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Italy Introduces Tax on Foreign Real Estate

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COUNTRY DIGEST

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Italy Introduces Tax on Foreign Real Estate

Italy's Parliament on December 22, 2011, passed Law 214, introducing a tax on the value of foreign real estate owned by Italian resident individuals. The new tax, which has retroactive effect from 2011, is imposed at a rate of 0.76 percent on either the cost or the fair market value of the foreign real estate.

The statute attempts to mitigate double taxation by allowing Italian residents to credit net worth foreign taxes (if any) paid abroad against, and up to the amount of, the new tax.

However, while real estate taxes may effectively be considered net worth taxes, it is unclear if real estate taxes levied by the foreign jurisdiction where the property is located are considered net worth taxes or are creditable against the new tax regardless of their classification under foreign laws.

Law 214 may answer that question by providing that the principles of the individual income tax are to be followed in applying and assessing the new tax. Under article 165 of the Italian Income Tax Code, individuals may claim a tax credit for foreign income tax paid on income earned and taxable in another country. This provision is generally interpreted as allowing a credit for any taxes paid on foreign income as long as they are "definitive." In that case, it would seem reasonable that Italian residents could credit against the new tax real estate taxes paid on the same property in the foreign jurisdiction where the property is located.

The foreign tax credit mechanism raises another concern. If it is applied in accordance with the income tax rules, it appears that the credit would be available only if the foreign property generates income reported in Italy. This is because, as in the U.S., the allowable FTC cannot exceed the part of a taxpayer's total Italian tax that is in proportion to the taxpayer's taxable income from non-Italian sources. Accordingly, the new tax appears to potentially discriminate between income-producing properties and real estate held for personal use.

Meanwhile, the tax affects U.S. and other foreign nationals who relocate to Italy without disposing of real estate interests in their home countries. The tax will also play an additional, significant role in the structuring of Italian nationals' investment in foreign real estate.

The way it is worded, the new statute seems to offer an easy way around the tax for individuals who are willing to hold title to foreign real property through a corporate entity, rather than directly. However, ownership through a corporation may expose the investor to a tax on foreign financial activities, also introduced by Law 214. To reduce or eliminate that additional imposition, taxpayers might want to consider coupling a corporate structure with a mortgage to reduce the FMV of the corporate stock. ◆

♦ *Alessandro-Adelchi Rossi, Funaro & Co. PC*