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New tax treatment of capital gains

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The Budget Law for 2023 has introduced material changes to the domestic tax treatment of capital gains realised by non-Italian tax resident shareholders from transfers of Italian and non-Italian participations that would trigger the indirect sale of Italian real estates.

The new provisions are designed to make Italian domestic tax law consistent with the Organisation for Economic Co-operation and Development's (OECD) most recent approach. This refers to article 13(4) of the OECD Commentary to the Model Convention. Several jurisdictions have already applied this approach.

Under previous domestic framework, foreign entities were only taxable in Italy on capital gains realised from a direct sale of Italian immovable property or from a direct sale of stock in Italian companies. The new regime amends this so that capital gains from transfers of non-Italian participations are deemed to arise in Italy. This is so that said gains are subject to the 26% Italian capital gains tax should more than 50%[(1)] of the value of the transferred company derive (directly or indirectly) from immovable property located in Italy at any time during the 365 days preceding the sale (ie, "land rich" company).

The new provision also deleted the exemption formerly applicable under tax law in respect to capital gains derived from "nonqualified"[(2)] participations in Italian companies or entities realised by non-Italian tax residents that are resident in a jurisdiction. This allows a proper exchange of information with Italian tax authorities included in the Ministerial Decree (dated 4 September 1996, as amended) or institutional investors established in that jurisdiction. Nevertheless, an exclusion from the new provision applies to capital gains derived from the sale of participations listed in regulated markets.

Furthermore, provided that certain conditions are met, the new rules do not apply to EU collective investment undertakings. The new provision does not apply to investment funds established in the European Union, or in qualifying countries of the European Economic Area that are either compliant with the Undertakings for the Collective Investment in Transferable Securities IV Directive or have a manager subject to regulatory supervision in the foreign country of establishment under the Alternative Investment Fund Management Directive. This exclusion is mainly aimed at avoiding discrimination issues at the EU level.

From a practical perspective, the new framework could have a material impact on foreign entities residing in countries without a taxation treaty with Italy or with a taxation treaty not protecting the state of residence in the case of capital gains derived from the sale of "land rich" companies (eg, Israel, France, United States, Canada, Hong Kong).

Although Italy has not yet ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), the new provisions should be carefully considered since, under the MLI, a higher number of double taxation treaties would allow the taxation of capital gains derived from equity interest whose value is mainly represented by Italian immovable property.**(3)**

Finally, it is worth noting that further clarification is expected from Italian tax authorities, since the application of the new provision is somewhat uncertain.**(4)**

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Endnotes

(1) Not computing Italian immovable properties related to the production and/or exchange of the business activity of the transferred company.

(2) Are deemed to be considered non-qualified participation equity interest in corporate entities where the shareholder has voting rights lower than 20 % (or 2% in case of listed entities) or to the share capital/net equity lower than 25% (5% in case of listed entities).

(3) However, even after Italy ratifies the MLI, the application of this provision will not be automatic, being subject to a specific option which must be exercised jointly by both contracting states. Therefore, although to date Italy has notified its intention to apply article 9(4) of the MLI, given the necessary reciprocity of the option, this provision will remain ineffective in respect to states that have not exercised the same option. From this it follows that with reference to those states that have not opted, or the Tax Treaty does not contain a provision similar to that of article 13(4) of the OECD Convention Model (such as for example Austria, Luxembourg and Switzerland) the changes introduced by 2023 Budget Law are deemed to remain ineffective, even after the entry into force of the MLI.

(4) For example, it should be clarified that gains from the disposal of participations in Italian real estate funds are not affected by the new rule.