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In this article, the author considers the application and implications of a special Italian tax regime designed to attract high-net-worth individuals, three years after its enactment.

In 2017 Italy introduced a new tax regime intended to entice foreigners and Italians who have been living outside Italy to transfer their tax residence to Italy by allowing them to pay a lump sum of €100,000 in lieu of the regular Italian income tax on foreign-source income. This tax regime for high-net-worth individuals has attracted more attention since world-famous soccer player Cristiano Ronaldo left Spain's Real Madrid to join Juventus, a top Italian team, in 2018 — a decision some speculate was predicated in part on his ability to benefit from the attractive new regime.

While it still may be too early to fully assess the impact of the regime and the Italian tax agency's approach to administering it, further review is warranted now that it has become a permanent feature of the Italian tax system.

Covered Taxpayers

On March 8, 2017, the Italian Revenue Agency issued Regulation 47060, which sets forth technical rules for the special tax regime. On May 23, 2017, the tax administration issued Circular No. 17/E to provide administrative guidance for interpreting and applying the special tax regime.

The special tax regime is not limited to a particular class of taxpayers. It extends to both Italian and foreign nationals and does not require that the income subject to the lump sum tax be remitted back to Italy.

The regime does not limit the activities a taxpayer can engage in while resident in Italy. A taxpayer who elects for the special tax regime is free to work, invest, or operate a business in Italy and can earn Italian wages, investment, or business income on which he will be taxed in accordance with Italy's regular income tax system at the usual graduated tax rates.

As a practical matter, since the lump sum tax applies in lieu of the regular income tax on foreign-source income, the special tax regime is designed for foreign individuals with significant investments, activities, or business interests outside Italy, and who earn large amounts of foreign-source income — in particular, income that is subject to no or low income tax rates in the country from which it is derived.

Overall, in 2017 a total of 95 individuals opted into the tax regime, with 226 doing so in 2018.[1] They hailed from at least 16 different countries, with the United Kingdom (28), Brazil (12), France (10), and Switzerland (10) topping the list.

Fiscal Residency Requirements

The special tax regime is offered to Italian or foreign national individuals who have not been Italian tax residents for at least nine of the previous 10 years but who are Italian tax residents in the tax year for which they make the election.

Tax residence is determined under Italian tax law in accordance with one of three alternative criteria that must be met for more than 183 days during a given tax year:

- registration on the register of the Italian resident population;

[1] "Capitali Dall'Estero in Aumento Grazie Alla Tassa Agevolata," *Il Messaggero*, Feb. 9, 2020 (in Italian).

- place of habitual abode (that is, a regular place of living where the taxpayer intends to stay indefinitely, rather than temporarily or for a specific, limited-time purpose); and
- domicile (that is, the main place of an individual's personal, professional, and economic interests).

Once one of these criteria is met, tax residence is retroactive to the first day of the tax year during which any of these criteria are met.

The registration test is completely within the taxpayer's control and easy to apply. The residence and domicile tests depend on the facts and circumstances of each particular case, and they are more open to controversy and interpretation. In some recent rulings, the Italian Supreme Court took the position that for the purpose of the domicile test, under some circumstances the presence of significant economic interests in Italy may prevail over the presence of personal and family ties to a foreign country, despite the fact that traditionally personal ties were given more weight than economic interests.

It is reasonable to expect that Italian nationals who were once Italian residents but transferred their residency to a foreign country will receive special scrutiny, and the disclosure of information about their non-Italian tax residence and possible continuing contacts with Italy in the past may expose them to potential audits regarding their non-Italian resident tax years — in addition to making them ineligible for the tax regime. Those who transferred their residence to tax havens will have to overcome the presumption that their tax residency was in Italy unless they demonstrate that they actually moved to and lived in the other jurisdiction.

Foreign nationals who purchased real estate in Italy and — perhaps upon the suggestion of local notaries or accountants and without considering the international tax ramifications — registered themselves as Italian residents at their new Italian address to benefit from an abatement of transfer taxes at the time of purchase triggered Italian tax residency under the registration test at that time. This may make them ineligible for the special tax regime. If they actually lived and kept all their interests in the other country, those individuals might be able to use the tiebreaker rules in their home country's tax treaty with Italy to connect themselves to their home country and avoid Italian tax liability on non-Italian income for the years in which they were Italian tax residents under the registration test. However, a tax treaty's tiebreaker rules cannot be used to overcome Italian tax residency under Italian internal law, which would be necessary to claim the special tax regime.

Foreign nationals who never registered as resident in Italy but who regularly visited the country or who own homes, run businesses, or hold other investments in Italy will need to provide detailed information about their presence and activities in Italy to allow the Italian Revenue Agency to assess whether they were ever Italian tax residents under the residence or domicile test.

Election Requirement and Process

The special tax regime is elective. Eligible taxpayers must file an election with their income tax return for the first year in which they are Italian tax residents or with the return for the immediately following tax year.

Taxpayers can — but are no longer required to — apply for an advance ruling on their eligibility for the special regime. If they file for an advance ruling, taxpayers must provide specific information to establish the relevant facts and circumstances concerning their tax residence during the previous 10 years, including any indications that they may have been Italian tax residents. The tax agency has 120 days to respond to the ruling request, and the failure to respond is equivalent to a positive answer. If the agency asks for additional information, a new 120-day period starts running from the date of the request. Therefore, taxpayers should prepare their applications with care to avoid delay.

The Italian tax administration issued a checklist of 20 items that must be properly disclosed and documented, either in the advance ruling application or attached to the tax return electing for the special regime. Taxpayers must use the checklist to assess their eligibility based on their facts and circumstances — preferably with the help of a tax adviser — before making the election. Nothing is said in the law or the administrative guidance about the situation in which a tax return electing for the special tax regime does not provide complete and sufficient information in response to all the items on the checklist. To avoid the risk that the election is treated as ineffective, taxpayers should carefully prepare a complete response to the agency's questionnaire.

The election is valid for (and automatically expires after) 15 years.

Special Election for Family Members

The election for the special tax regime can be extended to a taxpayer's family member who also establishes her tax residency in Italy and meets the other requirements for the election. For this purpose, family members include:

- a spouse;
- children and children-in-law;
- parents and parents-in-law; and
- siblings.

Whenever a covered taxpayer's family member becomes an Italian tax resident — that is, any time within the 15-year period of the initial election — the covered taxpayer and the qualifying family member can file the election for the special tax regime. Following this election, the family member is subject to a lump sum tax of €25,000 on her foreign-source income and enjoys all other benefits of the special tax regime.

The family member's election remains in place for the rest of the 15-year period, even if the principal taxpayer's election is revoked or terminated.

Termination of the Election

The taxpayer can terminate the election at any time. The election automatically terminates if the taxpayer moves her tax residence outside Italy or fails to pay the lump sum tax. Finally, the election automatically expires after 15 years.

Scope of the Special Tax Regime

The special tax regime, which encompasses all foreign-source income and foreign assets, has three important effects:

- it excludes foreign-source income from the scope of the regular income tax;
- it excludes foreign assets from the scope of the Italian estate tax; and
- it exempts the taxpayer from the normal duty to report foreign assets and financial accounts on the Italian income tax return.

Income Tax on Foreign-Source Income

The €100,000 fixed-amount tax applies in lieu of the regular Italian income tax on foreign-source income.

Foreign-source income is determined using the income sourcing rules of the Italian Revenue Code (article 23 of the Italian Unified Code on Income Taxes (Testo Unico delle Imposte sui Redditi)) and includes the following:

- employment income from foreign employment;
- income from personal services performed outside Italy;
- business income from business activities conducted through a permanent establishment located outside Italy;
- royalties paid by a foreign-based licensor;
- rents from the lease of foreign property;
- dividends paid by foreign companies;
- interest on bonds or similar obligations issued by foreign borrowers; and
- gains from the sale of stock or other ownership interests in companies organized outside Italy.

Notably, sourcing rules under Italian tax law differ from U.S. sourcing rules in many important respects, and they offer great opportunities to maximize the benefits of the special tax regime with careful planning.

The first and most prominent example is royalties. In Italy, the source of royalty income is determined by reference to the residence of the payer (licensee) regardless of the place of use of the license. Therefore, royalties that a foreign company pays to an athlete for the right to use her image in advertising campaigns or that a foreign company pays an artist for the right to publish or sell his works (for example, his music or books) are entirely foreign-source income regardless of the place of use of the license — even if the use of the image or the sales occur entirely (or in part) in Italy. An athlete or performer can license his image rights to a foreign company and receive tax-free foreign-source royalties — or, more specifically, foreign-source royalty income already covered by the lump sum tax payment —

for the use of his image in advertising campaigns run entirely in Italy. Conversely, the taxpayer would be well advised not to license image rights to an Italian company for foreign-run advertising campaigns because that would generate Italian-source royalties, which would be fully taxable under Italy's regular income tax regime.

Under Italian tax law, the source of capital gains is the place where the property is located rather than the seller's place of residence. For gains from the sale of stock or ownership interests in corporate or noncorporate entities, the gain is sourced with reference to the place of incorporation or organization of the entity. As a result, under U.S. law, the gain from the sale of stock in a U.S. corporation or partnership would be non-U.S.-source income that is not taxable in the United States, while under Italian law, it is foreign-source income that falls within the scope of the fixed tax regime.

Dividends and interest are sourced to the residence of the payer. However, dividends and interest earned through mutual funds, which are not treated as fiscally transparent entities, are specifically characterized as income from mutual funds and sourced to the place where the fund is organized. Therefore, even investments in Italian stock and bonds can generate nontaxable foreign-source financial income if the stock is held and managed by a foreign-organized mutual fund.

Likewise, income earned through trusts and similar arrangements is classified as income from a trust and sourced to the place of administration of the trust — not by reference to the source of the underlying items of income — which is presumed to be the place where the trustee is domiciled unless the taxpayer proves that the actual administration of the trust is carried out elsewhere. A revocable trust is disregarded: The settlor is treated as the owner of the trust's assets and income, which is sourced by reference to the source of the underlying items of income. Non-revocable trusts are generally treated as opaque unless the settlor retains sufficient control over the trust to result in the trust being treated as fiscally transparent. As a result, a taxpayer can lump her investments — whether Italian or foreign — into a foreign-administered trust and earn foreign-source income that is not subject to the regular Italian income tax.

Income from services is sourced with reference to the place of performance. Therefore, a soccer player who plays games inside and outside Italy must allocate part of his salary to the Italian games (which would be Italian-source income taxed under the regular income tax) and part of his salary to the games played elsewhere (which would be foreign-source income that is not subject to the regular income tax). Italian law does not include any clear rule setting forth a method for the allocation of the income. In the case of wages paid for general services, allocation is made on the basis of the time spent performing those services in Italy compared with time spent performing them abroad. However, remuneration for work on specific projects or tasks should be allocated with reference to the place where the project or task is carried out.

In the case of an athlete or performer, there may be a fair argument that part of her compensation should be allocated to games played in international competitions, such as the Champions League, or to other performances or events that take place outside Italy, which would mean she can treat that portion of her compensation as foreign-source income not taxable under the regular income tax. A musician who earns compensation for recording a record or performing at concerts outside Italy would be able to maintain that she earns foreign-source services income not taxable under the Italian regular income tax.

Foreign Tax Credit and Cherry-Picking

For foreign-source income that is excluded from the regular income tax and taxed by way of the substitute tax, no foreign tax credit applies for income taxes paid to the foreign country of source.

However, a taxpayer can choose to exclude specific countries from the scope of the regime. In that case, income from sources in the excluded countries is subject to the regular income tax, and there is an FTC for the income taxes paid in the excluded country of source.

Repatriation and Working Requirement

Unlike other countries' tax regimes that are designed to attract high-net-worth individuals, the Italian tax regime does not impose limitations regarding whether the exempt foreign income is repatriated to Italy, or the taxpayer engages in working or business activities in Italy while benefiting from the special regime. As a result, the lump sum tax will apply even if the taxpayer repatriates income that has been exempted from Italy's regular income tax to Italy, carries on unrelated professional or business activities in Italy, or invests money in Italy. Any Italian-source income derived from those activities, businesses, or investments would be subject to the regular Italian income tax.

Estate and Gift Taxes on Foreign Assets

Italy applies its own estate and gift taxes to the worldwide assets of an individual resident in Italy at the time of the gift or at the time of death. Fiscal residency for estate and gift tax purposes is determined using the same criteria that apply to determine a taxpayer's fiscal residence for income tax purposes.

Italian estate tax treaties do not contain tiebreaker rules similar to those of article 4 of income tax treaties, and the tiebreaker rules in income tax treaties cannot be used to assign tax residence to a foreign treaty country for purposes of Italian estate and gift taxes. Importantly, the special tax regime excludes foreign located assets from the scope of Italian estate and gift taxes. As a result, an Italian tax resident under the special tax regime will not be subject to Italian gift tax on gifts of assets located outside of Italy, or subject to Italian estate tax on the part of his estate that is located outside of Italy at the time of his death.

No Reporting of Foreign Assets

Under Italian tax law, a resident taxpayer must report all his personal and business property — including financial and nonfinancial assets such as homes, luxury boats, jewelry, and artwork that are located outside of Italy — on section RW of his Italian income tax return (regardless of whether the assets generate taxable income in the tax year).

The requirement for the tax reporting of foreign assets is wide in scope and generally costly and time-consuming.

The election for the special tax regime exempts the taxpayer from the duty to report his foreign assets under Italy's international tax reporting rules.

Replaces Asset Taxes on Foreign Properties

Italy applies a 0.76 percent tax on the fair market value of foreign real estate and a 0.2 percent tax on the FMV of foreign financial assets.

Neither tax applies if a taxpayer elects for the special tax regime.

Special Tax Regime and Tax Treaties

One issue that emerged is whether a taxpayer who elects the special tax regime is eligible to benefit from an Italian tax treaty — specifically, the treaty between Italy and the foreign country that is the source of some of the taxpayer's income.

In Circular No. 17/E, the Italian tax administration takes the position that a taxpayer should be eligible for treaty benefits since the taxpayer is a resident of Italy for income tax purposes and is taxed on her worldwide income — albeit through the regular income tax system for her Italian-source income and a fixed tax in lieu of the regular income tax on her foreign-source income. Based on that conclusion, the Italian tax administration also announced that it will issue certificates of tax residency to Italian taxpayers who elect the special tax regime.

It is worth reiterating that a taxpayer can always opt to exclude specific countries from the application of the special tax regime. In that event, the taxpayer would definitely be able to claim treaty benefits, including limitations on tax rates in the source country and qualifying for an FTC in Italy for any income tax paid on income from sources in that country.

Constitutional Issues

The special tax regime poses some constitutional issues. It is a departure from the general principle that every taxpayer should contribute to the country's public budget in proportion to his or her ability to pay, which is set forth in article 53 of the Italian Constitution. A key measure of a taxpayer's capacity to pay is taxable income, and the vision of article 53 has historically been carried out through a progressive income tax.

However, it is not clear how a constitutional challenge could be brought to the Constitutional Court. To bring a claim to the Constitutional Court, a party must have standing. In the case of the ability-to-pay clause, the taxpayer would need to demonstrate that there is a provision of law that subjects the taxpayer to less favorable tax treatment than what applies to other similarly situated taxpayers. In the case of the special tax regime, a taxpayer who is subject to the regular income tax might challenge the general provisions of the regular income tax and assert that his foreign-source income is taxed less favorably than a similarly situated taxpayer who is subject to the lump sum substitute regime. This would require the taxpayer to demonstrate that he possesses an amount of foreign-source income that would result in paying less under the special tax regime than under the regular income tax rules. For that challenge to be upheld, the court would need to rule that the regular income tax is constitutionally invalid across the board, which seems like a remote and unrealistic proposition. Moreover, a taxpayer who elects the special tax regime is not in the same position as a taxpayer who is not eligible for the special tax regime — the former is a nonresident who was not subject to Italian tax on non-Italian-source income and who voluntarily transfers her tax residency in Italy in exchange for being taxed under the special tax regime on her foreign-source income — and the special regime is temporary and expires automatically after 15 years.

Other Issues

Another interesting issue concerns how Italy will administer the exchange of information systems it operates with other countries that may ask for tax information concerning individuals who have moved to Italy to benefit from the special tax regime. By providing taxpayers who elect the special tax regime with a full exemption from reporting their foreign assets, Italy will not possess — and thus not be able to share — information that it would normally have from the taxpayer's return. Also, a taxpayer is not required to separately state his foreign-source income on his Italian tax return if it is not taxable under the regular income tax.

Conclusions

Italy's lump sum tax regime for nonresident high-net-worth individuals who become Italian tax residents has some very interesting features that make it attractive compared with similar regimes applied in other countries — both today and in the past.

Opting into the special tax regime requires specific planning, both to ensure that the taxpayer is eligible for the regime and to identify the best way to structure the taxpayer's affairs to maximize the benefits of the regime once the filing has been made, in particular planning related to the sources of the taxpayer's income.

Whenever a taxpayer moves her residence to Italy under the Italian registration test while keeping significant contacts and interests in other countries, thorough tax planning will require investigating the other countries' tax laws to determine whether the taxpayer might still be a resident of another country in accordance with that jurisdiction's residence or domicile test. The taxpayer will also need to determine any local source-based income tax that may apply.

While more time will need to pass before any case law or administrative tax rulings interpreting and applying the special tax regime become available, thus far the Italian tax agency has adopted a pro-taxpayer approach aimed at encouraging the use of the regime — which makes sense since the purpose of the regime is to attract wealthy individuals to move to Italy and contribute to the local economy. ■