Tax Alert | Budget Law 2023

Tax – Real Estate

Capital gains from the sale by non-resident investors of "real estate vehicles": Italy's taxing power broadened

Introduction

On 29 December 2022, the Italian Parliament adopted the 2023 Budget Law (Law No. 197 of 29 December 2022 - "**2023 Budget Law**") that provides, *inter alia*, a new territoriality rule on the taxation of capital gains realized by non-resident persons on the disposal of participations in non-resident "real estate vehicles", *i.e.* companies or entities, whose value derives more than 50% from Italian real estate assets (directly or indirectly)[1].

This new rule has been introduced in paragraph (1-*bis*) of Article 23 of the Italian Tax Consolidated Act ("**ITCA**") by Article 1 (96-99) of the 2023 Budget Law.

Accordingly, from 1st January 2023, such gains are now taxable in Italy under the new domestic rule. Further, the new source taxation rule should allow for foreign tax credit on equivalent gains in cross-border situations. The new rule aligns Italian domestic law with Article 13(4) of the OECD Model Tax Convention and Article 9(4) of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**")[2].

[1] We have also analysed the draft of the 2023 Budget Law in the Tax Alert available at this link: https://www.chiomenti.net/en/publications/tax-alert-2023-budget-law-4-4-

[2] Italy has not yet ratified the MLI and only some Treaties with Italy contain a provision based on Art. 13(4) of the OECD Model Tax Convention, i.e.: Armenia, Azerbaijan, Barbados, Canada, Chile, China, Colombia, Estonia, Finland, France, Hong Kong, India, Israel, Jamaica, Kenya, Mexico, New Zealand, Pakistan, Panama, Philippines, Romania, Saudi Arabia, Sweden, Ukraine, Uruguay and the United States of America.

I Overview of the new provision

Under the new paragraph (1-*bis*) of Article 23 ITCA, gains realized by foreign investors from the disposal of a participation 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 (at the rate of 26% under Article 5(2) of Legislative Decree no. 461/1997).

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"[3]:

- 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(1-*bis*) ITCA);
- gains realized by undertakings for collective investment established in a EU Member State or an EEA Country which allows an adequate exchange of information with Italy, that either comply with the requirements set out by the UCITS Directive (2009/65/EC) or are managed by a manager subject to regulatory supervision under the AIFMD (2011/61/EU) in the State of establishment.

Article 1 (97) of 2023 Budget Law, with respect to gains at issue, repealed the tax exemption set out for certain non-resident investors by Article 5(5) of Legislative Decree no. 461/1997.

The domestic exemption relates to gains from the disposal of non-qualified participations[4] in Italian resident companies or entities or participations in Italian funds.

In particular, such domestic exemption was applicable 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.

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[3] Article 1(98) of the 2023 Budget Law.
[4] Participation not exceeding 20% of the voting rights or 25% of the capital.

II Preliminary analysis

The new provision on gains taxation will affect cross-border investment structures for the investment in real estate assets located in Italy.

In 2003, the OECD Model Tax Convention has been amended by introducing a new paragraph 4 in Article 13 on capital gains: under such rule, capital gains derived by a resident of a Contracting State from the alienation of a participation whose value derives more than 50%, directly or indirectly, from real estate assets located in the other Contracting State (*e.g.*, Italy) may be taxed in that other State (*i.e.*, Italy). Such rule is aimed at preventing a non-resident investor from avoiding the taxation of gains from the disposal of the real estate assets through the sale of the – direct or indirect – participation in the company owning the real estate assets. Further, it is worth noting that in the context of BEPS the wording of Article 13(4) has been amended in order to cover not only gains from shares, but also gains from the alienation of interests in other entities (such as partnerships or trusts) and to set a 365-day observation period to verify the weight of real estate assets over the total value of the assets.

Under the Italian territoriality rule on taxation of gains set out by Article 23 ITCA before the amendments introduced by the 2023 Budget Law, under certain circumstances, the above rule set out by Article 13(4) of the OECD Model Tax Convention was applicable if the real estate assets were located in Italy and the participation was held directly in a real estate vehicle resident in Italy.

The new territoriality rule entails the taxation in Italy also of the gains related to immovable properties located in Italy in the following cases:

a) indirect participation in a real estate vehicle resident in Italy through a non-resident investment vehicle (or more non-resident investment vehicles);

b) direct or indirect participation in a non-resident real estate vehicle owning directly real estate assets located in Italy.

The taxation at issue will be allowed in case of application of a Treaty that includes a rule based on Article 13(4) of the OECD Model Tax Convention or in the absence of a Treaty.

Therefore, the actual taxation of such gain 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.

In particular, it should be verified if the applicable Treaty includes or not a rule based on Article 13(4) of the OECD Model Tax Convention. Only some Treaties with Italy already include such rule – that allows the taxation of the gains under analysis – while other Treaties could be amended to add such rule by opting for the MLI (in particular, Article 9 on the taxation of gains from the disposal of participation in "real estate vehicles"), that Italy has not yet ratified[5].

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[5] See footnote no. 2 for the list of Treaties that include a rule based on Article 13(4) of the OECD Model. Further Treaties could include such rule once MLI will be ratified by Italy.

However, the new rule will not apply if the gain is realized by a EU investment fund (UCITS or AIFMD).

The wording of the tax provision refers to "*gains realized by*", therefore such exemption will apply if the gain is realized directly by the EU investment fund. It should be further analysed the consequences of such exemption in case of gains realized by an investment vehicle wholly owned by the EU fund if not covered by the Treaty exemption.

As regards the "50% asset test" it will be necessary a case-by-case analysis to assess which immovable properties are or not included in the "50% asset test".

Finally, with respect to the repeal of the tax exemption on gains set out by Article 5(5) of Legislative Decree no. 461/1997, the wording of the tax provision refers to the "*sale of participations in companies and entities"*. It should be clarified that gains from the disposal of participations in Italian real estate investment funds are not affected by the new rule.

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For any further clarification please do not hesitate to contact Chiomenti's Tax Department at tax@chiomenti.net

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