

Italy - The New Tax Treatment of Capital Gains Arising from the Indirect Sale of Italian Real Estate Held by Non-Residents

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This paper aims to analyse the provisions introduced by the Italian Law on 29 December 2022, n. 197(Budget Law 2023), para. 96-99 of Art. 1, intended to make the tax treatment of capital gains realized by non-residents arising from the indirect sale of Italian immovable property equivalent to the one applicable to their direct sale. This newly introduced provision aligns the domestic tax regime with the one provided by Art. 13, para. 4, of the OECD Model Tax Convention, and by Art. 9, para. 4, of the Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting ("MLI"), which has been signed, but not yet ratified, by Italy.

1. Introduction

Law No. 197/2022 (hereinafter also referred to as “Budget Law 2023”), Art.1, para. from 96 to 99, introduced new provisions aimed at regulating the tax regime applicable to capital gains realized by non-residents deriving from the indirect transfer of immovable properties located in Italy. More in detail, Art. 1(96) amends Art. 23 of the Presidential Decree No. 917/1986 (*i.e.* the *Italian Income Tax Consolidated Code*, hereinafter also referred to as “ITC” or “TUIR”), which deals with the tax treatment applicable to non-residents.

The amendment prescribes the introduction of para. 1-bis, according to which the “*Miscellaneous income*¹ (category that includes capital gains) *deriving from the alienation of participation in non-resident companies and entities which, at any time during the 365 days preceding the alienation, derived more than 50 per cent of their value directly or indirectly from immovable properties* (named “real estate companies”) *located in Italy*” shall be considered to be sourced in Italy and, therefore, taxable therein².

In addition, when determining whether the value of shares arises for more than 50%, directly or indirectly, from immovable property in the previous 365 days (hereinafter also “prevalence test”), “*the real estate to the production or exchange of which the business activity is actually directed*” and “*those used directly in the exercise of the business activity*” (hereinafter also respectively referred to as “commodity” and “instrumental” real properties) shall not be taken into account (see Art. 1(98) of the Budget Law 2023). This newly introduced provision does not apply in the case of transfers of securities traded on regulated markets.

Before the introduction of this provision, the indirect sale of real estate properties by non-residents was taxable in Italy solely when selling shares of Italian companies. Differently, the new rule provides also for the taxation in Italy of gains deriving from the sale of shareholdings in non-resident companies, identifying the place where the immovable properties are located as a relevant *nexus* with the source State.

¹ Note that the Italian system distinguishes six different categories of income (see Art. 6, ITC), namely, income from immovable properties, income from capital, employment income, self-employment income, business income and miscellaneous income. This last category can be considered as a residual one, which also includes capital gains.

² As a general principle, under Italian tax Law (see jointly Art. 23 and Art. 151 of the ITC) non-resident entities carrying out a business activity without a permanent establishment in Italy are liable for tax in Italy on all income deemed to be Italian-sourced (*ex* Art. 23, ITC), regardless the fact that such income derives from a business activity or from other sources (so called “*principio del trattamento isolato dei redditi*”). On this topic, see R. Baggio, *Il principio di territorialità ed i limiti alla potestà tributaria*, pp. 460-463 (Giuffrè Ed. 2009); A. Di Pietro, *La nuova disciplina IRES: la tassazione dei Redditi dei non residenti e di principi comunitari*, Riv. Dir. Trib., IV, p. 593 and subs. (2004); and E.M. Bagarotto, *Brevi note sull'imponibilità dei redditi conseguiti dai soggetti non residenti privi di stabile organizzazione*, Riv. onl. di Dir. Trib. (29 Nov. 2022).

In addition, Art. 1(97) of Budget Law 2023 amends Article 5 of Legislative Decree No. 461/1997³ - concerning the substitute tax applicable to capital gains and other “miscellaneous income” arising from the alienation of participation referred to in Art. 67(1), lett. from c) to c-quinquies)⁴ of the ITC - introducing the new paragraph 5-bis, which provides for the application of an Italian substitute tax levied at the rate of 26% on capital gains and other miscellaneous income deriving from the alienation of “non-qualified” participations in real estate companies performed by non-residents.

The new legislation, even though with some discrepancies, renders the domestic law provisions more similar to those contained in the OECD Model Tax Convention and in the MLI (see *infra*).

2. The ratio legis of the new provisions introduced by Art. 1, para. 96 – 98 of the Italian Budget Law 2023

Under Article 23(1)(f), ITC⁵ capital gains realized upon the transfer of participations are deemed to be produced in Italy, if arising from the sale of participations in Italian companies. Accordingly, non-resident sellers are subject to a substitute tax of 26%, levied upon the realization of the capital gains. The newly introduced provisions consider produced in Italy also capital gains derived by the alienation of participations in non-resident entities whose assets are in prevalence represented by immovable properties located in the Italian territory, based on the assumption that their value is predominantly derived from goods located therein and, therefore, revert back the primary taxing right on said capital gains to the “Country of origin of wealth”. In line with this assumption, the new para. 1-bis of Art. 23 of the ITC goes beyond the legal separation between the immovable properties held by the non-resident entity and the entity itself so that this rule can be considered as the result of a substance-over-form approach in the selection of the taxing power allocation criteria.⁶ It should be noted that para. 1-bis of Art. 23 substantially mirrors the provisions set forth by Art. 13⁸(4)⁹ of the OECD Model Tax Convention (2017) and Art. 9¹⁰(4) of the “Multilateral Convention to Implement Tax Treaty related measures to prevent BEPS” (MLI) providing for the so-called “land-rich clause” (see *infra*). This clause aims at making direct and indirect disposals of real estate equivalent for tax

³ Legislative Decree No. 461 of 21 Nov. 1997, “*Riordino della disciplina tributaria dei redditi di capitale e dei redditi diversi*” deals with the tax treatment applicable on capital income and capital gains. For a detailed overview of Italian taxation of non-resident companies, see C. Silvani, *Italy - Corporate Taxation*, Country Tax Guides IBFD (accessed 19 Dec. 2022).

⁴ Art. 67(1)(c) of ITC provides for the notion of “qualified” shareholding referring to stakes which (i) represent more than 20% (2% in case of listed companies) of the voting rights in the ordinary shareholders’ meetings, or (ii) represent more than 25% (5% in case of listed companies) of the share capital of the participated entity. Differently, letters from c-bis to c-quinquies) of the same article refer to “non-qualified” participations, the notion of which can be inferred accordingly. In other words, the notion of “non-qualified” participation is complimentary to the one explicitly given in relation to the “qualified” ones.

⁵ Referred to by Article 151(2) of ITC for what concerns the taxation of non-resident entities without a permanent establishment in Italy.

⁶ As provided by the Legislative Decree No. 461 of 21 Nov. 1997, Art. 5(2).

⁷ Similarly, R. Rossi, *Cross-border capital gains on Italian participations: interaction between Italian domestic law, tax treaties and EU fundamental freedoms*, Riv. Dir. Trib., *Rubrica di diritto tributario internazionale e comparato*, VI, 104 (2022) where the Author states that “this rule can be considered also as the result of a substance-over-form approach in the selection of the drivers for the allocation of taxing powers between Countries further than an anti-abuse provision.”

⁸ For a detailed overview of the historical development of the clause reported in Art. 13 of the OECD Model Tax Convention, refer to H. Pijl, *Capital Gains: The History of the Principle of Symmetry, the Internal Order of Article 13 and the Dynamic Interpretation of the Changes in the 2010 Commentary on “Forming Part” and “Effectively Connected”*, 5 World Tax J. 1 (2013), Journal Articles & Opinion Pieces IBFD; E. Louca, “Article 13 - Capital gains”, in *History of tax treaties: the relevance of the OECD documents for the interpretation of tax treaties* (T. Ecker, G. Ressler eds., Linde 2011), p. 543 and subs.

⁹ Para. 4 of Art. 13 of the OECD Model Tax Convention has been introduced with the 2003 version of the same Model and lastly amended on 21 November 2017 by the report entitled “The 2017 Update to the Model Tax Convention”, adopted by the OECD Council on 21 November 2017, on the basis of another report entitled “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - Final Report”, endorsed by the G20 at the 2015 G20 Antalya Summit on 15-16 November 2015.

¹⁰ Art. 9 of the MLI contains provisions on “*Capital Gains from Alienation of Shares or Interests of Entities deriving their value principally from immovable property*”. However, Art. 9 is not among the minimum-standard provisions of the MLI. Therefore, each State may choose from different alternative provisions. Italy, for example, despite not having yet ratified the Convention, opted for the application of the land-rich clause contained in Art. 9 when it signed the MLI.

purposes, providing that the capital gains arising from the indirect alienation are subject to the same tax regime that would apply in the case of direct disposal of the underlying properties.¹¹

It has been also argued¹² that such a provision has an anti-abuse purpose, as it aims at making direct and indirect disposals of real estate equivalent for tax purposes. This view seems to be rather convincing, as the rule prevents the possibility of circumventing the source state taxation merely by interposing a company between the owner and the immovable property.¹³ This connotation, additionally, seems to be supported also by the following circumstances: (i) “commodity” and “instrumental” real properties are excluded for the purposes of the prevalence test (e.g., if the immovable property from which shares derive their value is that in which the main business of a company is carried on, the assumption that a corporate veil has been interposed between the owner and the immovable property is questionable);¹⁴ (ii) the prevalence test is deemed to be met in case immovable properties constitute more than 50% of the value “*at any time during the 365 days preceding the alienation*” of the participations (therefore preventing the immovable properties to be sold by the “real estate company” just a few days before the transfer of the participations); (iii) the provision includes also cases in which the value is “indirectly” derived from immovable property (in order to avoid multiple interpositions). However, in the Italian system, purely anti-avoidance rules can be normally disappplied by means of a tax ruling intended to demonstrate that the taxpayer did not undertake a specific structure/transaction/operation with the sole purpose of obtaining benefits the *ratio legis* of a given provision is aimed at avoiding. Differently, the rule at stake has been drafted as an autonomous distributive rule whose application is not limited to abusive situations (*i.e.*, determining the abusive intent of a transaction is not a requirement for the purposes of its application).¹⁵

3. Material scope – some relevant aspects.

The wording of the new para. 1-bis, Art. 23 of the ITC limits its material scope to capital gains deriving from the transfer of participation owned in the share capital of non-resident companies. This limitation relies on the fact that capital gains arising from the transfer of participation in resident

¹¹ See J. Li, F. Avella, *Article 13: Capital Gains*, in *Global Tax Treaty Commentaries*, IBFD online Books, (2017), para. 1.1.2.1. See S. Simontacchi, *Immovable Property Companies as Defined in Article 13(4) of the OECD Model*, Bull. Intl. Taxn, 1, 29 (2006).

¹² See J. Li, F. Avella, *Article 13: Capital Gains*, in *Global Tax Treaty Commentaries*, IBFD online Books, (2017), para. 1.1.2.1.; S. Simontacchi, *Immovable Property Companies as Defined in Article 13(4) of the OECD Model*, Bull. Intl. Taxn, 1, 29 and subs. (2006); C. Passi, *Prime osservazioni sui nuovi criteri di tassazione delle plusvalenze derivanti da cessione indiretta di immobili localizzati in Italia e detenuti da soggetti non residenti tramite “veicoli esteri”*, Riv. Onl. di Dir. Trib. (23 Jan. 2023).

¹³ See R.J. Vann, *International Aspects of Income Tax*, in Thuronyi, V. (ed.), *Tax Law Design and Drafting*, Washington, D.C.: International Monetary Fund, 718 – 743, (1998) according to whom immovable property company provisions “are intended to buttress the rules on taxing gains on [...] immovable property. A taxpayer can easily avoid those rules by holding the relevant asset in a company and then selling the shares in the company. [...] in practice it is not possible to prevent nonresidents from using variations on the same stratagem to avoid these rules. Rather than selling the shares in the resident company directly holding the relevant assets, a taxpayer can hold the assets through several tiers of companies (usually located in tax havens); it is then possible for one higher-tier nonresident company to sell the shares in the nonresident company below it in the tier and so effectively dispose of assets that may be several tiers below.” Regarding Spanish law (Art. 13(1)(b) of the Non-Resident Income Tax Law), see A.J. Martín Jiménez, *Domestic Anti-Abuse Rules and Double Taxation Treaties: a Spanish Perspective – Part II*, 56 Bull. Intl. Taxn, 12, 620- 621, (2002) where the author explains that “It is common to find companies whose main purpose is to hold real estate. This type of tax planning has several advantages, one being that, when selling the real estate, it might be more convenient to sell the shares of the company. Spanish internal law (Art. 13(1)(b) of the Non-Resident Income Tax Law (Real Decreto Legislativo 5/2004, de 5 de marzo)) provides an exemption for capital gains derived by residents of other EU Member States who do not have a permanent establishment in Spain. Art. 13(1)(b) also provides, however, that the exemption does not apply to capital gains derived from the sale of shares, participations or other rights in an entity which, directly or indirectly, owns Spanish real estate as its main assets. This exception to the exemption may well be regarded as an anti-abuse clause, and it may be asked whether the exception applies in the context of Spain’s tax treaties with other EU Member States.”

¹⁴ See C. Passi, *Prime osservazioni sui nuovi criteri di tassazione delle plusvalenze derivanti da cessione indiretta di immobili localizzati in Italia e detenuti da soggetti non residenti tramite “veicoli esteri”*, Riv. onl di Dir. Trib (23 Jan. 2023).

¹⁵ See S. Simontacchi, *Immovable Property Companies as Defined in Article 13(4) of the OECD Model*, Bull. Intl. Taxn, 1, 30 (2006) where the Author, referring to Art. 13(4) of the OECD Model (2005), describes it as “an autonomous distributive rule whose application is not limited to abusive situations (*i.e.*, determining the abusive intent of a transaction is not a requirement for applying Art. 13(4).”

companies are already taxable *tout court* in Italy, regardless of whether the investee company is or not a “real estate” one. In this regard, Article 23(1)(f), ITC establishes that “*for the purposes of the taxation of non-residents, the following are considered to be produced in the territory of the State: [...] miscellaneous income deriving from [...] assets located in the territory itself, as well as capital gains deriving from the alienation of shareholdings in resident companies.*”

Two cases only are excluded from the application of the aforesaid general provision, namely (i) capital gains realized upon the disposal of non-qualified¹⁶ participation in resident companies whose securities, wherever held, are traded on regulated markets, since they do not fall under the territorial scope of the ITC¹⁷; and (ii) capital gains derived from the disposal of non-qualified participation, if realized by persons resident in white-listed countries, as they are deemed to be exempted.¹⁸

Consequently, except for the cases in which one of the two exceptions is applicable, the disposal of participations in Italian real estate companies, undertaken by a non-resident, would constitute a taxable event and, therefore, would be subject to taxation in Italy.

It is worth deepening the peculiarity that capital gains arising from the “*disposal of securities traded on regulated markets*” are excluded from the scope of the new provisions.¹⁹ According to the clarifications provided by the Italian Tax Administration²⁰, to interpret the notion of regulated markets, reference should be made to the definition set forth in the Legislative Decree No. 58/1998²¹. Moreover, in addition to Italian markets authorized by the National Commission for Companies and the Stock Exchange (“CONSOB”), the notion of regulated markets should also include regulated markets located in EU or EEA States, EU and EEA multilateral trading facilities, and markets recognized by CONSOB under agreements with foreign authorities.

Such an exclusion seems justifiable because the Italian tax law recognizes all listed companies to meet the “commercial activity” requirement by default. Therefore, the tax regime applicable to the transfer of the related shareholdings is independent of the nature of the underlying assets. Even though not expressly provided, it seems reasonable to similarly exclude from taxation in Italy capital gains arising from the disposal of participations in unlisted foreign entities, whose value is mainly attributable to real estate located in the Italian territory and indirectly held by means of an interposed Italian listed entity. This happens, for example, when a foreign company participates in an Italian-listed real estate investment company (so-called “Società di Investimento Immobiliare Quotata” – “SIIQ”).²² Moreover, the tax exclusion should occur also in transfers of rights or securities through which the aforementioned shareholdings may be acquired, provided that the rights or securities are also traded in regulated markets.²³ However, on the other hand, the listing of non-equity securities, such as, for example, listed bonds issued by unlisted companies, is not deemed to be sufficient.²⁴

¹⁶ It is worth recalling, as already mentioned, that the notion of “non-qualified” participation is complementary to the definition of the “qualified” ones provided by Art.. 67(1)(c) of the ITC.

¹⁷ See Art. 23(1)(f), n. 1, ITC.

¹⁸ As provided by Art.. 5 (5), Legislative Decree No. 461/1997.

¹⁹ See Art. 23(1-bis), second sentence, ITC.

²⁰ Italian Tax Authorities, Circ. 23.12.2020 n. 32.

²¹ i.e., the Financial Markets Code (“TUF”).

²² The same conclusions should reasonably apply to foreign REITs. Therefore, the alienation of stakes in a foreign REIT predominantly investing in properties located in Italy, should not fall under the scope of the newly introduced rules.

²³ In this sense see. the Circular 26 October, 1999, No. 207, para. 1.3 which provided clarifications regarding the tax discipline of capital income and miscellaneous income of a financial nature in light of the amendments introduced by Legislative Decree No. 259/99 pertaining, *inter alia*, the Legislative Decree No. 461/1997.

²⁴ In the same sense, albeit with reference to a different topic, see Circular 12 December, 2004, No. 36, para. 2.3.4., concerning “*The new tax regime of capital gains deriving from the alienation of participations*” as provided by Art. 87, ITC (providing for the so-called “Participation exemption” or “PEX” regime). This latter provision, by providing for the 95% exemption from taxation of capital gains realized upon the sale of participation meeting specific requirements, including, amongst others, the conduction of commercial activity by the investee (the “commercial activity” requirement), excludes its applicability to capital gains deriving from the sale of participation held in real estate companies, inasmuch as they presumptively lack the aforesaid requirement. Such a presumption suffers a limitation as long as it is provided that the requirement of commerciality “*does not apply to participation in the companies’ share capital whose securities are traded on regulated markets*”. As clarified by the Italian Revenue Agency in the aforementioned Circular, “*The rule*

Another relevant aspect is represented by the circumstance that both Art. 23(1-bis) ITC and Art. 5(5-bis) of the Legislative Decree No. 461/1997 generally refer to “participations” held in non-resident “companies and entities”. This comprehensive reference seems to be coherent with the provision set forth by Art. 13(4) of the OECD Model when referring to “shares or comparable interests”. In this respect, the commentary to the OECD Model²⁵ clarifies that such a provision is intended “*to cover also gains from the alienation of interests in other entities, such as partnerships or trusts, that did not issue shares, as long as the value of these interests was similarly derived principally from immovable property*”. Whereas it seems reasonable to deem interest in partnerships as to be covered by the term “participations”, more doubts arise with reference to contractual trusts. In this respect, it is worth mentioning that the beneficiary does not really own a “participation” in the trust, but more of an entitlement to perceive, at a certain point in time, goods previously contributed to it by the settlor, the transfer of which is not susceptible to generate “capital gains”.²⁶

3.1 The tax treatment of capital gains realized by non-residents upon the sale of real estate investment fund units

As already mentioned, Art. 5(5) of the Legislative Decree No. 461/1997 provides for an exemption from taxation in Italy of the capital gains realized upon the alienation of “non-qualified” participation (referred to in Art. 67(1)(c-bis) – (c-quinquies) ITC), obtained by investors resident in white-listed countries. The new para. 5-bis - introduced in the aforementioned Art. 5 - excludes that such an exemption may be applied to capital gains realized from the alienation of “non-qualified” participation, when “*deriving from the sale of shareholdings in companies and entities (be they resident or not)²⁷, not traded on regulated markets, the value of which, for more than half, derives, at any time during the 365 days preceding their sale, directly or indirectly, from immovable property located in the territory of the State*”.

The general reference to "companies and entities" requires an inquiry on whether to include in the notion also foreign Collective Investment Undertakings²⁸ (a category in which real estate investment funds are also included). Based on the arguments illustrated below, it is reasonable to infer that they do not fall under the scope of the provisions introduced by the Budget Law 2023.

In fact, from a systematic point of view, under the interpretation according to which they would be included, the amendments introduced by the Budget Law 2023 would affect only the tax treatment applicable to capital gains and not that of income from capital.²⁹ This would

requires the listing of the company, as the mere listing of securities other than shares issued by unlisted companies, such as, for example, bonds, is not sufficient”. This clarification appears reasonably convincing in relation to the discipline at stake too, as it is based on the same rationale.

²⁵ OECD Model Tax Convention on Income and on Capital: Commentary (21 Nov. 2017), Treaties & Models IBFD.

²⁶ According to Assonime, Circ. Letter. 1° August 2023, No. 23, the term should include any shares and comparable interest, as, for example, financial instruments similar to shares and “stakes” in trusts.

²⁷ Unlike the provision of Art. 23, paragraph 1-bis ITC, which, as mentioned above, concerns only non-resident companies and entities, Art. 5(5-bis) of the Legislative Decree No. 461/1997 is also applicable to the transfer of “non-qualified” shareholdings in “companies and entities” resident in Italy. This can be inferred from the circumstance that Art. 67(1), lett. from c-bis to c-quinquies, ITC generally refers to the notion of “participation”, without any further specification with respect to the residence of the participated entity.

²⁸ According to Art. 1(1) (k), Legislative Decree No. 58/1998, a Collective Investment Undertaking (“OICR” in the Italian legislation) is defined as “*an undertaking set up for the purpose of providing an asset management service, the assets of which are pooled among a plurality of investors through the issue of units or shares, managed upstream in the interests of investors and independently of investors, and invested in financial instruments, loans[...]participation or other movable or immovable assets, according to a pre-determined investment policy*”.

²⁹ As previously mentioned *supra* (n 2), the Italian system distinguishes six different categories of income (see Art. 6, ITC), namely, income from immovable properties, income from capital, employment income, self-employment income, business income and miscellaneous income (which also include capital gains realized upon the alienation of participation). The difference between capital

imply the application of different tax regimes to the above-mentioned white-listed investors on income having the same nature, depending on whether they transfer the units held in real estate investment funds (be they resident or not³⁰), or receive the relevant income during the holding period.

In this latter hypothesis, with specific reference to income distributed by Italian real estate funds, Art. 7(1) of D.L. No. 351/2001 provides for the application of a withholding tax at the rate of 26%. In contrast, Article 7(3), D.L. No. 351/2001 grants an exemption in the event that the recipients of the distributions are “*pension funds, pan-European individual pension products (PEPPs) referred to in Regulation (EU) 2019/1238 and foreign collective investment undertakings, provided that they are established in States or territories included in the [white list],*”³¹ as well as on income received by international entities or bodies established pursuant to international agreements made enforceable in Italy and by central banks or bodies that also manage the official reserves of the State”.

Consequently, for an entity resident in a white-listed country – falling within the personal scope of both Art. 7(3) of the D.L. No 351/2001 and Art. 5(5-bis) of the Legislative Decree No. 461/1997 – it would be preferable to perceive distributions over the holding period, rather than realizing a capital gain. It appears evident that such an inconsistency is difficult to explain from a systematic point of view.

Another inconsistency regards the foreign real estate investment funds, whose investments are predominantly in real estate located in Italy. The relevant income received (over the holding period) by investors resident in a white-list country (other than that where the real estate investment fund is established) is excluded from any taxation in Italy due to the lack of territorial scope. In this latter case, therefore, there would also be a discrepancy, since, under the newly introduced provisions, capital gains deriving from the sale of units in foreign real estate investment funds (falling in the general notion of “entities”) would be subject to the application of a substitute tax of 26% in Italy. Moreover, from a literal point of view, although the term “entities” may appear broad enough to also include Collective Investment Undertakings, there are arguments to exclude that units held in such entities do not constitute “participations” for the purposes of the application of the provisions under analysis. Generally speaking, the legislator, when regulating the tax implications of transactions involving financial instruments representing investments in Collective Investment Undertakings, does not refer to “participations”, but rather to “units” (as, for example, amongst other provisions, it is done in the already mentioned Art. 7 of D. L. No. 351/2001).

4. The notion of “value” and the “dynamic” timeframe of the prevalence test

The term “value”, used with no further details in Art. 23(1-bis), ITC, raises some doubts concerning the “prevalence test” computation. The main issue concerns whether to consider the real estate assets’ book value (including any subsequent revaluation) or their market value.

The latter solution seems to be more consistent with the purpose of the rule, considering also that, in the opposite case (*i.e.*, using the book value), the investigation would be limited to the verification of merely formal data, inexpressive of the actual asset composition of the investee entity. In the same direction, the governmental report to the Legislative Decree No. 344/2003 – which introduced the

gains deriving from financial assets and capital income is that the first refers to income realized strictly by alienation, whereas the second derives from holding capital.

³⁰ Being the provision of Art. 5(5-bis) of the Legislative Decree 461/1997 also applicable to the transfer of “non-qualified” shareholdings in “companies and entities” resident in Italy.

³¹ Brackets added.

Participation exemption (“PEX”) regime in Italy – in relation to the anti-avoidance clause contained today in Article 87(5), concerning capital gains arising upon the sale of shareholdings in real estate companies, specified that the value of the assets “*is configured not in the book value of the net assets, but in the current value of the assets themselves. Accordingly, for the purposes of verifying the existence of the*” (“commercial activity” requirement),³² [...] *the comparison to be made is between the value of the real estate in question and the value of all the company assets*”.

It remains undisputed, however, that the performance of a “prevalence test” at market values would pose a number of practical issues when calculating the ratio [real estate/total assets]. These difficulties derive, first of all, from the fact that the test shall be conducted over a time horizon of one year, counted backwards from the day of disposal, and should monitor whether even in one single day immovable properties represent more than 50% of the entity value.

Secondly, such a monitoring activity should take into account also immovable properties owned by indirectly held entities and consider any possible sale and purchase operated over the preceding 365 days either by them or by the company whose shares are to be sold. Lastly, for the purposes of computing the above-mentioned ratio, any asset should be “re-expressed” at its market value, even though it could be recorded at its historical cost in the company’s financial statements.

5. The tax treatment applicable to UCITS residents in other EU/EEA countries (Art. 1(99), Budget Law 2023)

Art 1(99) of the Budget Law 2023 then asserts that “*The provisions of paragraphs 96 and 97 do not apply to capital gains realized by collective investment undertakings identified by Article 1, paragraph 633, of Law No. 178 of 30 December 2020*” (Budget Law 2021).

Art. 1(631) provided for the exemption from the 26% withholding tax on dividends perceived by UCITS IV Directive³³-compliant foreign UCITS and UCITS managed by an entity supervised under the AIFM Directive³⁴, established in the EU States and EEA States that allow an adequate exchange of information.³⁵ Accordingly, Art. 1(633) provided that when these same entities realized capital gains and losses upon the sale of shareholdings in Italian companies (“qualified” within the meaning of Art. 67(1)(c) ITC), these gains did not contribute to the formation of their income.

With the Budget Law 2021, the Italian legislator had intended to remedy unjustified discrimination – long denounced by the European Commission as detrimental to the fundamental freedoms enshrined in the Treaty on the Functioning of the European Union (TFEU) – that had been penalizing non-Italian UCITS as compared to the Italian ones. In this regard, the Commission had opened an investigation (EU Pilot 8105/15/TAXU) to verify the State's willingness to spontaneously adapt its internal regulations to the European guidelines, before initiating an infringement procedure.

³² Brackets added. The Participation exemption regime in the Italian system is set forth by Art.. 87, ITC, which recognizes a 95% exemption on capital gains realized upon the sale of participation held in companies and entities indicated in Art. 5, ITC (*i.e.* transparent entities: società in accomandita semplice, società in nome collettivo and assimilated entities), excluding partnerships, and in Art. 73, ITC (*i.e.* entities liable to the corporate income tax in Italy, such as società per azioni, società in accomandita per azioni, società a responsabilità limitata, società cooperative etc.), provided that some conditions are met: (a) the shareholding was held uninterruptedly for at least 12 months prior to the sale; (b) the investment was classified under financial fixed assets in the financial statements of the first tax period of the uninterrupted ownership; (c) the subsidiary carries out a commercial activity; (d) the majority of the subsidiary's income is not generated in a tax haven or a country with a privileged tax regime.

³³ Reference is made to the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

³⁴ Reference is made to the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

³⁵ For a more detailed analysis, see: M. Tiné, E. Fausti, C. Passi, *L'esenzione da ritenuta estesa agli OICR UE e aderenti al SEE*, Riv. Onl. Dir. Trib., (3 Nov. 2021); A. Bonissoni, R. Villa (2021). Italian Tax Authorities Provide First Clarification of the New Tax Exemption for Dividends Related to Direct Investment by EU/EEA Investment Funds, *European Taxation*, Vol. 61, No. 10.; O. Orlandoni, G. Moramarco (2021). Italy – Foreign Investment Fund: Change in Tax Regime for Dividends and Capital Gains, *European Taxation*, Vol. 61, No. 5.

Disregarding these last-mentioned provisions in Budget Law 2023 would have resulted in the nullification of the result finally achieved.

It should be noted that the specific reference, made by Art. 1(633) of the Budget Law 2021, to capital gains (realized by UCITS established in EU or EEA Member States) as of lett. c) of Art. 67(1) ITC limits its application solely to capital gains deriving from the transfer of “qualified” participation.

Such a limitation was not intended to recognize a favourable regime exclusively to alienations involving the aforesaid (“qualified”) shareholdings but was grounded in the fact that the tax treatment of capital gains deriving from the transfer of “non-qualified” shareholdings was already regulated by Art. 5(5) of Legislative Decree No. 461/1997. As mentioned *supra*, this provision allows a WHT exemption in case of capital gains realized by “entities” (among which fall UCITS too) resident in white-listed countries upon the alienation of “non-qualified” participation (referred to in lett. from c-bis) to c-quinquies) of Art. 67(1) ITC).

Therefore, the combination of these provisions – *i.e.* Article 1(633) of the Budget Law 2021, concerning the exemption from taxation only of capital gains deriving from the sale of “qualified” participation and Article 5(5), of Legislative Decree No. 461/1997, concerning the WHT exemption from taxation with reference to capital gains arising from the sale of “non-qualified” participation – grants complete exemption from any taxation on capital gains realized by European investment funds (or those located in the EEA) upon the sale of participation³⁶.

It should then be noted that the exclusion from the scope of the rule of capital gains realized by “UCITS identified by Article 1, Paragraph 633, of Law No 178 of 30 December 2020” should also include capital gains realized by real estate UCITS, as referred to in Art. 6, Decree-Law No 351/2001.³⁷³⁸ There is a threefold reason behind this thesis. First, because the very notion of UCITS, set forth in Article 1(1)(k) of Legislative Decree No. 58/1998 (The Italian Financial Markets Code – “TUF”), also qualifies as such those undertakings whose assets “*are invested in (...) movable or immovable assets, on the basis of a predetermined investment policy*”. Second, if the Italian Legislator had wished to place such a limitation, it is reasonable to assume that a specific provision would have been introduced, as indeed happened in the past, in Art. 10-ter(2) of Law No. 77/1983, which provided that “*The 20 per cent withholding tax³⁹ is also applied by the same entities referred to in paragraph 1 (...) other than real estate UCITS*”⁴⁰. Third, if this were not the case, the previously illustrated discrimination would still occur. In other terms, Budget Law 2021 was intended to remove the discrimination deriving from the circumstance that, according to Art. 73(5-quinquies), ITC, Italian UCITS, “*other than real estate UCITS*”, are not subject to taxation in Italy, whereas foreign UCITS were subject to the application of a substitute tax or a withholding tax at a rate of 26% upon the sale of participation or profits distributions. Similarly, an exemption from taxation is also granted to real estate investment funds by Art. 6(1), Decree-Law No. 351/2001. Therefore, should they not be included in the notion of “UCITS identified by Article 1(633) of Law No 178 of 30 December 2020” there would still be a case for discrimination against them.

One last aspect to investigate regards the determination of the foreign entities whose characterization potentially falls within the notion of UCITS compliant with UCITS and AIFM Directive - under the

³⁶ The treatment introduced by the Budget Law 2023 is coherent with the circumstance, also noted in para. 28.8 of the Commentary to Art.. 13(4) of the OECD Model, that in many jurisdictions pension funds and other similar entities have the status of entities exempted from income taxation on profits derived from their investments, which are taxed at the investors’ level, under the scheme “exemption taxation”.

³⁷ Which refers to real estate investment funds “*set up pursuant to Article 37 of the Consolidated Text referred to in Legislative Decree No 58 of 24 February 1998*” (“TUF”).

³⁸ In the same direction, Assogestioni, Circ. No. 26/2021/C.

³⁹ The withholding tax is now levied at the rate of 26%, due to the amendments introduced by Decree-Law No. 66 of 24 April 2014, converted, with amendments, by Law No. 89 of 23 June 2014.

⁴⁰ See M. Tiné, E. Fausti, C. Passi, *L’esenzione da ritenuta estesa agli OICR UE e aderenti al SEE*, Riv. Onl. Dir. Trib., (3 Nov. 2021).

assumption that foreign investment vehicles can adopt a plethora of legal forms⁴¹. In this respect, the Italian Tax Authorities have always adopted an “inclusive” approach⁴², clarifying that Foreign UCIs are those entities that have the substantive requirements as well as the same investment purposes of Italian funds and undertakings, regardless of their legal form and tax *status* (be them transparent or not), provided that either the UCI or the entity in charge of its management are subject to some form of supervision.

6. Similarities with Art. 13(4) of the OECD Model Tax Convention and Art. 9(4) of the Multilateral Instrument.

The provisions introduced by the Budget Law 2023 are in line with the OECD Model Convention and, in particular, with Art. 13(4) (the so-called “*land rich clause*”), according to which “*Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.*”. This provision operates in a context where, ordinarily, capital gains from the disposal of immovable property are taxable also (“may be taxed”) in the State where they are located⁴³, since the source of the income is recognized therein, whereas those arising from the disposal of participation are taxable in the State of residence of the alienator⁴⁴, since the “*financial resources grounding the investment are accumulated and deployed therein.*”⁴⁵

Art. 13(4) of the OECD Model Tax Convention restores the primary taxing right to the Country where the real estate is located, *i.e.* the country “of origin of wealth”, since the undelaying value of the company whose shareholding is disposed of derives predominantly from immovable properties located therein. Under this assumption, the OECD Model goes beyond the corporate veil, ignoring the legal separation between the immovable properties held by a company and the company itself, but rather assigning relevance to the economic link between these two components.

As of today, albeit with some variations from Art. 13(4) of the Model, just a few of the Double Tax Conventions concluded by Italy contain a “*land-rich clause*” providing for the taxation, under certain conditions, of capital gains deriving from the disposal of shareholdings in foreign companies whose assets are mainly invested in real estates located in Italy. These treaties are in place with Saudi Arabia, Armenia, Azerbaijan, Barbados, Canada, Chile, China, Colombia, Estonia, Finland, France, Hong Kong, India, Israel, Jamaica, Kenya,⁴⁶ Mexico, New Zealand, Pakistan, Panama, Philippines, Romania, Sweden, Ukraine, United States, Uruguay. This entails, in fact, that the new rule is concretely applicable solely to the cases where the transaction involves an entity resident in one of the Contracting States with which Italy has agreed a “*land-rich clause*” in the relevant Double Tax Treaty, while in all other cases, where the Convention attributes exclusive taxing right to the State of residence of the alienator, regardless of the assets’ composition of the investee company, the capital gain cannot be taxed in Italy.

⁴¹ For instance, partnerships, funds, and corporations.

⁴² See, among others, Circ. 9 March 2011, No. 11; ruling 27 May 2021, No. 327 and ruling 4 October 2021, No. 655.

⁴³ See Art. 13(1), OECD Model (2017), according to which “*Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*”

⁴⁴ See Art. 13(5), OECD Model (2017), according to which “*Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.*”

⁴⁵ See R. Rossi (2022). Cross-border capital gains on Italian participations: interaction between Italian domestic law, tax treaties and EU fundamental freedoms, *Riv. Dir. Trib. Supplemento online, Rubrica di diritto tributario internazionale e comparato*, 6, 105.

⁴⁶ The DTC between Kenya and Italy was ratified by the Law 7 October 1981, No 666, but never published in the Official Gazette, so that it has never entered into force.

In addition, it should be noted that the wording of Article 13(4) of the OECD Model Convention makes a generic reference to immovable properties, whereas the domestic provision of Article 23(1-*bis*), ITC, limits the notion, as already mentioned, to immovable properties other than those used as “instrumental” and “commodities”. Consequently, the material scope of application of this second rule is narrower than that of the corresponding clause included in some of the treaties entered into by Italy. Pursuant to Article 169, ITC⁴⁷, the domestic rule should override the one provided by the Double Tax Treaties, as it is more favourable to the taxpayer.

Likewise, the new domestic “land-rich clause” quite faithfully reproduces what is set forth by Art. 9(4) of the MLI⁴⁸ which provides that *“gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting Jurisdiction if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction.”*

The MLI is intended to achieve the goal desired by Action 15 of the *BEPS Project*,⁴⁹ which highlighted the desirability of a simultaneous update of existing Double Tax Treaties, precisely in order to give concrete effect to the BEPS Project *desiderata*, which aim at preventing, as far as possible, the tax base erosion and the shifting of profits to low-tax jurisdictions where companies have little or very limited economic activities⁵⁰.

Although Italy has not provided yet for its ratification, it signed the MLI on 7 June 2017, opting, for what is of interest herein, also for the application of Article 9(4). Therefore, when the MLI enters into force in Italy, it shall replace the land-rich clauses already included in the treaties in force to date and add the same clauses in some of the treaties not providing yet for it⁵¹, provided that the other Contracting Jurisdiction will have also exercised the same option.

⁴⁷ According to the mentioned Art. 169 of the ITC sets forth that the provisions of the same Italian Income Tax Consolidation Act (ITC) *“apply, if more favourable to the taxpayer, also in derogation of international agreements against double taxation.”*

⁴⁸ For a general overview of the MLI, *ex multis*, see M. Lang, P. Pistone, A. Rust, J. Schuch, C. Stringer (eds.) (2018), *The OECD Multilateral Instrument for Tax Treaties. Analysis and Effects* (Alphen aan den Rijn: Kluwer Law International); C. Billardi, *Il Multilaterismo nel BEPS e la sua interazione con le convenzioni per evitare la doppia imposizione*, in F. Amatucci, R. Cordeiro Guerra (eds.) (2016) *L’evasione e l’elusione fiscale in ambito nazionale e internazionale* (Roma: Aracne); P. Valente, *BEPS Action 15: Release of Multilateral Instrument*, Intertax 45(3), (2017). A. Cazzolara, *Il Trattato Multilaterale BEPS è self-executing?*, Riv. onl. Dir. Trib., (24 May 2017); P. Valente, *Rilevanza dello strumento multilaterale ai fini dell’implementazione delle misure BEPS*, Il Fisco, 4542 and subs., (2015).; B. Ferroni, *Firmata la Convenzione multilaterale del progetto BEPS: effetti su migliaia di trattati fiscali in tutto il mondo*, Il Fisco, 2952 and subs., (2017). For a detailed analysis of the main expected effects of the Multilateral Instrument and the reservations and options that can be chosen by the States upon signature, refer to N. Bravo, *The Multilateral Tax Instrument and Its Relationship with Tax Treaties*, World Tax Journal, 8, (2016). See also P. Pistone, D. Weber (eds.) (2018). *The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (Amsterdam: IBFD), and P. Pistone (2019) “Chapter 7: The BEPS Multilateral Instrument and EU Law”, in A.J. Martín Jiménez (ed.) *The External Tax Strategy of the EU in a Post-BEPS Environment* (Amsterdam: IBFD); B. Farinha Aniceto da Silva (2018). “Chapter 8: BEPS Action 6 and the LOB Provision: Restoring the Debate on the Compatibility with EU Law”, in P. Pistone, D. Weber (eds.) *The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (Amsterdam: IBFD).

⁴⁹ See OECD (2015). *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report*, OECD Publishing, Paris, where it is underlined that *“The interaction of domestic tax systems can lead to overlaps in the exercise of taxing rights that can result in double taxation. For example, if an item of income is earned in one jurisdiction (the “source jurisdiction”) by a resident of another jurisdiction (the “residence jurisdiction”), both jurisdictions may tax that income under their domestic laws. International treaties to address double taxation, many of which originated with principles developed by the League of Nations in the 1920s, aim to address these overlaps so as to minimize trade distortions and impediments to sustainable economic growth. [...] However, some features of the current tax treaty system facilitate BEPS. [...] OECD and non-OECD government tax treaty experts agree that changes to the model tax conventions, as well as the bilateral tax treaties based on those model conventions, are required to stop or significantly reduce these abuses [...] A multilateral instrument will implement agreed treaty measures over a reasonably short period and at the same time it would preserve the bilateral nature of tax treaties.”*

⁵⁰ The Preamble of the Multilateral Convention recognizes *“the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created.”*

⁵¹ For example, Argentina, Côte d'Ivoire, Croatia, Denmark, Egypt, Russia, Germany, Indonesia, Ireland, Yugoslavia, Kazakhstan, Malta, Mongolia, Poland, Portugal, Slovak Republic, San Marino, Senegal, Slovenia, Spain, Tunisia, Turkey, Vietnam.

7. Final observations

As illustrated above, the new rules, introduced with the Budget Law 2023, reproduce, despite some differences, the provisions of the OECD Model and the Multilateral Convention Model. In the international context, the so-called “land-rich clause” is grounded on the circumstance that *(i)* capital gains arising from the transfer of immovable properties are taxable in the Contracting State where the properties are located (Article 13(1)); and *(ii)* capital gains arising from the alienation of participation are taxable in the Contracting State of residence of the alienator (Article 13(5)). Therefore, Art. 13(4) deals with the possible “gap” between the provisions of Article 13(1) (concerning immovable properties) and Article 13(5) (concerning financial investments), reverting the primary taxing to the source State when the capital gain arises from the alienation of shareholdings which predominantly derive their value from immovable properties located in the source State.

From a practical point of view, considering the number of Conventions that already provide (and will keep also after the entering into force of the MLI) a land-rich clause and the number of States that, as of today, have opted for the introduction of such a provision after the ratification of the MLI, the discipline newly introduced in the Italian domestic law will apply to a narrow number of cases. However, its introduction was needed for the land-rich clauses set forth in the international context to be applicable.