Italian Revenue Agency provides guidance on the new definition of tax residence for income tax purposes – part two

In Circular Letter no. 20/E of 4 November 2024, the Italian Revenue Agency provides its interpretation of the new definition of tax residence for companies and other entities (as well as individuals, see our Tax Alert 2024/03) for income tax purposes. These rules came into effect (i) for companies and entities whose fiscal year coincides with calendar year, on 1 January 2024 and (ii) for other companies and entities, from the year following the one that was current on 29 December 2023.

Under the previous definition of tax residence provided for by Article 73(3) of the Italian Income Tax Code ("**ITC**"), companies and other entities were deemed to be resident if any of their registered office (legal seat), administrative seat or main business purpose was in Italy for most of the fiscal year.

The formal test of the **legal seat** (**registered office**) in Italy remains unchanged. However, the two other tests – the administrative seat and the main business purpose – were replaced by the **place of effective management** and the **place of primary day-to-day management** with the aim of reducing interpretative uncertainty and achieving greater consistency with the international system. Under new Article 73(3) ITC, the place of effective management is where the strategic decisions relating to the company as a whole are taken on a regular and coordinated basis, whereas the place of primary day-to-day management is where the day-to-day management activities related to the company as a whole are carried out on a regular and coordinated basis.

With respect to the two new tests, the Circular Letter offers limited insight, mainly referring to the definitions set forth by the new statute and the Government's explanatory report to the new rules.

As to the place of effective management, the Circular Letter confirms that a company's place of effective management is not affected by supervising and monitoring activities carried out by its shareholders, only their managerial decisions matter. The Circular Letter clarifies that the new provision aims at establishing a substance over form connection with the Italian territory and applying a criterion which should prevent potential dual residence situations. The Revenue Agency also points out that the increased use of information technologies may cause discrepancies between the place where the business is carried out and the place where strategic decisions are taken. Nevertheless, the Circular Letter merely acknowledges the need for a case-by-case analysis in the absence of internationally consolidated practice.

With respect to the place of primary day-to-day management, the Circular Letter takes the position that it should be interpreted as the place where the company's normal functioning and the activities relating to its ordinary management occur. In this regard, the Revenue Agency notes that this criterion aligns with paragraph 24.1 of the Commentary on Article 4 of the OECD Model, which lists the

place "where the senior day-to-day management of the person is carried on" as one of the elements that may be considered to resolve conflicts of residence between contracting States in the context of mutual agreement procedures. However, the Revenue Agency does not further elaborate on this concept, as this may vary depending on the business structure of the company and the type of activity that it carries out.

With respect to the rebuttable deeming rule whereby foreign companies (and other entities) that control a resident company and in turn are either controlled or managed by persons resident in Italy are deemed to be resident in Italy, the Circular Letter only notes that the rule was updated to reflect the above two new main tax residence criteria.

Finally, the Circular Letter addresses the interaction between the new domestic residence definition for companies and other entities and the Italian double taxation conventions. It highlights that the new domestic criterion of the place of effective management is in line with the tie-breaker rules of the Italian double taxation conventions in force, which are mainly patterned along with Article 4(3) of the pre-2017 OECD Model and thus allocate the tax residence, in case of conflict, to the contracting State where the place of effective management is located. This position confirms the Revenue Agency's approach to interpret the treaty "place of effective management" criterion in the light of the domestic tax residence definition.

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