cutting through complexity™

September 19, 2013
2013-128

flash International Executive Alert

A Publication for Global Mobility and Tax Professionals by KPMG's International Executive Services Practice

Italy – New Tax Agency Resolution Alters Tax Credit Calculations

by Antonio Deidda and David Roberts, KStudio Associato, Milan (K Studio Associato in Italy is a KPMG International member firm)

Italy's Tax Agency (Agenzia delle Entrate) published a resolution (48E)[1] on 8 July 2013, clarifying its position on the calculation of foreign tax credits available to Italian tax resident individuals who have employment income arising abroad. The resolution appears to make the position more complex and it is not clear whether the Tax Agency would seek to apply these principles retroactively. Given the level of audit activity by the Italian Tax Agency on income tax returns with foreign tax credits this development is cause for some concern.

Background

Under the Italian Tax Code[2] an Italian tax resident individual is subject to taxation on worldwide income. Italy has a comprehensive network of double taxation treaties which provide for relief of double taxation through the tax credit mechanism; and Italian domestic legislation also provides for the tax credit mechanism. Before a foreign tax credit can be given, the foreign tax must be regarded as definitively paid – that is, it should be final and conclusive and not capable of repayment by the foreign tax authority. In jurisdictions using self-assessment, the foreign taxes may be regarded as definitively paid when the self-assessment return has been filed and any balancing payment/refund claim made. In certain countries, it may be necessary to wait for a definitive foreign tax assessment to be raised (this can lead to a considerable delay in being able to claim a foreign tax credit). As a further complication, an Italian resident individual who works "continuously and exclusively" abroad, may be taxed on imputed income (based on tables published by the Labor Ministry) rather than actual employment income received abroad.[3] This is known as conventional income (*reddito convenzionale*).

KStudio Associato Note

Understanding the Revised interpretation and Foreign Tax Credit Calculations

Prior to Resolution 48E, it was our understanding that the foreign tax credit should be calculated as follows:

> Available foreign tax credit = (conventional income/gross income assessed in the foreign country) *x* tax paid abroad[4]

The figure calculated above cannot exceed the amount of Italian tax due on the foreign source income based on the ratio of foreign source income to total Italian taxable income.

As a result of the interpretation expressed in Resolution 48E, the tax credit should be calculated as follows:

Tax credit = ("reddito convenzionale"/ earned income as defined by the Italian tax code) *x* tax paid abroad

In the first method noted above, gross income results from the amount of employment income declared to or assessed by the foreign tax authority. The revised approach implies that the earned income should be recalculated and re-qualified according to Italian legislation.

According to Italy's Tax Agency, the ratio of foreign income ("*reddito estero*") to total income ("*reddito complessivo*") should be calculated using equivalent values. In other words, foreign income and total income must be calculated following the same legislative base. The implication is that foreign employment income should be restated in the same way as if it were taxable in Italy.

Impact of New Method Under the Resolution: Increased Complexity?

The approach suggested in the resolution appears to increase the complexity of foreign tax credit calculations. In arriving at the taxable employment income, each jurisdiction has its own rules for calculating different types of income, benefits-in-kind, etc. As an example, an Italian resident employee working in the U.K. and taxable in the U.K. might receive a salary and company car; for U.K. tax purposes the taxable benefit of the company car is calculated using U.K. tax rules. The implication of the approach suggested by Resolution 48E is that the car benefit should be recalculated according to Italian tax rules, in order to arrive at an equivalent value for calculating the foreign tax credit due in Italy. This would imply that to do the Italian tax calculation – and in order to be able to recalculate the taxable amount according to Italian tax rules – a detailed knowledge is also required of the foreign tax system. Substantial supporting documentation would also be required to provide an audit trail for the foreign tax computation and the restated Italian tax computation.

When the Italian government introduced the concept of "*reddito convenzionale,*" the aim was to simplify the calculations needed in respect of Italian resident individuals working abroad. Notwithstanding, the Tax Agency resolution does not follow the trend towards tax simplification in Italy but, instead, appears to contribute to increased computational complexity.

There is also uncertainty as to whether the Tax Agency will seek to apply this interpretation retrospectively. Hopefully the Tax Agency will reconsider the practical difficulties created by the resolution; but in the meantime, increased documentation may be required to calculate and document Italian foreign tax credit claims in respect of employment income. Making sure that Italian employees working outside Italy meet the necessary conditions to be considered as non-tax resident in Italy may be advantageous.

Given the timing of the resolution, it is our understanding that the new interpretation should apply to fiscal year 2014 and subsequent years. However, whether the authorities would seek to apply it with retroactive effect still remains to be clarified. KStudio Associato plans to seek further clarification from the Tax Agency on this issue.

Footnotes:

1 Agenzia delle Entrate - Risoluzione N.48/E – Rome, 8 July 2013.

2 Italian Tax Code – Articolo 165, DPR 22 dicembre 1986, n.917.

3 Italian Tax Code – Articolo 51, comma 8-bis , DPR 22 dicembre 1986, n.917.

4 Articolo 36, comma 30, del DL 4 luglio 2006, n 223 (converted by Legge 4 agosto 2006 n. 248).

* * * *

The information contained in this newsletter was submitted by the KPMG International member firm in Italy. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Flash International Executive Alert is an IES publication of KPMG LLP's Washington National Tax practice. To view this publication or recent prior issues online, please click **here**. To learn more about our IES practice, please visit us on the Internet: click **here** or go to http://www.kpmg.com .