

TAX ISSUES FACED BY FOREIGN PERSONS INVESTING IN ITALIAN COMMERCIAL REAL PROPERTY

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INTRODUCTION

This article examines the case of a foreign investor who directly or indirectly invests in commercial real estate properties located in Italy. Generally, foreign investors invest in the real estate sector indirectly, through Italian real estate companies or through real estate investment funds established in Italy.¹ This structure generally eliminates the risk of having a permanent establishment.

In comparison, the professional conduct of real estate investment activities in Italy by a nonresident investor involving the direct management of local multiple properties could give rise to a permanent establishment for tax purposes. In those facts, the income attributable to that permanent establishment would be taxable in Italy under the rules applicable to business income (“*redditi d’impresa*”).

The analysis in the balance of this article focuses specifically on income derived by a nonresident investor from the ownership, rental, and subsequent transfer of commercial real estate assets located in Italy to an unrelated purchaser. It begins with direct investment in real estate and then addresses indirect investment through Italian entities.

DIRECT CROSS-BORDER REAL ESTATE INVESTMENT

Rental Fees

According to Italian tax law, rental income received by nonresidents qualifies as income from immovable property (“*redditi fondiari*”) and is subject to taxation in Italy. The applicable regime varies, depending on whether the recipient is an individual or a legal entity. In either event, the nonresident investor is required to file a tax return in Italy.

Nonresident individual investors are subject to individual income tax (“*I.R.P.E.F.*”) at progressive rates varying from 23% to 43%, plus local surcharges.² In comparison,

¹ For more detail, see G.A. Giannantonio, G. Paladini, “*Investimento immobiliare e convenzioni internazionali contro le doppie imposizioni: la prospettiva italiana*” *Gli strumenti di investimento nel settore immobiliare italiano – Terza Edizione* (February 2017), page 222.

² Reference is made to Article 23, paragraph 1, lett. a) of Presidential Decree no. 917 of December 22, 1986.

nonresident companies are subject to corporate income tax (“*I.R.E.S.*”) at 24%.³ No regional tax (“*I.R.A.P.*”) applies.

Tax is imposed when income is recognized under the accrual method of accounting. In principle, the amount subject to tax is the higher of the following two amounts:⁴

- The rental fees, subject to a forfait (lump-sum) reduction under the tax regime provided by law⁵
- The *cadastral* (*i.e.*, State) value, recorded in the Land Register, revalued for tax purposes

In practice, the rental fees are higher in most cases.

Because this fact pattern involves the direct ownership of Italian real estate by non-residents, the domestic tax rules generally are not overridden by the real estate provision of income tax treaties entered into by Italy, such as Article 6 (Income from Immovable Property) of the Italy-U.S. Income Tax Treaty. It allocates the right to tax real estate to the State in which the property is situated. Relief from double taxation may be requested in the country of residence of the nonresident investor.

Lease payments on commercial properties located in Italy are subject to (i) V.A.T.,⁶ imposed at a nil rate or at a 22% rate or (ii) registration tax,⁷ generally imposed at a 1% or 2% rate. As an exception, the supply of hotel accommodations generally are subject to V.A.T. at 10%, and a similar rate of V.A.T. is imposed on the rental of housing having similar functions, such as B&B accommodations, tourist apartments and room rentals with services. If the landlord is a nonresident, registration for V.A.T. purposes in Italy generally is required.⁸

Ownership

The ownership of real estate properties in Italy, either as full ownership or under certain other real property rights – including *usufruct*,⁹ use, habitation, *emphyteusis*,¹⁰

³ Reference is made to Article 73, paragraph 1, lett. d) and Article 77 of Presidential Decree no. 917 of December 22, 1986.

⁴ Reference is made to Article 37, paragraph 4-bis of Presidential Decree no. 917 of December 22, 1986.

⁵ Flat reduction currently set at 5%.

⁶ Reference is made to Article 10, paragraph 1, no. 8 of Presidential Decree no. 633 of October 26, 1972.

⁷ Reference is made to Article 40 of Presidential Decree no. 131 of April 26, 1986.

⁸ See Resolutions of the Italian tax authorities no. 117/E/2004, no. 18/E/2021, no. 8/E/2014; Circular Letter no. 12/E/2007.

⁹ According to the Merriam-Webster Dictionary, usufruct is the legal right of using and enjoying the fruits or profits of something belonging to another, who holds bare legal title while the usufruct arrangement is in effect.

¹⁰ According to the Merriam-Webster Dictionary, *emphyteusis* is a Roman and civil law contract by which a grant is made of a right either perpetual or for a long period to the possession and enjoyment of originally agricultural land subject to the keeping of the land in cultivation or from depreciation, the payment of a fixed annual rent, and some other conditions.



or surface rights – gives rise to the application of the unified municipal tax (“I.M.U.”)¹¹ and other minor local charges, such as garbage tax. The standard I.M.U. rate is 0.76%; however, municipalities may, by specific resolution of the municipal council, decrease the rate or increase it up to 1.06%, which is the tax rate in most cases).

An exemption from I.M.U. is provided for inventory properties owned by companies. Examples are buildings constructed and intended for sale by the construction company, as long as they remain designated for that purpose and are not rented out. Filing obligations are mandatory.¹²

Capital Gains

In general, capital gains realized by nonresident individuals are subject to (i) *I.R.P.E.F.*, individual income tax, imposed at progressive rates varying from 23% to 43%, plus (ii) local surcharges.¹³ The filing of a tax return is mandatory. Alternatively, a nonresident individual seller may elect to be subject to a 26% substitute tax, in which case the notary overseeing the transaction becomes responsible for collection and payment of the tax and filing the required tax return.¹⁴

The taxable income (“*redditi diversi*”) will be calculated as the difference between the sale price and the purchase price or the construction, whichever is applicable.¹⁵ Again, *I.R.A.P.*, the regional tax, is not applicable.

Capital gains realized by nonresident companies are subject to *I.R.E.S.*, the corporate income tax, imposed at a 24% rate, and the filing of an Italian corporate income tax is mandatory.¹⁶ As with nonresident individuals, *I.R.A.P.* is not applicable.

The taxation rules change once real estate is held for more than five years from the completion of construction or from the date of purchase by a nonresident individual or a nonresident corporation. At that point, capital gains arising from the sale of the real estate are no longer subject to Italian income tax. Such favorable domestic tax treatment of real estate gains realized by nonresidents is not overridden by contrary terms of a capital gains article of an income tax treaty, such as Paragraph 1 of Article 13 of the Italy-U.S. Income Tax Treaty. Although the provision allocates the right to tax gain from the alienation of immovable property to the Contracting State in which such property is situated, Italy will not impose tax once the five-year threshold is reached.

¹¹ Reference is made to Article 11, paragraphs from 739 to 783 of Law no. 160 of 2019.

¹² Reference is made to Article 1, paragraph 751 of Law no. 160 of December 27, 2019.

¹³ Reference is made to Article 23, paragraph 1, lett. f) and Article 67, paragraph 1, lett. b) of Presidential Decree no. 917 of December 22, 1986.

¹⁴ Reference is made to Article 1, paragraph 496 of Law no. 266 of 2005.

¹⁵ Reference is made to Article 68, paragraph 1 of Presidential Decree no. 917 of December 22, 1986.

¹⁶ Reference is made to Article 73, paragraph 1, lett. d) and Article 77 of Presidential Decree no. 917 of December 22, 1986.

INDIRECT CROSS-BORDER REAL ESTATE INVESTMENT THROUGH ITALIAN COMPANIES

Rental Fees and Ownership

According to Italian tax law, rental income received by Italian tax resident companies qualifies as *redditi d'impresa*, or business income, and is subject to taxation in Italy. Both (i) *I.R.E.S.*, the corporate income tax, imposed at the rate of 24%¹⁷ and (ii) *I.R.A.P.* the regional tax, generally imposed at the rate of 3.9% apply.¹⁸

Income is recognized as it accrues. Taxation applies on the rental fees if the immovable property is recorded as business asset. The tax base is the greater of the following two items: (i) the rental fees charged and (ii) the *cadastral* (i.e., State) value¹⁹ computed for tax purposes as recorded in the Land Register.

The V.A.T., registration tax rules, I.M.U., and related local charges are the same as those discussed above for a nonresident owner

Distribution of Profits to the Nonresident Investor

According to Italian tax law, a 26% withholding tax generally is applied to dividends paid by Italian resident companies to shareholders that are not Italian residents.²⁰

If the recipient can provide documentary evidence issued by the competent tax authorities that it has paid a final tax in its country of residence on the gross amount of the dividends paid, the recipient generally is entitled to a partial refund up to 11/26ths of the withholding tax collected. This equates to a net 15% tax rate.

A different set of withholding taxes is imposed on dividends that are paid to companies and entities resident and liable to tax in (i) E.U. Member States or (ii) E.E.A. States that allow an adequate exchange of information with Italy. For these nonresident shareholders, a reduced 1.20% final withholding tax is levied on dividends.²¹

Under certain conditions, dividends paid to an E.U. resident parent company may be exempt in Italy.²² To obtain the benefit, the parent company must meet the following conditions:

- It must be resident for tax purposes in an E.U. Member State without being considered as resident in a non-E.U. country according to a Double Tax Treaty in force.

¹⁷ Reference is made to Article 73, paragraph 1, lett. a) and Article 77 of Presidential Decree no. 917 of December 22, 1986

¹⁸ Reference is made to Article 2, paragraph 1 and Article 16 of Legislative Decree no. 446 of December 15, 1997.

¹⁹ Reference is made to Article 90, paragraph 1, of Presidential Decree no. 917 of December 22, 1986.

²⁰ Reference is made to Article 27, paragraph 3 of Presidential Decree no. 600 of September 29, 1973.

²¹ Reference is made to Article 27, paragraph 3-ter of Presidential Decree no. 600 of September 29, 1973.

²² Reference is made to Directive no. 2011/96/EU, "*Parent-Subsidiary Directive*" and to Article 27-*bis* of Presidential Decree no. 600 of September 29, 1973.

- It must have one of the legal forms listed in the Annex of the Parent-Subsidiary Directive.
- It must be subject to one of the taxes listed in the Annex of the Parent-Subsidiary Directive, without the possibility of benefiting from an exception or an exemption, unless temporarily or territoriality limited.
- It must directly hold the capital of the subsidiary for a period of at least one uninterrupted year.

The Italian Tax Authorities require specific items of documentation to obtain the benefit of the exemption.²³ The first is a form issued by the tax authorities in the country of residence of the shareholder certifying that the shareholder meets the first two conditions relating to tax residence and legal form. The second is a self-declaration by the shareholder certifying that all conditions are met.

In addition to the requirements of Italian law, anti-abuse provisions of the E.U. Parent-Subsidiary Directive provide that the benefit of the Directive is denied where the structure implemented by the parent corporation and the subsidiary is not genuine and does not reflect economic reality.²⁴

Where the E.U. Parent-Subsidiary Directive is not relevant for one reason or another, a foreign parent corporation may be entitled to the benefits available by income tax treaty, such as those provided in Article 10 (Dividends) of the Italy-U.S. Income tax Treaty. Paragraph 2 of the Article 10 reduces the rate of withholding tax on dividends to 15%, in general, and to 5% where foreign shareholder holds at least 25% of the voting stock of the company paying the dividend for a 12-month period ending on the date the dividend is declared. Note that the recipient of the dividend must meet the anti-treaty shopping provision, if any, of the relevant treaty, which in the case of the of the Italy-U.S. Income tax Treaty appears in Article 2 of the accompanying Protocol.

“The Italian Tax Authorities require specific items of documentation to obtain the benefit of the exemption.”

Capital Gains Taxation

Taxable capital gains realized by Italian companies from the sale of commercial real estate properties qualify as *redditi d'impresa*, business income, and are subject to *I.R.E.S.*, corporate income tax, imposed at a 24% rate.²⁵ Those gains also are subject to *I.R.A.P.*, regional tax, generally imposed at a 3.9% rate.²⁶

In comparison, capital gains realized by nonresident investors from the sale of participations in, or the liquidation of, Italian companies generally are subject to taxation in Italy.²⁷ However, two provisions may reduce or eliminate Italian tax on the gain.

²³ Reference is made to Article 27-*bis*, paragraph 3 of Presidential Decree no. 600 of September 29, 1973.

²⁴ Reference is made to Article 27-*bis*, paragraph 5 of Presidential Decree no. 600 of September 29, 1973, as amended by Article 26, paragraph 2, lett. b) of Law no. 122 of July 7, 2016.

²⁵ Reference is made to Article 86 of Presidential Decree no. 917 of December 22, 1986.

²⁶ Reference is made to Article 5 of Legislative Decree no. 446 of December 15, 1997.

²⁷ Reference is made to Article 23, paragraph 1, letters b) and f), of Presidential Decree no. 917 of December 22, 1986.

- **Minority holdings.** The first provision applies to nonresident investors that hold minority interests in Italian companies. For this purpose, a minority interest is defined to mean less than 2% of a listed company and less than 20% for an unlisted company.

In either circumstance, a nonresident investor may benefit from a domestic exemption with regard to the capital gain, provided the investor is tax resident in a white-listed jurisdiction that has in effect an adequate exchange of information agreement with Italy.²⁸

- **Tax Treaty Exemption.** The second provision applies to nonresident investors that benefit from an income tax treaty with a favorable capital gains provision. Article 13 in Italy's income tax treaties generally allocates the right to tax gains to the country of residence of the taxpayer, subject to taxation in the country of situs where gains relate to immovable property and permanent establishment property.

Paragraph 12(b)(ii) of Article 1 of the Protocol to the Italy-U.S. Income Tax Treaty provides that the term (immovable property) in the case of Italy includes "shares or comparable interests in a company or other body of persons, the assets of which consist wholly or principally of real property situated in Italy * * * ."

Nonetheless, Paragraph 1(a) of Article 3 of the Protocol provides that favorable treatment under Italian domestic law cannot be overridden by the Treaty. It provides as follows:

1. The Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded: (a) by the laws of either Contracting State * * * .

Foreign Tax Credit

The Italian tax law²⁹ and Article 23 of the Double Tax Treaties signed by Italy provide for resident taxpayers (including Italian companies) a credit for income taxes paid abroad to avoid double taxation.

CONCLUSION

For nonresident investors, Italy contains many little known provisions to reduce or eliminate tax on income and gains arising from real property. A careful reading of domestic tax laws, combined with the proper application of bilateral income tax treaties, reveals numerous planning opportunities that can significantly enhance the efficiency of cross-border real estate investment, be it direct or indirect.

²⁸ Reference is made to Article 5, paragraph 5 of Presidential Decree no. 461 of November 21, 1997.

²⁹ Reference is made to Article 165 of Presidential Decree no. 917 of December 22, 1986.

While the *Dolce Vita* is still available, numerous regulatory pitfalls must be managed, including requirements, conditions, and holding period. This article should assist foreign investors and their legal and tax advisors in navigating the complex regulatory framework governing the Italian real estate sector.

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