resident Regime is reserved for individuals with citizenship abroad or in Italy who meet the following two conditions:

- They transfer tax residence to Italy.
- With regard to Italy, they have had nonresident status for tax purposes for nine out of the ten preceding taxable years.

As general rule, individuals are deemed to be resident in Italy if they meet any of the following conditions on 183 days or more during the tax year (184 or more days in case of leap years):

- The individual is registered in the Civil Registry of the Resident Population.
- The individual is domiciled in Italy pursuant to the Italian Civil Code.
- The individual is resident in Italy pursuant to the Italian Civil Code.

In order to prevent an abusive exercise of the election, the *Agenzia delle Entrate* has published a checklist to identify a series of factual circumstances that may be indicative of tax residence in Italy based on the individual's center of vital interests. Among the factors to be considered are the tax residence of a spouse or children in Italy and the availability of movable and real property assets in Italy. In addition, individuals who have never withdrawn themselves from the Italian Civil Registry of the Resident Population cannot apply for the regime.

Andrea Tavecchio is the founder of Tavecchio Caldara & Associati in Milan, Italy. He is a Chartered Accountant and TEP with experience assisting private clients and families in wealth planning, asset protection, and estate planning. Andrea is member of the Scientific Committee of STEP Italy and has also served on committees on economic and fiscal matters, reporting to the Ministry for Economic Development and the Prime Minister's office.

Riccardo Barone is an associate with Tavecchio Caldara & Associati. He is a Chartered Accountant and holds a Master in Tax Law from the Cattolica University of Milan. Riccardo focuses his practice on international taxation, asset protection, trust and estate planning, and taxation of financial investments.

When the two requirements are met, an individual may apply for the benefits of the New-Resident Regime and take steps to become registered in the Civil Registry of the Resident Population. According to the Circular, enrollment in the Civil Registry of the Resident Population is sufficient to qualify for benefits, although appropriate verification procedures may be carried out to prevent abuse.

Protocol No. 47060 clarifies that the regime is also available from 2017 for those who transferred their tax residence to Italy in 2016, provided that the nine-year residency requirement is met.

THE NEW-RESIDENT REGIME

Beginning with the 2017 fiscal year, the New-Resident Regime provides for lump-sum taxation of €100,000 per year on non-Italian-source income and gains. This payment is in lieu of the tax that would be applied ordinarily. Such income and gains are not subject to any additional income taxation, even if remitted to Italy. However, all Italian-source income and gains remain subject to ordinary tax rules under the Italian personal income tax regime.[1]

The New-Resident Regime can be extended to family members by paying an additional €25,000 per year, per relative. The family members who can benefit from the regime include spouses, sons and daughters (including sons-in-law and daughters-in-law), parents (including parents-in-law), and brothers and sisters. If the new resident does not have any sons or daughters, the direct closest descendants can benefit in their places. The New-Resident Regime may be extended to family members at different points in time. Consequently, each family member can access the regime at a later date if they remain resident abroad after Italian residence is established by the principal applicant.

The taxpayer may elect to apply the New-Resident Regime to income earned in all foreign countries or only selected countries ("cherry picking"). No tax credit is granted for taxes paid in countries for which the new resident has elected to be covered by the €100,000 Italian tax payment.

In general, income is deemed to be foreign sourced and is consequently covered by the lump-sum tax if any of the following conditions is met:

- The income is derived from assets located abroad.
- The income is derived from activities performed abroad.
- The payer is resident abroad.

In accordance with Italian law, certain foreign financial assets produce foreign income, even if they are held with Italian banks. Such foreign income is covered under the lump-sum tax. Consequently, a taxpayer utilizing the New-Resident Regime should advise the Italian bank of the election in order to avoid the application of domestic withholding tax to these financial assets. Where a bank has collected

---

[1] With reference only to Italian-source income and foreign income that is subject to Italian personal income tax ("I.R.P.E.F."), some deductions are granted (*e.g.*, for social security and welfare contributions, health care contributions (up to €3,615.20), and donations to certain qualifying religious organizations and universities).

withholding tax from income produced by these assets notwithstanding the income's foreign character, the withholding tax may be used to offset other Italian taxes pursuant to Article 17 of Legislative Decree no. 241 of 1997 or be recovered by submitting a claim for refund within the terms of Article 38 of D.P.R. n. 602 of 1973.

In some cases, the benefit of the New-Resident Regime is also granted to foreign-source income derived from assets held through a foreign or Italian subsidiary. In this regard, if the entity (*e.g.*, a trust, foundation, or company) is disregarded for Italian tax purposes, foreign income arising from the underlying assets is covered by the lump-sum tax. In comparison, if Italian movable or immovable assets are held through a foreign interposed entity, income arising from those assets is subject to ordinary Italian taxation.

Where an individual benefitting from the New-Resident Regime is a director in a company formed outside of Italy, the Circular clarifies that such entities are not considered to be tax resident in Italy, provided that a majority of the board of directors are not Italian resident individuals who do not benefit from the New-Resident Regime. Moreover, the Italian Controlled Foreign Companies rules do not apply to non-Italian-resident companies held by individuals benefitting from the New-Resident Regime unless the direct shareholder of the nonresident company is itself an Italian company.

In order to prevent abusive situations, the exercise of the election will not prevent the imposition of capital gains tax on foreign substantial participations ("Qualified Participations") generated in the first five years of residence under the New-Resident Regime. During that period, the gains will be subject to ordinary taxation in Italy. Pursuant to Italian law, a shareholding is a Qualified Participation when the shares meet either of the following thresholds:

- The shareholding represents a percentage of voting rights in the company's ordinary shareholders' meeting that exceeds 2% for listed shares or 20% for unlisted shares.
- The shareholding represents a participation in the share capital exceeding 5% for listed shares or 25% for unlisted shares.

Thus, if capital gains are derived on Qualified Participations during the first five years of Italian tax residence under the New-Resident Regime, the ordinary I.R.P.E.F. regime and a tax rate of roughly 25% will be applicable. However, a step up in basis is regularly available for Qualified Participations in unlisted companies provided that a charge is paid based on the fair market value of the company. Through June 30, 2017, the charge was imposed at the rate of 8%.

The five-year period starts from the first tax period of Italian tax residence. As such, if an individual transfers his or her tax residence during the 2017 fiscal year and applies for the New-Resident Regime from 2018, capital gains arising from the disposal of foreign qualified shareholdings will be out of the scope of the substitute tax through the close of the 2021 tax year.

The value of the Qualified Participation must be reported on Form RW of the Italian tax return during the first five years of Italian residence. For disposals within the initial five-year period, capital gain is calculated as follows:

- If, upon a move to Italy, the former country of residence imposed a departure

tax, the value used by that country to compute taxable gain becomes the tax basis for Italian tax purposes. In all events, the basis is capped at the fair market value of such shareholdings, as determined under principles of Italian tax law.

- If, upon a move to Italy, the former country of residence did not impose a departure tax, the tax basis for Italian tax purposes is the original purchase price.

Aside from Qualified Participations, the New-Resident Regime grants exemption from the following aspects of Italian tax law:

- Reporting obligations in relation to foreign assets (Form RW)
- Payment of wealth taxes on real estate properties and financial assets held abroad (respectively, I.V.I.E. and I.V.A.F.E.)
- Inheritance and gift tax on rights and assets held abroad

Italian tax residents are normally liable for gift tax and inheritance tax on transfers of assets by way of gift or at the time of death, whether the asset is located in Italy or abroad. In cases of foreign donors or deceased residents, the foreign assets are out of the scope of Italian gift tax or inheritance tax with regard to assets located abroad. Individuals who elect to be taxed under the New-Resident Regime, and the family members who accompany them in benefitting from the New-Resident Regime, will be exempt from gift tax and inheritance tax on transfers of assets located outside Italy regardless of the residence of the recipient or heirs. No cap is placed on this benefit. In comparison to this favorable treatment, "non-donor" acts (*liberalità indirette*) and deeds establishing restrictions on use (*atti di costituzione di vincoli di destinazione*) of property located in Italy will be subject to gift tax.

As mentioned above, an individual may elect out of the New-Resident Regime on a cherry-picking basis. This may allow the individual to benefit from certain tax treaties that might not otherwise apply to Italian residents benefitting from the New-Resident Regime. Where an individual opts out with regard to a country, Form RW must be filed and wealth taxes (*i.e.*, I.V.I.E. and I.V.A.F.E.) must be paid with respect to assets held in that country.

Individuals benefitting from the New-Resident Regime can add additional "excluded States" each year. However, once a jurisdiction has been excluded, it cannot be covered by the substitute tax in the following tax periods. The Circular also clarifies that where the individual has opted out of the New-Resident Regime with regard to income and gains realized in one or more foreign countries, the election is extended to inheritance and gift tax, also.

PROCEDURE AND TIMEFRAME

The election for the New-Resident Regime must be made on the personal income tax return related to either the tax period in which the individual transferred residence to Italy or the following tax year.

It is possible to obtain prior approval from the *Agenzia delle Entrate* by filing a ruling (a so-called *interpello*), although the request for a ruling is not mandatory. The

ruling can be filed even if the taxpayer has not yet transferred tax residence in Italy. In this case, the taxpayer must also submit a "checklist," which contains several questions related to the personal, social, and economic situation of the taxpayer and the taxpayer's family. The checklist published by the *Agenzia delle Entrate* is intended to identify factual circumstances that may indicate the absence of tax residence in Italy in nine of the ten years preceding the exercise of the election. If the taxpayer decides to exercise the option without filing a ruling request, the information requested in the checklist must be included on the Italian tax return in which the option is exercised.

"The lump-sum tax must be remitted in a single payment, due by June 30, each year and cannot be deducted from other taxes."

A response to a ruling request must be issued within 120 days, which can be extended by an additional 60 days under certain conditions. If the *Agenzia delle Entrate* does not reply within the above deadline, a positive reply is deemed to have been issued.

The taxpayer must indicate in the ruling request, or in the Italian tax return where the option is exercised, the jurisdiction or jurisdictions where residence was maintained prior to acquiring Italian residence. The *Agenzia delle Entrate* will exchange information with the tax authority of each such jurisdiction.

Once the New-Resident Regime is elected, special tax treatment is allowed for up to 15 years. During this period, entitlement to benefits is automatically renewed annually, unless an early withdrawal or reason for loss of entitlement occurs. The New-Resident Regime ceases to apply in the case of omitted or partial payment of the substitute tax or in the case of a transfer of tax residence to another country. In addition, the taxpayer, or accompanying family member, may revoke the election at any time. In any event, if the principal taxpayer withdraws from the New-Resident Regime, withdrawal will apply to the accompanying family. However, a family member to whom the regime has been extended can exercise an option to remain subject to the New-Resident Regime for the remaining tax period. In any event, if the principal taxpayer revokes the election or loses status under the New-Resident Regime, or if a family member opts in and then opts out of continued status under the New-Resident Regime, the loss of status is final and cannot be reversed.

The lump-sum tax must be remitted in a single payment, due by June 30, each year and cannot be deducted from other taxes. The New-Resident Regime cannot be combined with other tax relief related to the transfer of residence to Italy.

TAX TREATY RELIEF

When making an election for coverage by the New-Resident Regime, it is important to gage the effect of the election on treaty benefits with regard to income from sources outside Italy as well as capital, gifts, and inheritances involving property located outside of Italy.

The Circular clarifies that individuals benefitting from the New-Resident Regime are considered as Italian resident for the purposes of the double tax treaties entered into by Italy, since such individuals are taxed in Italy on their worldwide income and foreign income is subject to the lump sum substitute tax. Nonetheless, it is the view of the tax authorities in countries other than Italy that could be problematic. Consequently, entitlement to benefits from double tax treaties should be verified on a case-by-case basis.

In broad terms, the O.E.C.D.'s Model Tax Convention on Income and on Capital (the "Convention") defines the term "resident of a contracting state" as any person who, under the law of that state, is liable to taxation therein by reason of their domicile, residence, place of management, or any other similar criterion. However, some treaties contain a specific "subject to tax" condition that must be met for someone to be considered a resident of a contracting state. For example, the double tax treaty between Switzerland and Italy establishes that an individual will be deemed not to be resident in either country if the individual is not subject to the taxes generally levied on all the income in the state of purported residence.

With respect to inheritance in Italy, double tax treaties exist with the following countries: the U.S., Sweden, Greece, the U.K., Denmark, Israel, and France. Notably, only the treaty stipulated with France concerns both inheritance and gift taxes. Focusing on the double tax treaty between Italy and France, Article 4 states that the term "person domiciled in a contracting state" does not include persons whose inheritance or donation is subject to tax in a state only for the properties which are situated therein. Thus, an individual who elects to apply the New-Resident Regime, generally speaking, is not considered a resident for the purpose of this treaty.

NEW INVESTOR VISA

The new flat-tax regime is accompanied by changes to Italian immigration laws designed to make it possible for individuals who are not nationals of an E.U. Member State to avoid restrictions that usually apply to the acquisition of Italian residence. Article 1, paragraph 148 of the 2017 Budget Law introduced a special two-year "visa for investors" regime, which aims to attract foreign investors and high-net-worth individuals to Italy.

The newly introduced investor visa is for foreign investors who intend to meet one of the following thresholds:

- The individual will invest at least €2 million in bonds issued by the Italian government, and maintain that investment for at least two years.
- The individual will invest at least €1 million in an Italian company, or €500,000 in an "innovative start-up" Italian company, registered with the special section of the Italian Chamber of Commerce, and maintain that investment for at least two years.
- The individual will make a philanthropic donation of at least €1 million in support of an Italian project of public interest in the field of culture, education, immigration, or scientific research.

To request and obtain the investor visa, foreign investors must (i) demonstrate beneficial ownership of the sufficient liquid sums that can be readily transferred to Italy, (ii) submit a written statement committing to make the investment or gift within three months of entering Italy, and (iii) demonstrate expected income of an amount higher than the minimum level for the exemption from healthcare contributions (*i.e.*, €8,500).

The exact application procedure for the investor visa is yet to be determined. The Italian Ministry of Economic Development, Ministry of Internal Affairs, and Ministry of Foreign Affairs and International Cooperation will issue a joint decree setting out the

procedure and appointing the authority responsible for processing the application and issuing the clearance to authorize the consulate to release the visa. It is likely that the individual will be expected to submit the required documentation through a web platform. The Financial Intelligence Unit will be tasked to ascertain the lawful source of an applicant's funds. Finally, an applicant will likely be required to (i) present a copy of a passport or travel document with an expiry date that exceeds the required visa by a minimum of three months, (ii) provide proof of financial resources, (iii) provide self-certification of the legitimacy of the source of funds, and (iv) provide a clear and detailed description of the investment and its intended beneficiary.

If approved, the designated authority will send clearance to the relevant diplomatic or consular representative, who will issue the investor visa. As indicated above, the investor visa will grant the right to a two-year residence permit, which can be extended for an additional three-year period. In any event, the visa is revocable if a donation is not made within three months of the date of entering Italy or if an investment is disposed of before the two-year expiry date of the visa. After legally staying in Italy for five years, a foreign national can apply for permanent residency, provided the eligibility requirements have been met. Family members will also be allowed to join the foreign investor in Italy and receive a stay permit for family reasons.

Finally, it should be noted that specific criminal penalties are to be applied in the case of providing false documents or untrue certification regarding the lawful source of funds.

Disclaimer: *This article has been prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not be relied upon, used, or taken as legal advice. Reading these materials does not create an attorney-client relationship.*