CHIOMENTI

Newsletter

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The new Italian resident regime

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Introduction

Article 1(152) through (159) of the 2017 Budget Law introduced a favourable and optional regime (hereinafter, the "**Regime**") for individuals wishing to move their tax residence to Italy. The 2017 Budget Law entered into force on 1st January 2017. The new tax Regime represents a more convenient regime than the ordinary one applicable to Italian resident high net-worth individuals. In particular, the Regime provides for a privileged taxation, derogating to the ordinary Italian personal income tax regime ("**IRPEF**") related to the determination of Italian resident individuals' worldwide income.

Upon option, the Regime provides for a yearly Euro 100,000 substitute tax (hereinafter, the "**Substitute Tax**") on any foreign source income received by new Italian residents. An additional yearly Euro 25,000 Substitute Tax is due for each family member benefitting from the Regime. On the other hand, Italian source income is ordinarily subject to IRPEF at progressive rates up to a maximum 43%. New residents may choose to exclude one or more foreign States from the scope of application of the Regime (s.c., "cherry picking"). In such a case, any income arising from an excluded State will be taxed pursuant to the ordinary IRPEF regime. The Regime is granted for a maximum of fifteen tax periods.

On 8th March 2017, the Italian tax authority released the implementing rules No. 47060 (hereinafter, the "**Implementing Rules**") aiming at providing the guidance to apply for the Regime. In particular, the Implementing Rules clarified that individuals can apply for the Regime upon (i) submission of the income tax return related to the tax period of the transfer of tax residence to Italy (*i.e.*, the first tax period of eligibility), or (ii) submission of the income tax return related to the tax period following the one in which the tax residence has been moved to Italy (*i.e.*, the second tax period of eligibility). Applicants may also file an advance ruling request to the Italian tax authority, albeit not mandatory.

On 23rd May 2017, the Italian tax authority released the Circular Letter No. 17/E (hereinafter, the "**Circular Letter**") on several interpretive issues concerning the Regime. Please find below a brief summary of the main issues addressed and clarified by the Circular Letter.

I Requirements

The Regime applies to non-resident individuals, who move their tax residence to Italy, regardless of their nationality and their State(s) of last tax residency. In order to be eligible for the Regime, individuals must have been considered non-residents for at least nine out of the ten tax periods preceding the one of Regime's validity. The Circular letter clarified that who moved his tax residence to Italy during the 2016 tax period may opt for the Regime starting from 2017 tax period, provided that the requirement of the absence of residence is met.

II Foreign source income covered by the Substitute Tax

Income is deemed to be foreign-sourced and is consequently covered by the Substitute Tax when (i) the asset from which the income is derived is located abroad, or (ii) the activity through which the income is produced is performed abroad, or (iii) the payer is resident abroad.

Specific rules apply to certain types of income (in particular, to investment income and trading income). The Italian tax authority clarified that certain types of investment income and trading income arising from foreign financial assets, although held with Italian banks, are considered covered by the Substitute Tax; as a consequence, the new resident may inform the Italian bank about the option for the Regime in order to avoid the application of the domestic withholding taxes. Special refund procedures are also contemplated.

II.I Employment income

The employment income qualifies as foreign income when the duties are performed abroad. In case of duties performed both inside and outside Italy, an apportionment between the working days spent in Italy and those spent abroad has to be made in order to calculate the earnings covered by the Substitute Tax.

II.II Income received through interposed entity

On the one hand, if non-Italian resident companies held by the new Italian residents are considered as interposed and then disregarded for Italian tax purpose, the Italian source income arising from the underlying assets of the company would not be covered by the Substitute Tax. On the other hand, if the non-Italian resident disregarded foreign companies receive foreign source income, this would un any case be covered by the Substitute Tax. The same rules would apply to foreign trusts that are deemed to be interposed pursuant to the guidance set forth by the Italian tax authority.

In addition, pursuant to the Italian tax law, a foreign company is deemed to be Italian resident if its central management and control is carried out in Italy for the majority of the tax period. The Circular Letter clarified that such rule does not apply with respect to foreign companies managed by new resident individuals benefitting from the Regime, provided that the majority of the board of directors is not composed by Italian resident individuals not benefitting from the Regime.

II.III Applicability of the Italian CFC rules

The Italian tax authority stated that the Italian Controlled Foreign Companies rules do not apply to shareholdings in non-Italian resident companies held by the new Italian resident individuals, provided that the foreign company is resident for tax purpose in a State covered by the Substitute Tax (*i.e.*, cherry picking option has not been exercised with respect to such State). Italian CFC rules shall continue to apply to cases where the foreign entity is held through an Italian company; in such latter case the Italian CFC rules apply at the level of the Italian entity.

II.IV Capital gains upon disposal of qualifying shareholdings and tax cost of foreign shareholdings

Capital gains arising from the disposal of foreign qualified shareholdings are out of the scope of the Substitute Tax, if occurred during the first five tax periods.

For Italian income tax purposes, a shareholding is considered as "qualified" when the shares represent, in total (i) a percentage of voting rights in the company's ordinary shareholders' meeting higher than 2% for listed shares or 20% for unlisted shares, or (ii) a participation in the share capital higher than 5% for listed shares or 25% for unlisted shares. During the first five years of validity, the ordinary IRPEF regime is applicable (the applicable tax rate is roughly 21.38%).

The Circular Letter stated that the five-year period starts from the first tax period of Italian tax residency, even if the taxpayer applies for the Regime upon submission of the income tax return related to the tax period following the one in which the tax residence has been moved to Italy (*i.e.*, the second tax period of eligibility).

As regards the calculation of the capital gains upon disposal of shareholdings, the Italian tax authority specified that, in absence of an exit tax applied in the State of last residence, the tax value of the shareholdings is represented by the their purchase price. On the contrary, when the foreign State of last residence applies an exit tax, the tax value of the shareholdings is represented by the taxable basis of the foreign exit tax, provided that such value is not higher than the fair market value of such shareholding pursuant to the Italian provisions. In such a case, the tax value is equal to the fair market value as determined by the Italian ordinary rules.

III Ruling request

Taxpayers can apply for the new tax regime filing an advance ruling to the Italian tax authority within the deadline for submission of the tax return related to the tax period during which the tax residence is moved to Italy. Please note that the ruling is optional and not mandatory but it could be helpful in order to receive confirmation by the Italian tax authority about the eligibility to the regime.

In order to receive an answer to the ruling request before the expiration of the deadline for the submission of the yearly tax return (*i.e.*, each 30th September following a given tax period), it is advisable to file the ruling several months before the said deadline, also in light of the 120-day term for the Italian tax authority to reply to the ruling.

Such deadline can be postponed by 60 days, if the Italian tax authority asks to the taxpayer additional information and/or documentation. In the absence of a reply by the Italian tax authority within the said deadline, a positive reply is deemed to be issued.
It is noteworthy that the ruling request can be submitted even before the taxpayer has acquired the Italian residence.

Please finally note that the submission of the ruling request is not valid if taxpayer has already opted for the Regime in tax return.

Early action is therefore recommended.

IV Application for the Regime

As mentioned above, submitting the ruling request is not mandatory.

In particular, the Italian tax authority stated that individuals can apply for the Regime upon (i) submission of the income tax return related to the tax period of the transfer of tax residence to Italy, or (ii) submission of the income tax return related to the tax period following the one in which the tax residence has been moved to Italy.

Please note that the option provided in a tax return submitted within 90 days after the deadline (*i.e.*, 30th September following a given tax period) is not valid.

IV.I Cherry picking

The Circular letter clarified that taxpayers can add further "excluded States" in each yearly tax return. Such exclusion cannot be modified by the taxpayer in the following tax period (*i.e.*, once a State has been excluded, it cannot be covered by the Substitute Tax in the following tax periods).

V The Substitute Tax

The Regime provides for an exemption to the worldwide taxation principle that applies to Italian residents.

Under the Regime, all foreign source income received by new Italian resident individuals are subject to the flat Euro 100,000 yearly Substitute Tax, irrespective of their actual amount and taxation in the source State. Neither the former residence State of the new Italian resident, nor the foreign source State of income are relevant for the applicability of the Regime.

The remittance to Italy of the foreign-source income covered by the Substitute Tax does not trigger any further taxation in Italy. The Substitute Tax must be paid in a lump sum, for each tax period of validity of the Regime, within the deadline for paying the balance of IRPEF, which is currently 30th June following a given tax period. Please also note that the Circular letter clarified that taxpayers cannot regularize the omitted payment of the Substitute Tax.

In case of option for the Regime, the domestic tax credit for taxes paid abroad does not apply (except for "excluded States" deriving from the cherry picking option).

In case of extension of the Regime, the amount of the Substitute Tax is increased by Euro 25,000 per year for each additional family member included in the Regime.

VI Exemption from wealth taxes and tax monitoring fulfilment

Under the Regime, taxpayers are exempt from wealth taxes (*i.e.*, tax on financial assets held abroad, "IVAFE" and tax on foreign immovable properties, "IVIE") and they are not subject to tax monitoring rules concerning assets held abroad.

The Circular letter also clarified that qualified shareholdings are subject to IVAFE and to reporting obligation in the Italian tax return only during the first five tax periods of validity of the Regime.

As regards cherry picking, in case of exclusion of one or more foreign States from the territorial scope of application of the Regime, assets held in those Countries are subject to IVIE and IVAFE as well. These assets have also to be reported in the Italian tax return in order to fulfil the tax monitoring provisions.

VII Exemption from inheritance and gift taxes

Under the Regime, transfers upon death and gifts of assets located abroad are not subject to Italian inheritance and gift taxes. Such exemption applies regardless of the residence of the heir(s)/donee(s) and of the value of the asset/right transferred.

The Circular letter clarified that transfer of assets to trusts can also benefit from the exemption at stake.

Inheritance and gift taxes are due only in case of transfer of assets within the Italian territory. In case of extension of Regime to family members, exemption applies also to transfers made by those.

VIII Application of the DTTs

The Circular letter clarified that individuals benefitting from the Regime are considered as resident for the purposes of the DDTs entered into by Italy since they are taxed in Italy on their worldwide income, although the foreign income received is subject to the flat Substitute Tax (unless the specific DTT provides otherwise).

For any further queries please feel free to call or email your contact at Chiomenti or the tax team at tax@chiomenti.net