

New indirect tax regime of real property leasing

The yearly Italian finance act (now known as "Stability Law") has amended significantly the tax regime of real property leasing. The changes have been introduced to ensure that the indirect tax regime of real property leasing is neutral in determining the choice of financing the purchase of real property. The new regime will apply to leasing contracts on property acquired by the leasing company on or after 1 January 2011.

Prior to the change in law, the finance leasing of commercial property was subject to indirect taxation as follows:

- the sale of the property to the leasing company was exempt (without credit) for VAT purposes unless the seller (i) opted for the application of VAT, or (ii) the leasing company suffered a significant limitation in the deduction of input VAT, or (iii) the leasing company was not a taxable person for VAT purposes, or (iv) the relevant property could be characterised as "new" (i.e. sold by the person who had built/refurbished the property within four years from completion); moreover, a 2% aggregate mortgage and cadastral taxes tax would have been applicable, whereas registration tax would have been applicable in the amount of EUR 168 each;
- the leasing agreement was subject to mandatory registration, with application of a 1% registration tax on the leasing fees;
- upon exercise of the purchase option, a 2% mortgage and cadastral taxes (on top of applicable VAT) would have been applicable on the value of the property; such mortgage and cadastral taxes could have been reduced by the registration tax applied on the leasing fees over the life of the agreement.

In the case of leasing of residential property,

- the sale to the leasing company of property that could be characterised as "new" (i.e. sold by the person who had built/refurbished the property within four years from completion) would have been subject to VAT, whereas any other property would have been subject to a non-recoverable aggregate registration, mortgage and cadastral taxes of up to 10%;
- the leasing fees would have been exempt from VAT (without credit) and subject to a 2% registration tax;
- upon exercise of the purchase option, the value of the property would have been subject to a non-recoverable aggregate registration, mortgage and cadastral taxes up to 10% of the costs originally born by the leasing company.

Key Issues

Changes to the tax regime of purchase of the property, leasing fees and purchase option

The new regime makes finance leasing neutral vis-à-vis other forms of financing

Finance leasing of residential property no longer at a disadvantage because of tax regime

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This tax regime, providing for two separate payments by the leasing company and the lessee of the mortgage, cadastral and registration taxes due on the acquisition of the properties, made the finance leasing of residential property too complex to be a viable alternative.

Under the **new regime** applicable to commercial property, property under construction and building site, the VAT treatment will remain unchanged. However,

- mortgage and cadastral taxes will apply at the aggregate rate of 4% on the sale of the property to the leasing company (i.e. the same rate it would be applicable to a direct purchase by the ultimate user);
- there would be no obligation to register the contract, thus potentially saving the registration tax on the leasing fees (registration tax would apply only in the case of use, i.e. upon filing with an Italian court or with an administrative authority, unless such filing is mandatorily required by the law);
- upon exercise of the purchase option, registration, mortgage and cadastral taxes will be applicable in the lump sum of EUR168 each.

In the case of leasing of residential property the new regime is meant also to eliminate double taxation by providing that:

- the tax regime of the purchase by the lessor will not change;
- there would be no obligation to register the contract, thus potentially saving the registration tax on the leasing fees (registration tax would apply only in the case of use, i.e. upon filing with an Italian court or with an administrative authority, unless such filing is mandatorily required by the law);
- upon exercise of the purchase option, registration, mortgage and cadastral taxes will be applicable in the lump sum of EUR168 each.

The leasing company and the lessee are jointly and severally liable for the payment of the aforementioned mortgage, cadastral and registration taxes,

In order to compensate for the loss of revenue that the waving of the above amendments will determine, in the case of leasing agreements executed prior to 1 January 2011 a substitute tax will be payable by 31st of March 2011. The substitute tax will be computed as follows:

- by applying a 2% rate, for commercial property, or 3% rate, for residential property on the aggregate principal amount of the leasing;
- by deducting from the above amount the registration tax charged on the leasing fees (1 % in the case of commercial property or 2% in the case of residential property);
- by discounting the amount so determined by a percentage of 4% multiplied by the number of years still outstanding under the contract (e.g., in the case of leasing agreement with still 4 years to go as at 31 December 2010, the discount will be 16%).

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The following table summarises the old and new regimes:

PROPERTY	VAT Status	Regime as of 1 January 2011									Regime prior to 1 January 2011							
		Purchase by lessor			Leasing fees	Exercise of option			Purchase by lessor			Leasing fees	Exercise of option					
		RT	MT	CT	RT	VAT	RT	MT	CT	RT	MT	CT	RT	VAT	RT	MT	CT	
COMMERCIAL	Complete	NEW property	€168	3,0%	1,0%	0,0%	Subject	€168	€168	€168	€168	1,5%	0,5%	1,0%	Subject	€168	1,5%	0,5%
	Complete	VAT Option	€168	3,0%	1,0%	0,0%	Subject	€168	€168	€168	€168	1,5%	0,5%	1,0%	Subject	€168	1,5%	0,5%
	Complete	No VAT Option	€168	3,0%	1,0%	0,0%	Subject	€168	€168	€168	€168	1,5%	0,5%	1,0%	Subject	€168	1,5%	0,5%
	Complete	Private seller	7,0%	2,0%	1,0%	0,0%	Subject	€168	€168	€168	7,0%	2,0%	1,0%	1,0%	Subject	€168	1,5%	0,5%
	Building Area	Private seller	8,0%	2,0%	1,0%	0,0%	Subject	€168	€168	€168	8,0%	2,0%	1,0%	1,0%	Subject	€168	1,5%	0,5%
		VAT person	€168	€168	€168	0,0%	Subject	€168	€168	€168	€168	€168	€168	1,0%	Subject	€168	1,5%	0,5%
RESIDENTIAL	Complete	NEW property	€168	€168	€168	0,0%	Exempt	€168	€168	€168	€168	€168	€168	2,0%	Exempt	7,0%	2,0%	1,0%
	Complete	Other property	7,0%	2,0%	1,0%	0,0%	Exempt	€168	€168	€168	7,0%	2,0%	1,0%	2,0%	Exempt	7,0%	2,0%	1,0%
	Complete	Private seller	7,0%	2,0%	1,0%	0,0%	Exempt	€168	€168	€168	7,0%	2,0%	1,0%	2,0%	Exempt	7,0%	2,0%	1,0%
	Building Area	Private seller	8,0%	2,0%	1,0%	0,0%	<i>After 5 years from the date of completion</i>				8,0%	2,0%	1,0%	2,0%	<i>After 4 years from the date of completion</i>			
							Exempt	€168	€168	€168					Exempt	7,0%	2,0%	1,0%
							<i>Before 5 years from the date of completion</i>								<i>Before 4 years from the date of completion</i>			
							Vat	€168	€168	€168					Vat	€168	€168	€168
	Building Area	VAT person	€168	€168	€168	0,0%	<i>After 5 years from the date of completion</i>				€168	€168	€168	2,0%	<i>After 4 years from the date of completion</i>			
							Exempt	€168	€168	€168					Exempt	7,0%	2,0%	1,0%
							<i>Before 5 years from the date of completion</i>								<i>Before 4 years from the date of completion</i>			
Subject							€168	€168	€168	Vat					€168	€168	€168	

RT: Registration Tax (*Imposta di Registro*)

MT: Mortgage Tax (*Imposta Ipotecaria*)

CT: Cadastral Tax (*Imposta Catastale*)

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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