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Explanatory report

Italian tax system from a “non-resident perspective”

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FOREWORD

This report is aimed to describe Italian tax system from a “non-resident perspective”, and with a specific regard to tax implications of the possession of a building by an individual. Explaining the general tax treatment of the said topic will be then added the specifications needed for Mrs. YYYYYYY’s Villa (in the following, “the Villa”), as an “historical building”, subject to public restraint (“immobili vincolati”). This kind of estates receives a lot of tax relieves, which to a various extent allow savings and benefits as a kind of “compensation” against the State legal guardianship existing upon the estate. To have the report more “tailor made”, we explain also if each relief is specifically applicable to Mrs YYYYYYY, regarding her personal status.

The report will also address tax issues arising from the selling of the building.

Each information is referred to present legislation (November 2010), so any future decision based on the followings will need check and validation prior to be enacted.

A – THE OWNERSHIP OF A BUILDING: TAX REGIME

A1. STATE TAXES

Building ownership imply that an individual is subject to the major state tax, called IRPEF, acronym meaning “*Imposta sul Reddito delle Persone Fisiche*”, i.e. Personal Income Tax.

This tax is a comprehensive one, including all incomes get by the taxpayer, on a worldwide basis. As to non resident individuals, only Italian-source incomes are subject to IRPEF.

Personal income tax functioning needs some more explanations as to buildings possession. One could believe that the possession should not imply taxation if the estate is not used for renting purposes, because no real income is obtained from the building. By the other side, if the Owner rents the building and gains money from this activity, it seems reasonable that this income should be taxed under the IRPEF.

By contrary, also the ownership itself leads to a taxation, in fact each building enrolled in the “*Catasto Fabbricati*” – i.e. Italian buildings Cadastre (the archive that includes all buildings sited in Italy - except regarding few regions) – has a “virtual / potential income” called “*rendita catastale*” to be used for tax purposes, when set by law.

The “*rendita*” varies depending on a number of factors, basically:

- The localization of the building (“*zona censuaria*”, Pistoia area consists in one “*zona*” only)
- The “category” of the building, deriving from its normal use (for the scope of this work, we consider only dwelling use buildings)
- The kind of the building (ranging from popular houses, apartments and similar, to valuable villas, castles, manor houses)
- The extension of the building.

The Owner has to get this “virtual income” and to multiply it by specify figures provided by law. The result will form the “personal general income” (total taxable income) along with his/her any other income.

Basically, the only exception to this rule is represented by the building used as personal and family main dwelling: the income of taxpayer’s home is completely de-taxed.

Historical buildings special tax regime

Main rule explained in the precedent section is applicable also regarding historical buildings.

But thanks to a tax relief, the Owner has to consider not the specific “*rendita*” given to the his/her building, but the lowest one applicable in the zone where the building is located (called “*zona censuaria*”).

So, regardless the real “*rendita*” set for the Villa, income tax will be based on the lowest virtual income for buildings into Pistoia area.

Moreover, the tax allowance rule is also applicable as to leased buildings. The income derived from renting activity is de facto untaxed, because the Owner will include in her total taxable income only the “virtual one”, obtained from the lowest “*rendita*”, as focused above.

A.2 LOCAL (MUNICIPAL) TAXES

Individuals have also to burden taxes on a local basis.

The most important of that kind of taxes, as far as concerns our report, is the “*Imposta Comunale sugli Immobili*” (I.C.I.), which name could be translated as “municipal real estate tax”. It is applied by the Municipalities - as Pistoia - and regards almost all kinds of real estates, buildings or land properties.

The tax derives its working from the income tax: taxable basis is calculated the same way, once set the virtual value of the building as described above (but using a specific figure to multiply the “*rendita*”), you have to apply a tax rate ranging from 5% to 9%, depending on the use of the real estate.

Buildings like the Villa are subject to maximum rate, because of their discontinuous use. In other words, the Owner doesn’t “permanently” live in the Villa, nor does she permanently rent the estate. The law links this kind of use to a wealthy status of the Owner, allowing the Municipality to more heavily tax the property.

Recently, building used as “main house” by the Owner and his/her family were fully de-taxed. But taxation still operate if the house is categorized among the “top level” buildings, such as the Villa, so in our case the benefit won’t be claimed.

Historical buildings special tax regime

So, if the described use twins the upper class category, no savings at all, by contrary the property will be fully taxable, at a higher rate.

The only tax relief is provided by the rule described before and referred to income tax, that is the Owner is entitled to use the lowest “virtual income” among the ones fixed for Pistoia zone.

B. THE SELLING OF A BUILDING: TAX REGIME

B.1 General tax rule

Personal income tax may be involved also in case of property (re)selling.

The rule is that the Owner has to assess the property selling in annual income tax filing. Not the whole selling price is subject to tax, but only the “capital gain” (“plusvalenza”), i.e. the (positive) difference between purchasing price and selling price.

So, if a capital gain will occur, say, in year 2011, then on June 2012 the Owner has to include the capital gain in her tax return. It will be added to any other personal earnings to calculate “annual total income”, subject to personal tax.

Tax law provides then five tax brackets: to each of them matches to a tax rate, according to the following chart:

1st tax bracket: income from € 0 to € 15.000:	23% tax rate
2nd tax bracket: income from € 15.000,01 to € 28.000:	27% tax rate
3rd tax bracket: income from € 28.000,01 to € 55.000:	38% tax rate
4th tax bracket: income from € 55.000,01 to € 75.000:	41% tax rate
5th tax bracket: income above € 75.000:	43% tax rate

Personal total income has to be divided according to tax brackets, and each portion will be multiplied for its tax rate.

Tax law allows the Owner to lower the said capital gain, taking into account also the following items:

- costs for Public Notary fees on purchasing contract
- taxes paid for purchasing contract
- restoration costs related to the building

Capital gains are fully tax exempt in three cases:

- a) when the building was inherited by the Owner,
- b) when during the most period included from purchasing time and selling time, the Owner has used the building as main personal or family dwelling.

As for Mrs YYYYYYY, non-resident status doesn't allow her to claim such tax exemption.

- c) when the Owner has hold the property for at least five years from purchasing time.

Historical buildings special tax regime

No special or more favorable rules are applicable regarding to personal income tax.

B.2 Special tax allowance

To legally avoid the high expenditures deriving from capital gain taxation under the personal Income tax, the Owner can opt for a “special regime”. When signing the purchasing contract, he/she has to declare to the Public Notary that the capital gain is subject to a “substitute tax” of 20%, to be paid immediately and directly to the said Public Notary.

Basically, in place of the personal income tax of 23% minimum (see tax brackets, above), the Owner pays a flat rate of 20%. It should be noted that capital gain on building selling is normally much higher than the upper tax bracket, so it is reasonable to foresee that the major part of it will be taxed at a 43% rate. Substantial savings linked to this opportunity seem to be very clear.

C. INHERITANCE TAX

In case of death, heirs may have to cope inheritance tax.

This tax is levied on the portion of total wealth assigned to each heir.

Heirs having strict kinship to the dead Owner (sons, daughters, spouse,...) benefit of a tax relief of € 1.000.000, so up to that sum no inheritance tax will be due. Sum exceeding that figure will be taxed at a 2% rate.

The less strict is the link of heir with the dead Owner, the lower is the shelter and the higher will be tax rates.

It will also be paid "*imposta ipo-catastale*" (mortgage and land tax) at a 3% rate.

Historical buildings special tax regime

An historical building, subject to State constraint, will not be included in total wealth subject to tax, if Owner fulfilled the duties of good maintenance. Consequently, in our case transferring the Villa will not be charged of inheritance tax, irrespective of the kinship to the heirs. Heirs will had to inform the public body called "*Soprintendenza*" (local authority of the Ministry of cultural assets and heritage) and ask it for a certificate assessing the existence of public restraint on the Villa.

D. RESTORATION WORKS on HISTORICAL BUILDINGS: TAX REGIME

D.1 Public contributions

According to Italian law (ref article 29 and followings of Legislative Decree 22/01/2004 n. 42), Owners of historical buildings must take care of the “preservation” of properties, i.e. to do all the works of maintenance that are needed.

The works can be on a voluntary basis, or can be ordered by Government (that can even replace the careless owner). The former are subject to the prior consent of the authority (usually, the “Soprintendenza”). When the owner asks for the consent, it can also ask if works can benefit of public contributions.

Besides, the *Soprintendenza* can certify the works are “necessary”, so the owner can benefit also of a tax relief (see below).

Public contributions are (provided some conditions):

- 1) Italian State will cover up to 50% of the costs for works
- 2) Italian State will cover a certain amount of interests paid on mortgages (“grants on interests”)

The owner will have to comply with a lot of requirements to be entitled of such contributions, resulting in a very difficult and expensive procedure (be aware that is not guarantee you can obtain the funds).

The form to ask contributions has to be submitted within 30th Sept of each year (deadline).

At the present, as far as we know, public funds are run out. Contributions enquiries can be submitted but will be backed when Italian Ministry will renew funds.

A fundamental topic is that all historical buildings that benefit from public contributions have to sign an agreement with the Ministry to grant the “public opening and accessibility” of the building.

D.2 Tax allowances

D.2.1. Tax deduction for maintenance costs

Italian Income Tax code provides a specific allowance for owners that burden maintenance cost. It consists of a tax deduction of 19% of the expenditure, so Personal Income tax can be lowered of that amount.

As described above, only expenses certified as “necessary” by public authorities grant this tax relief.

Also non-resident people can access to this allowance.

D.2.2. Tax deduction on certain kind of works

Works of maintenance, restoration and renovation on dwellings - as defined by law – and on wooded areas can lead an indirect tax allowance, called “deductible cost”. An amount of 36% of these costs – not exceeding € 48.000 per dwelling - can be deducted – not to income tax itself but to total personal income, in 10 annual installments.

Moreover, works aimed to energetic savings can allow another “deductible cost”, amounting to 55% of expenses (up to certain amounts, depending on the kind of works), to be deducted in 3 annual installments.

Both the deductions are granted also to people having a non resident status.

The said two benefit cannot be combined for the expenses related to same works. By contrary, the “36%” benefit can be combined at the allowance described sub D.2.1, but the latter will be half reduced (i.e., 9,5%).

D.2.3 VAT rate

It is reasonable to forecast that renovation works can be categorized among those that allow a reduced 10% VAT rate, in place of the standard 20% rate.

D.3 Payments of restoration works – tips&tricks

This topic should be developed apart, because too many are the elements that impact on the pros&cons of various options.

Broadly speaking, all tax benefits and public contributions need a “traceable payment”, i.e. a payment via banking system: no cash then, also because Italian anti-money laundering laws forbid cash payments exceeding € 5.000.

There is no relevant difference in paying, say, construction costs, professional fees, administrative expenses, etc. using a “domestic” or a “foreign” bank account. Bank payments exceeding € 12.500 will be included in a “report” sent to anti-money laundering authorities, but it has no direct or harmful effects on the payer.

Payments should not be routed via a bank account not directly in the name of the Owner, because payments have to be aligned to invoices. In fact, invoices of contractors and professionals will be in the name of the Owner, and probably they expect that payments will be performed by the Owner. This is also the tax compliant solution.

E. HISTORICAL BUILDINGS: OTHER TAX ALLOWANCES

E.1. Exemption from tax on insurance premiums

Highly valuable ancient and historical buildings usually have insurance coverage against a wide range of risks. This kind of insurance is granted of the exemption from a special tax called "*imposta sulle assicurazioni*" (tax on insurance premiums).

E.2 Benefits for renting contracts and for renting fees

Buildings under public restraint can be lease without being bound to comply to general laws. Derogatory rules allow the Owner to sign a lease having following features:

- a duration from one to maximum 30 years (in place of ordinary terms),
- renting fee can be set at whatever figure,
- the notice to inform the lessee of the ending of agreement can be of only one month.

Tax laws also help in these cases. According to last statements of Italian Courts (there were disputes on the topic), the Owner is not taxed on rents, but only as described above, in chapter A.1.