Hard-Brexit case: Italian flat tax regime for inbound pensioners may be found attractive for UK Expats

For UK resident willing to relocate in EU Countries with less burdensome tax regime and to ensure themself the safe of an EU citizenship, Italy grants them (i) access to the special tax regime for pensioners transfering their tax residence to the Southern Regions of Italy paying a flat tax of 7% per year, in lieu of ordinary taxation on all non-Italian sourced income, (ii) alongside the possibility to start the procedure to acquire Italian/EU citizenship by residence. Such benefit also ensures social security and health, far from Coronavirus (Covid-19) risk (notoriously concentrated in few small towns in northern Italy).

Features of the Foreign Pensioners Italian Tax Regime in a nutshell

The Foreign Pensioners Italian Tax Regime (hereinafter "FPITR"), which entered info force as of 1 January 2019, may be opted by individuals who:

- receive foreign-sourced pension income or similar payments;
- move their tax residence to an Italian municipality, having a population not exceeding 20,000 inhabitants, located in one of the sunny southern regions of Italy (i.e. Sicily, Calabria, Sardinia, Campania, Basilicata, Abruzzo, Molise and Puglia);
- come from States having administrative cooperation agreements in force with Italy;
- have not been resident in Italy for tax purposes for the former 5 tax years.

Foreign pensioners that opt for the new flat tax regime, as new Italian residents, are normally imposed in Italy on their Italian-source income, but they can benefit from the following exemption areas:

- application of a 7% substitute tax on all their foreign income (in lieu of individual income national, regional and municipal progressive tax rates - IRPEF);
- no-payment of Italian wealth taxes on the value of foreign real estate and financial assets ("IVIE" and "IVAFE");
- no-reporting duties for their foreign assets to the Italian tax authorities and (quadro RW).

The election for the FPITR shall be reported in the tax return, related to the tax period in which the tax residency has been transferred to Italy.

Further, foreign pensioners may opt to exclude from the application of the FPITR foreign income arising in one or more foreign countries, in order to benefit from the applicable tax treaty regime.

The option:

- is valid for 9 tax years;
- may be revoked and ceases to have effect in cases of failure of payment of the tax due, unless paid within the deadline for the payment of the balance of the tax due with reference to the following tax year.

Acquisition of UE citizenship by Italian residence

Italian Immigration Law provides for the granting of Italian citizenship based on specific requirements of the applicants and on a minimu period of legal residence maintained in Italy in order to be eligible.

As a general rule, for non-EU foreigners, a 10 years' period of legal residence in Italy is required in order to acquire Italian citizenship (art. 9, subparagraph f). However, there are some other cases for which the period of legal residence required is lower:

- 3 years of legal residence: a) for the foreigners whose father, mother or any of their ascendants in a direct line of second degree were Italians by birth or b) for the foreigners born in Italy and residing there;
- 4 years for EU Member State citizens;

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In order to obtain the legal residence is necessary to be enrolled and registered in the Registry of the resident population. It's advisable that the applicant maintains said registration uninterrupted.

Good news for UK Expats

Domestically speaking, the UK tax system relies on residence rather than citizenship for tax purposes, meaning that UK residents are taxed on their worldwide income, while non-residents on UK sourced income only. Consequently, the transfer outside the UK will trigger taxation therein, only to the extent the expat continues to derive income from British sources.

Nonetheless, for UK pensioners who have not been resident in Italy for at least 5 years and now are willing to become resident in EU/one of the eligible Italian Southern Regions, the FPITR could represent an unique opportunity in order to:

(i) move assets back into Italy in a much more tax efficient manner;

(ii) to benefit in the same time from the Italian tax residence, in order to keep the EU citizenship.

More over, italians foreing pensioners, who are likely to return to Italy, are eligible as beneficiaries as well.

Considering the significant tax benefit granted and the consequences of an Hard Brexit, in fact, this favourable tax treatment seems to be suitable for those who intend to leave UK and move to EU-countries with less burdensome tax regime. Accordingly, interested in gain access to the regime at hand would be those individuals receiving pension income in addition to other foreign sourced income such as rental income, financial income and so on, all covered by the application of the 7% flat tax (in lieu of the Italian individual income progressive tax rates, from 23% up to 43).

Coming to the taxation of foreign pensions to be received in Italy, because the UK-Italy DTT gives to the resident State of the recipient (Italy) exclusive taxing rights on UK pensions, the inbound pensioner will be subject to taxation only in Italy, paying the flat tax of 7% per year.

In addition, unlikely the Italian HNWI's regime, the FPITR does not provide any anti-abuse clause applying to capital gains realized from the sale of all types of non-Italian shareholdings after the transfer of residence to Italy. In this view, the lack of such a limitation makes this measure even more attractive for those who intend to dispose of their overseas investment assets after having transferred their residence, as the lump-sum substitute tax of 7% (which will also cover the relevant capital gains realized, rather than appling the ordinary 26% capital gains tax).

In the following two examples, see how can differs italian taxes on foreign income of a UK inbound pensioners in table 1 (ordinary taxation) and table 2 (flat tax regime).

Table 1

UK Foreign Income	Amount of income	Italian National Ordinary Taxation	Taxes due
Rental Income	15k	23%	3.45k
Foreign Pension	25k	23% up to 15k 27% from 15k to 25k	5.95k
Capital Income (gain)	150k	26% flat rate	39k
Total	**190k**		**48.4k**

Table 2

UK Foreign Income	Amount	FPITR 7% flat rate Taxes due
Rental Income	15k	
Foreign Pension	25k	
Capital gain	150k	
Total	190k	**13.3 k**

Its unspoken that the actual convenience of applying for such regime must be ascertained on a case-by-case basis, taking into account the assets/income held abroad and the country of source (the taxable income derived from the country of source could remain subject to Italian ordinary tax regime, per option, in order to benefit from the application of tax treaty protection).

After all, the reason for this unusual generosity granted by the Italian Tax Authorities derives from the need for Italy to better compete with other European Countries, such as Portugal, which has provided since 2012 inbound pensioners with a non-taxation on their foreign pension income for the first 10 years of residency.

However, lately tax increase on the Portugese tax rate from 0% to 10%, due to complaints that the Portugese scheme when combined with bilateral DDT resulted in an effective zero rate on private pensions - which is unlikely to happen under the FPITR do to the application of the 7% flat tax - will result in making Italy much more appealing and suitable for wealthy retired foreigners, especially for those who already own immovable properties in Southern Italy.

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The tax professionals of BLCI expert in cross border financial planning can assist everyone who can benefit from this special regime and remain at your disposal for any further query needed.