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New Italian Capital Gain Taxation on Real Estate Vehicles

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1. Foreword

The Italian 2023 Budget Law has introduced new important tax measures related to the taxation of capital gains deriving from the disposal of interests in companies or other entities deriving more than half of their value from real estate located in Italy.

In a nutshell, the amendments are aimed at ensuring Italian capital gain taxation on the disposal of real estate entities in line with the provision of Art. 13(4) of the OECD Model Convention which Italy will probably try to ensure also through the ratification of the **Multilateral Convention**.

2. Preceding regime

Before these amendments, Italian tax law did not have a specific regime for capital gains on real estate vehicles (other than a specific provision related to the non-application of the participation exemption regime with respect to companies mainly deriving their value from real estate properties not used for the purpose of carrying out a business activity).

General provisions on capital gains were providing for some specific exemptions that, under certain circumstances, could have allowed foreign investors to sell their interests into Italian or foreign vehicles holding real estate in Italy without facing any Italian capital gain taxation.

2.1 Portfolio Participation Exemption

Art. 5(5) of the Legislative Decree no. 461/1997 provided (and actually still provides) that capital gains derived by Italian non-resident persons from the disposal of **portfolio participations** held in Italian entities were not subject to tax in Italy to the extent that such non-resident persons qualify as:

- white-listed resident entities;
- international bodies set-up pursuant to international agreements ratified in Italy;
- white-listed foreign **institutional investors**, even if not liable to tax;
- central banks and other bodies managing State's reserves.

2.2 Listed Participation Exemption

Regardless to the requirements listed under § 2.1 above, non-resident persons may still derive capital gains from the sale of interests in Italian entities without any Italian tax liability arising.

Pursuant to the Italian **sourcing rules** (contained in Art. 23 of the TUIR), capital gains derived from the sale of portfolio participation in Italian listed companies are not considered to be sourced in Italy, hence they are not taxable therein if derived by any non-resident person.

2.3 Irrelevance of the Sale of Foreign Entities

In addition, the sale by a non-Italian resident of a participation in a foreign entity was not considered to be tax relevant in Italy regardless to the nature and location of the assets held by the foreign entity sold. Indeed, the Italian sourcing rules did not have any provisions creating Italian domestic claims with respect to the sale of foreign entities by non-residents.

2.4 Tax Treaty Exemption

Even where none of the provisions described in the paragraphs above applied, non-Italian investors might still have disposed of interests in Italian entities holding immovable properties located in Italy without facing any Italian taxation.

Indeed, where the foreign investor was resident in a Country that has a tax treaty in force with Italy, the provisions of such treaty might have granted exclusive taxing rights to the State of residence of the investors. Only 24 of the roughly 100 treaties concluded by Italy contain a provision similar to Art. 13(4) of the 2017 OECD Model. In the absence of such a provision, the residual paragraph of Art. 13 of the OECD Model kicks in (para. 5), granting exclusive taxing rights to the State of residence of the investor.

Italian tax treaties in force with a provision similar to Art. 13(4) of the OECD Model		
Armenia	France	Pakistan
Azerbaijan	Jamaica	Panama
Italian tax treaties in force with a provision similar to Art. 13(4) of the OECD Model		
Barbados	Hong Kong	Philippines
Canada	India	Romania
China	Israel	Saudi Arabia
Colombia	Kenya	Sweden
Estonia	Mexico	Ukraine
Finland	New Zealand	Uruguay

3. New provisions for real estate entities

The tax treatment described above has now changed as a consequence of some amendments introduced by the 2023 Italian Budget Law.

3.1 Extra-territorial Taxation on Real Estate Entities Capital Gains

The Italian sourcing rule contained in Art. 23 of the TUIR has been supplemented by providing that capital gains derived by non-Italian resident from the sale of interests in non-Italian entities deriving more than half of their value, directly or indirectly, from real estates located in Italy are considered to be sourced in Italy for tax purposes.

Through this new rule, where foreign investors dispose of their interests in non-Italian real estate entities a taxable event occurs for Italian purposes. It is clearly an extra-territorial form of taxation as the only connection that the sale has with the Italian territory is given by the real estate properties held by the relevant entity (indeed, the taxable person and the entity whose participations are sold are located outside of Italy).

However, the scope of the above-mentioned rule is limited by the following provisions:

- in order to assess how much of the value of the entity is derived by real estate properties located in Italy, all the real estate properties (i) owned by enterprises whose business activity consists in building or selling such properties or (ii) directly used for business purposes, must not be taken into consideration;
- the new rule does not apply where listed participations are disposed of;
- the new rule does not apply to capital gains derived by investment funds compliant with Directive 2009/65/EC (UCITS IV Directive), or funds not compliant with the above mentioned Directive but whose management company is subject to forms of supervision in the country of establishment in accordance with Directive 2011/61/EU (AIFM Directive), to the extent that they are established in a EU Member State EEA State allowing for an adequate exchange of information with Italy.

The relevant provision of law makes reference to entities whose value is derived both directly and indirectly from Italian real estate. From this, it should follow that the new rule should also apply where several entities are interposed between the seller and the Italian real estate properties.

3.2 (Partial) Repealing of the Portfolio Participation Exemption

In addition to the above-mentioned new sourcing rule, the 2023 Italian Budget Law also amended the portfolio participation exemption described under para. § 2.1 above.

In particular, it is now provided that the portfolio exemption provided for by Art. 5(5) of the Legislative Decree no. 461/1997 does not apply with respect to the sale of interest in entities deriving more than half of their value, directly or indirectly, from real estates located in Italy. The objective scope of this provision entirely overlaps with the one of the new sourcing rule.

In other words, as the portfolio participation exemption scope has been narrowed, the foreign investors mentioned in Art. 6 of the Legislative Decree no. 239/96 are not going to be able to enjoy such

exemption anymore with respect the sale of Italian or foreign real estate companies mainly holding real estate properties in Italy.

Accordingly, in principle, under Italian domestic law, a capital gain tax may apply with respect to the sale of interests in entities (wherever located) deriving more than half of their value from immovable properties located in Italy. However, as it will further described in the next paragraph, in order for such taxation to actually be applied, one also needs to check the effects of the relevant tax treaty, if any.

Finally, it is important to note that the same limits to the scope of the provision already described with respect to the new sourcing rule under § 3.2 above (*i.e.* real estate used in business activities, listed participation exception and regulated funds exception) also apply with respect to this new provision.

Taxation in Italy of non-residents deriving gains from the sale of shares

<table>
<tr><th colspan="2">Type of participation in the company</th><th>Non-real estate companies</th><th>Real estate companies</th></tr>
<tr><td rowspan="4">Non-Portfolio Participations</td><td>In Italian (unlisted) companies</td><td rowspan="2">Territorially relevant in Italy.
26% substitute tax</td><td rowspan="2">Territorially relevant in Italy.
26% substitute tax</td></tr>
<tr><td>In Italian (listed) companies</td></tr>
<tr><td>In foreign (unlisted) companies</td><td rowspan="2">Not territorially relevant</td><td>Territorially relevant in Italy.
26% substitute tax</td></tr>
<tr><td>In foreign (listed) companies</td><td>Not territorially relevant</td></tr>
<tr><td rowspan="4">Portfolio Participations</td><td>In Italian (unlisted) companies</td><td>Territorially relevant in Italy.
Exemption from substitute tax for white-list persons or 26% substitute tax in the other cases</td><td>Territorially relevant in Italy.
26% substitute tax</td></tr>
<tr><td>In Italian (listed) companies</td><td>Not territorially relevant</td><td>Not territorially relevant</td></tr>
<tr><td>In foreign (unlisted) com-panies</td><td rowspan="2">Not territorially relevant</td><td>Territorially relevant in Italy.
26% substitute tax</td></tr>
<tr><td>In foreign (listed) compa-nies</td><td>Not territorially relevant</td></tr>
</table>

3.3 Interaction Between the New Italian Provisions and Tax Treaty Law

The new Italian domestic claim connected to real estate entities must be tested against the relevant applicable **tax treaty**.

Indeed, the new provisions will have an immediate effect only where:

- the person deriving the relevant capital gain is resident in a Country which does not have a tax treaty in place with Italy;
- the person deriving the relevant capital gain is resident in a Country which does have a tax treaty in place with Italy but such person is not entitled to treaty benefits (e.g. it is not considered to be **liable to tax** therein).

In all the other cases, in order to ascertain whether or not the new Italian provisions may actually be applied, a specific analysis of the treaty between Italy and the State of residence of the seller needs to be carried out.

With respect to the 24 treaties that already have a wording which is similar to the one contained in Art. 13(4) of the **OECD Model Convention**, the new Italian provisions should immediately be applicable. However, the specific wording of the relevant treaty needs to be carefully assessed as they do not always identically overlap with the new Italian provisions (e.g. the provision contained in protocol, 8) a), first sentence, to the Italy-France treaty).

With respect to other treaties Italy has entered into until today, their application will not currently allow the new Italian provisions to apply.

However, this may change in the future as, based on the last official news on the topic, Italy have elected to apply Art. 9(4) of the MLI to its existing treaties. In addition, Italy has also opted for Article 9(1) not to apply to its existing treaties. However, Italy has not ratified the MLI yet.

From this, it follows that, in cases where the tax treaty concluded between Italy and another Country does not currently contain a provision similar to Art. 13(4) of the OECD Model, the new Italian provisions will not be applicable.

However, should Italy actually ratify the MLI by electing for the options just reported and should the other Contracting State have also opted to apply for Art. 9(4) of the MLI, then the treaty will be considered as containing the provisions of Art. 13(4) and the new Italian provisions will be compliant with the treaty.

The ratification of the MLI by Italy may also affect the treaties that already contain a provision which is similar to Art. 13(4). Indeed, also based on the way both the Contracting States will (or already have) ratify the MLI, the 24 already existing provisions which are currently considered to be similar to Art. 13(4) might be replaced by the provision contained in Art. 9(4) of the MLI, which is entirely overlapping with the new Italian provisions.

Taxation in Italy on gains on real estate vehicles under treaty law

Tax Treaty between Italy and the State of residence of the seller	Taxation in Italy
Not in place	Yes
In place but without a provision similar to Art. 13(4) of the OECD Model	No
In place but without a provision similar to Art. 13(4) of the OECD Model but the State of residence has opted in for Art. 9(4) of the MLI	Italian taxation might be allowed based on when and how Italy will actually ratify the MLI
In place and with a provision similar to Art. 13(4) of the OECD Model	Yes, but both the wording of the Italian domestic provisions and of the treaty need to be checked to see if they are complaint to each other

4. Glossary

Budget Law

Law which needs to be enacted every year regarding the State expenditures and revenues for the following calendar year.

Institutional investors

Entities carrying out the activity of making or managing investments on their own behalf or on behalf of other persons and which are subject to a form of regulatory supervision in the Countries in which they are established.

Liable to tax

Under tax treaty law, these terms refer to a person which is fully liable to tax in his Country of residence, even if only potentially liable to tax and not subjcet to any actual taxation.

Multilateral Convention

OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"), aimed to update automatically a series of tax treaty measures.

OECD Model Convention

Tax treaty model issued and amended throughout the years by the OECD (together with a related Commentary) as a sample and guidance for treaties to be concluded by OECD Countries.

Portfolio participation

Shareholdings that grant up to the 20% of the voting rights, or up to the 25% of the share capital (2% or 5%, if listed in a stock exchange) (art. 67(1)(c-bis) of the TUIR).

Sourcing rule

Rule aimed at establishing that a given kind of income, under certain conditions, is considered to be sourced in Italy, i.e. it is considered to be taxable therein even if the person deriving such income qualify as non-resident in Italy for tax purposes. The most important Italian sourcing rules are provided for by Art. 23 of TUIR.

Tax treaty

Tax treaty International Convention concluded between two States for the avoidance of double taxation and double non-taxation in economic transactions involving them.