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In this article, the author examines Italy's effort to attract high-net-worth individuals by offering a special flat tax to newcomers. He takes a close look at the regime, which is supported by detailed regulations and guidance, a year and a half after it became law.

Last year, as part of an extensive package of measures designed to attract individuals and businesses to Italy and to foster inbound investments, Italy introduced a beneficial elective tax regime for individuals who move their tax residence to Italy. The regime — included in the Italian Finance Bill for 2017 (Law No. 232 of December 11, 2016) — offers a lump sum tax of €100,000 per year that covers income tax as well as gift and inheritance taxes on all non-Italian income and assets. Italian-source income remains subject to ordinary taxation.

For obvious reasons, the regime has been compared with the United Kingdom's regime for non-domiciled individuals, although there are remarkable differences between the two regimes — most notably, the Italian regime does not include remittance basis taxation, meaning foreign income is not subject to tax upon remittance to Italy.

A year and a half after its introduction — and following the Italian Revenue Agency's publication of implementing regulations and issuance of related guidelines — the special regime is now effective and fully operational. It is therefore worth reviewing the regime and considering some of the specific issues that have arisen in practice.

Legislative Framework

The government introduced the special regime for new residents as a permanent measure regulated by article 24-*bis*, a new statutory provision in the Italian income tax code (Testo Unico delle Imposte sui Redditi, or TUIR).[1] The Italian Revenue Agency has released implementing regulations[2] that contain procedural rules regarding the election, amendment, and termination of the regime, as well as details on the process of paying the substitutive tax. The agency has also issued detailed guidelines governing the special tax regime.[3]

In line with the goal of attracting individuals and capital, both the regulations and the guidelines present a positive and friendly approach to the regime, with Italian tax authorities conceding some important points (described below) favoring access to the special tax regime.

Eligibility Requirements

To be eligible for the special tax regime, individuals must meet both of the following conditions:

- the individual must transfer their residence for tax purposes from a foreign country to Italy; and
- the individual must not have been resident for tax purposes in Italy for at least nine of

[1] Presidential Decree No. 917 of Dec. 22, 1986.

[2] Regulation of the Italian Revenue Agency No. 47060 (Mar. 8, 2017).

[3] Circular Letter of the Italian Revenue Agency No. 17/2017.

the 10 years before electing to apply the special tax regime.

Whether an individual has become a resident for tax purposes is determined in accordance with Italian law.

An individual is considered tax resident in Italy under article 2, paragraph 2 of the TUIR if they meet either of the following requirements for most of a calendar year — that is, for at least 183 days (or 184 days in a leap year):

- the individual is registered in the register of the Italian resident population (the formal requirement); or
- according to the Civil Code, the individual has either his residence (place of habitual abode) or domicile (center of vital interests) in Italy (the substantial requirement).

Because Italy uses a calendar year for individuals, an individual must begin to meet one of these conditions no later than June 30 of the relevant year. For example, if the register of the Italian resident population records the individual as resident in September 2018, he will not be considered a resident in 2018 under the formal requirement because he cannot meet the minimum period. Italy will consider him a resident only from 2019, as long as he remains recorded in the register for at least 183 days in 2019.

Registration in the register of the Italian resident population is made upon request to the municipality of the city where the individual intends to reside. The request must indicate the address where the individual will reside. The Italian Revenue Agency directs the local authorities to assess the individual's compliance with the declarations made in the request. If the individual is not present — which may well happen because of work or personal reasons — the authorities will invite him to go to their office in person. If, following several attempts over time, the individual is unreachable, then the local administrative authorities will remove him from the register of the resident population; the tax authorities will not consider him a resident of Italy, and he will not be eligible for the special tax regime. It would still be possible to qualify under the substantial requirements, provided that the relevant conditions are met.

One issue that often arises is whether an individual can maintain connections of various kinds — family, a house, club memberships, and so forth — in his country of origin. For the special tax regime to apply, it is sufficient that Italian law regards the individual as a resident. It is, therefore, irrelevant if the individual maintains connections in other countries. However, those circumstances may be relevant to the other countries; their competent tax authorities might assert that the individual is a tax resident of their country for tax purposes under their domestic laws. A foreign tax authority making that assertion would not per se undermine the individual's eligibility for the Italian special tax regime. Clearly, however, if another country is going to tax the individual on a worldwide basis, then the benefits of the special tax regime would be ineffective. Planning a transfer of residence to Italy, therefore, requires a careful analysis of the tax implications in the country of origin to avoid any adverse consequences.

In a case of dual residence — that is, when both Italy and another country regard the individual as a tax resident — if a tax treaty applies, then the countries will resolve the conflict under the tiebreaker rules envisaged in all of Italy's tax treaties. Although there is no specific guidance addressing this event, if the tax treaty rules consider the individual to be a resident of the other country, then it seems reasonable to conclude that the individual would no longer qualify for the special tax regime.

The second fundamental eligibility requirement is that the individual has not been a resident for tax purposes in Italy for at least nine years during the 10 years preceding the application of the special tax regime. The fact that an individual was a resident before that period does not preclude the election of the special tax regime. Regarding the burden of proof: While the individual is not formally required to prove he resided in another country during the relevant period, in substance the only way to prove he was not resident in Italy is by showing some evidence that he resided in another country.

Generally, citizenship is not relevant to the special tax regime. Both EU and non-EU citizens are eligible for the regime. In fact, non-EU citizens who apply for the regime are entitled to use a simplified procedure to obtain the necessary visa.

A special rule applies to Italian citizens who transferred to blacklisted jurisdictions and intend to return to Italy. Those individuals are also eligible for the special tax regime, but they must prove that they were effectively resident for tax purposes in the other jurisdictions.

Family Members

The special tax regime is also available to family members if they satisfy the eligibility requirements. Qualifying family members include spouses, children, parents, siblings, children-in-law, and parents-in-law. The annual lump sum tax for family members is €25,000 per person.

Income Taxes

Under the special tax regime, individuals are subject to an annual substitute tax of €100,000 (plus €25,000 for each family member) on any foreign-source income. Consequently, foreign income of any kind is not subject to any further taxation. As noted above, there is no remittance rule: Foreign income can be remitted to Italy without any adverse tax consequences.

The Italian Revenue Agency has stated that Italian rules apply in determining whether an item of income was produced abroad, regardless of how the other country classifies that income. Under these rules, Italy will consider the following items of income, *inter alia*, as foreign-source:

- income from real estate located abroad;
- income from employment or other activities carried out abroad;
- dividends, interest, and capital gains from non-Italian entities (with the exception detailed below regarding qualified participations).

The agency has clarified that it will consider dividends and capital gains from blacklisted jurisdictions to be foreign income for purposes of the special tax regime. Moreover, Italian controlled foreign corporation rules do not apply.

The Italian Revenue Agency has specifically addressed the tax treatment applicable to the holding of assets through interposed entities. An entity is deemed to be interposed if the legal and economic ownership of the assets can be attributed to another person. For example, a trust may be an interposed entity if the settlor can revoke the trust at any time and dispose of the assets without limitations. According to the agency's guidelines, it will apply a look-through approach to these entities. As a result, Italy will attribute any income of an interposed entity to the new resident that is the actual beneficial owner and tax it depending on the source: If the income is foreign-source, the substitute tax will cover the income; if the income is Italian-source, standard taxation will apply. A taxpayer can obtain advance clearance from the agency regarding the foreign origin of income from interposed entities.

A very important clarification concerned (non-interposed) entities controlled by new residents that effectively carry out a business abroad. The Italian Revenue Agency used to scrutinize in great detail the holding of participations in foreign companies, and often such scrutiny results in a claim that the foreign company is effectively managed in Italy and should therefore be treated as a resident of Italy for tax purposes. The Italian Revenue Agency specified that, in light of the special tax regime, it will not raise any such claims regarding foreign companies held by new residents, even if the companies are effectively managed in Italy by those new residents.

Taxpayers can choose to opt out of the special tax regime for specific countries. In that case, any income from the excluded countries will be subject to ordinary taxation. A taxpayer might opt out of the regime for some countries if he expects that those countries may deny treaty benefits.

To avoid abuse, capital gains from the sale of qualified participations — that is, any participation that entitles the holder to over 20 percent of the voting rights in or over 25 percent of the share capital of a company (respectively, 2 percent or 5 percent for listed companies) — realized within the first five years that the taxpayer uses the special tax regime are not covered by the substitute tax. Instead, they are subject to ordinary taxation as follows:

- for capital gains realized in 2018, progressive tax rates (up to a maximum of 43 percent) apply to 58.14 percent of the amount; and

- for capital gains realized from 2019 onward, a tax rate of 26 percent applies to the full amount of the gain.

After the five-year period, the annual substitute tax will include capital gains from the sale of qualified participations, and they will not be subject to any further taxation.

Any Italian-source income is subject to standard individual income taxation. New residents are entitled to the standard deductions and allowances for individual income tax purposes (for example, the allowance for dependents).

Inheritance and Donation Tax

Wealth transfer across generations is a sensitive issue for high-net-worth individuals (HNWIs). The high tax burden that many jurisdictions impose on wealth transfers has always induced HNWIs to develop sophisticated structures and seek out ways to mitigate or eliminate the tax burden. The framework of the special regime addresses these concerns by providing an exemption from Italian inheritance and donation tax.

For successions opened and donations made during the tax periods that the deceased or the donor elected for the special regime, Italian inheritance and gift taxes are due only on assets and rights located in Italy at the time of inheritance or donation. Therefore, if the deceased or donor exercised the option for the special tax regime, their foreign assets and rights are not subject to inheritance and donation tax.

In this respect, the exemption from inheritance and donation tax derogates from the territorial scope of application that generally applies to the Italian inheritance and donation tax. Indeed, under domestic rules,[4] if the deceased or the donor is resident in Italy at the time of inheritance or donation, inheritance and donation taxes are due on all — both domestic and foreign — assets and rights transferred. If instead the deceased or donor is not resident in Italy at the time of the inheritance or donation, inheritance and donation tax applies solely to those assets and rights transferred that are in Italy. Since the key criterion for applying the inheritance and donation tax is the tax residence of the deceased or donor, the heirs or recipients resident in Italy for tax purposes are not subject to any inheritance or donation tax under ordinary rules (unless the assets received are located in Italy).

Assets and rights are considered to be in Italy if they are physically or legally present; the latter includes, for example, shares and other securities held in deposit with an Italian resident financial intermediary. For these purposes, there is an irrebuttable presumption that the following assets and rights are in Italy:

- rights and assets of the state registered in public registries;
- shares and units of companies and entities if the legal seat, administrative seat, or the main activities of the issuing company or entity are located in Italy;
- bonds and other securities — aside from shares — that the Italian government or Italian companies and entities have issued;
- certificates representing assets or goods in Italy;
- receivables, promissory notes, and checks, if the debtor is resident in Italy;
- credits secured by assets in Italy, up to the value of the assets; and
- assets that are in transit abroad, but that are addressed to Italy.

If the individual opts out of the special tax regime for one or more specific jurisdictions, the opt-out is also relevant for Italian inheritance and donation tax purposes. Thus, the standard domestic provisions regulating the scope of application of inheritance and donation tax would apply to assets and rights in the excluded jurisdictions.

Net Wealth Taxes

Italy does not have a general net wealth tax. However, it does have a tax on real estate property abroad (Imposta sul Valore degli Immobile situati all'Estero, or IVIE)[5] and a tax on foreign financial assets (Imposta sul Valore delle

[4] D.Lgs. No. 346/1990.

[5] IVIE applies at a rate of 0.76 percent on the value of foreign real estate (article 19, paras. 13-17 of D.L. No. 2/2011).

Attività Finanziarie detenute all'Estero, or IVAFE).[6]

Under the special tax regime, new residents are exempt from IVIE and IVAFE. If the new resident opts out of the special regime for one or more jurisdictions, the exemption does not apply to the assets in the excluded jurisdictions.

Tax Treaties

One notable question is this: Are individuals who opt for the special tax regime entitled to the application of tax treaties?

Italy's tax treaties are based on the OECD model income tax treaty. Article 1 of the model says that the convention "shall apply to persons who are resident of one or both of the Contracting States."

Article 4, paragraph 1 of the OECD model convention reads:

> the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. . . . *This term, however, does not include any person who is liable to tax in that State in respect of income from sources in that State or capital situated therein*. [Emphasis added.]

Paragraph 8.1 of the commentary on article 4 clarifies that the second sentence of article 4(1) targets special situations in which individuals — like the foreign diplomatic or consular staff serving in some states — are "subject only to a taxation limited to the income from sources in that State or to capital situated in that State." Moreover, paragraph 8.3 of the commentary on article 4 further explains that the second sentence of article 4(1):

> has to be interpreted in the light of its object and purpose, which is to exclude persons who are not subjected to comprehensive taxation (full liability to tax) in a state, because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.

Based on these statements, it can be reasonably argued that article 4(1) of the OECD model does not address the specific case of the new residents regime and does not prevent the application of tax treaties to individuals resident in Italy who elect for it.

In contrast, if two countries want to exclude treaty benefits for persons who are subject to tax only on domestic income in accordance with a special exemption regime, they should include a specific provision in the treaty to that effect. That is done, for example, in the Italy-Switzerland tax treaty. Article 4(5) of that treaty reads:

> The following persons shall not be deemed to be residents of a Contracting State within the meaning of this Article: . . . .
>
> (b) an individual who in the Contracting State of which he would be a resident by virtue of the preceding provisions, is not subject to the taxes generally imposed on all items of income arising from the other Contracting State which are generally taxable income under the tax law of the first-mentioned State.

That said, individuals who elect for the special tax regime:

- are subject to standard taxation on Italian income and assets;
- are subject to a fixed annual substitute tax on foreign income and assets; and
- can opt out as concerns specific countries.

In light of the above, the Italian Revenue Agency confirmed that individuals who opt for the special tax regime are resident in Italy for treaty purposes — that is, unless the relevant tax treaty contains a specific provision expressly excluding the application of the treaty.

How to Apply

The election must be made in the Italian tax return for the first year that the special tax regime is to be effective. In particular, an individual may either opt into the regime on the tax return that reflects income from the tax period when she became resident in Italy, or do so in the next return.

[6] IVAFE applies at a rate of 0.2 percent on the value of financial products, bank accounts, and savings accounts held abroad (article 19, paras. 18-23 of D.L. No. 2/2011).

Electing taxpayers may file a ruling request to obtain advance clearance from the Italian tax authorities regarding their eligibility. The ruling is not mandatory, but it is recommended in most cases as it provides certainty on the applicability of the special tax regime. The ruling may also cover the application of the special tax regime to family members who can join it at any time. The individual can also file a ruling request before becoming a resident for tax purposes. In that case, the ruling is conditional upon the individual actually becoming an Italian tax resident.

According to the implementing regulations, the applicant must complete a specific checklist and attach it — along with the necessary documentation — to either the ruling request or the tax return in which the election is made.

The Italian Revenue Agency has stated that the burden of proof differs depending on the strength of the applicant's personal and economic connections with Italy and on the status — for tax purposes — of the applicant's jurisdiction of origin, with the authorities devoting particular attention to the applicant's ties with her former residence to ensure that the individual was not an Italian resident for nine of the past 10 years. If the applicant's connections with Italy are weak and do not include personal ties, her burden of proof may be limited to a brief description of her connections with the jurisdiction where she lived before transferring her residence to Italy. However, if the applicant's connections are stronger, she must describe her personal and economic connections with foreign jurisdictions in detail, thus excluding Italy as her state of residence and showing that she meets the requirements for the regime.

The Italian Revenue Agency must reply to a ruling request under the special tax regime within 120 days of the filing. The agency may request further information or documentation within that period. In that case, the agency has an extended response period that lasts up to 60 days from receipt of the additional information or documentation.

If the agency does not give an answer within the allotted time, the rules deem the request to be approved.

During the first year that the special tax regime was in effect, my experience has been that the Italian Revenue Agency always replied in a timely manner. Moreover, the approach shown during meetings has been taxpayer-friendly and focused on problem solving. Thus, I would generally advise applicants to file an advance ruling and resolve possible interpretative issues upfront rather than via an ex post assessment.

As previously discussed, electing taxpayers may exclude one or more jurisdictions from the coverage of the special tax regime.

Family members have an autonomous ability to opt out regarding specific jurisdictions that is distinct from the choice made by the main applicant. Therefore, the countries that the main applicant excludes and those that the family members exclude may differ. The choice of jurisdictions to exclude can also be made after the election of the special tax regime. The list can only be modified to include additional jurisdictions — the opt-out cannot be revoked.

Substitutive Tax

Electing taxpayers must pay an annual substitute tax of €100,000, regardless of the amount of foreign income realized. Each family member included in the election must pay an annual substitute tax of €25,000.

The substitute tax is a one-time payment that follows the term generally provided for the final payment of income taxes — that is, payment is due by the end of June in the year following the relevant tax period.

As for any withholding taxes that Italy levied during the tax period when the applicant moved to Italy but before the election took effect, the taxpayer can offset those payments against taxes on Italian-source income or request a refund. The substitute tax cannot be offset in any way, however.

Duration and Termination

The special regime is automatically renewed every year and terminates after 15 years.

The taxpayer can revoke the election at any time in his tax return, even if he already paid the substitute tax for the relevant tax period. Termination of the special tax regime may also occur because of a failure to pay (or incomplete payment of) the substitute tax or when the

applicant transfers his tax residence to a jurisdiction outside of Italy.

It is possible to terminate the special tax regime for specific family members, too. Generally, the main applicant's revocation — voluntary or involuntary — also terminates the special tax regime vis-à-vis family members to whom it has been extended. However, if the special tax regime terminates because of circumstances involving the main applicant, family members may exercise a new, autonomous option to continue to benefit from the regime. In such a case, starting from the autonomous election, the new applicant should pay the substitutive tax of €100,000. This option is available for up to 15 years minus the number of years in which the family member already benefited from the special tax regime — that is, for a total of 15 years including those both before and after the main applicant's termination.

After the revocation or termination, the main applicant cannot apply for the special tax regime again.

If the main applicant dies during the special tax regime, the heirs may confirm the election and pay the substitute tax.

If they meet the eligibility requirements, the heirs may exercise an autonomous option for the remainder of the 15-year period.

Reporting Obligations

As a general rule, new residents must file a tax return in the first year of residence to apply for the special tax regime.

In subsequent years, new residents who elect the special tax regime will only have to file a tax return in the following cases:

- if they receive any Italian-source income, which is subject to ordinary taxation; or
- if, in the first five years under the special tax regime, they hold qualified participations in foreign companies.

New residents do not have to report their foreign assets or investments, with the exception of qualified participations in foreign companies in the first five years.

Final Remarks

Since its entry into force, Italy's special tax regime for new residents has attracted the interest of many potential applicants, and — as always follows the introduction of new disruptive measures — some critics.

From a tax policy perspective, some argue that the special regime will cause Italy to become a tax haven for HNWIs. However, this argument seems to ignore the fact that similar regimes have been available in other countries that are certainly not considered tax havens, including the United Kingdom.

Another issue that critics initially raised — and which has now almost disappeared from the conversation — is whether the special tax regime is compatible with the principles of the Italian Constitution, because it would seemingly discriminate between new residents and established residents. In my view, this argument does not have any legal basis. There are several reasons for this conclusion, and I will only mention a few. On the one hand, it is clear that there is a difference in the tax treatment of new residents and established residents. On the other hand, the different treatment is temporary — 15 years — and subject to special conditions, including the payment of an annual substitute tax of €100,000. Most importantly, there is no infringement of any constitutional principle because the benefit to the new residents only affects individuals who would have not moved to Italy absent the special tax regime. The arrival of these new residents does not worsen conditions for existing residents — the new residents can only bring benefits to the Italian economy in terms of capital and knowledge. The special tax regime is therefore justified by other principles that have equal dignity from the perspective of the Italian Constitution. Also, from a practical perspective, there is no reasonably viable way to raise the issue of constitutionality before the Italian Constitutional Court.

That said, in my experience, the special tax regime is working well. Interest in the regime is constantly growing, and the Italian Revenue Agency's collaborative approach has been an important element in the regime's success. ■