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Italy: A Country for Tax-Savvy Old Men?

Giorgio Beretta (Editor) (Amsterdam Centre for Tax Law (ACTL) of the University of Amsterdam; Lund University) · Friday, January 11th, 2019

The *Italian Stability Law for 2019* finally approved on 30 December 2018 has introduced a *new art. 24-ter* in the *Income Tax Act* (ITA). It includes a *substitute tax of 7%*, in lieu of ordinary taxation, on all non-Italian-sourced income earned by *foreign pensioners* transferring their tax residence in the southern regions of Italy. The special regime is *optional* and available for the fiscal year in which the transfer of residence occurs and for the following *5 years*. Despite its novelty, the potential field of application of the regime already appears quite narrow. Contrary to the special regime for High-Net-Worth-Individuals (HNWIs) inserted in art. 24-*bis* ITA in 2017, the new regime for incoming pensioners is in fact subject to *several requirements*. These requirements are summarized below in bullet points and a short clarification is provided for each of them.

1. Subjective Requirements

The new regime is limited to pensioners. The identification of the applicant as a "pensioner" is made through a reference to the person in question receiving "pension income" as defined by art. 49(2)(a) ITA, which for income tax purposes includes pensions in the same category of income from dependent employment. Foreign pensions are therefore defined not based on a *renvoi* to the domestic tax rules of the relevant foreign state (and indeed, which state? The country in which the entity paying the pension is located or the country of the taxpayer's last tax residence?), but by way of a "mirror reading" of the Italian relevant tax rules.

Interestingly, the definition of art. 49(2)(a) ITA includes not only "pensions of all kinds" but also other similar payments (even non-periodic or lump-sum). As explained by the Italian Ministry of Finance in the Circular Letter No. 1 of 1973, pension remuneration in particular includes sums paid in respect of past employment other than dependent employment (e.g. self-employment), disability pensions, and survivor's pensions. Instead, the regime does not seem to be equally available to individuals receiving social security or war pensions, since under Italian income tax such kinds of pensions are exempt.

It should also be considered that no distinction is made under Italian income tax between pensions from private and public employment, as instead provided by arts. 18 and 19(2) of the OECD Model. Given the broader possibility to tax pensions from public employment granted to the source state under art. 19(2) of the OECD Model, which Italy consistently follows in its tax treaties, it can however be assumed that the new special regime would appeal especially to those receiving a pension from private employment, since this latter is taxed only in the recipient's residence state.

The regime entails a look-back period. The option for the special regime is in fact restricted to pensioners who have not been Italian tax resident for at least 5 years before exercising the option in the first income tax return. Tax residence is determined based on the three alternative criteria laid down in art. 2(2) ITA, i.e. (i) registration in the municipality register of resident individuals, (ii) domicile in Italy under art. 43(1) of the Civil Code, or (iii) residence in Italy under art. 43(2) of the Civil Code.

Limitations also exist with regard to the country of departure. The applicant must in fact be a former resident of a country with which, at the moment of the exercise of the option, tax cooperation agreements are in place, such as the OECD Multilateral Convention on Administrative Assistance in Tax Matters, the EU Directives on Administrative Cooperation and Tax Recovery (respectively, Directive 2011/16/EU and Directive 2010/24/EU), a tax treaty, or a TIEA. The existence of a tax cooperation agreement is necessary to enable Italian tax authorities to transmit information about the exercise of the option for the special tax regime to the tax authorities of the last state in which the individual was a former tax resident.

Finally, although not expressly mentioned in the provision, former residents of black-listed countries are excluded from the regime, since under art. 2(2-*bis*) ITA Italian nationals who transfer their residence to black-listed countries are still regarded as Italian tax residents, unless proof to the contrary is provided.

2. Objective Requirements

The new 7% substitute tax applies exclusively to all non-Italian-sourced income, i.e. not only foreign pensions but potentially all types of foreign-sourced income. Similar to what the special regime for HNWIs under art. 24-*bis* ITA provides, in order to establish whether income derived by the taxpayer is foreign-sourced, the new art. 24-*ter* ITA makes reference to the sourcing rules laid down in art. 23 ITA (by way of a "mirror reading" of the criteria listed therein).

Connected with its subjective requirements, the regime prescribes that pension must be paid by a foreign entity. As such, the objective scope of the regime appears quite narrow, since, for instance, it cannot be opted by individuals who have worked for an Italian company in a foreign country and have remained in that country once retired. Also, the regime is not available to Italian pensioners who, in recent years, due to the combined effect of the financial crisis and the poor amounts of most Italian pensions, have fled Italy in great numbers to relocate in a country with a milder tax regime (e.g. Portugal).

Nonetheless, the special regime also covers capital gains from the sale of all types of non-Italian shareholdings (the different tax treatment of substantial and portfolio shareholdings has been removed as from 2019). An analogous possibility, with regard to capital gains from substantial shareholdings, is instead precluded to HNWIs under the regime of art. 24-*bis* ITA. Indeed, the lack of a similar limitation in the new regime of art. 24-*ter* ITA may render it more vulnerable to tax planning (e.g. a pensioner relocating to Italy to realize capital gains from the sale of his substantial shareholdings in a foreign company or, even worse, a pensioner acting as a figurehead of a taxpayer resident abroad).

3. Territoriality Requirements

The transfer of residence by the individual requires the fulfillment of two cumulative conditions. First, the individual must transfer his tax residence in one of Italy's southern regions (Abruzzo,

Apulia, Basilicata, Calabria, Campania, Molise, Sardinia, Sicily). Second, the individual must become a resident of a municipality, located in those regions, having no more than 20,000 inhabitants. Since the special regime does not cover the entire Italian Peninsula, tax benefits provided therein might be found in breach of the prohibition of state aid laid down in art. 107 TFEU, especially considering that eligible municipalities are singled out exclusively based on the low number of their inhabitants and not on economic indicators suggesting that the standard of living in those areas is abnormally low.

4. Tax Benefits

The new regime provides, in lieu of ordinary taxation, for a substitute tax of 7% on all non-Italian-sourced income of incoming pensioners (interestingly, the OECD considers preferential regimes with a tax rate lower than 10% on foreign financial assets at a high risk of being used to circumvent the Common Reporting Standard). Applicant taxpayers are instead required to pay ordinary income tax on all of their Italian-sourced income.

Despite the nature of substitute tax and the rate applied are straightforward, there are uncertainties with regard to the circumstance that the tax must be "calculated on a lump-sum basis". Probably, this provision merely serves to rule out the possibility to deduct any kind of expenses, meaning that the tax at a flat 7% rate is levied on a gross basis. Alternatively, the provision in question could perhaps be explained by the fact that an identical expression is contained in the wording of art. 24-*bis* ITA (introducing a lump-sum substitute tax of EUR 100,000 per tax year on foreign income of HNWIs), from which the legislator has borrowed massively for designing the new regime. Thus, the phrase in question could be the unintended result of a "copy and paste" exercise.

Although the option cannot be exercised for each single item of income (e.g. only for foreign pensions), the taxpayer is not obliged to include all foreign states where the income he derives is sourced according to Italian sourcing rules. The taxpayer can in fact cherry-pick the countries to include in the special regime and the territorial extension of the regime can be modified by the taxpayer in the tax return filed each year. Income sourced in a foreign country not included in the special regime is subject to ordinary taxation and a foreign tax credit is granted in respect of the taxes levied in that state.

Finally, among the benefits provided by the new regime, like the special regime for HNWIs, there are also an exemption from Italian wealth taxes on the value of foreign real estate and financial assets held abroad ("IVIE" and "IVAFE"), as well as the non-application of foreign asset reporting obligations ("quadro RW"). Benefits are however limited to income and wealth taxes. No favorable regime is introduced for other types of taxes, such as inheritance and gift taxes, as instead provided under the special regime for HNWIs, despite such an extension could arguably have been very much appealing to individuals in the last span of their life.

5. Validity Period

The special regime is available for the fiscal year in which the option is exercised and for the following 5 fiscal years. However, the option can be revoked at any time by the taxpayer. Moreover, the option is forfeited in the event the substitute tax is not paid in a timely manner, or where the subjective, objective, and territoriality requirements summarized above are no longer fulfilled by the applicant. In this connection, the permanence of a tax cooperation agreement between Italy and the country of the applicant's former tax residence does not seem to amount to a

requirement for the application of the regime. Rather, what is clear enough is that, while the effects of the regime for previous fiscal years are permanent, a renewal of the option is not permitted in case of revocation or forfeiture of the original one.

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The new special tax regime for incoming pensioners follows suit the introduction under Italian tax laws, in the last few years, of *several special tax regimes* aimed at encouraging foreign individuals to move and invest in Italy, such as the fiscal incentives for incoming professors and researchers of art. 44 of Law Decree No. 78 of 2010, the favorable regime for highly skilled inward expatriates of Legislative Decree No. 147 of 2015, and the special regime for HNWIs of art. 24-*bis* ITA. All these special regimes contain some deviations from the fundamental pillars of the Italian tax system, such as the *equality and ability-to-pay principles* and the *progressivity rule* enshrined in arts. 3 and 53 of the Italian Constitution. And yet, despite the significant tax benefits granted and the important derogations made, the author submits that, given the several constraints which it entails, *the new special regime would hardly meet the goal to encourage foreign pensioners to relocate in Italy*.

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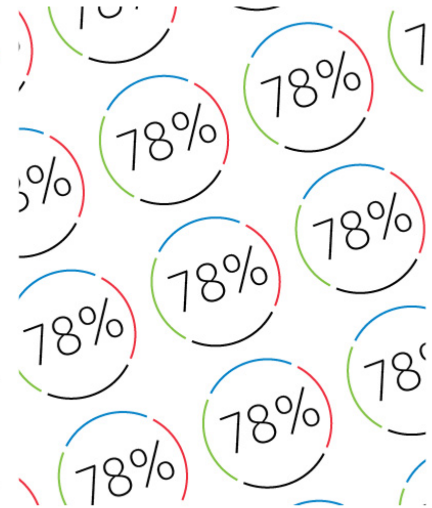

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