

The ‘Center of Vital Interests’: A Review of Italy’s Rules on Tax Residence

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PRACTITIONERS' CORNER

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The Italian Revenue Office has been forwarding questionnaires to many individuals who, in the last five years, registered with the Register Office for Italians Residing Abroad (AIRE) and subsequently returned to Italy, because of those individuals' financial assets and shareholders' equity held abroad or because of income produced in foreign countries during that period.

This article provides a brief description of tax residence as the "center of vital interests" of individuals, a concept in article 2, paragraph 2 of the Italian Income Tax Code (Testo Unico delle Imposte Dirette, or TUIR).

Tax Residence of Individuals

TUIR Article 2

The rule on the tax residence of individuals is set forth under TUIR article 2 ("taxable entities") and is found in Chapter I of Title I, which relates to the IRPEF (personal income tax).

TUIR article 2 refers to two situations in particular:

- the basis for acknowledging tax residence in Italy (TUIR article 2, paragraph 2); and
- the deemed residence in Italy of entities that have transferred their residence to tax havens (TUIR article 2, paragraph 2-bis).

This article focuses on the first case, as the concept of "center of vital interests" derives from it and is the basis to identifying the tax residence of individuals.

TUIR article 2, paragraph 2 states:

individuals who, for the greater part of the tax period are registered with AIRE or, are domiciled or, are resident in the state territory pursuant to the Civil Code, are deemed resident.

Individuals are resident in Italy if, for the greater part of the tax period, they meet one of the following conditions:

- *They are registered with the Office of Resident Individuals in the state, although they remained abroad for the greater part of the tax period.*¹
- *They are not registered with the Office of Resident Individuals but are domiciled in the state.* That is, they have established their main place of business in the above state (article 43 of the Italian Civil Code).
- *They are not registered with the Office of Resident Individuals but are resident in the state.* That is, they have their habitual abode in Italy, the place where they generally dwell (article 43 of the Italian Civil Code).

Tax Residence Identification Basis

Scholars agree with case law that being deleted from the Office of Resident Individuals and being registered

¹As far as tax residence is concerned, only individuals who have established their habitual abode in the municipality of Campione d'Italia may be registered with the Office of Resident Individuals therein.

with AIRE² do not on their own determine an individual's domicile or residence in the state, because that information may be inferred through other sources and, in some cases, may conflict with information obtained from the office's records.³

Having established domicile in Italy for civil law purposes or taken up residence in the state territory are sufficient to demonstrate tax residency, regardless of a taxpayer's registration with the Office of Resident Individuals.

An individual who has been transferred abroad and carries on an activity abroad may still be tax resident in Italy provided he keeps the center of his family and social interests⁴ in Italy. Identifying the center of a person's family and social and economic ties is necessary in determining his place of domicile.⁵

Regarding tax residence, TUIR article 2, paragraph 2-*bis* provides:

Italian citizens, save proof to the contrary, who have been deleted from the office of resident individuals and who have expatriated to states or territories with privileged tax regimes, are also deemed resident, as established by Decree⁶ of the Ministry of Finance to be published in the Official Gazette.

Regardless of any particular tax regime in force in the state where an individual's residence is established, the Revenue Office has specified in Resolution 351 of August 7, 2008, that the verification of a tax resident's status may not occur in the course of a tax ruling, but only during an audit, since the examination of possible personal and social ties with the state territory are involved.

According to the Revenue Agency, in order to answer all questions regarding the determination of tax residence and to clarify the meaning of tax domicile, one should refer to the applicable income tax treaty.

For example, article 4, paragraph 1 of the Italy-U.K. treaty⁷ specifies:

the expression "resident of a contracting State" designates each person that, by virtue of the Laws of the said state, is subject to taxation in

such state by reason of his/her domicile, residence, seat of management or any other similar criterion.

In situations in which an individual is resident in both contracting states on the basis of national rules (that is, a dual resident), paragraph 2 of the Italy-U.K. treaty provides that he may claim residency in only one state for tax purposes.

The concept of domicile and residence used in tax law and found in TUIR article 2, paragraph 2 may be drawn from the Italian Civil Code, which, under article 43, defines a person's domicile as the "place wherein an individual has established his/her seat of business and interests." Residence is defined as the "place wherein the individual holds his/her habitual abode." They are both significant; in order to identify a tax residence, only the existence of either one is sufficient.

Circular 304 of December 2, 1997, confirmed prevailing case law that specified that a "habitual abode" is characterized by two elements, one objective (the length of stay in a given place) and the other subjective (the willingness to settle in such place).

The circular further clarifies that the term "domicile" refers to a juridical circumstance characterized by the willingness to establish and keep in a particular place "the main seat of one's own business and interests," which does not depend on the individual's actual physical presence.

Therefore, the expression "business and interests" in article 43, paragraph 1 of the Italian Civil Code is to be broadly interpreted and should not be restricted to economic relations but should also comprise moral, social, and family ties.

The Ministry of Finance's Resolution 8/1329, dated October 14, 1988, had considered as tax resident an Italian individual who, although having transferred his residence abroad (where he carried on his business), had kept the center of his family and social interests in Italy.

That an individual keeps in Italy his family ties or the center of his economic and social interests is sufficient grounds to establish a permanent and legally relevant link with Italy.

In determining an individual's tax residence in Italy, outside any physical presence or work performed mostly abroad, the following factors are significant, according to Circular 304/1997:

- location of permanent lodgings;
- presence of family members;
- crediting of income anywhere realized;
- ownership of movable goods;
- individual's attendance at business meetings;
- corporate appointments of executives and committee members;
- hotel expenses;
- association and club memberships; and

²AIRE was established in Law 470 of October 27, 1988.

³Ministerial Circular Nos. 304/E of Dec. 2, 1997; Supreme Court Decision 1812 of July 17, 1967; Supreme Court Decision 4829, Sept. 20, 1979; Supreme Court Decision 2070, Mar. 24, 1983; Supreme Court Decision 791, Feb. 5, 1985.

⁴Ministerial Circular 9/E of Jan. 26, 2001.

⁵Supreme Court Decision 1342, May 22, 1963.

⁶White lists must be issued by a ministerial decree. Until the lists are issued, TUIR article 2, paragraph 2-*bis* presently refers to Ministerial Decree of May 4, 1999, containing the blacklist of low-tax countries.

⁷Ratified in Italy with Law 329 of November 5, 1990.

- organization of one's business activities and commitments, also on an international level, directly or through entities working in Italy.

It would be appropriate to evaluate the various relationships the individual has entered into in Italy as a whole to establish whether, while he resided abroad according to AIRE, the individual had lost all significant ties with Italy and might therefore be considered a nonresident for tax purposes.

In other words, it is necessary to consider all the possible ties a person may have with the state.

If the individual is resident in Italy, his aggregate income, wherever realized, will be liable in such state to taxation under article 3 of the TUIR.

The Role of Municipalities

The transfer of residence abroad has been regulated by Decree Law 112 of June 25, 2008, converted by Law 133 of August 6, 2008, which under article 83, paragraphs 16 and 17, has relaunched the role of municipalities in Revenue Office inspection.

The rule refers to verifications whether the residence within Italy has ceased to exist and to relevant inspections throughout the three-year period following a registration request with AIRE.

In particular, the above provision established that the municipalities provide the Revenue Office with confirmation of the taxpayer's last tax domicile within six months following the taxpayer's registration request with AIRE, stating that the taxpayer has ceased to reside in the state's territory.

Inspections by both the municipalities and the Revenue Office are also carried out for individuals who have requested registration with AIRE as of January 1, 2006.

Although the involvement of Italian administrative bodies in countering tax evasion has been valuable, no specific guidelines have been issued to coordinate the interaction between the various municipalities and the Revenue Office, without whose absence the new measure might remain inapplicable.

Identification of Residence

Concept of 'Center of Vital Interests'

Taking up "domicile" in Italy for civil law purposes or establishing one's "residence" in Italy is sufficient to prove residency for tax purposes, regardless of registration with the Office of Resident Individuals.

In that case, it is necessary to refer back to notions of residence and domicile provided by the Italian Civil Code, TUIR article 2, paragraph 2, and the interpretation provided for them by the Supreme Court in its Decision 791 of February 5, 1985.

The term "residence" is defined by the Italian Civil Code as "the place wherein the person habitually dwells." According to the Supreme Court, a residence

may be determined by the voluntary habitual dwelling of a person in a given place, so that both the objective aspect of the stable dwelling in that place and the subjective aspect of the willingness to remain in such place meet the definition of residence.

Neither the continuity nor the permanence thereof is required for the condition of habitualness of the abode to exist.⁸ Consequently, the habitualness of the abode remains when the person works or carries on other activities outside the municipality of residence, provided he keeps his abode therein, returns thereto whenever possible, and discloses the intention to keep therein the center of own family and social ties.⁹ Residence is not invalidated by absences due to special needs deriving from contemporary lifestyles, such as study, work, care, or leisure reasons.¹⁰

Article 43 of the Italian Civil Code defines an individual's domicile as the place where he has established "the main seat" of his business and interests.

Case law states that the domicile identifies a legal relationship with the center of one's own business and does not consider the actual presence of a person in a particular place.¹¹ Domicile is a legal circumstance that, regardless of the physical presence of the individual, is characterized by the subjective element — that is, the willingness to establish and keep in that place the main seat of own business and interests.¹²

Identification of domicile may be completed based on all factual elements that directly or indirectly reveal the presence in a certain place of a certain set of relations and the role these relationships play in the life of a person.¹³

In the final analysis, therefore, that the person may have kept family ties or the "center of his/her own economic and social interests" in Italy must be deemed sufficient grounds to prove the existence of an actual and permanent link to Italy, as long as the timing requirements set forth by the provision are complied with.¹⁴

Revenue Office Search

The Revenue Office may decide to conduct a thorough search for evidentiary elements, even indirect ones, which may be necessary to challenge the resulting data obtained from the office of resident individuals and to identify the actual center of vital interests

⁸Supreme Court Decision 2561, Apr. 29, 1975; Supreme Court, Joint Sessions, No. 5292, Oct. 28, 1985.

⁹Supreme Court Decision 1738, Mar. 14, 1986.

¹⁰Supreme Court Decision 435, Feb. 12, 1973.

¹¹Supreme Court Decision 3322, Dec. 29, 1960.

¹²Supreme Court Decision 884, Mar. 21, 1968.

¹³Supreme Court Decision 2936, May 5, 1980.

¹⁴The rule states that for residence purposes in Italy, the link with Italy must exist for the greater part of the tax period.

of an individual. This search is carried out by investigators in each regional department of the Revenue Office, with the assistance of offices in charge of inspections and the tax police (the Guardia di Finanza), both of which may also act independently.

The following are some fundamental steps the Revenue Office may take in their search:

- Acquire reliable information on the historical personal records from the municipality where the last tax domicile in Italy was registered. Each municipality as well as the Italian Ministry of Interior keeps files that gather individual records of families deleted from the Office of Resident Individuals regarding the individual's permanent transfer abroad.
- Acquire all the information that may be found in the Tax Register Information System.
- Acquire a copy of the deeds relating to donations, purchases, and sales, or incorporation of partnerships or joint stock companies.
- Carefully evaluate relationships entered into with interested parties in the above deeds.
- Acquire information on sums flowing to and from foreign countries, on the place and date of issue of bank checks, and on investments in Italian common stock and bonds.

The Revenue Office conducts investigations meant to recover all tangible evidential elements regarding:

- family or sentimental ties and loyalty to Italy;
- business interests in Italy;
- the interest in keeping or returning to Italy proceeds realized abroad; and
- the intention of living in Italy in the future, which may be determined based on convincing facts and deeds, namely, by public statements.

In addition to a thorough analysis of the documentation collected, the above elements may also be gathered from a careful search of the local and national press.

As an example, other useful elements that may help identify the center of key interests include:

- extended stays in Italian localities (evidenced by air flights returning from abroad);
- participation in concerts, fashion shows, or social events held in various Italian cities; and
- frequent appearances on national TV shows, as well as various agreements entered into with recording labels and Italian insurance companies.

Once the center of vital interests (that is, the place of domicile or residence) has been properly identified, in the light of the Supreme Court's interpretative position, such center will be crucial in identifying the individual's tax residence.

Bilateral Tax Treaties

Most countries, Italy included, have tax systems based on economic as well as personal ties, since they apply both the worldwide principle as well as the source principle regarding income produced inside its own territory by nonresident entities. To prevent possible double taxation, each state may enter into income tax treaties.

Generally, treaty provisions prevail over internal regulations. However, these must be interpreted by referring back to the internal laws of the contracting state unless the context otherwise requires. In that case, treaty provisions may be interpreted without referring to the legislation of the contracting states.

Even though Italy has signed many income tax treaties, there are still many states with which it has not entered into a treaty. As a result, the following scenarios may arise:

- if there is no treaty, only internal state rules will apply (of source and residence); and
- if there is a treaty, treaty rules will apply, although they are commonly interpreted by referring to internal laws.

The dual residence issue for individuals is resolved thanks to the application of treaty article 4(2), which establishes that when an individual is deemed to be a resident of both contracting states, the right to tax is determined as follows:

- The individual is considered as a resident of the contracting state in which he has a permanent home. When the individual has a permanent home in each of the contracting states, he is considered as a resident of the contracting state in which his personal and economic ties are closer — that is, where his center of vital interests is established.
- If the contracting state in which the individual has his center of vital interests cannot be identified, or if the individual does not have any permanent home in any of the contracting states, the individual will be deemed a resident of the contracting state in which he has a habitual abode.
- If the individual has a habitual abode in both contracting states, or does not have a habitual abode in either of them, the individual will be deemed a resident of the contracting state of which he is a national.
- If the individual is a national of both contracting states or is not a national of either state, the competent authorities of the contracting states will settle the matter in an amicable manner (according to the mutual agreement procedure in article 25 of the OECD model treaty).

The above provisions are defined as tiebreaker rules and foresee a number of criteria to determine, in case

of a dual residence, which of the two contracting states will prevail in considering the individual taxpayer as a tax resident.

The criteria in question are not to be deemed as alternatives, but follow a hierarchical order for application purposes. It might be useful to ponder the interpretation provided by the OECD regarding the concepts of “permanent home,” “center of vital interests,” “habitual abode,” and “nationality.”¹⁵

Given that in signing treaties Italy adopted the OECD model even for the listing of tiebreaker rules, from the comparison of article 4(2) with the domestic legislation, one can conclude:

- the expression “permanent home” corresponds to the residence set forth under article 43, paragraph 2 of the Italian Civil Code (habitual abode);
- the expression “center of vital interests” corresponds to the domicile set forth under article 43, paragraph 1 of the Italian Civil Code;
- the term “nationality” corresponds to citizenship, as clarified by special laws and by international case law; and
- “habitual abode” should fall under the scope of habitual abode in article 43, paragraph 2 of the Italian Civil Code.

In the absence of any treaty, when an individual has, on the basis of the national rules of each state, the center of vital interests (that is, personal and economic interests) in two EU member states, the dual tax residence is solved by attributing the center to the state in which personal ties may be found. This principle was restated by the European Court of Justice in *Louloudakis v. Greece* (C-262/99), July 12, 2001. The Court said that if an individual has personal and professional ties

in two member states, the place of his “regular residence” is where the individual’s permanent center of interests will be identified, and should the entire evaluation procedure not allow well-defined criteria to be established, the aspect relating to personal ties will prevail (physical presence of the person and his family members, availability of a home, place where the children go to school, or place where the professional activity is carried out).¹⁶

Conclusion

The identification of the center of vital interests is necessary for the allocation of tax residence, and it becomes all the more important when one considers that tax regulations, and thus the tax burden to which individuals are subject, depends precisely on where the individual has established his center of vital interests.

As a consequence, the Revenue Office, before allocating¹⁷ the tax residence to an individual who has declared his foreign residence, must perform a number of investigative steps that are often complex and costly to determine whether there is any possible simulation by the individual who:

- despite evidence gathered from office records that may attest to the transfer of the residence abroad, keeps his center of vital interests in Italy;
- by prearranging multiple centers, creates difficulties in identifying the main seat of business and interests; or
- through the formal imputation of proceeds, directly realized, to third parties (companies), may have created a fictitious interposition.

Because a standard investigation may not be implemented by the Revenue Office, its officers are obliged to conduct their research in such a way as to pinpoint all the elements noted above that may be suitable for providing any evidence of the residence in Italy of the individual under investigation. ◆

¹⁵The commentary examines the single criterion — permanent home: The home may be owned on whatever basis, provided that the entity avails itself of the home continuously and not occasionally for the purpose of brief stays; the home must, therefore, have been put into order and such to be used permanently. The center of vital interests is where an individual’s personal and professional relationships are stronger. In this case, a closer inspection will involve his family and social ties; occupation; political, cultural, or other activities; and the business seat or the seat where his property is managed from.

¹⁶This is the position adopted by the Supreme Court, Tax Section, Decision 9856, Apr. 14, 2008.

¹⁷Under TUIR article 2, paragraph 2, the burden of proof regarding the residence of an individual falls on the Revenue Office.