Italy Changes Course on Bonus Tax Deferment For Inbound Employees

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In this article, Rossi examines changes to Italian taxation of foreign-source and earned income for Italian residents.

On August 4 the Italian Revenue Agency (Agenzia delle Entrate) issued Ruling No. 199/2025,[1] revisiting — and ultimately reversing — its position on the taxation of deferred compensation received by employees who relocate to Italy. The case involved an employee performance bonus earned and vested over several years. The employee spent part of that time living and working abroad but was paid after he had moved to Italy and become tax resident there.

In Ruling No. 81/2025,[2] issued March 25, the agency adopted a pro rata approach, allowing employers to exclude the portion of the bonus corresponding to services performed abroad during periods when the employee was not resident in Italy from Italian tax. Foreign-earned portions during periods of foreign residence — even if paid after relocation — were excluded from Italy's taxing jurisdiction.

In Ruling No. 199/2025, the agency abandoned that approach, reaffirming a residence-at-payment principle: If the recipient is an Italian tax resident at the time of payment, the entire amount is taxable in Italy, with double taxation relief available solely through the foreign tax credit.

The Facts and the Applicant's Role

The applicant was the Italian permanent establishment of a German corporation, which was the parent of a multinational group operating across multiple jurisdictions. As a PE, it acted as the local employer for Italian payroll purposes, responsible for calculating and withholding Italian income tax on employment income paid to its staff, including international employees assigned to Italy.

The employee in question was based in the United Kingdom until the very end of 2023. For the period from 2021 through most of 2023, he was a U.K. tax resident and worked for the U.K. affiliate of the German group. As part of his compensation, he was granted participation in the group's long-term cash bonus plan, introduced in 2021 and designed to run through 2026.

The plan granted the participants a bonus that would vest across a multiyear performance period covering 2021-2026, with annual vesting after each completed year. Payments were scheduled for the following February, provided the employees remained with the group through each vesting date. The amount of each annual bonus payment reflected performance over a rolling three-year period.

From 2021 until his relocation in late 2023, the employee's work and residence were entirely in the U.K., and he accrued bonuses tied to those service years while he was a U.K. tax resident. In December 2023 he was assigned to the Italian PE

[1] Agenzia delle Entrate, Risposta N. 199/2025 (Aug. 4, 2025) (in Italian).

[2] Agenzia delle Entrate, Risposta N. 81/2025 (Mar. 25, 2025) (in Italian).

of the German parent, physically relocating to Italy. On January 1, 2024, he became an Italian tax resident under article 2 of the Italian Income Tax Code (TUIR), continuing his employment with the Italian PE.[3]

This move was followed by a sequence of payments and planned payments blending pre-relocation U.K. services and post-relocation Italian services:

- **February 2024**: Payment of a bonus entirely attributable to U.K. service years (2021-2023), already taxed in the U.K.
- **February 2025**: Bonus for 2022-2024, two-thirds linked to U.K. service, one-third to Italian service.
- **February 2026**: Bonus for 2023-2025, one-third U.K. service, two-thirds Italian service.
- **February 2027**: Bonus for 2024-2026, entirely Italian service.

The first payment, made after the employee had become an Italian tax resident, covered a bonus earned during a period of employment in the U.K. — performed when the employee was a U.K. resident. The following payments, also processed after the employee had become an Italian tax resident, covered bonuses earned partly in the U.K. when the employee was a resident there and partly in Italy when the employee was an Italian tax resident.

Withholding and the Applicant's Position

For the February 2024 payment, the Italian PE withheld Italian income tax on the entire bonus amount — despite that the accrual was entirely linked to U.K. service years, performed when the employee as a U.K. resident — because the payment was processed through the Italian payroll and the employee was by then an Italian resident. The same full withholding approach was planned by the PE for the 2025, 2026, and 2027 payments.

In its ruling request, the PE relied on the agency's reasoning in Ruling No. 81/2025. According to that ruling, the portion of each bonus attributable to services performed in the U.K. when the employee was a U.K. tax resident should not be taxed in Italy because of a lack of connection to the country by either the residence of the payee during the vesting of the bonus or the place of performance of services from which the bonus was derived.

Under this approach, the 2024 payment — entirely tied to U.K. service and U.K. tax residence periods — would have been excluded from Italian taxation altogether. The PE proposed that — although it had already withheld on the full amount in 2024 — it could adjust withholding in the year-end reconciliation to reflect only the Italian-source portion. Any residual liability arising from the employee's residence at payment would be settled by the employee in the annual income tax return, offset by the foreign tax credit for U.K. taxes paid.

For the mixed-source and residence bonuses in 2025 and 2026, the PE intended to withhold only on the Italian-source portions vested after the start of the Italian residence, leaving any other Italian tax due — based on worldwide income rules — to be addressed in the employee's return. From 2027 onward, when the bonus would be fully Italian-source, the PE would withhold on the entire amount.

Analysis and Reversal of Prior Guidance

The Agenzia delle Entrate rejected the applicant's argument and explicitly reversed its earlier stance in Ruling No. 81/2025.

Under article 3(1) of the TUIR, residents are subject to tax on their worldwide income. Individual taxpayers are generally taxed on a cash basis when an item of income is received or realized and therefore recognized for income tax purposes. Article 51 of the TUIR defines employment income broadly to include "all sums and values, in whatever form, received in connection with employment,"[4] regardless of the period or place of accrual. Italian tax is imposed in the year of perception (receipt), not the earning year.

Applying these domestic law provisions, the agency concluded that because the employee was resident in Italy when the bonuses were paid, the entire amounts fell within Italy's taxing

[3] Presidential Decree No. 917/86, at art. 2 (Dec. 22, 1986) (in Italian).

[4] *Id.* at art. 51(1).

jurisdiction, even if the services were performed abroad during periods of foreign tax residence.

Article 15 of the Italy-U.K. Treaty

The agency then referred to article 15 of the Italy-U.K. double taxation avoidance treaty (DTA).[5] Paragraph 1 provides that salaries, wages, and other similar remuneration derived by a resident of one contracting state are taxable only in that state unless the employment is exercised in the other contracting state; if the work is performed in the other state, that other state may also tax the income.

On this basis, the agency concluded that two distinct taxing rights coexist:

1. The primary taxing right of the state of residence at the time of payment — in this case Italy, which acquired jurisdiction because the employee was resident there when the bonus was paid; and
2. The concurrent taxing right of the state of source where the work was performed — in this case the U.K., which retains taxing jurisdiction because the services generating the bonus were carried out there during the vesting period.

It is particularly significant that the agency explicitly recognized Italy's taxing right, even for portions of the bonus accrued in years when the employee had no connection to Italy whatsoever — neither through residence nor through the place of performance of the work. At the time, the right to those portions was accrued, the employee resided in the U.K., was employed by the U.K. affiliate, and performed his services entirely in the U.K. Nevertheless, the agency ruled that, under the treaty, the establishment of Italian tax residence at the time of the payment was sufficient to give Italy full taxing jurisdiction over the payment.

OECD Commentary

The agency then referred to paragraph 2.2 of the OECD commentary to article 15, which confirms that the source state's right to tax exists whenever remuneration is derived from employment exercised in that state, regardless of when the payment is made and in which country the taxpayer is a resident of when the income is received.[6] This ensures that the U.K.'s taxing right over the U.K.-earned portion of the bonus is unaffected by the timing of payment or the change in the employee's residence status.

The agency also cited paragraph 2.3 of the OECD commentary,[7] which emphasizes the need to identify the real source of each item of remuneration by examining the underlying facts and circumstances. This determination is essential to decide whether — and to what extent — the remuneration arises from work performed in a given state. In the present case, the portion of the bonus corresponding to U.K. service years was clearly linked to work performed in the U.K., confirming that state's source-based taxing rights.

Outcome

The agency ruled that, based on article 15 and the OECD commentary, the bonuses were taxable both in Italy as the state of residence at the time of payment and in the U.K. as the state of source where the income accrued. Italy's taxing right applies even to portions earned in years when the employee had no connection to Italy because tax residence at the time of payment is decisive for the residence-state taxing power over the income. Relief from double taxation is available only through the foreign tax credit under article 165 of the TUIR.

Ruling No. 81/2025 Reversed

In Ruling No. 81/2025, the agency considered a similar fact pattern involving cross-border employment and deferred bonuses. Its analysis applied what was, in substance, a dual nexus test for determining Italy's taxing rights over deferred remuneration:

1. **Residence at the time the bonus was earned** — identifying the state of personal nexus; and

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[5] Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Italian Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, at art. 15 (Oct. 21, 1988).

[6] OECD, "Commentaries on the Articles of the Model Tax Convention," at commentary on art. 15, para. 2.2 (Nov. 22, 2017).

[7] *Id.* at para. 2.3.

2. **Place of performance of the services** — identifying the state of economic nexus (the source of the income).

If both the residence and the place of performance at the time of accrual were in the same foreign state, the conclusion was that Italy — as the new state of residence at payment — had no taxing right over that portion. The lack of any personal or economic link to Italy during the vesting period meant that the income was foreign-source and foreign-earned and thus excluded from the Italian tax base even if payment was made after the employee became an Italian resident.

This position led to the practical pro rata allocation method: bonuses were taxed in Italy only to the extent attributable to service periods in which the employee was resident in Italy or performed work in Italy. The remainder — earned during periods of foreign residence and foreign service — was excluded from Italian taxation.

By contrast, Ruling No. 199/2025 rejects the dual-test approach. Under the newer analysis, residence at the time of payment is sufficient to establish Italy's taxing right over the entire bonus, even if, at the time of accrual, the employee was resident abroad, the work was performed abroad, and there was no Italian nexus of any kind. The place of performance remains relevant for determining the source state's concurrent taxing right under the treaty but no longer limits Italy's jurisdiction as the residence state at payment. Relief from double taxation is given exclusively through the foreign tax credit mechanism, not by exclusion from the tax base.

Earlier Interpretation: Resolution No. 61/E

The agency's position in Ruling No. 199/2025 also diverges from its prior interpretation of the DTA in Resolution No. 61/E (2016).[8]

That case concerned severance pay (Trattamento di Fine Rapporto, or TFR) payable to the family member of a deceased employee. The agency noted that such payments are taxed in the same manner as they would have been if received by the employee. Applying article 15 of the DTA, the agency concluded:

- **the portion of TFR accrued for work performed in the U.K.** could be excluded from Italian taxation even though the recipient was an Italian resident at the time of payment; and
- **the portion of TFR accrued for work performed in Italy** was taxable in Italy under the source rule.

This reasoning — allocating taxing rights based on the place and period of accrual rather than the residence at payment — mirrors the pro rata approach of Resolutions No. 341/E[9] and No. 343/E[10] (discussed below) and even Ruling No. 81/2025.

The contrast with Ruling No. 199/2025 is stark: The agency has now embraced a view that the residence state at the time of payment retains taxing rights regardless of whether the work was performed there or the employee was a resident in the state during accrual — even under the same treaty language it had previously interpreted to require a pro rata exclusion.

Treaty-Dependent Outcomes

The reasoning in Ruling No. 199/2025 is not universally applicable. The allocation of taxing rights for deferred compensation can differ substantially depending on the specific treaty provisions.

An earlier decision, Resolution No. 341/E of 2008, involved severance paid by an Italian employer to a German resident at the time of payment. The employee had performed work in both Germany and Italy as a resident of each state during the corresponding work periods.

The agency characterized TFR as deferred employment remuneration falling within the scope of article 15 of the Italy-Germany treaty.[11] Importantly, that treaty provided that salaries and

[8] Agenzia delle Entrate, "Risoluzione N. 61/E" (July 25, 2016) (in Italian).

[9] Agenzia delle Entrate, "Risoluzione N. 341/E" (Aug. 1, 2008) (in Italian).

[10] Agenzia delle Entrate, "Risoluzione N. 343/E" (Sept. 11, 2020) (in Italian).

[11] Convention Between the Federal Republic of Germany and the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the Prevention of Tax Evasion, at art. 15 (Oct. 18, 1989).

similar remuneration are taxable only in the state where the work is performed unless the article 15(2) conditions for taxation in the residence state are met.

Recognizing that TFR accrues year by year, the agency concluded that the portion attributable to work performed in Italy while the employee was an Italian resident was taxable exclusively in Italy, while the portion attributable to work performed in Germany while living there was taxable exclusively in Germany. The new state of residence at the time of payment had no taxing rights over income earned abroad during periods of foreign tax residence.

This earlier interpretation — rooted in a treaty that limits the residence state's taxing right — stands in contrast to the concurrent taxing power recognized in Ruling No. 199/2025 under the DTA. It illustrates that the agency's position on deferred compensation is treaty-specific and that different wording in the distributive rule of article 15 can produce different results.

Resolution No. 343/E of September 11, 2020, addressed a more complex mobility pattern. The employee was hired in Italy in 2003, seconded to Switzerland from 2010 to 2019, and became a Swiss tax resident in 2012. The agency split the TFR into three distinct tranches:

1. **Italy-exclusive taxation** for the portion linked to work in Italy during Italian residence (2003-2009).
2. **Concurrent taxation** for the portion linked to work in Switzerland during Italian residence (2010-2011), with Italy taxing by residence and Switzerland taxing by source.
3. **Switzerland-exclusive taxation** for the portion linked to work in Switzerland during Swiss residence (2012-2019).

Both resolutions applied a matching principle, aligning taxation with the residence and source state at the time the income accrued. The new state of residence at payment did not gain an automatic right to tax prior periods' foreign-earned compensation unless there was a concurrent nexus during accrual.

This makes the change in Ruling No. 199/2025 significant: Under the DTA, the agency now claims concurrent taxing power even where, at the time of accrual, there was no Italian residence, no Italian source, and no other substantive connection to Italy.

Resolution No. 126 of March 2023,[12] which, like Resolution No. 343/E, involved employment exercised partly in Switzerland, applied the same pro-rata approach to deferred compensation. The agency determined that the portion of the payment referable to years in which the employee was resident in Italy and performed work in Italy was taxable exclusively in Italy; the portion accrued while resident in Italy but working in Switzerland was subject to concurrent taxation in both countries; and the portion accrued while resident and working in Switzerland was taxable exclusively in Switzerland. This mirrored the reasoning in Resolution No. 343/E and reinforced the then-settled position that for cross-border workers with deferred remuneration both residence and place of performance during the accrual period were decisive for allocating taxing rights — not the residence at the time of payment.

Comparison With the Italy-U.S. Treaty

The shift in Ruling No. 199/2025 also raises questions about how the Italian Revenue Agency would apply similar facts under treaties with explicit severance allocation rules**.**

For example, article 18(3) of the Italy-U.S. tax treaty provides that:

> If a resident of a Contracting State becomes a resident of the other Contracting State, lump-sum payments or severance payments (indemnities) received after such change of residence that are paid with respect to employment exercised in the first-mentioned State while a resident thereof, shall be taxable only in that first-mentioned State.[13]

By its terms, this provision applies regardless of the general dependent personal services article (article 15) and allocates exclusive taxing rights to the state of former residence and employment when a lump-sum or severance payment is made

[12] Agenzia delle Entrate, "Risoluzione N. 123" (Mar. 2023) (in Italian).

[13] Convention Between the Government of the United States of American and the Government of the Italian Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion, at art. 18(3) (Aug. 25, 1999).

after the employee has moved to the other state. The rule expressly covers amounts connected to termination of employment and, in practice, has been interpreted to include certain forms of deferred compensation such as end-of-service bonuses.

If an analogous case to Ruling No. 199/2025 arose under the Italy-U.S. treaty, article 18(3) would likely bar Italy from taxing the portion of the bonus earned during U.S. employment while the taxpayer was a U.S. resident, even if the employee resided in Italy at the time of payment.

This illustrates that treaty language matters; where the treaty contains an explicit rule tying taxation to the state of accrual-period residence and source, the concurrent-taxing approach now adopted in the U.K. case would be precluded. In treaties without such provisions, however, Ruling No. 199/2025 suggests that Italy may assert taxing rights based solely on residence at payment, relying on domestic law and article 15's silence on post-move payment.

Transitional Relief for Withholding Agents

In Ruling No. 199/2025, the agency acknowledged that, under the earlier interpretation in Ruling No. 81/2025, some employers may not have withheld Italian tax on foreign-earned portions of bonuses paid to new residents. For such cases, employers can regularize any missed withholding tax payments without penalties or interest, relying on the taxpayer protection clause set forth in article 10(2) of the Charter of Taxpayer's Rights (Statuto del Contribuente).[14]

Impact on Cross-Border Compensation Plans

The reversal in Ruling No. 199/2025 has immediate consequences for both employers and employees. Italian PEs and Italian affiliates of foreign-owned multinational enterprises must now withhold Italian income tax on the full amount of any bonus paid to an Italian tax resident, even if part of the accrual period relates to pre-relocation service in another country and during nonresidence in Italy.

For employees, this change can create material cash flow pressures and increased double taxation risks. Full Italian tax is withheld at payment, while foreign tax relief is only available later through the annual return. And even then, relief may be partial or denied altogether if there are mismatches in tax years, credit limitations, or differences in the taxable base between the two jurisdictions.

From a planning perspective, the ruling removes the brief opportunity created by Ruling No. 81/2025 and underscores the need for treaty specific analysis. The applicable bilateral tax treaty — and whether it contains any "taxable only" language or special provisions like article 18(3) of the Italy-U.S. treaty — will often determine whether Italy can tax pre-relocation accruals. Employers and advisors must assess each case individually, factoring in the employee's mobility history, the timing and vesting of the incentive, and the treaty in force before finalizing withholding and compliance strategies.

Conclusion

Ruling No. 199/2025 reaffirms Italy's traditional residence-based approach to taxing deferred compensation: If you reside in Italy when you receive the payment, Italy will tax it in full regardless of where it was earned. Any relief for foreign tax comes through the credit mechanism, not exclusion.

By explicitly reversing Ruling No. 81/2025, the agency has closed a short-lived pathway for excluding foreign-earned portions of bonuses from Italian tax, signaling a return to its long-established interpretation reflected in earlier rulings, such as Resolution No. 92/2009 and Ruling No. 783/2021. For multinational employers and mobile employees, the message is clear: In Italy, residence at the time of payment is decisive. ■

[14] Statuto del Contribuente, at art. 10(2) (July 27, 2000) (in Italian).