

# **U.K. Domicile Rules: An Italian Perspective**

**by Alessandro Adelchi Rossi**

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# U.K. Domicile Rules: An Italian Perspective

by *Alessandro Adelchi Rossi*

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In his article “U.K. Tax Update: Not Discrimination, Just Negative Favoritism” (see *Tax Notes Int’l*, Feb. 28, 2005, p. 771), Trevor Johnson expressed his concern that a non-U.K. domiciliary can enjoy a tax break that is denied to U.K. nationals. His complaint is that some individuals who are resident, but not domiciled, in the United Kingdom for tax purposes are relieved of tax liability on income not brought into the United Kingdom. Suppose a U.K. resident and domiciled individual buys some shares in a U.S. company and chooses to have the dividends paid into an account in the United States; he would have to pay U.K. income tax on those dividends. However, if a U.S. citizen working in London but domiciled in the United States were to do exactly the same, he would not have to pay U.K. tax. Mr. Johnson’s detailed analysis of European case law did not help his case against the more favorable treatment given by the United Kingdom to foreigners than to its own citizens.

To make matters worse, the U.K. domiciliary rules also lend themselves to possible abuse by foreign nationals, as discussed in the following paragraphs.

Those rules require determining the country where an individual is domiciled because if an individual is not domiciled in the United Kingdom, he must be domiciled in another country. That becomes relevant when the other country asserts tax jurisdiction based on domicile. Italy is one such country.

Italy taxes its residents on a worldwide basis. As a general rule, under Italian tax law, individuals are considered to be residents of Italy if any of the following three conditions is met for the greater part of the tax year:

- they are registered with the Office of Records of the resident population;
- their residence, within the meaning given to that term by the Italian Civil Code, is in Italy; or

- their domicile, within the meaning given to that term by the Italian Civil Code, is in Italy.<sup>1</sup>

Accordingly, an individual who would otherwise be treated as a nonresident of Italy because he does not meet either of the first two conditions mentioned above still would be subject to Italian income tax on his worldwide income if he is domiciled in Italy.

The Italian Civil Code defines domicile as the center of an individual’s vital interests.<sup>2</sup> That definition is very close to that of the “center of vital interest” established under treaty law. When a person is resident in both Italy and the United Kingdom under their respective tax laws, article 4 of the income tax treaty between the two countries<sup>3</sup> provides for a tiebreaker mechanism to assign a single country of residence under the treaty. The tiebreaker rules provide for many tests, to be applied in the order in which they are stated, that look at the personal connections (namely, permanent home, center of vital interests, habitual abode, and nationality) between the individual and the two countries.

The discussion of those tests is outside the scope of this article. However, assuming that the first test (permanent dwelling available to the individual) is met in both countries, the next tiebreaker rule (the center of vital interests) must be considered. In that case, the proper test is to determine in which country an individual has deeper roots, taking into account his personal and economic interests.<sup>4</sup> The commentary on article 4 of the OECD model states that in determining a person’s center of vital interests, relevant factors include (but are not limited to): family and social relations; occupation; political, cultural, and other activities; place of business; and

<sup>1</sup>See article 2(2) of DPR 917/86 *Testo Unico delle Imposte sui Redditi* (the Italian Tax Code, or TUIR). Also, TUIR article 2(2-*bis*) establishes a rebuttable presumption of Italian residence if an Italian citizen who formerly resided in Italy becomes a resident of a country that is considered a tax haven jurisdiction by Italian tax authorities. (For a list of countries considered tax haven jurisdictions, see article 1 of *Decreto Ministeriale* of May 4, 1999).

<sup>2</sup>See article 43 of the Italian Civil Code.

<sup>3</sup>Convention between the United Kingdom and Northern Ireland and the Italian Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (entered into force December 31, 1990).

<sup>4</sup>See paragraph 15 of the OECD commentary on article 4 (“circumstances must be examined as a whole”).

place of property administration. The commentary also suggests that a person who starts with his center of vital interests in one country (for example, Italy) cannot easily change that center unless there is a clear shift to the other country.

Whether one looks to Italian domestic law or to the Italy-U.K. treaty, a change in domicile is a much tougher test to satisfy than that of non-Italian residence. Time in another jurisdiction is usually not sufficient by itself to establish a non-Italian domicile. In many instances, Italian citizens working in London or elsewhere in the United Kingdom do not establish community ties that are strong enough to indicate an absence of any fixed intention of returning to Italy.

Determining the country that is of greater significance to an individual based on his conduct might prove to be a tough proposition. However, an Italian citizen's intention to change his domicile of origin can be judged not only by looking at his conduct, but also by looking at statements he makes to U.K. tax authorities. For example, it is this author's understanding that an individual arriving in the United Kingdom to take up employment should file Forms P86 and DOM1 with the U.K. Inland Revenue to help establish his residence and domicile status. Those forms ask the individual which country he considers himself domiciled in, on what grounds he bases those considerations, his intentions for the future, and other relevant questions concerning the center of his vital interests.

Forms P86 and DOM1 seem to represent a bona fide domicile test. If the outcome of that test is that the individual is domiciled in the United Kingdom, then he will be subject to tax in the United Kingdom as an ordinary resident. Conversely, if the individual answers that he is domiciled in Italy, then he will also be taxable in Italy.

In the absence of an exchange of information program between the two countries, an individual may be tempted to conclude that it is safe to claim an Italian domicile for U.K. tax purposes and a U.K. domicile for Italian tax purposes. To encourage compliance, Italian tax authorities can use the enforcement provisions of article 27 (exchange of information) of the Italy-U.K. tax treaty. The purpose of article 27 is to prevent fraud and tax evasion in general; therefore, the exchange of information does not necessarily have to occur in connection with a specific provision of the treaty. In fact, the sharing of information may be sought in the context of the administration of domestic provisions.

From the tax authorities' perspective, the advantage of applying the exchange of information article is twofold: It enables Italy to enforce its own tax laws and the U.K. to identify persons not entitled to the benefits of U.K. taxation on a remittance basis. That second objective is attained when Italian tax authorities return documents to U.K. authorities, advising them that the persons to whom the documents apply are not filing as domiciled in Italy for Italian income tax purposes.

Granted, the exchange of information makes little or no difference to U.K. nationals, as they still have to pay taxes on their dividends from non-U.K. sources. However, they may draw a little comfort from the fact that U.K. residents who are domiciled in countries such as Italy pay their fair share of taxes to their country of origin. Until U.K. authorities review the domicile rules, the international enforcement discussed above might be the only viable alternative to prevent abuse of the rules by foreign nationals. ♦