ITALY

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Assessing the tax treatment of employees working in Italy during the pandemic

Alessandro Valente of Valente Associati GEB Partners/Crowe Valente looks at a key ruling which clarifies the tax treatment of Italy-based employees engaged in smart-working during the pandemic.

In a response to the disruption caused by the COVID-19 pandemic, governments have enacted unprecedented measures. As such, these measures may have an overwhelming impact on the tax residence of individuals and on the tax treatment applicable to income from employment.

On July 7 2021, the Italian tax authorities issued Ruling No. 458/2021 which deals with the tax treatment of workers that temporarily returned to Italy as a result of the COVID-19 pandemic and could not leave the country due to the travel restrictions enforced by China.

In the ruling, the Italian tax authorities were presented with a case involving a series of employees that were hired by the Italian parent company and seconded to the Chinese subsidiaries. Such employees moved to Italy in January 2020, as the pandemic broke out in China, and returned to China in July of the same year.

This resulted in some employees spending less than 184 days in Italy and in others exceeding of the 183-day threshold. During their stay in Italy, these individuals continued to work remotely on behalf of the companies located in China.

The Italian multinational company, which is the employer of the seconded employees, filed a tax ruling request looking for guidance on the following:

1. Whether the employment income received by the employees that spent less than 184 days in Italy in the relevant calendar year should be considered Italian-sourced income that would trigger Italian withholding tax obligations for the Italian company;
2. Whether the presence in Italy for more than 183 days in the relevant calendar year may result in the employees obtaining the status as Italian tax resident;
3. In case of an affirmative response to question two, the Italian multinational company sought the following clarifications:
   - Whether the taxable income would be determined on the basis of the provisions contained in Art. 51(8-bis) of the ICTA;
   - Whether the 183-days threshold, provided for by Art. 51(8-bis) of the ICTA, was met.

Tax Ruling No. 458/2021

In the ruling, the Italian tax authorities have provided clarifications on the subject of the tax treatment of remuneration for employees paid to residents and non-residents who, due to the COVID-19 emergency, carry out their work activities in Italy, in 'smart-working', instead of in the foreign country where they were initially seconded.

In a document dated April 3 2020 and subsequently updated on January 21 2021, the OECD Secretariat shed light on the impact that the restrictive health measures adopted by countries following the pandemic had on international treaties. In particular, such document addressed concerns related to the change to the residence status of individuals and to the income derived from employment.

In this regard, the OECD indicated that the guidelines included in the document represent the point of view of the Secretariat on the interpretation of the provisions of tax treaties and recognised that each jurisdiction may adopt its own indications to provide tax certainty to taxpayers.

This view is reiterated in the ruling by the Italian tax authorities, that specified that the OECD guidance applies solely to the interpretation of double tax treaties, and it does not affect the interpretation of the Italian domestic tax laws.

Therefore, based on the facts provided by the Italian multinational company to the Italian tax authorities in Ruling 458/2021, the tax relevance of the income earned by the company's employees must be assessed in light of the following:

- The provisions granted by the Italian legislation; and
- The agreement between Italy and China for the avoidance of double taxation and the prevention of fiscal evasion with regard to taxes on income (DTT), signed in Beijing on October 31 1986 and ratified by Law No. 376 of October 31 1989.

Interpretation of the ruling

In view of the above, regarding the ruling's first query, the Italian tax authorities responded that Italy had the right to tax the Italian-sourced income resulting from the non-resident employees (which spent less than 184 days in Italy), without its taxing rights being constrained by the DTT with China.

Pursuant to Article 23, paragraph 1, letter (c), of the ICTA, income from employment carried out in Italy by a non-Italian tax resident is considered Italian-sourced income.

Furthermore, Article 15, paragraph 2, of the DTT does not preclude Italy from taxing income produced by an employee resident of the other contracting state in relation to employment within its territory if:

a) The employee stays in the other state for a period or periods not exceeding a total of 183 days during the calendar year in question; and
b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other state; and
c) The burden of the remuneration is not borne by a permanent establishment or fixed base that the employer has in the other state.

Given that in the case at hand, the remuneration was provided by an employer resident in Italy, the condition set out in the above-mentioned letter (b) is not deemed to have been met and, consequently, the remuneration in question is taxable in both countries.

The Italian tax authorities clarified that the resulting double taxation will be resolved, pursuant to Article 23, paragraph 3, of the DTT, through the recognition of a tax credit by China, the state of residence of the employees.

In relation to the ruling's second query, the Italian tax authorities indicated that for the purposes of identifying the tax residence of an individual in the absence of a specific regulatory provision that takes into account the COVID-19 emergency, it is necessary to refer to the criteria indicated in the cited Article 2 of the ICTA.

Pursuant to Article 2, paragraph 2, of the ICTA, persons who for the greater part of the tax period are registered as resident population in Italy or have their domicile or residence in the Italian territory are considered Italian residents.

The Italian tax authorities also referred to Article 4, paragraph 2, of DTT, which establishes, the so-called 'tie breaker rules' to resolve any possible conflicts of residence between the contracting states. These rules give relevance to the concept of permanent residence followed, in hierarchical order, by the centre of vital interests, habitual residence and nationality.

As such, according to the Italian tax authorities the employees of the Italian multinational company should be considered resident taxpayers given their Italian domicile for the greater part of the calendar year. Moreover, dual residency conflicts generated by the Italian tax authorities' position should be addressed by application of the aforementioned 'tie-breaker rules'.

Finally, concerning the ruling's third query, the Italian tax authorities clarified that the seconded employees should be deemed Italian-tax residents. As a result, the principles expressed by Article 51 (8-bis) of the ICTA could not be applied. In fact, for Article 51 (8-bis) to have applied, the taxpayer must had spent more than 183 days abroad in the relevant 12-month period.

The ruling offers some interesting, as well as critical viewpoints in that, for the first time since the COVID-19 emergency, the Italian tax authorities provide some key criteria for assessing the tax residence of a subject.

The Italian tax authorities consider national provisions and those of the DTTs (where they exist) to be decisive in assessing tax residence. In addition, the Italian tax authorities reiterate the connecting criteria for the taxation of income derived from employment in Italy for resident and non-resident subjects paid by a non-resident entity.

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