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Tax Key News - Real Estate

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Focus on 2023 Budget Law

Summary: 1. Legislation – 2. Case-law – 3. Italian Tax Authority's Rulings

Highlights

- *2023 Budget Law:*
  - *New provisions on real estate capital gains realised by non-resident investors*
  - *Permanent establishment: introduction of the Investment Management Exemption*
  - *Tax incentives for assignment of assets to shareholders and transformation into a non-commercial partnership*
  - *Step-up of tax value of land and participations*
  - *Investment funds: 8% substitutive tax on income related to Collective Investment Undertakings' (UCIs) units or shares*

- *22% VAT for the sale of property to be demolished classified in the cadastral category "F/2" (Ruling No. 554 of 7 November 2022)*

I Legislation

2023 Budget Law

New provisions on real estate capital gains realised by non-resident investors

(Article 1 paragraph 96 to 99)

Pursuant to the new paragraph (1-*bis*) of Article 23 of the Italian Income Tax Code (hereinafter, the "**ITCA**") introduced by the Law No. 197 of 29 December 2022 ("**2023 Budget Law**"), gains realised by non-resident investors on the alienation of participations in non-resident companies or entities whose value derives, more than 50%, at any time during the 365 days before the transfer, from the direct or indirect investment in Italian real estate assets, are subject to tax in Italy.

In such case, the tax rate would be 26% (pursuant to Article 5, paragraph 2 of Legislative Decree No. 461/1997).

The new provision aligns the Italian tax system with Article 13, paragraph 4 of the OECD Model Tax Convention and Article 9, paragraph 4 of the BEPS MLI[1].

In order to trigger the taxation in Italy, the value of the participation in the non-resident vehicle shall derive, more than 50%, from the value of real estate assets located in Italy owned:

a. directly by the non-resident real estate vehicle, or
b. indirectly by the non-resident vehicle through intermediate entities.

Such rule would apply to non-resident persons irrespective of the Country of residence for tax purposes and irrespective of the level of participation in the non-resident vehicle.

The following real estate assets are not included in the "50% asset test":

- immovable properties in which a business is carried on directly by the owner (so-called *immobili strumentali*);
- immovable properties to whose construction or sale is aimed the business of the owner (so-called *beni merce*).

Such regime shall not apply with respect to:

- the transfer of shares listed in regulated markets (Article 23, paragraph 1-*bis* ITCA);
- gains realized by an undertaking for collective investment established in a EU Member State or an EEA Country which allows an adequate exchange of information with Italy, that either complies with the UCITS Directive (2009/65/EC) or is managed by a manager subject to regulatory supervision under the AIFMD (2011/61/EU) in the State of establishment.

[1] OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

Paragraph 97 of Article 1 of the 2023 Budget Law, with respect to gains at issue, has repealed the domestic tax exemption set out by Article 5, paragraph 5 of Legislative Decree No. 461/1997 for certain foreign investors with respect to gains from the alienation of participations in companies or entities resident in Italy.

The domestic exemption was applicable, for example, to *(i)* persons resident for tax purposes in a Country which allows an adequate exchange of information with Italy or *(ii)* institutional investors established in that Country.

Clarifications on the new provision will be needed; for example, to clarify whether the domestic tax exemption has been repealed also with respect to gains from the sale of participations in Italian real estate funds or SICAFs.

The actual taxation of such gains should be analysed in light of the Double Tax Treaty with Italy applicable in the specific case, to verify if the applicable Treaty prevents or not Italy from taxing such gain under the Treaty rules[2].

Permanent establishment: introduction of the *Investment Management Exemption*

(Article 1 paragraph 255)

The 2023 Budget Law amends the permanent establishment provision set out by Article 162 of the ITCA with reference to asset managers of foreign investment vehicles.

Under the new provision, the activities carried out in Italy be the asset managers do not give rise to a permanent establishment if certain conditions are met.

For foreign investment structures, the existence of a permanent establishment in Italy for tax purposes could have deterrent effects with respect to the decision to locate asset managers in Italy (as noted by Explanatory Report on the Budget Law).

The requirements at issue may be summarised as follows:

- the non-resident investment vehicle and its subsidiaries are located in one of the States allowing an adequate exchange of information for tax purposes;
- the investment vehicle complies with certain independence requirements that will be set out by a specific Decree of the Minister of Economy and Finance;
- the asset manager that perform its activity in Italy on behalf of the foreign investment vehicle does not hold any directorship or managing office in the corporate bodies of the foreign investment vehicle and its subsidiaries;
- the asset manager must not be entitled to more than 25% of the profits of the foreign investment vehicle;
- the remuneration paid to the asset manager is supported by adequate transfer pricing documentation.

Tax incentives for assignment of assets to shareholders and transformation into a non-commercial partnership

[2] See the Tax Alert for insights: "Capital gains from the sale by non-resident investors of "real estate vehicles": Italy's taxing power broadened" available at the following link: https://www.chiomenti.net/public/files/0/1101-News-Alert-Tax-ENG---RE-gains.pdf

(Article 1 paragraph 100 to 105)

The 2023 Budget Law introduces tax incentives for:

- the assignment or sale to shareholders of (i) real estate assets other than those used for business purposes and (ii) movable properties enrolled in public registers that are not used in the business activity; and
- the transformation of a corporation into a non-commercial partnership.

The tax regime provides for a 8% substitute tax on the capital gains arising from the above transactions, in lieu of corporate income tax (24%) and regional income tax (the rate of the substitute tax is increased to 10.5% in the case the transferor is a non-operating company).

The substitute tax is applied on the difference between the fair market value and the tax value of the assets. Alternatively, in the case of real estate assets, the gains may be determined using the cadastral value rather than the fair market value (the cadastral value is determined on the basis of the value indicated in the Public Real Estate Registry).

In addition, the write-off of any tax-deferred reserve as a result of the above transactions is subject to a 13% substitute tax rather than to ordinary income taxes.

As regards transfer taxes, the registration tax is reduced by half and mortgage and cadastral taxes are Euro 200 each. VAT is applicable under the ordinary rules.

Step-up of tax value of land and participations

(Article 1 paragraphs 107 to 109)

The new provision allows the step-up of the tax value of shares, including those listed on regulated markets, owned as of 1 January 2023, through the payment of a 16% substitute tax.

The revaluation increases the tax value of the assets and, thus, reduces the taxable capital gain in the event of subsequent disposal of such assets (since the capital gain is calculated as the difference between the sale price and the tax value, *i.e.* the value recognised for tax purposes).

The substitute tax is applied on the entire value resulting from an appraisal to be prepared by 15 November 2023; for listed assets, the tax is due on the fair market value determined according to the average of the prices of December 2022.

The substitute tax shall be paid by 15 November 2023 (full amount or first instalment; the subsequent instalments – up to 2 – shall be increased of interest at the rate of 3%).

Substitutive tax on income related to participations in Collective Investment Undertakings' (UCIs)

(Article 1 paragraph 112 and 113)

The provision introduces a favourable tax regime for the income related to participations in UCIs (fund or SICAF) pursuant to which such income may be subject, by option, to 14% tax rather than 26% tax (ordinary tax for financial income).

The substitute tax is applied on the difference between (a) the value of the participation as of 31 December 2022 and (b) the purchase price or subscription cost.

In case of option, income deriving from the subsequent sale (or redemption) of the participation will be subject to 26% tax but will be determined taking into account that a portion of such income has been already subject to tax (*i.e.* the 14% tax).

The provision does not specify the criteria to determine the value as of 31 December 2022. It is reasonable that this value should be determined on the basis of the fund's annual report. Clarification from the Italian Tax Authority would be advisable on this point.

The option must be exercised by 30 June 2023 by means of a communication to the financial intermediary who has a custody, administration, or portfolio management relationship with the taxpayer. The option cannot be exercised with respect to assets held under the so-called "*risparmio gestito*" tax regime pursuant to Article 7 of Legislative Decree No. 461/1997. In the absence of the above mentioned intermediary, the tax regime is applied directly by the taxpayer.

Property tax (IMU) exemption for occupied properties

(Article 1, paragraph 81)

Article 1, paragraph 81, of the 2023 Budget Law introduced the exemption from the property tax ("**IMU**") for properties that are illegally occupied (Article 1, paragraph 759 of Law No. 160/2019 letter *g-bis*).

For the purpose of the exemption, the owner of the property shall file a criminal complaint or commence a criminal proceeding relating the specific crimes set out by the provision at issue.

Case-law

Procedures to notify the "adjusted" cadastral income relevant for tax purposes

(Supreme Court, Decision No. 31900 of 28 October 2022)

The case regards a tax assessment on the IMU. The competent Municipality requested higher property tax on the basis of an adjustment of the cadastral income (which is relevant for the taxable base of the property tax) that was not notified to the taxpayer. The court of appeal accepted the arguments of the Municipality, stating that the Municipality had effectively communicated the adjustment of the cadastral income even if indirectly, through the notification of the IMU assessment notice.

The taxpayer challenged such decision in light of Article 74, paragraph 1 of Law No. 342/2000, which provides that "*deeds of any kind adjusting or modifying cadastral income for land and buildings are effective only as from their notification*" to the taxpayer.

The Supreme Court upheld the appeal of the taxpayer. In particular, the Supreme Court stated that the adjustment of the cadastral income must be notified the taxpayer with a specific notice while it cannot be simply communicated in the context of a tax assessment which is based on such adjustment.

II Italian Tax Authority's Rulings

22% VAT for the sale of crumbling buildings to be demolished classified in the cadastral category "F/2"

(Ruling No. 554 of 7 November 2022)

The Ruling analyses the VAT regime applicable to the disposal of crumbling buildings to be demolished classified in the cadastral category "F/2" (so-called *unità collabenti*).

The Tax Authority reiterates that the cadastral classification of the properties at the moment of the sale is relevant for the application of the VAT regime provided for the disposal of buildings under Article 10, paragraphs 8-*bis* and 8-*ter*, of Presidential Decree No. 633/1972.

Furthermore, the Authority states that the destination that the properties will have after the sale as a result of the renovation works is not relevant for the purposes of the VAT regime applicable to the disposal (in the case at issue: residential properties).

According to the Italian Tax Authority, for the identification of the applicable VAT regime, is relevant that the property "*is classified in the cadastral category F/2"* at the time of sale "*on the basis of elements certifying that status, such as photographic documentation as well as technical appraisals – if possible sworn – that provide a faithful representation of it*".

The Italian Tax Authority states that the sale of crumbling properties to be demolished and classified in the category "F/2" will be subject to the ordinary VAT regime at a rate of 22%, as sale of goods, and not to the special regime provided for the sale of completed buildings by Article 10 of Presidential Decree No. 633/1972. Moreover, on such basis, registration, mortgage and cadastral taxes shall be applied at a fixed amount of Euro 200 each (pursuant to Article 40, paragraph 1, of Presidential Decree No. 131/1986, Article 1 of the Annex of Legislative Decree No. 347/1990 and Article 10, paragraph 2, of the Legislative Decree No. 347/1990).

The Ruling makes reference to the following decisions of the European Union Court of Justice:

- Judgment of 12 July 2012, Case C-326/11: the ongoing demolition and the impossibility of using the building as such excludes the VAT exemption provided for the sale of residential properties);
- Judgment of 19 November 2009, Case C-461/08: the sale of a land together with a building to be demolished, when the demolition is ongoing, constitutes a single transaction for VAT purposes different from the sale of completed building (in the process of demolition) (see).

Pension Funds: VAT treatment of outsourced functions

(Ruling No. 583 of 7 December 2022)

The Italian Tax Authority provided clarifications on the VAT regime applicable to certain services outsourced by Italian pension funds to a service provider, including the internal audit function, the risk management function and advisory on financial management control.

The matter under analysis was the applicability of the VAT exemption provided in Article 10, paragraph 1, number 1 of Presidential Decree No 633/1972 for the "*management [...] of pension funds pursuant to Legislative Decree No 124 of 21 April 1993*".

The Italian Tax Authority confirmed that the fundamental functions of internal audit and risk management of a pension fund (under Articles 5-*ter* and 5-*quater* of Legislative Decree No. 252 of 2005) are "*essential and specific to the management of the fund*", as well as "*fundamental for the production process linked to the management of the mutual fund, even if supplied by a third party*". Therefore, the supply of such services shall be exempt from VAT pursuant to Article 10, paragraph 1, number 1 of Presidential Decree No. 633/1972.

In relation to the services provided by the service provider to the pension fund for the advisory on financial management control, the Italian Tax Authority noted that it is necessary to assess the responsibility of the service provider since the VAT exemption applies to "*consulting services that the company provides in outsourcing with direct assumption of responsibility if provided for the management of funds*" (as clarified by the previous Rulings No. 363 and 364 of 2022). Conversely, advisory services for which the provider's liability is limited to technical aspects – and are not extended to the specific and essential elements of fund management – shall be qualified as taxable for VAT purposes.

Contact

Giuseppe Andrea Giannantonio
Partners – Chiomenti
giuseppeandrea.giannantonio@chiomenti.net

Gabriele Paladini
Counsel – Chiomenti
gabriele.paladini@chiomenti.net

Giulia Bighignoli
Senior Associate – Chiomenti
giulia.bighignoli@chiomenti.net