

technical factsheet 141

The case for property investment in Italy

Italy has traditionally been a country favoured by a consistent number of British citizens as a holiday destination and as such it has also benefited by a steady stream of investments into properties by British investors. Currently Italy is the third most favourite country by UK property investors after Spain and France. Investors mainly look to purchase a holiday home or a place where they can spend their retirement or alternatively they may look to buy to achieve a capital return. Regions such as Tuscany and Umbria have been on top of the list for many years for British property investors, which were especially attracted to properties in rural areas that required renovation. The blend of tranquillity, cultural wealth and some of the finest food and wine in the country still leave the two regions above as firm favourites, although the increased request for properties in the area and consequent rise in prices has created steady interest for properties in different and more affordable areas like the region of Le Marche.

Over the past decade property prices in Italy have generally shown a sharp increase throughout the country. The rise is the result of the interaction of a number of factors the main of which appears to be the introduction of the Euro currency in 2002. As well as outright inflationary pressure in the immediate aftermaths of its introduction, the single European currency has created over the years a stable economic environment with low interest rates and inflation. Lower interest rates have allowed property buyers to borrow more to finance their acquisitions therefore increasing liquidity in the housing market. In addition to that the reduction in yields on government and corporate bonds, in both nominal and real terms, and the volatility of the global stock markets have made property investment look both safer and more remunerative to Italian investors. The savings of the Italian families have flooded the property market, after having being diverted from the traditional risk-free investment in government bonds, increasing demand, prices and rent levels. It is difficult to forecast whether the trend in rising property prices is likely to continue in Italy, much will depend over the medium period on the overall economic performance of the country and on the conditions of the internal credit market which is going to be affected by international factors and by the level of competition in the banking sector.

Irrespective of whether substantial capital returns will be achieved or can be expected, the Italian property market is likely to continue to attract a large number of private British investors. The stability demonstrated by the performance of the Euro currency over the past few years will make sure that property investment in Italy will serve the purpose of being at least a solid reserve of value for the investors, together with fitting the role of holiday or retirement destination of choice. The intention of this article is that of providing practitioners that are faced with clients willing to invest in property in Italy with a number of tools that would allow them to be able to provide professional advice on the main *legal, administrative and practical requirements* and on the various tax implications that such an investment would entail. In particular we will look at the case of a British investor intending to buy a holiday home in Italy which will be then rented for short periods during the peak summer holidays period.

Practicalities and legal background of property acquisition

In order to locate a suitable property and to be able to fulfil the various encumbrances of a property transaction the choice of the intermediary is essential. A British investor might rely on UK based estate agents who operate branches in Italy or resort to reputable Italian agents to be guided through the process of locating, transacting and purchasing a property. There are various national networks of estate agencies in Italy, operated under franchise, which are able to provide services to English speaking clients. The activity of estate agencies in Italy is regulated by law and subject to registration with the local chamber of commerce, which also acts as regulating body and can be consulted to verify that an individual is authorised to carry the intermediary activity. Upon registering with an estate agent through the compilation of the various relevant forms it is important checking that the agent's commission, usually expressed as a percentage of the purchase price and under current market conditions normally in the region of 3%, is clearly indicated in the documents. The agent will normally follow a property transaction all the way through from the search stage to the signature of the notary deed.

The most important phase of a property transaction in Italy is the formulation of the offer. The offer is made in writing to the seller, normally via a specific form compiled with the help of the estate agent and signed by the purchaser, and contains within its terms a period of validity. The offer is legally binding for the purchaser throughout the period of validity, in practice that means that it cannot be revoked. It is consolidated practice that a deposit of 10% of the value of the offer is paid to the seller via a non-transferable banker's draft, to be addressed strictly to the seller, at the time the offer is accepted. If the offer is accepted in writing by the vendor within the period of validity, the sale agreement is considered as sealed and producing full legal effects from the time the acceptance reaches the purchaser. From such point onwards a legal obligation arises on both parties to respectively acquire and sell the property for the offered price and within the timeframe stated in the offer. The deposit paid becomes non-refundable and withdrawal from the agreement by any of the parties is likely to instigate a lawsuit by the compliant party that may result in the forcible execution of the sale or the award of damages on resolution of the contract.

Soon after the acceptance of the vendor and before the signing of the notary deed, a preliminary sale agreement is stipulated by the parties. The preliminary (preliminare di compravendita or compromesso) is a private instrument which normally replicates the terms agreed in the formal offer and integrates such terms in respect of aspects not normally included in the offer.

The effective transfer in ownership of a property takes place via the notary deed (rogito notarile), which is normally a public instrument conveyance or is alternatively the authentication of the private instrument preliminary agreement.

The choice of the notary public is left to the purchaser, which also pays the notary fees. The notary will also verify the legitimacy of the seller's title of ownership and the existence of any mortgage charges on the property being sold; if the documentation in respect of the property is not in order the notary might advise the purchaser to withdraw from the preliminary agreement.

The delivery of the keys to the property and the payment of the balance of the price take place upon signature of the notary deed. The registration of the conveyance with the land registry (Agenzia del Territorio) will also be attended to by the notary within 30 days from the signature of the deed.

In order to deal with the various encumbrances of a property acquisition in Italy and to facilitate the dealings with the Italian revenue service and local authorities, it appears most practical opening a bank account in the place where the investment is going to take place.

General taxation considerations

The taxation of UK tax residents in respect of income generated in Italy is regulated by the Double Tax Convention (Double Tax Treaty) between the two states that was introduced by Statutory Instrument 1990/2590. In particular Article 6 of the Treaty deals with income from immovable property and states that income derived by a resident of a contracting state from property situated in the other contracting state may be taxed in that other state. Article 13 of the Treaty deals with capital gains from property and contains almost identical terms. In practice the provisions of the Treaty allow the Italian authorities to tax UK residents on properties located in that country and that takes place in the same way as other non-residents are generally taxed. Immovable properties in Italy are subjected to various taxes that relate to the income and gains generated by them, to their ownership and to the transfer of ownership. In particular the following taxes will be encountered by a British property investor:

- personal income tax (imposta sul reddito delle persone fisiche – Irpef);
- additional regional and local income tax (addizionale comunale e regionale all'Irpef);
- taxes relating to the acquisition of properties, like VAT (Iva) **or alternatively** stamp duty (imposta di registro), mortgage tax (imposta ipotecaria) and cadastral duty (imposta catastale);
- council tax (imposta comunale sugli immobili).

Some of the taxes paid in Italy are allowed for tax relief in the UK under the terms of the Convention, like for instance personal and local income tax, while others like the taxes on the acquisition are inadmissible for both treaty and unilateral tax relief. We shall consider how the various taxes are relieved or otherwise taken into account when we consider each of the various stages to which they are applicable.

Taxes on property acquisition

The stage of the acquisition of a property in Italy requires the undertaking of some administrative steps by a UK resident that will allow the person to register with the Italian revenue office (Agenzia delle Entrate). A person acquiring a property will be deemed to have his/her fiscal domicile in Italy in the territory of the Council (Comune) where the property is located or, in the case of more than one property, in the Council where the highest income from a property is produced. Fiscal domicile is important for determining the local tax office that the British resident will need to contact to apply for a tax code (codice fiscale), which will be used as identification for the person for all the dealings with any Italian public sector entity. Applying for a tax code is mandatory for a non-resident investing in Italy and requires attendance in person of the local tax office and presentation of an identification document, like a passport.

As mentioned above there are various taxes that can be levied upon the purchase of a property in Italy and the relevance of each will depend on the seller's status and on the age of the property sold. In the case of a new or substantially renovated property sold by a property development company or firm within 4 years since the end of the building work, VAT is chargeable on the transaction at 10% of the purchase price, or at 20% if the property is classified as a luxury property. In addition a fixed amount of stamp duty, mortgage tax and cadastral duty is due at the level of €168 for each of the three taxes.

In the case of a property sold by a property developer more than 4 years after the end of any building work or by a private individual, no VAT is chargeable on the sale but taxes and duties are chargeable in the following way:

Stamp duty at 7%, Mortgage tax at 2% and Cadastral duty at 1%.

It is important to note that, conversely to VAT, the taxes above are not normally calculated by reference to the purchase price of the property but on a lower amount that is called the cadastral value of the property. The application of the cadastral value in place of the purchase price is optional and is applicable only to the purchase of residential properties. The choice of the option must be notified to the notary public at the time of completion and allows a reduction of 30% of the notary fees, which as mentioned above are payable exclusively by the purchaser. The cadastral value of a property is determined starting from the rateable value of a property (rendita catastale), which is assigned to a property by the land registry (Catasto Urbano) and by multiplying it by a numerical coefficient, normally 120 for a residential property. The calculation is done by the notary, which will use the data resulting from the property conveyance and which will also calculate the taxes due and provide to their payment within 20 days from the date of completion. The effective purchase price still needs to be included in the purchase deed, as it will be relevant for other tax purposes, or the option to use the cadastral value will be ineffective and penalties could be imposed. It is in the interest of the acquiring party to make sure that the correct price paid and not a lower one is indicated in all circumstances. That is especially clear if a mortgage application is going to be made, and therefore the loan could be restricted, and as the price in the deed will be the basis for the Italian and/or UK taxation on any capital gains realised on the property.

The practical implications for a British investor which has set eye on a country house with annexed land and development potential costing €300,000 and with a rateable value of €1,750 are as follows:

- if the property is sold by a property development firm and has been built or renovated in the previous 4 years, the purchaser will have to pay €30,000 (10% x €300,000) to the firm as VAT and will also have to pay to the notary a total of €504 (€168 x 3) in various taxes;
- if the property is sold by a private individual or, in case sold by a property development firm, has been built or renovated more than 4 years prior to the sale the purchaser will have to pay to the notary €21,000. That is derived by the cadastral value of €210,000 (€1,750 x 120) multiplied by 10% in various taxes (7% in stamp duty, 2% in mortgage tax and 1% in cadastral duty respectively).

A British investor with a set preliminary budget for the purchase of an Italian property should therefore devote attention to the taxation that will be levied on the acquisition and be able to reduce it accordingly by considering the status of the seller and the type of property acquired.

The taxes paid in Italy on property acquisitions are inadmissible for treaty or unilateral relief against any UK taxes. Such taxes can be considered as incidental costs of acquisition of the property in the determination of the chargeable gain or loss upon disposal for the purpose of UK Capital Gains Tax.

Taxation of property income

The taxation of income from property in Italy is subject to rules substantially different from those applicable in the UK. Following on from the example above we might consider that the investor has purchased the country house from an individual and after having performed some maintenance work, he/she decides to spend some time at the property and to rent it for a few weeks during the peak of the holidays season via a local estate agent or to some British friends. The investor incurs €2,000 in costs to paint the interior of the house and to repair a faulty boiler and receives €6,000 from renting the property in the summer months.

Rental income is subjected to personal income tax (Irpef) but it is worthwhile pointing out that properties in Italy are subject to income tax even when they are not rented or kept free for the personal use of the owner. A holiday home in Italy kept free for the non-resident owner's use will be taxed on the basis of its rateable value (rendita catastale), in our example that value is €1,750 as indicated by the notary in the deed.

If the property is let but the rental received in a tax year is below its rateable value the chargeable income will remain the amount of the rateable value.

In our case the investor will be assessed on the rental income on the basis of the amount received reduced by 15%, unless the property was located in Venice in which case the reduction would be 25% of the rent. As simple as it may appear that is the rule for the taxation of property income received by individuals in Italy, no other specific deductions are allowed like for instance maintenance costs or interest on mortgages.

Together with mainstream income tax, property income is also subject to additional regional and local income tax (addizionale regionale e comunale all'Irpef), which is levied by the region and council in which the tax-payer has his/her fiscal domicile. The maximum rate cannot exceed 1.4% and 0.8% respectively, the applicable rates for each region and council are indicated in the compilation notes of the tax return and the payment is made in conjunction with the mainstream income tax.

The income assessable in our case will therefore be €5,100 ($€6,000 \times 0.85$) and will be taxed at the current rate of 23% to give a personal income tax (Irpef) liability of €1,173, we shall also assume a total additional regional and local income tax at the rate of 1.5% giving a liability of €77 ($€6,000 \times 0.015$), which will give an overall Italian tax liability of €1,250.

It has to be noted that the Irpef rates have been re-arranged several times in the past few years; however the basic rate of 23% has remained the same recently and is applicable to income up to €15,000, increasing to 27% for the following €13,000 in the tax year ending 31 December 2007. There is no starting rate for the Irpef and no personal allowances are available for income not derived from employment, pension or self-employment. Property income can be remitted to the UK without any withholding tax.

Foreign property income earned by British resident and domiciled individuals is taxed in the UK in a similar way as UK property income. From 6 April 2008 non-domiciled individuals which have been resident for 7 out of the previous 10 years will also be taxable on their worldwide income and therefore also on foreign property income.

Property income earned abroad cannot avail of the provisions allowed for furnished holiday lettings in the UK. Furthermore UK and foreign property business are treated as separate businesses and losses realised overseas cannot be offset versus UK property income and vice-versa. Losses relating to an overseas property can be offset versus income of other overseas properties and any unrelieved losses can be carried forward to be set-off against future overseas property profits. Travelling expenses incurred wholly and exclusively for the purpose of the overseas property business are allowed. Interest incurred on a loan to purchase the overseas property is similarly allowed but it is apportioned for the part of the year in which the property is not available for letting or is occupied by the owner. In the case of furnished residential lettings the cost of furniture and furnishing can be allowed on a renewal basis or alternatively the 10% of net rent wear and tear allowance can be claimed. Repairs to the building and to its fixtures are also allowed.

In our case therefore the foreign property income assessable in the UK will be given by the rent received less the cost of the repairs carried out and the 10% wear and tear allowance for a total of €3,400 ($€6,000 - €2,000 - €600$).

The amount in Euro can be translated in Sterling by using the average rate of exchange over the tax year which we can assume being 1.45 (the exchange rate used is indicative only, to check for up to date rates visit www.oanda.com) to give an assessable income of £2,345 (€3,400/1.45). If the investor is already a high rate taxpayer he/she will have a UK income tax liability of $40\% \times £2,345 = £938$ before double tax relief, foreign income being treated as top slice income.

Double tax relief can be provided under the provisions of a double tax agreement or be given by way of unilateral relief conceded by the UK. Double tax relief is given by way of credit for the foreign tax paid against UK tax payable in respect of the same income. If the UK resident finds it more beneficial, tax credit for foreign tax paid may not be claimed and the foreign tax levied on income which is also taxable in the UK can be deducted from the UK assessable income.

Article 2 of the Double Tax Convention with Italy indicates the specific taxes covered by the agreement in both countries. Irpef (personal income tax) is specifically included in the Treaty and therefore it can be relieved against UK income tax.

Relief is given at the lower of the UK tax chargeable on foreign income and foreign tax suffered. In our case UK tax is £938 while Italian tax is £862 (€1,250/1.45) meaning that the full amount of £862 will be given as double tax relief in the UK leaving a liability of £76.

As well as the specific taxes indicated in the Treaty, UK residents can obtain unilateral double tax relief for other taxes paid in Italy which are indicated in the HMRC's Double Taxation Relief Manual under DT10153.

There is an important tax provision in Italy in respect of properties that allows a substantial reduction of personal income tax and is available to non-resident property owners as well. The tax facility consists of a tax credit allowed in respect of work carried out on properties which amounts either to extraordinary maintenance, renovation, conversion or extension. The tax credit allowed is 36% of the costs sustained for the property work up to a maximum credit limit of €48,000 and is spread over ten tax years. The Budget for 2008 (Legge Finanziaria 2008) has just maintained the relief for relevant costs incurred up to 31 December 2010. In order to attain the tax credit the taxpayer needs to notify the Italian Revenue (Agenzia delle Entrate) before the start of the work and needs to pay all the invoices by means of bank transfer.

Interestingly enough some of the items identified as extraordinary maintenance costs by the Italian Revenue are treated by HMRC as repairs and therefore allowable against rental income. That is the case for instance for roof replacement, the substitution of windows with double glazed ones and the renewal of fixtures like bathroom suites and boilers.

The UK property investor in our example that had also spent €30,000 in renewing some parts of the property bought, by for instance replacing the roof tiles, refitting the bathrooms and double glazing the house, would have been able to obtain a tax credit of €10,800 ($36\% \times €30,000$) to set off against his/her Irpef liability at the tune of €1,080 per year for ten years.

The same expenditure may be available for relief versus UK income tax on the foreign property income.

The use of the tax credit facility on property renovation can therefore significantly reduce or cancel the liability to Italian tax for UK investors that intend to improve the property bought or that have bought a property in a derelict state and find it more convenient to restore it.

Tax considerations relating to property disposal

An attractive aspect of the Italian tax system in respect of property investments is that gains realised on the sale of properties that have been owned for more than 5 years are exempt from any taxation.

If a property is otherwise sold within five years of its acquisition, the resulting gain will be treated as 'other income' and included in the amount taxable under personal income tax (Irpef) in the year in which the sale takes place.

The gain (which is indicated in the Italian Tax Code as 'plusvalenza') is calculated by deducting from the proceeds of the sale both the un-indexed cost of acquisition and the costs of maintenance and improvement relating to the property.

As outlined above Irpef tax rates start at 23% and rise gradually to the maximum rate of 43% for income exceeding €75,000.

From 1 January 2007 it is possible for the seller of the property to opt in a different and more convenient, for a pure property investor, method of taxation of such property gains. At the time of the finalisation of the written sale agreement, the vendor may request the notary to apply on the gain a withholding tax in substitution of the Irpef. The applicable rate for the alternative method is set at a flat level of 20%.

The notary will then take care of the administrative side of the tax payment and will discharge all the obligations towards the Italian tax authorities so that the gain will not need to be included in the individual's tax return.

A UK resident is chargeable to Capital Gain Tax in respect of gains accruing on assets located anywhere in the world. Such a rule applies to all classes of residents except those that retain their non-domiciled status and which are chargeable on foreign assets gains only if they are remitted to the UK.

It follows that a UK resident and domiciled individual will be subject to UK CGT upon realising a gain on the sale of an investment property in Italy.

The way of calculating the gain on the property disposal in the UK differs from the way the same gain is calculated in Italy. For the UK computation it will be possible to deduct from the sale proceeds the incidental costs of disposal (e.g. the estate agent fees) and of acquisition (e.g. stamp duty, mortgage tax and cadastral duty paid in Italy) as well as the cost of purchase and any enhancement expenditure.

From 6 April 2008 such a gain will be taxed at the flat rate of 18% for the amount exceeding his/her annual allowance; no indexation allowance or taper relief will be available.

On the basis of the taxation of gains on investment properties applicable in Italy, as it has been outlined above, it is likely that most UK investors will not incur any Italian tax charge on the disposal of their properties and will not need to claim any double tax relief in the UK.

However in the case of properties sold within five years of acquisition a tax charge on the resulting gains will be payable in Italy as income tax (Irpef) or alternatively as withholding tax at the time of the transaction. Both types of tax charges should be admissible for double tax relief in the UK against Capital Gains Tax.

Article 24 of the Double Tax Convention deals with the elimination of double taxation and limits relief of Italian tax against UK tax to profits and incomes; therefore leaving out relief for the taxation of capital gains. On the other hand even if the HMRC's Double Taxation Relief Manual, under DT 10153, does not clarify whether the above Italian tax on property gains is either admissible under the Convention, admissible under unilateral relief or inadmissible, the Revenue and Customs practice would normally allow relief. The HMRC practice that allows UK relief for a capital gain that is taxed overseas as income is detailed in Statement of Practice 6/88.

The mechanics and the principles of double tax relief in the case of capital gains are the same as those illustrated above for the case of property income.

As said UK CGT will be levied at 18% of the gain, computed under UK principles, which exceeds the annual exemption threshold. Relief against UK CGT will be limited to the lower of the UK tax and the corresponding Italian tax on the gain.

Inheritance Tax considerations

It is worthwhile clarifying the inheritance tax implications for a UK domiciled individual owning investment property in Italy. A specific Double Tax Convention between UK and Italy deals with the levying of inheritance duty on UK and Italian domiciled individuals in respect of foreign assets and with other aspects such as the system of obtaining double tax credit and the rules establishing the domicile of the deceased person. The Convention was introduced by Statutory Instrument 1968/304 and is one of only ten conventions on inheritance tax stipulated by the UK in total. It is interesting noticing that no such a convention exists with Spain that is the most favourite country for UK property

investors. The existence of the Convention is particularly helpful for UK individuals intending to transfer their domicile to Italy as it contains detailed rules to determine the domicile of a deceased person, a sort of tie-breaker clause, where he/she would fall to be deemed domiciled in both countries for inheritance tax purposes under local legislation. Such rules would avoid that the whole estate of an individual is charged to inheritance tax in both countries and clarify what a UK person needs to do in order to move his/her domicile to Italy. As we will hereinafter see the taxation of a deceased's estate is much lower in Italy than in the UK and therefore obtaining Italian domicile could be tax efficient for somebody that for instance wanted to retire to Italy.

In the case of a UK domiciled property investor it has to be noted that land and buildings property situated in Italy is subject to Italy's inheritance tax. The provisions of Article III and IV of the Convention determine where various kinds of property are deemed to be situated in the case they attracted inheritance duty in both countries. Land and immovable property are deemed to be situated where they are located and therefore the Convention does not avoid double taxation in this instance. The situs of property under the Convention may actually differ from its actual location depending on the category of the property.

Italy's inheritance tax (Imposta sulle successioni) is charged at 4% of the net value of the deceased's chargeable estate for transfers to spouses or direct line relatives, like children, grandchildren and parents, with an exemption threshold of €1 million for each beneficiary. The assessable value of land and building properties for inheritance tax in Italy is their cadastral value. Above we have clarified that the cadastral value of a property is determined by its rateable value (rendita catastale) multiplied by a numerical coefficient, normally 120 for residential property. The estate that will fall under Italian inheritance duty for a UK property investor will consist of the cadastral value of any properties owned in Italy. The investor will in any case be able to make use of the exemption threshold for each beneficiary, which in the instance of a person with a spouse and two children will extend to €3 million in total, and be able to mitigate or avoid the inheritance duty altogether.

An obligation to file a declaration for transfers on death (Dichiarazione di successione) within 12 months from the death of an individual is placed on the beneficiaries of the estate.

Regardless of the fact that residential properties situated in Italy become subjected to inheritance duty, death transfers of such properties attract mortgage tax and cadastral duty at the rate of 2% and 1% of their cadastral value.

The subsequent sale by the beneficiaries of inherited properties is exempt by any tax on the gains realised, regardless of the length of ownership.

Properties owned in Italy will form part of the estate chargeable to UK inheritance tax of a UK domiciled individual. It is worthwhile pointing out that rules in respect of the nil-rate band have changed from 9 October 2007 following the Chancellor of the Exchequer Pre-Budget Report. The new rules allow the transfer of any unused nil-rate band on a person's death to the estate of the surviving spouse or civil partner. As a consequence unused nil-rate band will not be lost if individuals did not stipulate specific testamentary dispositions leaving assets up the value of the nil-rate band. If for instance the whole estate of an individual was left to the surviving spouse or partner, the transfer would be exempt and the entire nil-rate band will be transferred to the surviving person.

The use of the nil-rate band and exemption both in the UK and Italy creates meaningful interactions for a UK domiciled individual with property located in Italy and requires some inheritance tax planning to minimise the taxation and to avoid possible effective double taxation.

If the estate of a UK domiciled property investor becomes liable to Italian inheritance tax following his/her death, the Double Tax Convention provides relief against UK inheritance tax. Article VI of the Convention requires that the tax payable in the UK attributable to property situated in Italy should be reduced by a credit equal to the tax imposed in Italy on such property. The relief cannot exceed the amount of UK inheritance tax charged on the property.

In addition to conventional relief, the provisions of section 159 of IHTA 1984 would allow the application of unilateral relief if it resulted that the relief allowable unilaterally was greater than what would be granted under the terms of a double tax convention. Unilateral relief allows a credit against UK inheritance tax in respect of the amount of overseas tax charged on the value of a property that is of a character similar to inheritance tax in the UK or that is chargeable on or by reference to death. In theory unilateral relief would extend to taxes similar to inheritance tax as well as those that

are levied overseas on an individual's estate in connection with his/her death, therefore achieving a wider scope than a specific tax convention relief. In any case the amount of relief could not exceed the amount of UK tax.

In the case of investment properties located in Italy the Tax Convention specifically provides relief for inheritance tax (Imposta sulle Successioni) only and it is open to debate whether HMRC would allow unilateral relief in respect of mortgage tax and cadastral duty levied. Mortgage tax and cadastral duty are not of similar character to inheritance tax and are chargeable both on a death transfer and on a normal property purchase as seen above. The availability of unilateral relief is therefore uncertain.

If no unilateral relief is available the amount of mortgage tax and cadastral duty payable on the death transfer of property can be taken to reduce the value of the Italian investment property for UK inheritance tax purposes.

As mentioned above the interactions in the use of nil-rate bands and exempt transfer rules available both in the UK and Italy need to be carefully considered to minimise the overall tax liability and avoid possible double taxation. As a general rule the most convenient way of making use of nil-rate bands and exempt transfers is that of avoiding an overseas tax charge that exceeds the domestic tax chargeable on the same assets. The reason for this is that the excess overseas tax cannot be relieved against UK tax and is effectively double taxation. A case in point would be if inheritance tax was charged in Italy on a death transfer but the transfer was exempt in the UK, the tax paid in Italy could not be relieved against a UK liability and would be lost.

With the new provisions in respect of transfer of nil-rate band between spouses and civil partners it can be envisaged that in many cases the entire estate of a deceased person will be transferred to the surviving partner. Such transfer would be exempt and would avoid an immediate tax charge, while the nil-rate band of the deceased will be preserved and could be used upon the death of the surviving partner.

An example may be used to illustrate that the exemptions and nil-rate bands available in both countries must be considered to minimise the overall inheritance tax charges and that what is effective tax planning in the case of a pure UK based estate may be ineffective when the estate includes foreign assets.

We may look at the case of an individual that at the time of death owns a UK estate worth £1,000,000 and also residential properties in Italy valued €2,000,000 (assumed to translate into £1,500,000). The individual has a spouse and a child that will be the sole beneficiaries of the death estate. UK nil-rate band is assumed to be £350,000 per individual whilst the Italian nil-rate band is €1,000,000 per beneficiary.

One option available would be that of an exempt transfer of the entire estate to the spouse. As far as Italian inheritance tax is concerned there would be a €2,000,000 transfer to a single beneficiary which will exceed the nil-rate band by €1,000,000 and will determine a charge of €40,000 ($€1,000,000 \times 4\%$). The UK value transferred to the spouse will be £2,500,000 and will not attract any UK liability, while the deceased's nil-rate band will go to the surviving spouse. The Italian tax of €40,000, equivalent to £30,000, will remain unrelieved as there is no equivalent UK tax in respect of the same properties. At the death of the remaining spouse the child will inherit the whole estate. The Italian tax charge will again be €40,000, based on a transfer to a single beneficiary of €2,000,000. The UK charge will be based on a death transfer of £2,500,000 less the cumulative nil-rate bands of the two spouses totalling £700,000. The UK liability will therefore be £720,000 ($£1,800,000 \times 40\%$). Double tax relief can be claimed in this case for the Italian tax paid of €40,000 or £30,000, giving a final UK liability of £690,000. The overall inheritance tax paid on the individual's estate will therefore total £750,000 circa ($€40,000 + €40,000 + £690,000$) by the time it reaches the child.

If alternatively the Italian tax charge is avoided at the first death transfer the overall inheritance charge will be lower. At the individual's death it is possible to transfer to the surviving spouse an amount of Italian property that will not exceed the Italian nil-rate band therefore avoiding un-relievable Italian tax. In our example it is possible to transfer the entire UK estate and €1,000,000 of the Italian properties to the surviving spouse with the remaining €1,000,000 transferred directly to the child. There would be no Italian tax chargeable in this instance as the transfers of €1,000,000 each to the beneficiaries will be covered by the nil-rate band. In respect of the UK tax position the exempt transfer to the spouse will total £1,750,000 and will not attract inheritance tax. The transfer to the child of €1,000,000 or £750,000 will generate a tax liability of £160,000 after the individual's nil-rate band is used ($(750,000 - 350,000) \times 40\%$). At the surviving spouse's death the child will inherit the remainder of the estate. The transfer of the Italian properties will be

again covered by the nil-rate band of €1,000,000 and there will be no Italian tax charge. The UK position at the second death will see a transfer of £1,750,000 to the child that will generate an inheritance tax liability of £560,000 after the use of the remaining nil-rate band $((1,750,000 - 350,000) \times 40\%)$. As a result the overall inheritance tax charge on the estate transfer will be £720,000 (£160,000 + £560,000).

Planning to avoid un-relievable Italian tax, because it would exceed UK tax on the same death transfer, generates a saving of €40,000 or £30,000 in our example. The downside of avoiding excess Italian tax could be that of anticipating part of the UK tax charge at the death of the first spouse, £160,000 in the example, which would otherwise be levied at the time of death of the surviving spouse. In general is however more convenient to avoid what is effectively double taxation than delaying a tax liability.